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Ansgar Belke*

Monetary Dialogue 2009-2014: Looking Backward, Looking Forward

In response to the financial crisis, the ECB has had to adopt new instruments to support the euro area economy and preserve the integrity of the single currency. This has challenged the current framework of the Monetary Dialogue exercise. This paper briefly assesses the implications of enhanced transparency and "forward guidance" for the effectiveness of the ECB's policies. It then checks whether the Monetary Dialogue works, and if and how the current Monetary Dialogue framework needs to change in order to fulfil its goal.

The EP resolution of 4 May 1998 on democratic accountability in the third phase of EMU "calls ... for the organisation of a dialogue between the European Parliament and the future ECB on monetary and economic affairs, the framework for which dialogue should be confirmed through a mutual agreement".[1] The Treaty on European Union also contains provisions regarding the issues of transparency and accountability of the ECB vis-à-vis the EP. Based on these requirements, it was agreed that the President of the ECB would appear four times a year before the Economic and Monetary Affairs Committee (ECON).

With the end of the EP's seventh legislative term, it seems appropriate to reflect on the working of the Monetary Dialogue, to review the past five years of monetary dialogues, as well as to look for potential improvements. To this end, this paper investigates the role of the Monetary Dialogue in the context of the ECB's evolving monetary policy. This is done along several dimensions: the ECB's adoption of forward guidance on interest rates, the ECB's model choice and data revision policies for inflation forecasts, its role in the troika and as a financial supervisor, its bond purchasing programme and its role in the US Federal Reserve's envisaged exit from unconventional monetary policies and its effects on the ECB's communication strategy. This paper assesses on a case-by-case basis the information exchange between the EP and the ECB and elaborates on how to improve it via the Monetary Dialogue exercise, taking into account the ECB's communication strategy.

This paper first discusses the arguments in favour of more ECB transparency. The effectiveness of publishing minutes and the instrument of the Monetary Dialogue are then compared with reference to the new ECB voting model – the so-called rotation model that will be activated as soon as the 19th member enters the EMU. The paper also describes why a lack of ECB transparency may serve as an incentive to improve on the conception of the Dialogue. To this end, the current framework, the Monetary Dialogue and potential changes in its conception are discussed in terms of the ECB's new "forward guidance" instrument, the transparency of data revisions and the choice of the underlying macroeconomic model. The paper then elaborates on how accountable the ECB should be towards the EP. The need for increasing the ECB's transparency and accountability stems from its new supervisory roles. Given their importance, they are emphasised separately. The paper finally discusses issues related to the limits to transparency and communication.

Transparency and forward guidance – a new role for the monetary dialogue?

In response to the financial crisis, the ECB has been forced to adopt new tools/instruments to support the

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1 See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:51998IP0110:EN:HTML.

Ansgar Belke, University of Duisburg-Essen, Germany; and Monetary Experts Panel, European Parliament.

euro area economy and preserve the integrity of the single currency. This has challenged the current framework of the Monetary Dialogue exercise. For instance, Transparency International believes that

> the accumulation of the ECB's influence and power especially in the area of banking supervision has not been matched by improvements in transparency and accountability. In this respect, the ECB falls short of the good practices implemented by both its fellow EU institutions and its central banking peers around the globe. Such practices include the publication of meeting minutes and voting records, external independent membership of Boards, robust parliamentary oversight, participation in the EU Transparency Register, clear, detailed policies and procedures for handling conflicts of interest, a "cooling off" period for senior ECB executives returning to the private sector, and a proactive policy on access to ECB documents[2]

(taking care, of course, of confidentiality issues).

The Monetary Dialogue, if improved according to the suggestions sketched out in this paper, implies robust parliamentary oversight. With benefits also for democratic legitimacy and accountability, a guiding principle is that "democratic control and accountability should occur at the level at which the decisions are taken".[3]

A growing need for ECB transparency? The arguments

Monetary policy and sovereign bond purchases

The discussion about more transparency of the ECB has been rekindled by a distinct change of ECB role during the financial crisis. With the Securities Market Programme (SMP) and its announced Outright Monetary Transaction (OMT) programme, the ECB has blurred the distinction between monetary and fiscal policy. As emphasised in more detail later in this paper, this has implications also for the design of the Monetary Dialogue.

2 Transparency International: Improving the Accountability and Transparency of the European Central Bank, Brussels, 18 October 2012, available at: http://www.transparency.de/fileadmin/pdfs/Themen/Finanzmarkt/2012-10-18_TI_ECB_position_paper_final-1.pdf.

3 A. Belke: Towards a Genuine Economic and Monetary Union – Comments on a Roadmap, in: Politics and Governance, Vol. 1, No. 1, 2013, pp. 48-65.

The ECB as a member of the troika

Another critical aspect is the ECB's role within the troika in the context of financial assistance to programme countries. This has significantly challenged the previous smooth working of the Monetary Dialogue.[4] This is partly because none of the troika partners seem to view the troika arrangement as ideal. Indeed, during the Greek programme, significant differences of views emerged among the troika members, in particular with respect to growth projections and their revisions; and partly because internal working procedures were uncoordinated. Lastly, documentation of the vast programme is huge, sometimes overlapping, and holds different degrees of secrecy.[5]

In the context of this paper, the main problem is the ECB's role within the troika.[6] Conflicts of interest are rendering the ECB's membership of the troika a doubtful venture. The Treaties limit the ECB's role strictly to monetary policy. But the bank may have overdone things relative to its original mandate by taking an active role in prescribing the crisis countries' "austerity" measures and structural reforms. Moreover, the ECB's negotiations with the programme countries have clearly been less transparent than necessary – in the same way as its emergency liquidity assistance (ELA) measures which targeted specific euro area member countries. Most strikingly, an important but hidden feature of, for instance, the Greek programme "was that there was no conditionality on areas within the competency of the currency union's central bank".[7] In addition, the ECB and the national central banks, for instance in the case of ELA, appeared to be the institutions within the troika with the largest discretion on setting conditions on their own. This goes against democratic accountability and transparency guidelines as set for instance by the European Court of Auditors.[8]

In order to avoid conflicts of interest and legal grey areas in the future, the role of the ECB within the troika may have to be fundamentally reworked. Moreover, it should be accompanied by even more transparency and ac-

4 S.C.W. Eijffinger, E. Mujagic: An Assessment of the Effectiveness of the Monetary Dialogue on the ECB's Accountability and Transparency: A Qualitative Approach, in: Intereconomics, Vol. 39, No. 4, 2004, pp. 190-203.

5 IMF: Greece: Ex post Evaluation of Exceptional Access under the 2010 Stand-By-Arrangement, IMF Country Report No. 13/156, 2013.

6 D. Gros, C. Alcidi, A. Belke, L. Coutinho, A. Giovannini: State-of-Play in Implementing Macroeconomic Adjustment Programmes in the Euro Area, European Parliament, Brussels, February 2014; IMF, op. cit.

7 IMF, op. cit., p. 30.

8 Ibid, p. 30.

countability standards imposed through the Monetary Dialogue.[9]

The ECB as a financial market supervisor

In the financial sector of country programmes for Greece, Ireland and Portugal (and less so for Cyprus), the "ECB had an obvious claim to take the lead, but was not expert in bank supervision where the Fund had specialist knowledge".[10] It will be crucial for the members of the "Monetary Experts Panel" and the EP in the next few years to assess whether and to what extent the ECB gets into conflicts of interest as regards its extended competencies in banking supervision and banking union. The Monetary Dialogue is in principle a suitable forum to cope with these new issues. However, it may have to increase its scope to be capable to do this. This is not only due to the high technical complexity of the new ECB tasks, but also to the high level of non-transparency implied.

Despite large additional competences conferred to the ECB, the foreseen accountability mechanisms "are limited to the usual hearings at Parliamentary committees, presenting an annual report to Parliament and European Council and providing answers to written questions by MEPs. This is the same level of accountability that the ECB currently has for monetary policy functions. There is no reference to increased transparency as well".[11] There is also a clear need of more transparency on lobbying.[12] Ideally, joining the EU Transparency Register would be a way forward. But also the Monetary Dialogue could have a function here. For instance, the members of the "Monetary Experts Panel" could check empirically whether specific monetary policy decisions closely follow the Taylor reaction function communicated in the ECB's forward guidance framework or whether the empirical fit is much better with some balance sheet events in one larger euro area bank.[13]

A closer look at the new institutional framework quickly reveals that the ECB's new tasks relate mainly to its supervisory role and body (Supervisory Board) rather than to the ECB itself. Therefore, one conceivable and important change in the scrutiny work of the Monetary Dialogue would be to cover the activities of the Supervisory Board. However, this will not be an easy undertaking for both political and economic reasons.

The ECB and the exit from unconventional monetary policies

Another issue the conception of the Monetary Dialogue is confronted with is the role of communication in guaranteeing a smooth exit of central banks such as, currently, the US Fed from current unconventional monetary policies and effects on the euro area.[14] Because the price effect of asset sales is ambiguous and complex in technical terms, international institutions such as the IMF recommend that central banks adopt communications strategies focusing on the interest rate path instead of pre-specified sales volumes.[15] This has a direct bearing on the contents of the Monetary Dialogue as regards the assessment of forward guidance (see below). Most important, the ECB's usual communication strategy through press conferences and the Monthly Bulletin is not sufficient because the potential impacts of exit strategies on the euro area are not the exact counterpart of the effects of unconventional monetary policies.

Implications for the Monetary Dialogue

On the basis of the arguments discussed above, the ECB shall be held accountable in sufficient detail to the EP, as finance ministers are vis-à-vis their national parliaments.[16] To an accountability question raised by the EP in a troika-related questionnaire the ECB responded that: "… (t)he members of the ECB's Executive Board stand ready to share with the European Parliament the

9 See ECB: ECB's replies to the questionnaire of the European Parliament supporting the own initiative report evaluating the structure, the role and operations of the 'troika' (Commission, ECB and the IMF) actions in euro area programme countries, Frankfurt/Main, 2014; D. Gros et al., op. cit.; and http://www.europarl.europa.eu/news/en/top-stories/content/20140110TST32314/html/Parliament-investigates-the-decisions-that-have-been-made.

10 IMF, op. cit., p. 31.

11 Transparency International, op. cit.

12 See, for instance, B. Masters: Bank Regulators Warm to Liquidity Rethink, Financial Times, 2 September 2012, available at: http://www.ft.com/intl/cms/s/0/63a74260-f506-11e1-b120-00144feabdc0.html?siteedition=uk#axzz2u2bNDxvo: "People familiar with the discussions say the industry has had little success persuading anyone beyond the ECB to accept asset-backed securities, despite extensive lobbying."

13 However, the latter pattern could still be covered by the ECB's mandate as a borderline case, motivated by financial stability considerations. This simple example again shows the technical complexity of the issues involved and the strongly increased need for transparency.

14 A. Belke: Exit Strategies and Their Impact on the Euro Area – A Model Based View, Briefing paper prepared for presentation at the Committee on Economic and Monetary Affairs of the European Parliament for the quarterly dialogue with the President of the European Central Bank, December, Brussels 2013.

15 IMF, op. cit.

16 However, the ECB is not accountable to national parliaments which, in the past, did not exclude ad hoc consultations between ECB staff members and national parliament representatives for the sole purpose of sharing views on economic conditions (ECB, op. cit.).

ECB's views on the situation in programme countries and to explain the technical advice given as part of the troika, as they have done on several occasions in the past".[17] But given the extent that the crisis has blurred the distinction between monetary and fiscal policy, the working of the Monetary Dialogue needs to be changed so as to make the ECB fully accountable towards the EP and, perhaps, even towards the European Court of Auditors. This is not yet the case. One obvious example is the lack of transparency in the context of (realised or announced) ECB programmes of sovereign bond purchases, which, admittedly, affects EU taxpayers' money and European citizens' savings. But the EP through its monetary experts shall pay attention that national vested interests do not get too strongly involved in the design of community-wide policies. To the benefit of ensuring the ECB's continued credibility, it is key that ECB policies are publicly communicated as providing an European public good and, as such, must be fully accountable through the Monetary Dialogue.

And in fact there is no alternative to the Monetary Dialogue. The Q&A session of ECB's monthly press conferences following Governing Council monetary policy decisions in its present form does not provide any information of the discussion on monetary policy within the Governing Council. In contrast, ECB President Mario Draghi has become in my view increasingly frank about specific issues such as the relationship between monetary policy and structural reforms in his quarterly reporting before the EP (Monetary Dialogue).

As an example of this, let me quote Mario Draghi directly from his appearance before the ECON committee:

> Second, we look closely at the relation between market interest rates and incentives to reform. Do you really think that a country would change its electoral law because interest rates are a couple of hundred basis points higher? Do you think that a country would actually change its educational system or its judiciary because interest rates are higher? It seems implausible … regarding the real structural reforms, do you think that a country would really change labour market legislation because of interest rates? I think this would probably be unlikely.[18]

Such pieces of evidence are "news", improve the understanding of the ECB's current strategy in "non-normal" times and, hence, represent valuable information for market participants.

Publishing minutes and the Monetary Dialogue – the example of the rotation model

A couple of months ago, ECB President Mario Draghi recommended that the ECB publish the minutes of the Governing Council meetings. By publishing Governing Council meeting minutes, the ECB may improve the transparency and efficiency of its policies significantly, which would support its stability-oriented orientation.[19] The foreseeable extension of the Governing Council due to the envisaged further widening of the euro area and the reform of the Council's voting modalities enhance the rationale for publishing the minutes. Further euro area enlargement will increase the number of Governing Council members and will have an impact on the effectiveness of the decision process. The upcoming rotation model for voting makes an increase in transparency effort even more necessary.[20]

Hopefully, the rotation model for voting will not favour the re-surfacing of nationalism. As the rotation model may limit the representativeness and the effectiveness of monetary policy decisions, the Monetary Dialogue shall gain visibility and importance.[21] In a situation when even big euro area countries such as Germany must drop out from voting every fifth month, accountability and transparency towards the EP must become key to safeguard a common monetary policy. This should include also the *ex post* publishing of minutes.[22]

Lack of ECB transparency as an incentive to improve the Dialogue?

Is the ECB becoming less transparent when taking into account its increasing responsibilities? Can we imagine other instruments enhancing ECB transparency beyond the publication of minutes and better explanation of ECB

17 ECB, op. cit., p. 6.

18 M. Draghi: Committee on Economic and Monetary Affairs, Monetary Dialogue with Mario Draghi, President of the European Central Bank (pursuant to Article 284(3) of the Treaty on the Functioning of the European Union), Brussels, 16 December 2013.

19 A. Belke: Non-Standard Monetary Policy Measures – Magic Wand or Tiger by the Tail?, Section 4, Briefing paper prepared for presentation at the Committee on Economic and Monetary Affairs of the European Parliament for the quarterly dialogue with the President of the European Central Bank, Brussels, September 2013.

20 A. Belke, B. von Schnurbein: European Monetary Policy and the ECB Rotation Model – Voting Power of the Core versus the Periphery, in: Public Choice, Vol. 151, No. 1, 2012, pp. 289-323.

21 A. Belke, B. Styczynska: The Allocation of Power in the Enlarged ECB Governing Council – An Assessment of the ECB Rotation Model, in: Journal of Common Market Studies, Vol. 44, No. 5, 2006, pp. 865-895; A. Belke, B. von Schnurbein, op. cit.

22 S.C.W. Eijffinger, R. Mahieu, L. Raes: Estimating the Preferences of Central Bankers: An Analysis of Four Voting Records, CEPS Discussion Paper No. 9602, Centre for Economic Policy Research (CEPR), London 2013.

policies within the current framework of the Monetary Dialogue?

The ECB has regularly been placed quite high in a variety of transparency rankings conducted for the pre-crisis period. But this transparency weakened significantly in the course of its SMP. The ECB merely published the weekly total amount of bonds purchased without informing about the country-specific structure of the purchases, the maturities of the bonds, the criteria and/or the extent of future purchases. This lack of transparency is striking, especially in comparison to the high degree of transparency of the Fed and the Bank of England in the course of their quantitative easing programmes.[23]

In public, the ECB frequently justified its "secrecy" of the sovereign bond purchase programmes with efficiency arguments. If there were no secrecy, the programme would have lost its efficiency. For instance, complete transparency about the large predominance of bond purchases from Greece, Italy and Spain could have resulted in strong disagreement by northern euro area member countries, endangering the financial stability of the whole system. This argument looks flawed, however, as traders could have easily identified the geographical location of bond purchases.

The same caveats can be raised with respect to the ECB's lack of transparency about its Long-Term Refinancing Operations (LTROs). Bond spreads fell across the board with the LTRO implementation. This raised the suspicion that the additional liquidity was largely used for bond purchases by the commercial banks (the so-called "Sarko trade"). Although this raised serious doubts about the programme, the lack of published information did not enable analysts, including Monetary Panel experts, to assess the LTRO effects.

Enhanced ECB transparency combined with a proper working of the Monetary Dialogue could help avoid confusion about, and negative side effects of, its unconventional monetary policies.

Are there other instruments available to enhance transparency and to give a better explanation of ECB policies than previously? Traditionally, credible exchange rate pegs deliver the largest possible transparency of monetary policies. They allow a public monitoring of the policies' compliance with the exchange rate target. The textbook alternative is direct oversight with formal control through the government. But, clearly, both solutions are not realistic alternatives with an eye on the flexible exchange rate of the euro and strongly emphasised ECB independence. This in turn increases the pressure to strengthen other aspects of transparency in order to make the central bank accountable to its stakeholders, the markets.[24] From another perspective, this underlines the importance of putting the ECB's inflation forecasts/projections under more scrutiny because the euro is a floating currency and exchange rate forecasts have implications for the ECB's inflation forecast.

Monetary Dialogue, "forward guidance" and the transparency of data revisions and model choice

Before we are able to assess the role the Monetary Dialogue could play in the context of the adoption of forward guidance on interest rates, we have to establish the actual and the optimal extent of the ECB's "forward guidance". Reflecting the increasingly vivid transparency debate, the ECB has moved to deliver an outlook on its future path of policy rates ("forward guidance"). In this context, a second question becomes relevant: will the ECB adhere to the "forward guidance" instrument even after the crisis period has ended? This is important in our context because the design of the Monetary Dialogue may be adapted to this systematic change in the ECB's policy toolbox.

Forward guidance as practised right now is not a commitment to keep official interest rates lower than will be necessary in the future or, expressed differently, to create inflation. It does not just represent an additional stimulus by an *ex ante* commitment to a time-inconsistent policy path. Instead, the main aim connected with the interest rate outlook is to elucidate the ECB's assessment against the background of the overall subdued inflation prospects and, more specifically, the bank's policy reaction function. From this perspective, the ECB does not describe anything other than a policy rule for its future interest rate path (which only makes sense for maturities up to two years). Forward guidance is thus meant as strengthening the credibility of ECB monetary policy strategy.[25] This seems adequate under current circumstances in order to calm down markets and to curb speculation on rapidly increasing interest rates because, in times of higher uncertainty, transparency and clarity help to give orientation and to stabilise expectations of market participants. Hence, "forward guidance" is an indirect instrument to loosen credit conditions and thus stimulate credit supply and economic growth without conducting any further interest rate cuts under non-normal circumstances. Most importantly, "forward guid-

23 A. Belke: Non-Standard Monetary Policy Measures ..., op. cit.

24 Ibid.

25 Ibid.

ance" cannot correspond with any long-run commitment to a specific interest rate level because this would insinuate an intended change in the medium-term oriented monetary policy strategy. And here I would now add with the benefit of hindsight: "which ECB representatives are publicly denying".

If this is true, however, it is clearly not appropriate to speak of a change in the reaction function of the ECB driven by forward guidance, which makes a change in the design of the Monetary Dialogue necessary. Moreover, most likely, the ECB will not be able to decouple its policies from those of the Fed during and after the process of normalisation.[26] As soon as the crisis is over and we will have entered more "normal times", the ECB should and probably will not abide by this instrument. This is because such kind of "forecasts" are vexed by much uncertainty and entail risks, also for the reputation of central banks. From this point of view, the instrument of forward guidance is almost surely not the most relevant challenge for appropriate communication and transparency requirements and, thus, for the design and structure of the Monetary Dialogue.

However, there are also arguments in favour of a short- to medium-run relevance of the forward guidance tool for the Monetary Dialogue. The ECB will have to struggle to avoid confusion of different interpretations of "forward guidance" by ECB representatives. The ECB President knows that "forward guidance" should be formulated as only dependent on the bank's inflation forecast/projection. What is more, the ECB's announcements may not necessarily be conceived as credible – for instance, there are election dates between the announcements and the dates on which the inflation outlook is published. In that case, deviations of the markets' action and the central bank's ideal projection of market behaviour cannot be excluded. Indicating the need to curb official rates for the next few years could convey the impression that the bank anticipates the crisis lasting for several years to come. But if markets become more pessimistic, consumers' and investors' spending will suffer.[27]

On a more general level, it thus seems fair to state that "forward guidance" and the discussion about the publication of minutes have indicated that during the crisis the relevance of the classic interest rate instrument has decreased. The future Monetary Dialogue should thus take into account that expectations of future monetary policy will play a higher role than before, especially in the context of the North-South debate (e.g. financial repression of northern savers through lower long-term interest rates). Hence, "manipulating" expectations does potentially represent the more effective monetary policy. This is exactly the point where the Monetary Dialogue has to step in in the future to avoid this kind of "manipulation". The euro area long-term interest rate is the result of the expected patterns for short-term rates which, in turn, are driven by inflation forecasts. A key task of the "Monetary Experts Panel" will be to assess the current ECB inflation forecasts/projections and the pattern of revisions to detect systematic downward or upward biases.[28]

Revisions of, for instance, output gap estimations in Europe which usually enter inflation forecasts may turn out to be especially worrisome since (medium-term) adherence to the ECB's inflation target is assessed with reference to initial data periods.[29] It is found that: (a) preliminary releases tend to be biased and inefficient predictors of subsequent data periods; (b) such systematic bias in data revisions represents a general feature; (c) Eurostat's decisions explain a significant share of the bias and contribute some evidence of practices of window-dressing; and (d) political cycles, among other factors, contribute to data revision patterns.

Ley and Misch find that output data revisions alone may significantly undermine the reliability of real-time estimates of the overall and structural fiscal balances, and that output data revisions may result in unplanned and substantial debt accumulation. The paper also shows that there are significant differences across country income groups.[30]

Kempkes analyses real-time output gaps for EU15 countries over the 1996-2011 period.[31] His results suggest that the ECB's monetary policy (Taylor) rule should incorporate *ex post* checks of the un-biasedness of the

26 A. Belke, D. Gros: Asymmetries in Trans-Atlantic Monetary Policy Making: Does the ECB Follow the Fed?, in: Journal of Common Market Studies, Vol. 43, No. 5, 2005, pp. 921-946; A. Belke, Y. Cui: US-Euro Area Monetary Policy Interdependence – New Evidence from Taylor Rule Based VECMs, in: The World Economy, Vol. 33, No. 5, 2010, pp. 778-797.

27 A. Belke: Non-Standard Monetary Policy Measures . . . , op. cit.

28 Mayer, for instance, argues that the current low interest rate policy in the euro area negatively affects the long-term yields of euro area savings (in contrast to Mario Draghi's view), exactly because long-run interest rates are driven by the sequence of the inflation forecasts by the ECB staff: T. Mayer: Wer hat Schuld an der Not der Sparer?, in: Frankfurter Allgemeine Sonntagszeitung, 11 January 2014.

29 F. De Castro, J.J. Perez, M. Rodriguez-Vives: Fiscal Data Revisions in Europe, in: Journal of Money, Credit and Banking, Vol. 45, No. 6, 2013, pp. 1187-1209.

30 E. Ley, F. Misch: Real-Time Macro Monitoring and Fiscal Policy, Mannheim and Washington, mimeo, 8 March 2013; an earlier version was published as World Bank Working Paper No. 6303.

31 G. Kempkes: Cyclical Adjustment in Fiscal Rules: Some Evidence on Real-time Bias for EU-15 Countries, Discussion Paper, Deutsche Bundesbank, No. 15/2012, Frankfurt/Main 2012.

cyclical components used within the rule. Potential biases would then decrease or increase future limits for the monetary policy stance as measured for instance by the policy rate.

Another issue at stake is the choice of appropriate models and their adequate application to inflation forecasting at the ECB.[32] Best academic practice requires that the choice of the adequate model should not be based on ideological priors of the contracting authority ("Keynesian" versus "non-Keynesian", socialist versus conservative, etc.) but, instead, on the much more neutral use of widely accepted empirical model selection criteria.[33] The Monetary Dialogue should move significantly more into the direction of focusing on the issue of non-partisan macroeconomic model choice.

To facilitate the dialogue, the ECB in turn should become more detailed in the publication of its inflation forecast. It could do so by drawing more on alternative scenarios, their impact on credit, growth and inflation, and on pricing in systematic biases of its inputs (output gaps, exchange rate trends, etc.). As a positive side effect this would help financial markets and – even more importantly – firms, unions and governments to incorporate risks in their decisions.

The ECB – how accountable within the Monetary Dialogue?

Through more openness in its communication, the ECB intends to convey to financial markets more information regarding the bank's future course. The widespread view among economists is that "more information is better".[34] Why?

They tend to assume a model with rational expectations and exogenously provided public and private information. As such, these models do not consider that the provision of public information may weaken the incentive of market participants to privately collect information on their own.

The more predictable monetary policy becomes, the better market participants are able to align their decisions with those of the central bank. Frictions and volatility decline since actors are better able to forecast the future time path of monetary policy and related variables. This view that more transparency reduces market volatility is frequently corroborated by empirical evidence.

However, things may be different in some specific settings, according to theory. Under a different set of assumptions, a public provision of information can interfere with the function of markets. As the "theory of the second best" suggests, the abolishment of a bias may not improve competitive allocations if further biases exist. It follows that enhanced transparency may not necessarily lead to a welfare improvement. There may be an optimal degree of "secrecy" which is larger than zero.[35]

But a policy of limited transparency will hardly be able to solve internal disputes and hassles in the ECB Council. On the contrary, it may cause irritating signals, which in turn trigger undesirable volatility on financial markets. While more transparency is welcome, it is not clear how far this process should go as the upper boundary for transparency is likely to be less than 100 per cent. The "optimum degree of the ECB's secrecy" is an issue that has a direct bearing on the Monetary Dialogue.

This view can also be supported from a policy cycle perspective.[36] Full accountability to and "democratic control" through the EP may conflict with the central bank's policy and instrument independence. Policy independence may be endangered as soon as different political groups in the EP pressure for the adoption of specific macroeconomic models or even different monetary policy measures.[37]

Instrument independence may be hampered by the fact that policy tools such as the ECB's sovereign bond purchases may be effective only when they are not anticipated. Because the Monetary Dialogue would lose its social value if the ECB's independence is threatened, Monetary Panel experts will warn as early as possible about the danger of such negative feedback.

32 Since the business cycle and financial cycle are of different length in the euro area (C. Borio, P. Disyatat, M. Juselius: Rethinking Potential Output: Embedding Information about the Financial Cycle, BIS Working Papers No. 404, Bank for International Settlements, Basle, February 2013), the ECB may still fail to use adequate output gaps in its inflation forecasts/projections. This is just another aspect that has become virulent since the start of the financial crisis and should be an object of the Monetary Dialogue.

33 D. Gros et al., op. cit.; H.M. Pesaran, B. Pesaran: Working with Microfit 4.0 – Interactive Econometric Analysis, Oxford 1997, Oxford University Press.

34 A. Belke: Non-Standard Monetary Policy Measures . . . , op. cit.

35 See, for instance, H. Gersbach, V. Hahn: Should the ECB publish its minutes?, Vox EU, 7 October 2013.

36 A. Belke, N. Potrafke: Does Government Ideology Matter in Monetary Policy? A Panel Data Analysis for OECD Countries, in: Journal of International Money and Finance, Vol. 31, No. 5, 2012, pp. 1126-1139.

37 For details, see D. Gros et al., op. cit., Section 2.4.

The ECB and banking surveillance in the euro area: increasing transparency and accountability duties

Let us now briefly revisit the new ECB role as a financial market supervisor. Are there particular transparency and accountability obligations resulting from this? If yes, how can these be best accomplished?[38]

In fact, the ECB must become even more transparent as soon as it is tasked with the surveillance of the large majority of the EU banking system. Indeed, a bank restructuring may imply an additional burden for the public budget and, in addition, the ECB will have to take up law making powers once it is tasked to issue regulations regarding banking oversight. The ECB shall therefore become fully accountable to the EP in the context of the Monetary Dialogue exercise, something which did not happen with regards to the SMP and OMT programmes.

To this end, the "Monetary Experts Panel" will have sufficient access to the minutes of the ECB Supervisory Board as well as the ECB Governing Council, as far as "the latter are related to questions regarding financial oversight issues". Information with respect to company secrets of single banks or specific group of banks must be exempt of course.

Limits to transparency and communication within the Monetary Dialogue?

In this section, we tackle the confidentiality versus accountability trade-off issue of the ECB. Otmar Issing, the former ECB chief economist, warned against a so-called "crystalline central bank".[39] What exactly are the limits of transparency and communication of central banks towards financial markets and the public?

> Surely, transparency becomes critical if the publication of minutes improves the markets' understanding of monetary policy as strongly as if people would have taken part in the Council meetings themselves. This is well understood by market participants.[40]

What is more, central banks must avoid being driven by financial markets and their expectations or by journalists' questions during ECB press conferences. For this purpose, they should dispense with *ex ante* publishing the exact dates of planned interest rate movements and, thus, the future long-term rate. It is equally important to counteract market expectations that the ECB will change its official interest rates as a rule only on the days when the bank publishes its new inflation growth projections. This is because other forces such as, for instance, credit and money growth could decisively drive Council decisions to change interest rates.

Furthermore, limits to transparency are reached if the publication of the minutes allows interest groups to lobby Council members and thus to diminish the ECB's ability "to align its policies with the interests of the citizens of the Eurozone as a whole".[41] Limits to transparency also stem from the necessity to avoid all the details of internal discussions among Governing Council members. A certain degree of secrecy may prove to be useful as a potential threat to curb market participants' expectations.

However, a high degree of transparency may protect Governing Council members against undue pressure from national governments as potential deviations of ECB policy from a stability-oriented monetary policy would be brought to the surface.[42]

From this perspective, a well-designed monetary dialogue would support rather than hamper a stability-oriented monetary policy. But what does "well-designed" actually mean? The key aim of the Monetary Dialogue is to better understand the ECB Council's decisions.

Hence, the Monetary Dialogue exercise should not scrutinise every single ECB decision. Rather, it should make sure that the ECB's strategy is well understood, and enable the EP and the market participants to get an idea of the ECB's policy targets and of how the bank is intending to reach them.

Conclusions

According to Eijffinger and Mujagic, the ECB has been highly accountable to the ECON in the first years of EMU (1999-2003), i.e. in normal times.[43] In this paper, we argue that the Monetary Dialogue is currently even more important than in "normal" times. We suggest changes, procedural as well as regarding its focus, to make it more effective. In our view, the (lack of) transparency issue represented by a Supervisory Board "hosted" by the ECB needs to be addressed by the Monetary Dialogue. A crucial challenge is to find out the optimal degree of ECB transparency and accountability towards the EP.

38 The following is taken from A. Belke: Non-Standard Monetary Policy Measures ..., op. cit., Section 4.

39 FAZ: Issing lehnt eine "gläserne Notenbank" ab, in: Frankfurter Allgemeine Zeitung, 19 January 2006.

40 Ibid.

41 H. Gersbach, V. Hahn, op. cit.

42 A. Belke: Non-Standard Monetary Policy Measures ..., op. cit.

43 S.C.W. Eijffinger, E. Mujagic, op. cit.