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OPINION

Coming in from the cold

Sep 23rd 1999

From The Economist print edition

It is time for central banks to open their doors

"YOU are not here to tell me what to do. You are here to tell me why I have done what I have already decided to do," Montagu Norman, the Bank of England's longest-serving governor (1920-44), is reputed to have told his economic adviser. Today, with luck, economic analysis actually precedes policy decisions. But how much of its thinking should a central bank share with the public? Traditionally, central banks had a reputation for secrecy and mystery; their language was designed to blur and obfuscate. But now their new buzzwords are transparency and accountability.

This change has gone hand in hand with increased independence. In a democratic society, transparency and accountability are essential if central-bank independence is to remain politically acceptable. Central banks need to make the public aware of the benefits of price stability now that memories of high inflation are fading. Clear monetary-policy goals can also help to guide inflationary expectations and thus influence the behaviour of firms and workers. But perhaps most important of all, central banks need to communicate clearly with the financial markets. By becoming more predictable, central banks can help to make market reactions to interest-rate changes easier to predict, which then makes monetary policy more effective.

Mervyn King, at the Bank of England, has argued that "successful monetary policy should be boring". Changes in interest rates should be predictable, not make headline news. "Successful central bankers should be seen as neither heroes nor villains, but simply as competent referees, allowing the game to flow." There is little chance that any central bank will ever get to be so boring, but certainly most of them have become a lot more transparent.

None more so than the Bank of England, which is now widely regarded as a model central bank. Since it was made independent in 1997, interest-rate decisions have been taken by its Monetary Policy Committee, which consists of five Bank officials and four independent economists. The minutes of each meeting, explaining the reasons behind changes in interest rates, and the details of how individual members voted, are published within two weeks. The Bank's quarterly *Inflation Report* is also probably the best document published by any central bank. It includes an inflation forecast and a detailed assessment of how inflation is developing against the target rate of 2.5%.

The Fed and the Bank of Japan have also become more transparent in recent years. The Fed publishes the minutes of its policy meetings and its voting records with a six-week delay, the Bank of Japan within eight weeks. The ECB, however, prefers to remain rather opaque. It refuses to publish minutes of its meetings and individual voting records, and keeps its inflation forecast to itself. All this has earned it a reputation for secretiveness. Willem Buiter, a member of the Bank of England's Monetary Policy Committee, argues in "Alice in Euroland"* , a scathing attack on Europe's new central bank, that the ECB's lack of transparency and accountability could undermine the whole EMU project.

Otmar Issing, the ECB's chief economist, responds to these criticisms in an equally robust manner in "Willem in Euroland"†. He denies that the ECB favours secrecy and obfuscation. Indeed, he

agrees that transparency and accountability are essential for monetary policy, but disagrees with Mr Buiter on how these are best achieved.

More transparent than thou

Some of the accusations made against the ECB are indeed unfair. For example, at the monthly press conferences the bank holds immediately after its meetings (something the Fed does not do), Wim Duisenberg, the ECB's president, explains the policy decisions the governing council has just taken. This comes close to providing instant summary minutes. As Mr Issing sees it, that may be preferable to publishing carefully edited minutes weeks later.

The ECB's mistake, perhaps, has been not to call its press statement "minutes", and not to call its monthly bulletin an "inflation report". Many private-sector economists think highly of its monthly bulletin, which provides a clear analysis of economic and financial trends in the euro area. As for the ECB's decision not to publish its inflation forecast, this partly reflects the huge uncertainties it faces. It has a harder job than other central banks because the introduction of the single currency and consequent changes in the financial sector may affect the reliability of economic statistics and change economies' response to interest rates. That could make the ECB's inflation forecasts unreliable in the early years.

But why does the ECB not publish individual votes? Mr Issing claims that if it did, interest-rate setting might become politicised as members came under pressure to vote for narrow national interests. But the exact opposite seems more likely: that governors may take advantage of anonymity to vote on national lines. Publication of voting records would make it easier for them to resist political pressure. It would also make individual members more accountable, thus encouraging independent decisions.

Although the ECB is no match for the Bank of England so far as openness is concerned, in one way it is more transparent than either of the other two big central banks, the Fed and the Bank of Japan. This is because it has clearly defined its mandate of price stability as 0-2% inflation over the medium term. In contrast, neither of the other big banks has such a clearly stated goal; indeed, the Fed, under the 1978 Humphrey-Hawkins act, officially still has a dual mandate to pursue full employment and price stability at the same time. But then the Fed has a reputation which gives its policy credibility, whereas the ECB has no track record, so it needs to work that much harder on being transparent.

Moreover, the ECB is less accountable than the Fed. Unlike other central banks, it has no government to which it is answerable. Mr Duisenberg cannot be sacked. He is required to testify before the European Parliament, but that is not quite the same as Mr Greenspan appearing before Congress. Yet without proper accountability, the ECB will find it hard to win the public support that the Fed or the Bundesbank have enjoyed. Politicians will find it easy to blame the ECB for all kinds of economic ills. To gain public trust, therefore, it is crucial that the ECB becomes as open as possible.

Mumbling with great incoherence

One reason why the ECB gets a much worse press than the Fed is that Mr Greenspan is seen as a kind of god. As long as he appears to be delivering the goods, nobody minds about his lack of transparency. Mr Greenspan has made the obfuscatory language of central banks into something of an art form. In his early years he once replied to a congressman: "If I seem unduly clear to you, you must have misunderstood what I said." On another occasion he told a hapless interlocutor: "I know you believe you understand what you think I said, but I am not sure you realise that what you heard is not what I meant." Mr Greenspan's speeches are still somewhat

opaque, but in recent years he has become a bit clearer, partly in order to prepare the bond market for interest-rate changes, and so allow it to do some of the work for him. The Fed's operating strategy has also become more open than it was. Until February 1994 the bank did not even announce policy changes on the day they were decided on.

Many economists argue that Congress needs to update the Fed's mandate and give it an explicit inflation target to make its objectives and decision-making more transparent. Under Mr Greenspan, the Fed has in fact embraced a policy not unlike inflation targeting, but, as a recent book* argues, its strategy is not clear, creating uncertainty about its intentions and thus extra volatility in financial markets.

Another concern is that the Fed's credibility currently rests too much on the skills of the chairman. Mr Greenspan cannot stay in office forever. Also, his successor might not be able to maintain the good relationship Mr Greenspan has recently had with the administration. In a different political environment, the Fed might find itself under pressure to become much more expansionary. A numerical inflation target, argue the book's authors, would reduce market uncertainty about the Fed's policy and help to depersonalise monetary policy. It would also increase accountability, by making it easier for Congress to judge the Fed's performance against a benchmark. This would help to protect its independence against any future political backlash.

Suppose that Mr Greenspan and his board of governors were forced to resign because of a financial scandal: financial markets would plummet. Yet in Japan, markets barely twitched in March last year when Yasuo Matsushita, the governor of the Bank of Japan, resigned along with several other top officials, following the arrest of a senior employee for leaking market-sensitive data to banks. Embarrassingly, this happened only weeks before the Bank of Japan was due to be given independence in monetary policy. How has the Bank of Japan matched up to its new responsibility?

Legally, the Bank of Japan is now as independent as the Fed, but in practice it is rather less so. The finance minister or a representative can attend policy meetings and express his view, though he cannot vote. The make-up of the bank's policy board also undermines its credibility. Because of the scandal, the new law giving the bank independence came into effect when it was suffering from a power vacuum. Masaru Hayami was appointed governor mainly because he was respected and untainted by scandal, but he had retired 17 years earlier, and even when he was still in harness his career had been on the international side, not in monetary policy. One of the two deputy governors is a journalist rather than a trained economist or experienced central banker. The other deputy, Yutaka Yamaguchi, is an economist and a career central banker. Of the six outsiders on the policy board, only one (Kazuo Ueda) is a monetary economist; most of the others lack expertise in monetary economics. This is very different from the Fed or the Bank of England, where the overwhelming majority of the members of the policymaking boards are professional economists.

A further worry is that every one of the bank's moves to ease policy over the past year has given the appearance of responding to political pressure. For instance, the February cut in interest rates, to virtually zero, came after several politicians had called for the bank to loosen the monetary reins. Sadly, these defects have undermined the Bank of Japan's efforts to become more transparent. The bank's minutes are actually more detailed than the Fed's. But in common with the Fed, the Bank of Japan lacks a clear definition of its goal of price stability, so its intentions often remain obscure. Financial markets seem distinctly unimpressed by the bank. Unlike other central banks, the Bank of Japan is 45% privately owned, with shares traded on the stock exchange, and in the 1990s its share price has fared even worse than the Tokyo market as a whole (see [chart 17](#)).



Central banks need to become more open, but transparency is no panacea. In an ever-changing world which has no precise model of how the economy works, and in which

stable consumer prices and soaring asset prices send starkly conflicting signals, a central bank cannot be completely definitive about its monetary-policy decisions. A central banker cannot say more than he knows or understands. He would, however, be wise to have his excuses ready when things go wrong.

* "Alice in Euroland", by Willem Buiter. CEPR policy paper No 1.

† "The Eurosystem: Transparent and Accountable. Or Willem in Euroland", by Otmar Issing. CEPR policy paper No 2.

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