The Institutional Politics of Central Bank Independence in France, Greece and the U.K.

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Abstract

This thesis analyses the politics of making central banks independent within the European Union. Unlike other studies that focus solely on the economics of the debate, this study also concentrates on the political aspects of the reform through an institutional approach. It examines the interaction of interests, institutions and ideas in the process of reforming one of the most essential organs in the process of economic policy-making. The research concerns the attempts of governments of three member-states of the European Union - France, Greece and the U.K. – which signed the same Treaty, but which nonetheless followed different paths in implementing Central Bank Independence (CBI). The thesis aims to explain the differences between the three cases about the considerations of CBI, the exact timing of introducing the reform and the particular models of independence chosen.

This study suggests that there are three main variables which shaped and influenced why, when and how the three member-state governments implemented CBI in the 1990s. Those variables are the position of the country within the international political economy, the established rules and processes of political competition, and finally the traditional patterns of post distribution and democratic control. The first variable mainly explains the interest and attitude towards CBI, based on the standing and the status of each country in the European and the international politico-economic scene. The analysis of the case studies showed that the greater the exposure of an economy to global economic pressures and financial market flows, the more likely were its elites, in seeking monetary stability and credibility, to consider the idea of CBI and to bring it onto the political agenda. The second refers to the domestic politico-economic parameters which determine the stance of the main actors and account for the time and method of establishing CBI. The research revealed that the electoral cycle is particularly important. Newly elected governments, whether of the same party or not, attempt significant reforms early to show their difference, prove their effectiveness and minimize opposition. In all three cases CBI has been established by new governments which took advantage of the significant parliamentary majority they had and the 'grace period' they enjoyed during their first months. Finally, the third variable justifies the differences among the institutional characteristics between the models of CBI. Policy makers are bound by the prevailing arrangements of distributing public offices and the procedures for democratic control in each country and therefore adopt CBI appointment and accountability procedures which follow these traditional patterns.

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Chapter I: Explaining Economic Policy Changes

Economic policy-making has always been one of the most fundamental aspects of public policy. Especially today the process of globalisation, that is the free movement of capital, products and money, has enhanced even more the role that economic policy plays in determining the course of life and prosperity throughout the world. Global integration in the fields of trade, direct investment, capital and money markets has created a new economic framework. Within such an environment, economic authorities in order to pursue their objectives have to keep in mind not only national parameters but also global conditions.

Since the early nineties, when the Maastricht Treaty was signed with the aim of creating an Economic and Monetary Union (EMU), European Union (EU) member-states' governments were obliged to follow policies that would ensure economic convergence within the EU area. Consequently, their room for independent national policies was restricted. Participation in the EMU required economic changes and reforms that in many countries seemed inconceivable before the signing of the Treaty. This inevitably generated conflicts since a significant number of EU citizens were not ready to give absolute priority or even agree to participate in a single European currency.

This thesis analyses the politics of making central banks independent within the European Union. It examines the interaction of interests, institutions and ideas in the process of reforming one of the most essential organs in the process of economic policy-making. During the last decade, the idea of central bank independence, that is the authority to act independently in monetary matters, spread all over the globe with considerable speed and remarkable reception. This was mainly because of the suggestions of numerous empirical studies that pointed to the economic advantages of independent central banks and the arrangements for the independent European Central Bank. Nevertheless, the implementation of such a reform involves political difficulties for most governments. The majority of governments that granted independence to their central bank during the last decade succeeded in doing so only after overcoming strong opposition and significant delays.

Economic policy-making is a highly political process. It will always be a never-ending struggle between competing interests, parties and social groups, which have different objectives and preferences, thus making the process of policy-making and reform extremely complicated. Only rarely has an economic policy reform satisfied everyone affected by it. All participants in public life are thus constantly trying to influence policy-making for their own, separate, ends.

Amidst conflicting interests, views, desires and pressures the task of any government, which is ultimately responsible for the final direction of policy-making, is extremely difficult. Ideally, the government implements policies according to what it believes to be in the best interest of the country and its citizens. However, what constitutes 'the public interest' or 'good' and 'bad' policies is a very subjective matter. Public policy-making initiatives, choices and implementation are certainly affected by political variables. In order therefore to locate the determinants of economic policy reform one has to examine the elements that influence government actions.

This research concerns the attempts of governments of three member-states of the European Union - France, Greece and the U.K. – which signed the same Treaty, but which nonetheless followed different paths in implementing Central Bank Independence (CBI). Neither did they proceed with the reform at the same time, nor did they give their newly independent central banks identical institutional characteristics. The central concern in this thesis is to account for the different ways in which the dominant political elites of these three EU members dealt with CBI after the Maastricht Treaty, to examine why there were within the EU different national debates, and to clarify why similar policies were interpreted in different terms. It must be emphasized that the thesis aims to explain differences of timing over a short period, differences of models within a limited range and differences of appointment procedures which diverge relatively little. However, these differences are significant as they pinpoint the differentiation of perceptions that exist within the EU.

Although there have been numerous studies that have examined the issue of central bank independence, most have concentrated on the economic aspects of the change and especially on its implications in the conduct of monetary policy (see Chapter III). Only recently has the literature begun to explore the political and institutional aspects of CBI.

However, these studies have either neglected to examine the whole process and have focused instead on some of its stages (origin, acceptance, adoption or maintenance) or they were conducted before the signing of the Maastricht Treaty or even they focused on countries not related to the European Union developments and thus in a completely different framework.[1] Our research differs from existing studies on CBI in two basic aspects. First, it is concerned with the efforts of governments in three member states of the European Union all of which signed and ratified the Maastricht Treaty (albeit with an opt-out clause in the case of the UK). CBI in these states took place, therefore, in a completely different context to that considered in all other studies. The majority of those studies are concerned either with OECD countries in general, or even with developing countries and closed-economies (see Maxfield, 1994; Clark, 1993; Franzese, 1995; Cukierman & Webb, 1994). Second, its primary focus is not on the economics of the debate - although these too will be examined - but rather on the political and institutional aspects of the reform. The thesis explores mainly when and how governments of EU member states decided to establish CBI. In so doing, it complements studies which focus on why governments of some countries, at particular times, favour CBI or why CBI works in some countries and not in others (see Maxfield, 1997; Posen, 1993; Alesina, 1988; Goodman, 1992; Clark, 1994; Cukierman, 1993; Franzese, 1995; Hall, 1994; Bernhard, 1995). It does not however provide a model which can be applied to any country in the world. The idea is to carry out an extensive examination of all the factors affecting such a reform and to analyse the role of the central actors, in order to create a comprehensive and systematic account of the politics of the decision-making process of granting CBI within the EU context.

The remaining part of the introduction is divided into five sections. The first section reviews the main traditional theoretical approaches to policy-making and reform. The second constructs an analytical framework for the analysis of the particular study. The third section describes the policy change process from a theoretical point of view, while the fourth explores the role and influence of the main participating actors. Finally, the last section analyses the argument of this thesis and discusses the methodology and structure of the subsequent chapters.

[1] A more detailed analysis of existing studies on CBI can be found in Chapter III, pp.77-78.

POLICY-MAKING / POLICY REFORM PROCESS

It is not an easy task to identify a theoretical framework within which one can analyse the course that economic policy will take, or the reasons why and when governments legislate for central banks to become independent. There are two broad categories of traditional theorising about decision-making and economic policy reform. The one is society-centered and the other state-centered. According to the first approach, the decisions concerning public policies are understood in terms of relationships of power and competition among individuals, groups, or classes in society. In contrast, the state-centered theory emphasises the relative autonomy of the government and the broad orientations of the state in pursuing their policy choices.

STATE-CENTRIC APPROACHES

State-centric theories base their arguments on the assumption that the state is relatively autonomous from societal pressures. According to this view the state, as expressed through the actions of the government, has the ability and power to accomplish its interests and preferences regardless of societal objections and opposition. Eric Nordlinger (1981: 203) emphasises the above with the following argument: "The democratic state is frequently autonomous in translating its own preferences into authoritative actions, and markedly autonomous in doing so even when they diverge from those held by the politically weightiest groups in civil society".

However, even if we accept that the state is not as dependent on social and interest group pressures as other theories imply, we cannot entirely separate it from societal context and its preferences. If state-centric theories reject the influence that groups and interests have on the state how can we explain the course of policy-making? State-centric analyses have developed three different explanations to the above question but still leave some parts unanswered.

The first explanation argues that policy-making is guided not by the logic of rational actors, whether these are individuals or institutions, but by that of bureaucrats. The defendants of this argument see the policy-making process as the result of competition

among bureaucratic 'players' within the state, who try to achieve their goals and interests (See Allison, 1971 and Halperin, 1974). Essential in the outcome of the above mentioned competition are the organisational roles and capacities of each actor. Also the preferred policy of each actor is defined by his available resources and his position within the government. Although such an approach can provide a useful framework for investigating and understanding inter-governmental conflict, bargaining and decision-making, it has serious limitations. The main problem is that there are no guidelines or indications of the policy course. Bureaucratic logic and politics are too vague to be counted as a model of policy-making. One cannot predict or identify the specific ideology of the participating actors or the power each one of them has in order to propel his or hers preferences.

A second explanation of state-centric approaches holds that the state's choice of which policies will be implemented depends on whether it has the required capacities and resources. The state is thus considered a rational unitary decision-maker that chooses among alternative courses of action on the basis of the potential to achieve the decision-makers' preferences (See Allison, 1971; and Frohock, 1979). If the state cannot afford to implement a programme, economically, politically or institutionally, then it will not undertake its accomplishment. Although such an argument seems fair, we must not neglect the fact that the ability and capacities of the state to proceed with the implementation of any policy depends a great deal on the relations with society. Rational actor approaches are particularly useful in exploring why decision-makers in cases of uncertainty, complexity, and conflict adopt incremental or marginal changes, but are less useful in explaining the conditions under which fundamental reforms are introduced. Rational actor models focus within the organisational context of decision makers and thus provide little insight into how societal interests, historical experiences, rules and norms affect or shape their position. However, societal forces are not exogenous factors and thus cannot be ignored. They are the ones that more or less determine the capacities of the state.

Finally, some state-centric theorists explain the policy-making process not as a result of competitions and conflicts within the state, but as a process of social learning. According to this view, policy-making is significantly affected by experiences and lessons from past policies. Problems, dilemmas and consequences of older policies influence policy-

makers, and as a result new perceptions and preferences are generated. This concept of social learning was heavily influenced by Hugh Heclo (1974: 305-6), who claimed that "policy-making is a form of collective puzzlement on society's behalf…Much political interaction has constituted a process of social learning expressed through policy". Paul Sacks (1980: 356) further argues that "the most important influence in this learning is previous policy itself". Sacks also relates social learning with the autonomy of the state: "the 'politics as learning' approach implies that elements within the state, acting, presumably, in pursuit of the national interest, decide what to do without serious opposition from external factors".

The concept of policy-making as social learning seems to provide a logical explanation to state-centric theories, but it also has its deficiencies. First of all lessons from the past are not always reliable. Hall (1986: 16) states that "lessons do not come unambiguously from history", arguing that many different people have often drawn divergent, and often contradictory, lessons from past policies. Secondly, this process can be affected by factors and developments outside the boundaries of an autonomous state and may involve broader participation and conflicts within the whole political system.

On the whole, we can argue that the claims of state-centric theorists about the autonomy of the state are not particularly persuasive. The state is more or less related to the society and its institutions in all aspects. Societal influence of some form, either direct or indirect, is real and affects state officials and decision-makers. The important issue is from where and how this influence emerges, and how significantly it can alter the preferences of the state and its actors.

SOCIETY-CENTERED APPROACHES

Functionalist / Systems Theories

Functionalist models regard political life as an organic whole: each political entity is not isolated from the rest, but interrelated and functional only in conjunction with the whole system of politics. According to this model, the actions of the state are represented through various functions for the stability and survival of the whole political system (Hall 1986: 5). In regard to economic policy-making, systems theories suggest that state

actions be pursued in order to ensure either the long-term interests of capital ('accumulation') or the maintenance of existing social harmony ('legitimation').

The main problem of functionalist theories however, is that they are too vague in explaining the precise functions which the state has to perform. Marxist claims that the state will act to reproduce the economic system by performing 'accumulation' and 'legitimation' functions, still cannot specify the policies or institutions that will perform these functions since such notions are too general. Furthermore, they do not provide a satisfactory account of why the state should either be permeated with the interests of the capitalist class or face a functional imperative to defend those interests. Such analyses confuse the consequence of an action with its cause. Hall (1986: 7) states that the problem of functionalist analyses is that they reverse the priority to institutional structures. He explains that "it might be possible to identify the functions of a given institutional structure, but it is virtually impossible to derive structure from function in a systematic and non-arbitrary way. Structural-functionalism only works if it gives priority to structure rather than to function".

Cultural Theories

Cultural analyses claim that the motives and actions of politicians and state officials are highly influenced by the political culture within which they operate. Verba (1965: 513) defines political culture as "the system of empirical beliefs, expressive symbols, and values which defines the situation in which political action takes place. It provides the subjective orientation to politics". Cultural theorists argue that the explanation of divergence between national policies is due to the different political cultures between nations. Hayward (1976: 341), for example, claimed that differences between France and Britain to reform their economies rested on "the operation of culturally-based dominant values that inhibit or preclude some kinds of government action and favours others".

Although no one can doubt the influence that cultural parameters can have, cultural analyses of policy-making has two serious drawbacks. The first is that usually cultural explanations are too extensive and vague to track down the more detailed policy-making differences between divergent national policy models. The second problem is that even in cases were these underlying differences are identified, their origins and processes often remain unexplained. Theorists, who attribute differences in national policies and

variations in the actions of states to cultural reasons, cannot explain why and how these political cultural differences occur and are reproduced. Cultural theory provides limited explanation for the process of policy-making, and uses too general arguments to prove that certain state actions are due to the political culture of its actors.

Public Choice Theory

Public choice approaches regard politics as a competition between self-interested individuals who, acting rationally, try to achieve their objectives in the most efficient way (See Ames, 1987; Anderson and Hayami, 1986; Bates, 1981; Breton, 1974; Buchanan and Tullock, 1962; and Schumpeter, 1943). Individuals and institutions, which act as individuals, in their effort to gain as much political power and public resources as possible, use rationally developed methods to gain the support of electors who are also self-interested. According to public choice theorists, elected public officials in their effort to achieve their politically rational goals, namely to remain in power, use public resources in a way that is often irrational both from an economic as well as from a social point of view.

Various studies, however, have shown results that are not always the ones public choice theorists would expect. Although these theories provide explanations of why 'the public interest' is not often achieved, they are less able to explain how policy changes or the policy itself leads to broad beneficial outcomes that are opposite to powerful interests' preferences. The public choice approach by focusing on the power of vested interests demonstrates the barriers to reform that exist due to well-established previous preferences and the political relationships that these entail. However, the approach cannot explain in a systematic way why, how, or when reform occurs. It just explains existing policies with references to the rationality of self-interested actors.

The suggestions of organisational theory, which is close to public choice theory, seem much more promising (See Cyert and March, 1963; and March and Olsen, 1989). They assert that policies are not solely the result of rational behaviour since they are constrained by the organisational environment and the rules within which policy-making is exercised. Organisational theorists claim that rational actors are affected by the organisational settings and consequently the policy result is also affected. According to

this approach, organisational conditions can identify the direction of self-interest rational action and the potential means to be applied for its accomplishment.

Group Theories

Group theories have as their basic unit of analysis neither the economic system nor the individuals, but the societal groups and classes who compete within the political system (See Bentley, 1908; Dahl, 1971; Lowi, 1969; McConnell, 1966; Nordlinger, 1981; and Truman, 1951). Policy is the result of 'battles' between struggling interests organised into groups. The main point of this theory is that through groups and coalitions almost anyone can have some access to politics and power. What is more, individuals can belong to more than one competing group, thus stimulating participation, something that makes groups even more powerful. Policy is then formed according to the balance of power among competing groups, with the state acting as an arbitrator. In the words of Earl Latham (1956: 239), "What may be called public policy is actually the equilibrium reached in the group struggle at any given moment, and it represents a balance which the contending factions or groups constantly strive to tip in their favour... The legislature referees the group struggle, ratifies the victories of the successful coalition, and records the terms of the surrenders, compromises, and conquests in the form of statutes".

The weakness of group theories is that they fail to explain how these groups and coalitions are formed and structured. Although the pressure they exert seems crucial in the determination of policy-making, group theories need to provide more information on the way demands and ideas are shaped, resolved and altered. Furthermore, the extensive underestimation of the role of elected public officials in the initiation, formulation, and implementation of change comes into contradiction with instances where policy-makers have shown significant autonomy over policy-making (See Marsh and Grant, 1977; and Wilson, 1983).

AN INSTITUTIONAL APPROACH TO POLITICS

Policy-making and policy change is a long process during which various actors and institutions interact and influence the final outcome. The process of policy-making differs, depending on the time or the country. In an effort to analyse the reasons for these differences, various theories have been developed. The theories and models analysed in the previous section contribute to our understanding of the way policy making is directed. Each one focuses on particular factors, reasons and conditions to explain the behaviour of the state and all others involved in the policy process. To some extent they have succeeded. One cannot deny that cultural and traditional factors have an influence on people's beliefs and the way they approach policies, that interest and social groups can put a lot of pressure on governments for specific changes, and that elected decision-makers are always thinking about how to ensure re-election. Moreover, it is proven that the state can occasionally act quite autonomously from the society. However, all these theories have a major disadvantage: they are sound so long as they are viewed in a vacuum, in isolation from one another. None of the above theories can explain in a consistent way the differences of policy-making patterns and processes followed by governments under similar conditions. Furthermore, they cannot justify the strong continuities present in national patterns of economic policy that have no direct connection to the preferences of competing groups or individuals either within or outside the state.

Due to such limitations it is suggested that more emphasis should be given to structural factors. In order to analyse structural consistencies, this study considers an institutional analysis to be the most appropriate. According to Peter Hall (1986:19), such an approach is "capable of explaining historical continuities and cross-national variations in policy. It emphasises the institutional relationships, both formal and conventional, that bind the components of the state together and structure its relations to society. While those relationships are subject to incremental change, and more radical change at critical conjunctures, they provide the context in which most normal politics is conducted."

Institutional approaches base their arguments on the importance that institutional structures, rules, procedures and practices have on the relations between the state and

society. According to this view, institutional factors have two crucial effects on policy outcomes. The first is that institutional and organisational structures determine the power and the degree of pressure that an actor can have over policy-making. The second is that, according to an actor's position in the organisational framework, institutional arrangements determine also the direction of the pressure exercised.

Institutional models emphasise the organisational factors and dynamics, both inside and outside the state, which affect the needs and preferences of various actors and indirectly influence their behaviour. Policy-making is a long process that passes through many stages. It is therefore inevitable that the interactions between individuals and institutions will have an impact on the final policy outcome. When new issues arise, actors primarily process them by classifying the issue in terms of previous organisational experiences and the collective historical memory of institutions. Also, the pressure of social and interest groups is embodied within the institutional and organisational structures and through them the policy of the government is affected. Within such an institutional framework, decision-makers respond to situations with the most appropriate action, given prevailing rules and the consequences for institutional stability.

In a study of central bank reform, institutional structures are very important. The reform of the status of such an important body can change the balance of power in exercising national economic policy. As the national central banks under review will be part of the European Central Bank this transfer of power may be even more important. In order to analyse the politics behind this reform we need to identify not only the role of the institutions associated with the society and the economy but also the national and global organisational networks that frame national policies.

The institutionalist framework for analysing such a reform must also fit within the unique macro-economic policy-making environment. The rapidly changing economic conditions and the volatility of foreign exchange markets have transformed the way economic policy is being exercised. The identification of the incremental changes in relation both to the dynamic and unpredictable macro-economic environment and to the broader socio-economic reforms are very important since they form the national institutional policy patterns upon which the reform of the central bank is based.

This study focuses on the major organisational locations, such as the European Union, the International Organisations, the Governments (in particular the Ministries of Finance and the Prime Ministers' office), the Central Banks, the Parliaments, and the major parties. Attention will also focus on the ways these organisations developed distinctive procedures for scanning and processing information, understanding the external environment, making decisions and advocating their interests to other organisations, societal groups and the public.

In the examination of the above-mentioned institutions, of particular importance are the key actors who represent them. However, actors would appear not only as representatives of their establishment, maintaining its roles, perceptions, culture and stability, but also as individuals with their own interests as these are formed within the broader institutional framework. Institutional structures affect the direction and the power of actors' pressure and needs. The position of individuals will therefore be considered within a broadly institutional perspective. The analysis of this thesis is based on the assumption that although the preferences of core executive actors and other influential personalities are influenced by their rational aspirations, broader institutional forces determine their eventual position and thus the process of reforming the central bank's status.

Before examining and classifying the key participating actors, it is necessary first to analyse and explain in a more systematic way the process of policy change. This will be particularly helpful as a guide for examining the course of progress in establishing an independent central bank in the case chapters. It will also facilitate to identify the role of key individuals and institutions in each stage of the reform.

POLICY CHANGE PROCESS

The process of policy change can be divided into five main stages, although in practice some of them often overlap. The first stage is concerned with the emergence of the new policy proposal. The second stage involves the diffusion of such a proposal, through mobilising some political or other support, for the proposal to become an item of the policy agenda. The third stage deals with the final governmental decision to implement the new policy proposal or reform. The fourth stage of the process is concerned with the setting of the reform's characteristics in order to receive parliamentary approval. Finally, the last stage involves the implementation of the new reform.[2]

THE EMERGENCE OF NEW POLICY PROPOSALS

The initiatives and incentives for new policy proposals can emerge from various sources and for different reasons. What we need to clarify, however, is that policy changes are not in reality 'new' policies. Policies are not created, born or innovated out of nowhere since 'new' policies or changes in policy-making are based and formulated upon existing policies. Guy Peters and Brian Hogwood (1980:1) claim that "most policy-making is actually policy succession: the replacement of an existing policy, program or organisation by another".

Motives and reasons for policy changes or reversals can be distinguished between those coming from 'inside' and those coming from 'outside'. We say that a policy reversal emerges from 'inside' when policies and institutions destroy themselves rather than being destroyed from outside. Such instances are very common in policy-making. In the majority of policy change cases one of the main reasons for reform is the dissatisfaction with the existing policy. The mere fact that policy change is considered shows that the existing policy is not satisfactory. Of course one cannot expect that policies can completely satisfy everyone involved. Policies are supposedly designed and conducted by governments in the public's interest. There are always parts of the society which demand changes. However, if the way policies are exercised malfunction and do not

[2] The final stage will not be an area of particular attention because the aim here is to analyse the process through which a new proposal is been considered as a potential policy reality.

serve the purpose for which they were designed, then the considerations for their replacement become imminent.

Policy change considerations and forces that do not occur as a result of dissatisfaction to existing policies, can be regarded as coming from 'outside'. These can be divided into the following categories:

The force of new ideas which, in some way, succeed in upsetting the existing status quo. The power of ideas in the determination of social events was heavily influenced by Keynesianism. Keynes (1936: 383), in one of his most famous quotations said, "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else."

There have been many objections, however, on how influential ideas can be in practice. The argument is that ideas do not have an immediate impact. Dicey (1926: 10) claimed that 'public opinion' represents the absorption of the views of intellectuals by a wider body after a significant time lag. Ideas are usually simplified, through newspaper articles, speeches, and university courses, over a long period. They may not even be implemented before the death of their original inventors.

The above argument, however, does not reject the impact that ideas can have in policy-making. Max Hartwell (1989: 119) argued that "Of course, ideas influence policy, but not neatly". He claimed that ideas at the messy level of day-to-day history can be translated into action and can influence particular policies. But he agreed that at the macro-level, more powerful ideas must go along with other influences in order to have a more immediate effect. He concludes by saying, "there is no doubt that powerful ideas can still have an over-riding influence on the formulation of policy. Ideas count, and always have, for good or for ill".

The fact remains that policy-making can be influenced around, and consequently structured around, a particular set of ideas, just as it can be structured by a set of institutions. Hall (1993: 290) claims that "the two often reinforce each other since the routines of policy-making are usually designed to reflect a particular set of ideas about

what can be done in the sphere of policy". From this set of ideas the ones which will survive are the ones which satisfy certain criteria. Kingdon (1984: 210) suggests that these criteria include technical feasibility, congruence with the values of community members, and the anticipation of future constraints, including a budget constraint, public acceptability, and politicians' receptivity.

Ideas can emerge as a result of three conditions. First, through 'empirical evidence'. An idea for a particular policy change can derive from a similar situation either in another country or in another policy area. For example, if a particular idea to face a policy problem has been successfully implemented by other countries, then the people in countries with the same problem may consider that particular idea as well. Also, if a specific policy pattern, such as deregulation, has been successful in one policy sector then very often we observe considerations to implement it in other related sectors.

Ideas can also come through 'rhetoric power'. Academics, researchers, writers and many other 'think tanks' exchange views and ideas through speeches, papers, bill introductions and conversations. In this process new proposals come into contact with one another, are revised, combined and altered, and as a result give rise to new ideas. This exchange of proposals and conceptions continuously generates new ideas.

Finally, ideas may emerge as a 'logical force'. Certain ideas emerge as a natural outcome or consequence of the existing situation. Very often the conditions under which a particular policy is exercised and the intensive need for change initiate new proposals. David Henderson (1986: 10) explaining his experience in Whitehall, argues that the ideas which emerged in Treasury committees did not originate either from past university economics courses or from writings of economists inside or outside the departments concerned. These doctrines were intuitive and self-generated. As he states "those who held them thought that what they were saying was plain common sense, which needed no prompting or authority". As Kingdon (1984: 76) argues "Ideas come from anywhere. Nobody has a monopoly on ideas. They come from a plethora of different sources. Thus the key to understanding policy change is not where the idea came from but what made it take hold and grow".

The force from pressures of interests, which succeed in achieving changes that suit their purposes. New policy proposals can also emerge from various interest groups pressing for changes. As stated, there are many theories that argue that the market place of interests is very important in determining actual policy outcomes. Governments cannot normally ignore and resist the preferences and demands of pressure groups. The degree of pressure group success depends on how well it is organised and the political power it has. Small, unorganised pressure groups cannot expect to influence policy-making and raise demands unless they form coalitions with other groups to back one another. The only politically significant demands come from producer groups such as firms, labour unions, and trade associations, that have high stakes and low information costs and are well organised to pursue collective interests (George Stigler, 1971).

Heclo (1978: 97) argued that as more public policies today are exercised, more groups have entered the policy process and more complex relationships have emerged. The result of this, he argues, is that congestion among those interested in various issues grows, and the chances for accidental collisions increase. Interest groups in their effort to gain more power to achieve their goals, form alliances. These alliances which are not established in any particularly formal way are linked together through shared interests.

Apart from interest coalitions which are formed to pressure for specific changes there are some other forms of alliances which affect the course of policy. There are two main linkage groups that recent policy making theorists view as most important in influencing decision-making: epistemic communities and advocacy coalitions.

Epistemic communities, according to Peter Haas (1992: 3), are networks of professionals with recognised expertise and competence in a particular domain, shared principles and beliefs, shared notions of validity and a common set of practices. Members of an epistemic community can be professionals in government, international agencies, academics, and people from the media. Epistemic communities are usually formed when there exist conditions of uncertainty in a certain policy area. They provide information and advice on complex technical issues, but they can also suggest and generate policy alternatives to decision-makers. Haas (1992: 5) argues that "members of transnational epistemic communities can influence state interests either by directly identifying them

for decision makers or by illuminating the salient dimensions of an issue from which the decision makers may then deduce their interests".

Paul Sabatier (1988: 139) describes advocacy coalitions as people from various positions (elected and agency officials, interest group leaders, researchers) who share a particular belief system - i.e. a set of basic values, causal assumptions, and problem perceptions - and who show a non-trivial degree of co-ordinated activity over time. Advocacy coalitions work together to turn these specific policy beliefs into actual governing policy. Their beliefs are not based, as with epistemic communities, on scientific evidence and expertise, but on the self-interests of members as well as on the organisational interests of their respective agency.

It is apparent from the above that these two forms of linkage groups can have much more influence in supporting or forcing a particular policy alternative than initiating one. That does not mean, however, that they do not have the power, the resources and the appropriate individuals to promote new issues and proposals of policy. As long as their beliefs and interests are not served by existing policies and practices, they have both the capability and the knowledge to press for new ones that will suit their preferences.

The force from changes in the social 'habitat' which make old policies obsolete in the face of new conditions. Motives and reasons promoting changes or reforms are very often initiated due to new political, social, economic and technological conditions. Factors external to a policy subsystem[3] can alter significantly the conditions, constraints and opportunities that policy actors face. In such circumstances participants whose interests and beliefs are affected, try to promote reforms in order to retain or improve their position in the policy subsystem.

Sabatier (1988: 136) lists three types of dynamic (systemic) events which affect the constraints and resources facing subsystem actors. The first is changes in socio-economic conditions and technology. Such changes can undermine the causal assumptions of present policies or alter the political support of various coalitions. The result of such

[3] Sabatier (1988: 131) defines policy subsystems as the interaction of actors from different institutions interested in a policy area.

situations can be pressure from various actors and groups for changes and reforms. The second factor is changes in systemic governing coalitions. As James March and Johan Olsen (1989: 113) state, elections and renegotiations of government coalitions have an impact on policy programs, as do changes in the relative position of agencies, professional groups, experts, and organised interests in society. Finally, another factor that can affect the beliefs and interests of subsystem actors are policy decisions and impacts from other subsystems. The impact of a policy decision in one particular sector can cause a lot of disturbances in related sectors, either by indirectly imposing constraints or by raising opportunities. In this way, various affected interests will demand and press for changes either to benefit or not to lose from the new situation.

All the factors, forces and explanations we have examined in this section cannot of course be viewed in isolation from the others. Policy changes and reform proposals can be the result of a combination of the reasons we have analysed. However, what is important is not only how a new proposal is initiated but also what makes it prevail.

AGENDA SETTING AND MOBILISATION OF SUPPORT

Having discussed the ways in which new policy proposals emerge, we can now turn to the second stage of policy change process, that of agenda setting. The agenda, as Kingdon (1984: 3) understands it, is "the list of subjects or problems to which governmental officials are paying some serious attention at any given time". Not all agendas are the same. These range from highly general agendas, such as the list of subjects the president and his closest advisers are occupied with, to rather more specialised agendas, such as the list of items occupying various subcommittees. We should also distinguish between the governmental agenda, which is the list of subjects that are getting general governmental attention, and the decision agenda, which is the list of subjects of the governmental agenda that are up for an active decision.

Once an issue or proposal has taken a place in the governmental agenda, change is visible and potentially attainable. In order for a proposal to get into the governmental agenda however, it either has to become a subject of general debate and public attention or it has to become, at least, an active government consideration. Peters and Hogwood

(1980: 21) argue that for any change to take place, the issue must be taken seriously by the relevant political institutions. Proponents of an issue have to show that the existing policy is unsatisfactory and that their proposal is a more promising solution. Furthermore, in order to establish the legitimacy of the proposal, sufficient interest must be generated to stimulate discussion. This can be achieved by creating a consortium of interests. This consortium will have to include all possible people who can benefit from the particular change and can politicise and 'agendise' the issue rapidly.

Once an issue has come into the governmental agenda, the next crucial step is to mobilise support to press the decision-making bodies of the government for its implementation. In order for this to happen, it is necessary, for those who are interested in the new proposal, to develop a coalition which will generate political support among a number of interests. The form this pressure can take varies according to the position and power of each actor. Public support can be influenced through open discussions, speeches, press and media publications and presentations, which advertise the advantages of the new proposal. On the other hand, powerful supporters with political connections can directly press key politicians and government officials to promote the issue.

The problem, however, is that a number of interests may be satisfied or suited with the existing situation and may resist change. In such a situation, not only will they refuse to promote the new proposal but they may also well actively oppose it, generating organisational or ideological conflicts.

Organisational conflicts may occur since any change to existing programs or policies will affect the concerned organisations. The impact a policy change can have in an organisation can vary from the alteration of some administrative procedures to the termination of a whole program or even the whole organisation. In any case, many organisational actors who fear that their positions and status will be threatened by the new proposals, will resist proposed changes. Organisational conflicts are more likely to occur in cases where policy changes will enforce termination or consolidation of programs or organisations.

Ideological conflicts may occur as a result of proposed changes affecting either broader ideologies, e.g. socialism or democracy, or less general ideologies which have more to do with the conduct of policy-making, such as privatisation policy, independent public institutions, drug-use penalisation, etc. In general, we can say that ideological conflicts can occur when a policy change proposal promotes changes in the accepted manner of delivering certain types of public services.

On the other hand similar organisational and ideological factors can promote policy change rather than oppose it. Many actors, for example, may be dissatisfied with the existing bureaucratic or dysfunctional way organisations function and may support with all their power the policy reforms under consideration. Also, actors may view some new proposals as an opportunity to further strengthen their position and power, and thus press for changes. Likewise, some other actors may find that the proposed changes can advance their ideological positions, which have been underestimated under the existing situation.

Therefore, it is important for those in favour of a reform to take on their side not only the general public and the politicians, but also the actors most imminently affected by that change. There have been many cases in political history where although the majority of a country was in favour of a particular change, the change never occurred because the actors most affected exerted dynamic opposition.

RECEIVING GOVERNMENTAL APPROVAL FOR IMPLEMENTATION

Mobilising political support for a particular proposal does not mean that it automatically gains a position to the decision agenda. Proposals and ideas for changes can remain in the governmental agenda for long time. Kingdon (1984: 211) argues that the probability of an item to get into the decision agenda is dramatically increased if three elements are linked to a single package: problems, policy proposals, and political receptivity.

The above three parameters often exist on their own. On certain occasions, they may form partial couples but even that may not be enough to generate actual change. Solutions may couple to problems, but without a receptive political climate; politics to proposals, but without serving any particular problem; politics to problems, but without

specific solution proposals. Partial couplings are less likely to take a proposal into the decision agenda. By the time, however, that these three elements join together the odds that a subject will become firmly fixed on a decision agenda are significantly improved.

The difficulty to get an issue on the decision agenda and the importance of joining problems, solutions and politics together is well acknowledged. Actors seeking a change wait for the appropriate opportunity to push attention to their problems and advance their solutions. They wait to find open policy windows to bring greater attention to the problems about which they are concerned. Windows are opened by events in either problems or politics. For example, when a new problem emerges there appears an opportunity to attach a solution to it. Also, when there is a change of government or of national mood these might be opportunities to emphasise problems and push solutions. Open policy windows whether predictable or not, large or small, are opportunities which come and pass fairly quickly. People waiting for such opportunities to get their proposals to the decision agenda have to act at the right time, otherwise the chance is missed and they must wait for another.

Even if the right opportunity occurs and the advocates of a proposal push their solutions to it, that does not still guarantee that the government will decide to implement changes. Opportunities, crises, resources, organisational conditions and other non-structural parameters play an important role on whether a government will decide to proceed to policy changes or not.

Nevertheless, regardless of how important non-structural parameters can be, it is structural factors that ultimately determine the capacity of a government to implement changes. Peter Hall (1983: 44) lists three structural factors that affect the ability of a government to innovate: factors associated with the structure of the state itself, organisational features that characterise state-society relations and institutional relations implicit within society itself. The first includes the elements of internal organisation that determine the balance of power and the relations between the executive and legislature, between the political leadership and the civil service, between the judiciary and administration, and among departments themselves. The second deals with the leverage state managers have when seeking the consent of societal groups in new policies. Finally, the third refers to the relationships between various institutions and social groups or

sectors, such as relations between financial institutions and the industrial sector, between the industrial sector and trade unions, etc.

All the above factors can significantly determine the final course a new policy proposal can take. The government will have to balance its needs, preferences, and resources, as well as any resistance it encounters, and decide whether or not to proceed with the implementation of the new policy. Something which can prevent a lot of conflict and can help the government execute its decision more swiftly, is if there exists any successful implementation of similar formulas in an adjacent area. For instance, if privatisation in banking is successfully implemented then the government can turn to other privatisation proposals with much less opposition.

RECEIVING LEGISLATIVE APPROVAL

Once the government has decided to introduce the proposal as a new bill, it then has to obtain a majority in the legislature to legitimate that policy change.[4] We can say that if a proposal reaches this stage it is almost sure that it will become law. The government in power usually has the votes needed to pass the bill. Of course, the political systems differ from country to country, and in some countries the procedure may require a majority in more than one legislature organ. This may cause some problems since in some cases the government may be a minority in one of the legislature organs. If this is the case and there is strong resistance to the new bill then the government will be forced to make some amendments that will satisfy the opposition.

In many cases, the resistance to a new bill is not directed to the whole issue under consideration but rather to some of its implications under the specific proposed formulation. For example, in a bill on banking deregulation the disagreements from the opposing parties may not be on whether the banking sector should be deregulated or not but on specific aspects of deregulation. This is the reason why the details and peculiarities of a proposed policy change play such an important role and may be the centre of conflict.

[4] There are cases in which there is no need for legislative approval, since some policy changes are made through regulatory and administrative mechanisms. However for the purposes of this thesis these cases of policy change are not going to be analysed.

When bringing a bill to vote, governments generally know whether or not they have the capacity to pass it. Only if they have strong signs that they have many chances to pass the bill will they bring it to vote. Otherwise they will either withdraw it until the conditions are more suitable, or they will alter it significantly to stand some more chances of approval.

ACTORS / PARTICIPANTS IN THE POLICY CHANGE PROCESS

Having analysed the process of policy change, we can now discuss the role of the main participants. We will explore which are the important players in each stage and in what way they can influence the policy outcome. Actors will be reviewed both as individuals and as representatives of their institutions or organisation in order to obtain not only a narrow-personal perspective but also a broader-institutional one. We can distinguish between two types of actors, those within and those outside the administration.

PARTICIPANTS WITHIN THE ADMINISTRATION

The participants within the administration can be divided into the members of the Cabinet (the Prime Minister and his political appointees) and the civil servants (bureaucracy). The members of the Cabinet are probably the most important actors in the policy-making process. They (or at least some of them) are usually involved in all stages of the process and have a dominant role in almost all of them. The Prime Minister is more involved in setting the decision agenda and supervising the legislative process than formulating the details of the new proposal and mobilising support. The latter is more of concern to his appointees, who in some cases can also be the initiators of the whole change process. Whatever the case is in each particular policy change process, the cabinet will always have the final word on whether an issue will be taken in the decision agenda and whether it will be implemented or not.

Career civil servants are important both in initiating a reform as well as on the specifications of the proposal and on its implementation. March and Olsen (1989: 112) state that civil servants can become key players in public policy making - as defenders of different institutions, agencies, values and clients. Their views and preferences are formed by the tasks they perform and the environment with which they interact, and thus can significantly influence both their attitude towards a change as well as their involvement in it. On the other hand, however career civil servants are sometimes bound to resist change as it can undermine their budgetary support, policy scope, and personal status.

PARTICIPANTS OUTSIDE THE ADMINISTRATION

Actors who do not occupy administrative positions can also be very important to the policy-making process. People outside the administration come into contact, on a daily basis, with those inside and as a result they have a significant influence on ideas, values and information of the latter. Furthermore, people outside the administration are often summoned to provide their services either on an informal or a formal basis. In practice, therefore, the distinction between actors within and outside of the administration is not as explicit as it may seem. The fact, however, that people in governmental positions have statutory authority to conduct policy-making and are accountable for their actions, is something which cannot be ignored.

Interest Groups

Interest or pressure groups are, according to some people (pluralists), the most significant actors outside the administration. Kimber and Richardson (1974: 3) define pressure groups as "any group that articulates a demand that the authorities in the political system or sub-systems, should make an authoritative allocation". There are many different types of interest groups. The most important ones are: business and industry, professionals, labour, public interest groups, and governmental officials as lobbyists[5].

[5] S.E. Finer (1966: 3) defines 'the lobby' as "the sum of organizations in so far as they are occupied at any point in time trying to influence the policy of public bodies in their chosen direction, though (unlike political parties) never themselves prepared to undertake the direct government of the country".

Interest group activities vary. Some affect the setting of the agenda; others affect the alternatives and the specifications; some promote new courses of action while others do the opposite. In general, we can argue that interest group activity has more influence in agenda setting and, furthermore, in proposing amendments to, or substitutions for, proposals that are already on the agenda. Interest groups are, above all, concerned with protecting their existing position and the benefits they enjoy. This is why they are more often involved in blocking initiatives and proposals that would reduce those benefits.

Of course, whenever they have the opportunity they press for changes that would further improve their position and power. We should note that even in cases where interest groups raise an issue, they are not necessarily entirely involved in the whole debate. Similarly, they may get an issue on the agenda but they may not participate in the consideration of alternatives or influence the final outcome.

Interest groups have various ways to put pressure on the government. They can get the attention of government officials by writing letters, sending delegations, mobilising support and generally making an issue as small as it may seem appear like a big problem through media intervention. Interest group power is heavily dependent on how organised it is. Richardson and Jordan (1979: 173) state that "The very nature of the process by which those interests are directly affected and brought into close consultation (consultation often means negotiation) excludes those interests that are not organised, even though those interests may be quite important numerically".

There are two resources that can strengthen significantly the influence of interest groups. The first is when the group is in a position to tie up the economy. In such a case, the effects of a strike or some other similar action can have disastrous effects not only for that particular sector but also for the whole economy. In such instances, the government will have to be very careful in the way it handles the matter since even a small conflict can bring about great disturbances. The second resource concerns the cohesion of an interest group. The group has to convince the government that its position is well supported by all its members. If differences exist among the positions of interest group leaders and their followers then their persuasive power is minimised.

The Media

The media are also important participants in the policy process. Media are the mediums through which the mass public is usually informed about the actions and the intentions of the government. Although one would expect that the media would have a substantial impact on the policy-making process given the rapid dissemination of information today, surveys and indications are not as encouraging. Media participation and involvement in policy changes is not, in practice, as important. There are two probable reasons for this. One reason is that the media are usually heavily concerned with a story for only a short period of time. They cover an issue as long as it is new and seasonable. After a while, as the public gets tired of it, they neglect it and focus their attention on something new. The second reason is that the media do not usually raise an issue to the agenda but just report what is happening. Only very rarely will the media be the initiator of a new proposal.

All the above, however, does not mean that the media do not have power in the policy-making process. Media can act as a mediator between the public and the emergence of an idea, a proposal, or a problem. The media are the mirror of public opinion and a magnifying glass for the issues that occur in everyday life. For this very reason, the media can be very powerful. People usually outside the government, who do not have the power to raise their issues, can use the power of the media to make their problems known. Thus, the media can be an indirect means of pressure to the government.

Political Parties and Politicians

Political parties can play some role in the policy process by various ways; by developing new ideas and proposals, by pressing the government for changes and by resisting others. The parties that are not in a governing position are the first to put pressure on the government, to improve the current policies. In many cases, however, they do so only for reasons of impression and not because they have better proposals. Opposition parties generally complain for almost every policy issue, in order to create a negative climate around the government. However, since they represent a number of the electorate and a certain ideology they do have some strong support behind them, which they often use in various ways to influence governmental actions. For instance, trade unions and protestation groups are usually backed and influenced by the position of a particular party, thus enhancing their political power. Apart from opposition parties, the members of the ruling party also have significant power that in many cases is very influential in

cabinet decisions. In-party differences are often a major constraint for innovative reforms since a denial of support from some party members may be crucial for the ratification of the bill. Ministers often give way under pressure from their own party members and make amendments in order to gain their support.

Academics, Researchers, and Consultants

Another important set of non-administrative actors is academics, researchers and consultants. They can be involved in all stages of the policy process, but mainly on the initiation of new ideas and proposals, and the formulation of the alternatives and specifications. Government officials very often appeal to this set of people to get expertise advice and consultation on various matters. Academics are also often involved in governing from within since they regularly occupy top positions in government and major institutions.

Although the importance of this group is universally recognised for their expertise and knowledge, there are many people within the administration who nurture a dislike for them (mainly the academics). There are two reasons for this: the first is that because of the nature of their subject they are not particularly united. Academics, and especially economists, do not speak with one voice. For any one issue various interpretations are developed, something that does not help the ones outside the profession to understand more. The second reason is the fact that they are usually more concerned with the long-term considerations, as opposed to the short-term views of politicians. Most of their ideas and proposals refer to the impact policies will have in the future. For this reason, government officials who are more concerned with their present problems, usually use the analyses and proposals of the academics for simple advice.

Public Opinion

Finally, governmental officials can never ignore the effect and stance of the general public on the policy process. The administration can always feel what the needs and preferences of the public are. Paul Quirk (1988: 39) states that politicians and other office holders have, and tend to act upon, beliefs about the public interest. Furthermore, they "have or at least perceive reasonably strong incentives to respond to broad, unorganised constituencies". Re-election is always in the minds of politicians and therefore new policies always take into account the effect on the electorate. The political

cost of many reforms is one of the fundamental reasons why governments often withdraw many of their initial plans.

Public opinion affects the setting of the governmental agenda, either in a positive or in a negative way. When the general public seems in accord with some particular proposal, then vote-seeking politicians and government officials will seek to implement it. On the other hand, negative public opinion about a policy change will certainly be a significant obstacle for the governmental plans. On the whole, we can say that mass public opinion can only affect the setting of the agenda and not the rest of the policy change process.

ARGUMENT, METHODOLOGY AND STRUCTURE

The purpose of this introductory chapter was to consider approaches of the policy change process in order to form the theoretical approach upon which the analysis of the three countries' attempts to reform their central banks will be based. This examination addressed the following issues: the origins and initiatives for change; the way ideas direct the course of this change; the conditions for change; the motivations behind the actions of governments; the factors affecting the government's agenda; and finally, the role and influence of the main policy actors. In exploring these issues it was argued that to rely on a single approach to policy-making is very limiting. The discussion of the main theories in the previous sections has shown that no one theory can explain, on its own, the actions of governments and the process of policy-making, without leaving many questions unanswered. Policies are formed according to different needs, conditions and forces, making the creation and application of a universal theory seem unattainable.

Central bank independence, although a necessity for the creation of the European Central Bank, is just one of the factors which characterise the whole attempt of establishing a monetary union with a single European currency. This study, therefore, does not intend to analyse the factors that explain the conditions, motives and factors behind EMU. This

research concentrates only on the policy process of establishing CBI in these three EU countries, though always within the EMU context.

For the purposes of this thesis, the analysis will be conducted within an institutional framework. As previously mentioned, such an approach is capable of explaining cross-national variations in policy-making. This thesis considers that the key to understanding the differences among the three countries' progress in granting central bank independence rests to a great extent upon the established institutional patterns and conditions. Existing institutional structures, rules and dynamics determine the power and the direction of pressure that various actors can exercise over policy-making. The general behaviour of actors is understood as ultimately being affected more by the political and institutional environment within which they operate than by any other factor.

Our analysis assumes that the government is in the centre of the decisional activity. This is inevitable since the government is the ultimate body that decides if, when and how the central bank's status will be reformed. Although the context, initiatives and debates concerning the reform may differ from country to country, and although the pressures may come from various sources, the final decision is taken by the government. However, governments are political creatures and thus, even in an economic reform, political variables have a decisive impact on the reform process. Economics can not be separated from politics. Economic logic may mediate specific policies but they can only be pursued if politics accommodate them. Behind any economic move there are a number of political considerations.

Central bank independence, as well as the Economic and Monetary Union, is created in the name of the economic benefits it entails. In this respect, there is a distinctive economic character in changing the Bank's status. However, this reform involves a significant transfer of power from the elected government to a non-elected body, thus altering the balances of political as well as of economic power. In Europe, central bank independence is considered a necessary step towards the creation of EMU which in itself is a step closer towards politico-economic stability and prosperity. The ratification of the Maastricht Treaty, and therefore the acceptance by the political elites of the Maastricht criteria – including central bank independence – in order to participate in the Economic and Monetary Union has changed the institutional framework for exercising national

policy-making. Within such an environment any consideration for the change of the bank's status has undoubtedly been associated with participation in the EMU. Governments willing to take part in the single currency had accepted that they needed to grant independence to their central bank regardless of whether they wanted such a reform or not. Governments are therefore faced with an essential dilemma. Are the benefits in terms of monetary stability so vital in order to surrender such power to an unelected and possibly uncontrolled institution? Inevitably, governments' judgement will depend on the broader political considerations associated with such a move. Political elites are willing to surrender their authority not simply because of their belief in the superiority of independent central banks in controlling inflation, but because of other political objectives they try to achieve.

The analysis of the attempts of France, Greece and the UK to reform their central Bank's status is conducted on two levels, economic on the one hand and political on the other. The originality of this thesis is that it aims to synthesise in a coherent analysis data from both the economic and the political field. The former contributes to our understanding of the debate about economic policy, moving from the objectives (creation of a stable economic environment) to the instruments to be employed (independent central banks), thus providing the theoretical argument in favour of the reform. The latter reveals what governments actually do, when they do it and how. This is particularly important since the Maastricht Treaty does not explain in detail the procedure for establishing central bank independence and consequently member states are free to adopt different approaches. The analysis is conducted by a wide search of all the data available from economic ideas to political processes, thus illuminating how and why in some countries certain ideas are implemented while in others they are not.

As already stated, the basic assumption of this thesis is that in order to explain the differences between the three cases about the considerations of CBI, the exact timing of introducing the reform and the particular models of independence chosen, political and institutional variables are more significant than economic ones. This study suggests that there are three main such variables which shaped and influenced why, when and how the three member-state governments implemented CBI in the 1990s. Those variables are the position of the country within the international political economy, the established rules of

political competition, and finally the established patterns of post distribution and democratic control.

These three are all classed as 'institutional variables' in the sense that they, as P.Hall (1986) claims, refer to the specific organisation of aspects of the environment facing policy-makers. They present established positions, rules, compliance procedures and standard operating practices that structure both individual perceptions and relationships between individuals in different parts of political and economic elites. As such, these variables affect not only the influence that any set of actors has over policy outcomes but also any actor's definition and direction of his own interests. This thesis demonstrates how institutional factors explain how economic policy ideas are perceived, when particular policies are adopted, and how the particular idea of CBI is matched with national traditions of making public appointments.

The position of the country within the international political economy is considered as a structural variable since it reflects the relative openness of national markets and the weight and position of each national economy in the international economic system. As such, it represents a form of institutional framework. The relative standing, strength, and importance of each of the three national economies in relation to such formal institutional frameworks as the Single Market, the World Trade Organisation, and the financial and capital markets helps define its specific position within the international scene, and in turn considerably influences how elites perceive certain ideas. More specifically, the different traditional links and interests of each of these three national economies, both within the European Union as well as internationally, clearly affect the stance taken by its leaders towards EMU and one of its main requirements: CBI. Hence, the identity of the main trade partners, the direction of money inflows and outflows, the sources and places of investment, the economic and political links with other countries are factors that are always taken into account by policy-makers (see Frieden, 1997).

The analysis of the case studies showed that the greater the exposure of an economy to global economic pressures and financial market flows, the more likely were its elites, in seeking monetary stability and credibility, to consider the idea of CBI and to bring it onto the political agenda.

Nevertheless, although the international position of each country affects domestic interest group preferences and can explain the general attitude of leaders towards EMU and CBI, it cannot by itself account for either the exact time of implementation of the reform or the particular features of the model of CBI in that country. This thesis argues, as previously stated, that in order to explain the differences in relation to these issues two other domestic structural variables play important role: the established rules of political competition and the established patterns of post distribution.

The established rules and conditions of political competition are very crucial in determining the capability of a government to implement any important economic policy reform like CBI. The present thesis notes that there are four interrelated rules, or parameters, of political competition, which determine the moment in time when a government is willing to proceed with such a policy as CBI. The first parameter that a government always takes into account in order to decide when and under which form to introduce a reform is the potential cost associated with it. The aim of every government is to implement its policies with the minimum cost. Governmental policy-makers determine the disadvantages of the reform, evaluate what the opponents can or will do and decide if and how it would be best to proceed. The second rule is to try to neutralise hostile groups and the press. This can be attempted by technical presentations of the reform (which stress its neutrality in ideological terms) and identifying and deliberately minimising the associated costs. This technique is particularly appropriate for complicated and unfamiliar issues, where the public cannot fully understand either their precise objective or their direct implications. The third rule is to present the change in such a way as to maximise its benefits. Hence, government leaders try not only to stress the advantages of the reform to the public, and to exploit possible 'windows of opportunity', but also to mark public opinion by demonstrating the government's decisive policy tactics. A quick, bold move can sometimes do more for the government's image than the effects of the actual reform. A final rule that affects the government's decision is 'policy maturity': whether its existing policies are already credible and in similar line with the proposed one. No government will risk proceeding with a significant reform unless other related policies have been tested, introduced, implemented and accepted by the public. In the specific case of CBI such related policies concern the establishment of a positive consensus for 'neo-liberal' policies, monetary stability and minimum state involvement in the economy.

The research revealed that the electoral cycle is particularly important. Newly elected governments, whether of the same party or not, attempt significant reforms early to show their difference, prove their effectiveness and minimize opposition. In all three cases CBI has been established by new governments which took advantage of the significant parliamentary majority they had and the 'grace period' they enjoyed during their first months.

Finally, this thesis explains the differences observed in the three cases between the particular characteristics of the CBI model (i.e. appointment procedures, composition of the Monetary Policy Council, term of office of the members, etc.) in relation to the established patterns of distributing public offices and the procedures for democratic control in each country. Policy makers are bound by prevailing arrangements of post distribution and find it extremely difficult and politically costly to introduce methods different from those accepted in each country. This occurs despite the fact that sometimes an arrangement different from the customary one would provide a much more efficient, reliable and suitable operational framework. This study showed that in some instances legislatures and policy-makers have opted for methods of making appointments which, in order to respect national traditions of executive, legislative or partisan patronage, were opposed to the whole idea of central bank independence.

The present study is based on the analysis of the three above-analysed variables in an effort to justify why and how the attitudes, efforts and the outcome of these three member states governments' to reform their central bank, within the framework of the European Union and the guidelines of the Maastricht Treaty, varied significantly. In order, however, to have a more comprehensive account of the reasons behind the differences between the three case studies, alternative explanations based on other institutional variables (such as partisan factors, governance and sectoral characteristics, and electoral systems) are considered.

In short, the general conclusion of this thesis is that in the process of establishing central bank independence, economic considerations play a crucial role, but it is ultimately political factors that determine the character and direction of the reform. However, since politics cannot be separated from the established institutional patterns, any reform

attempt will depend on the degree of elites and societal familiarity, acceptability or adaptability towards new ideas. As a new idea, CBI will be established only if the broader institutional and political framework of a country has the adequate capacity, in terms of political receptivity, societal consent and economic knowledge, to accommodate the new idea. The position of the country in the international political economy and the degree of its exposure in the global markets might explain the general attitude towards CBI but what is ultimately critical for its establishment and its character are domestic politics.

The particular countries were chosen for various reasons. First, all three countries reformed their central bank's status after the Maastricht Treaty. This is an interesting factor especially in the case of the U.K. where the government decided not to participate in the first wave of countries to form the Economic and Monetary Union. Second, there are differences in the phasing each government selected to implement the reform. These differences reveal the underlying reasons and conditions affecting the decision-making process. Finally, the three countries have chosen to follow different models of central bank independence which in some cases were outside the guidelines of the Maastricht Treaty.

Apart from the above-mentioned differences which are directly related to the reform of the three central banks, the three countries were selected among the EU member states because they vary considerably in regard to their position and power within the EU and also in the stances of successive governments towards EMU. France is a big country with considerable economic and political power, one of the founder members of the European Community, and an originator of EMU. French leaders wanted to join EMU, and their country had the necessary qualifications, and did so from the start. Greece, on the other hand, is a small, relatively poor country, with limited economic and political influence, that entered the EC at a late date. Greek governments have usually followed European decisions for the benefits of being part of EU rather than for ideological reasons. Greek leaders wanted Greece to be a first-wave member of EMU but could not due to economic reasons. Finally, the U.K. is a big, second-wave member of the EC, with significant economic and political power and was economically 'qualified' to be part of EMU. However, the present government (in 2000), like its predecessor, has not yet decided when or whether it wants to join. The Major Government signed the Maastricht Treaty

with an 'opt out' clause for EMU, which implied an automatic 'opt in' right. The logic of the 'opt out' was against the single currency and its institutions at the times set down in the Treaty, rather than against the principle of CBI. Nonetheless, subsequent moves towards CBI in the UK – whether the 'Ken and Eddie' dialogues or the Brown reform[6] – took place in the context of the continuing EMU debate in the UK and they were inevitably seen by journalists and politicians, in Britain and in the rest of the EU, as steps towards an 'opt in'. In short, irrespective of the wishes of individual political leaders, and the need for monetary credibility within the new global economic framework, the politics of the CBI reform in Britain were linked to the Maastricht framework, although clearly not as closely as in France or Greece. We can characterise member state stances on EMU in three ways: initiator / follower / doubter, willing / hesitant / reluctant, and able / potential / incapable. In these terms, when the Maastricht Treaty was ratified, our three case studies could be seen as: France – initiator/willing/potential, Greece – follower/hesitant/incapable and Britain – doubter/reluctant/able. Subsequently, the French stance moved from potential to able, and the Greek stance from hesitant to willing and from incapable to potential and, recently, to able. Whether or not Britain has moved from reluctant to hesitant is still unclear.

Finally, these countries were also chosen as case studies because of the nature of their similarities. All are not only members of the same European Union, but also have two basic common features. First, they are all parliamentary democracies, and parliament is an essential, controlling factor in the reform process. Secondly, they are not only unitary states but also have traditions of centralisation and the concentration of power in the hands of the political executive. Traditionally, all three had highly dependent central banks.

In the effort to collect all the relevant data available in regard to central bank independence, Chapter Two first examines the core debate about Economic and Monetary Union. This involves a chronological presentation of European developments; the EMU objectives; the examination of the institutional obligations for participation, and the Maastricht Treaty guidelines for the establishment of an independent central bank. The progress towards Maastricht and the EMU objectives provide a clear and

[6] See Chapter Seven.

consistent framework within which the idea for an independent central bank emerged and spread, thus increasing our understanding of the whole philosophy behind the reform. The material on the ESCB and the ECB provides the framework in which the independent national central banks will operate under EMU and offer a general model for reform.

Chapters Three to Five are concerned with the exact definition, purpose and origins of an independent central bank. The purpose is to identify in precise and practical terms the concept of central bank independence; its advantages and disadvantages; the specific characteristics of different models; and their importance not only for the conduct of monetary policy but also in relation to the power of the affected actors. Particularly helpful in the identification of all the above was the use of the US Federal Reserve Bank, the German Bundesbank, and the New Zealand Reserve Bank as models of previously established independent central banks. This examination will be particularly helpful as a guide for the assessment of the stance of the main actors in the analysis of the three case studies that follow. In Chapter Three there is also a section on the EMU debate which is considered essential since it provides the general arguments for and against upon which the independence of the central banks is based.

Chapters Six to Eight constitute the main part of this thesis as they analyse the attempts of the three countries, France, Greece and the UK, to change their central bank status. This involves a review of the developments that have affected the introduction, acceptance and final formulation of the reform, through an economic, political and institutional perspective, revealing in this way the differences behind the three reform outcomes.

The research is conducted on the basis of all kinds of data relevant to the issue of central bank independence and the politico-economic developments in the three countries. This is particularly important for exploring exactly what has been done in each case. The study used both published and non-published sources. The former were particularly useful in understanding the developments in the European Union; the requirements for participation in the EMU; the theoretical arguments for and against central bank independence; and the different models of independence. Published sources also provided the basis for examining the process of establishing independent central banks in

the three case studies. This was achieved by a systematic examination of all coverage on the issue through the Greek press and the electronic Financial Times Profile which includes daily coverage of all main UK and European newspapers, periodicals and news press services. Extensive use was also made of reports of international organisations such as the OECD and the IMF; of annual reports and the bulletins of the three central banks; of the governmental annual budgets, the relevant reports and minutes of evidence in Parliaments (both plenary sessions and select committees); and also of academic studies and literature on relevant issues and on the three countries' overall economic and political developments.

In the three case studies of this thesis there was a massive difference in the type and quality of data available. More specifically, there was huge amount of interviews material in public domain on CBI for the French and the UK cases. The research via the FT Profile service provided numerous interviews with all the important actors involved in these two cases and therefore there was no purpose duplicating, especially long after the event. There is no reason to believe that an interview by the researcher would provide anything else to what the actors said to FT or Le Monde. This was not the case for Greece. The research provided very little information or interviews for the Greek case and therefore it was necessary to conduct personal interviews and meetings with ministers, government officials, central bankers, members of the political parties, journalists, trade unionists, academics and members of the financial, banking and business sectors in order to bring the information to what is included in the public domain. In order to have compatibility of data the questions in these interviews were constructed in such a way so as to approximate those included in the French and British press. These interviews and meetings were used with due caution and cross-checked as much as possible with other published sources so as to provide in much detail and precision as possible the processes by which decisions were made. Moreover the interviews were on the record and the people interviewed were aware that their answers would be published. Fortunately, the answers were also of similar terms and what these interviews provided were not any particular secrets but mostly details about procedures and personal views, as was the case with the ones published. Therefore, it is considered that all personal interviews reflected the true motivations and beliefs of the people interviewed and therefore compatibility of data was achieved.

The research of the case studies concentrated on collecting all available data that could provide information on what was decided, when it was decided, which issues were of central debate issues, who took which side, how the idea emerged, what kind of pressures were exercised and generally any data associated with the process of establishing central bank independence. Although the information retrieved was not all of similar quality, each different source contributed to understanding specific sections of the reform process. Newspaper and periodical reports provided a lot of facts and facilitated the examination and sequencing of the process. They offered straight-forward information about what people were saying and thinking and how they reacted. Documentation on parliamentary debates provided a clear understanding of the position of the main parties and the core executive. These debates were particularly helpful in revealing the genuine intentions of decision-makers and in particular in stressing parliament members' anxiety as to who will control the independent central bank. These debates also exposed the priority that Members of Parliament gave to politics over economics. Finally, the conduct of interviews was necessary in order to complete the data set and provide some essential details or revelations about the course of events and the intentions behind them.

Having analysed the process of establishing central bank independence in the three countries, the final chapter synthesises the outcomes of the case studies in order to reach an understanding of the politics of establishing such an important reform and the reasons behind the differences. By analysing the most data available it is possible to explain how and why considerable divergence among the three countries exist. The last chapter concentrates both on the broad country-oriented factors that influenced the course of events as well as on the more narrow, personal-oriented interests that influenced the stance of the main actors. Although the analysis confirms the significance of the three variables stated in our hypothesis in the establishment of central bank independence, the research also reveals how in some cases personal interests, in their search for status and authority, also played a significant role in the reform process.

Chapter II: The Institutional Context Within Economic and Monetary Union

The purpose of this chapter is to explain the slow evolution towards Economic and Monetary Union (EMU) in Europe, to review the EMU objectives and requirements for member states' participation in the single currency and to present the objectives, tasks and organisation of the European System of Central Banks (ESCB). The review on EMU is considered essential in order to understand the broader framework within which the idea of central bank independence emerged and spread. The material on the ESCB constitution reveals the model of CBI that member states approved in Maastricht and in a way provides a consensus of the kind of CBI required for national central banks.

THE TREATY ON EUROPEAN UNION

THE ROAD TO MAASTRICHT

The Treaty on European Union (TEU) was adopted in Maastricht on 9-10 December 1991 by the Heads of State and Government of the twelve members of the European Union (then 'European Community'), and was signed on 7 February 1992. The Treaty on European Union (or the 'Maastricht Treaty', as it is commonly known) was not in any way revolutionary, disruptive or isolated from the long-standing European Community philosophy and principles. The union treaty was a further step in the process towards European integration with a very important and ambitious aim: the establishment of an Economic and Monetary Union (EMU). EMU was the evolution of a series of European developments beginning after the end of World War II at a time when many committees, institutions and communities were established in order to promote European co-operation and integration.

The Treaty of Paris in 1951 which established the European Coal and Steel Community (ECSC), might not have fulfilled all of the integration hopes of its initiator, Jean Monnet, but it acchieved two things. First, it reduced customs duties, transport costs, discrimination and barriers to investment. Second, it cultivated a spirit of co-operation

and a belief that it constituted a pointer for the future. As a result, similar projects for other areas (agriculture, health, transport and defence) emerged in the following years. Yet, proposals to create an even wider Political Community went too far for many countries and were thus rejected.

Despite such difficulties, efforts to apply the ECSC method to a wider economic front succeeded after long negotiations and hard bargaining. The Treaty of Rome in 1957 established the European Atomic Energy Community (Euratom) and the European Economic Community (EEC). The Treaty embodied the hope that the creation of an economic community (through a customs union) would lay the foundations for a deeper and wider co-operation among nations long divided by war. The above wish of the EEC's founders is characteristic of the use of economic means to achieve political ends. Despite the fact that the Community did not produce significant tariff reductions it forced other countries, and in particular Britain, to seek closer relations with it and thus encouraged consideration for further integration. Nevertheless, French proposals in 1961 to create a political union were rejected.

Following a few years of inaction, and after the resignation of the French President De Gaulle who had opposed the powers of the European Parliament and the voting methods of the Council's meetings, the Community moved forward again. The Hague conference in 1969 looked forward to new policy initiatives such as union in both political and monetary fields and enlargement. Following the "Hague" proposals, the Werner Report in 1970 published for the first time a detailed plan to create a monetary union. The economic crises of the early 1970s resulted in the Snake agreement[7] in 1972 and the creation of the European Monetary Co-operation Fund in 1973. The continuous monetary problems led finally to the establishment of the European Monetary System (EMS)[8] in 1978 that aimed to ensure monetary stability among the participating currencies. Despite these attempts to promote integration and co-operation the European Community was ineffective until the mid-eighties. Disagreement over budgetary contributions, the questions over Common Agriculture Policy (CAP) and the economic crises made the operation and progress of the Community problematic.

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[7] The Snake was the first European exchange-rate agreement.

[8] The EMS has as its main instrument the Exchange Rate Mechanism (ERM) which sets the range within which national currencies can fluctuate.

The 'relaunching' of the Community occurred in 1984 with the EP Draft European Union Treaty, a document outlining the transition to a European Union. Under it the decision-making processes of the Commission would be more effective but accountable to the European Parliament, whose role would be enhanced. This draft document and the decision in 1985 to complete the Internal Market led the way to the Single European Act (SEA) in 1987. The SEA amended the previous Treaties and had as objectives the completion of the 'Internal Market', monetary co-operation, social policies, foreign policy co-operation as well as cohesion, research and development, and environmental issues.

Although the SEA gave back to the Community its dynamism, some countries desired further integration and more democratic processes. It was considered necessary to complement the Internal Market with further social and monetary measures. This led to the Delors Report in April 1989, which contained conclusions for the Economic and Monetary Union and the Draft Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB). The collapse of the Soviet Empire and the unification of Germany in 1990 called for a strengthening of the effectiveness and democratic legitimacy of the EC in economic, political and social matters. As a result, a Commission Memorandum of October 1990 proposed a higher international profile for the Community through the establishment of common foreign policy, increased democratic legitimacy of its institutions and decision-making processes and closer links with the people of Europe through the concepts of European citizenship and subsidiarity.

Despite the objections of almost all member states on several of the Commission's proposals, the desire for further integration and the belief in the advantages of a single currency allowed the European Council meeting at Maastricht in December 1991 after long hours of negotiations to reach an agreement on a Treaty on European Union. As the process towards Maastricht was developing, however, Europe was sliding once more into an economic recession and electorates started to become restless and disappointed. This was well perceived during the ratification debate in 1992.[9] On the one hand the Treaty's requirements for participation and the three-stage process set the framework and forced governments to convergence, on the other hand, however, in an unstable period, they

[9] In particular, Denmark ratified the Treaty in the second referendum whereas France ratified it in the first referendum but with marginal difference(51% to 49%).

raised even bigger public protestations. It was not just the economic crisis that was of major concern but other social problems, such as migration and unemployment. Yet, despite the exchange rate instability in 1992 and 1993, which threatened the whole ERM arrangement, as well as all sorts of difficulties and conflicts that emerged throughout the nineties over EMU, member-states managed to converge and improve their economies accomplishing, by 1999, the launch of the single currency.

EMU OBJECTIVES

The objectives of the Treaty on European Union as stated in Article B of Title I are:

"to promote economic and social progress which is balanced and sustainable, in particular through the creation of an area without internal frontiers, through the strengthening of economic and social cohesion and through the establishment of economic and monetary union, ultimately including a single currency in accordance with the provisions of this Treaty";

"to assert its identity on the international scene, in particular through the implementation of a common foreign and security policy including the eventual framing of a common defence policy, which might in time lead to common defence";

"to strengthen the protection of the rights and interests of the nationals of its Member States through the introduction of a citizenship of the Union";

"to develop close co-operation on justice and home affairs";

"to maintain in full the 'acquis communautaire' and build on it with the view to considering, to what extent the policies and forms of co-operation introduced by this Treaty may need to be revised with the aim of ensuring the effectiveness of the mechanisms and the institutions of the Community".

According to Article 2 Title II of the Treaty, the task of the European Community will be: to promote a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity.

In order to reduce the economic and political cost of the establishment of an EMU the Treaty provides, in Article 3a, that the activities of the Member States and the

Community should include the adoption of an economic policy which is based on the close co-ordination of Member States' economic policies, on the internal market and on definition of common objectives. These activities should include the irrevocable fixing of exchange rates leading to the introduction of a single currency, the ECU (today 'Euro'), and the definition and conduct of a single monetary policy and exchange rate policy the primary objective of both of which shall be the maintenance of price stability and, without prejudice to this objective to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition.

STAGES TO ACCOMPLISH EMU

The Economic and Monetary Union is not something that could happen from one day to the next. An EMU requires a high degree of convergence in economic performance by the participating members in order to exploit the benefits of such a union and until the signing of the Treaty that was not the case. For this reason the Maastricht Treaty provided a three-stage process to accomplish EMU:

Although there is no explicit mention of Stage I in the Treaty, because it actually began before the signing of the TEU on the 1 July 1990, nevertheless there were provisions managing the first stage. Specifically, the Treaty provided that during Stage 1 the removal of all restrictions on payments and the free movement of capital within the EC should occur (Art. 109e(2) & Art.73b). It also involved the so-called Monetary Committee promoting the co-ordination of member states' policies in the above and all other areas necessary for the effective functioning of the Internal Market (Article 109c(1)).[10] Another requirement, for Stage I, was that credit facilities with central banks and measures establishing privileged access to financial institutions favouring EC, government, or public bodies should be abolished (Art.104 and 104a). Also member states were requested, where necessary, to adopt multiannual programmes to promote the lasting economic convergence required for further progress towards EMU, with particular attention to the maintenance of price stability and sound public finances (Art. 109e(2)(a)). Also, in Stage I as well as in Stage II member states had to treat exchange

[10] The Monetary Committee was originally set up in accordance with the provisions then found in Article 105(2) of the Treaty of Rome and will be dissolved at the beginning of Stage III (Art.109c(2)).

rate policy as a matter of common concern, co-operating within the framework of the European Monetary System (Art. 109m(1)). Finally during the first stage the Council had to assess the progress towards economic and monetary convergence and implementation of EC law relating to the completion of the Internal Market (Art. 109e(2)).

The second stage of EMU began on 1 January 1994 (Art.109e(1)). During this stage all preparations for the Economic and Monetary Union had to be completed. First of all governments of the member states had to improve their budgetary situation and endeavour to avoid excessive budget deficits and public debt[11] (Art.109e(4)). Stage II also provided preparations with regard to the institutional and legal framework for EMU. As such, member states gradually granted national central banks their full independence, and amended national legislation so that it complied with the relevant provisions of the Treaty and the Statute of the European System of Central Banks (Art.108 and 109e(5)). Another important element of Stage II was the establishment of the European Monetary Institute (EMI). The EMI was comprised by the governors of the national central banks and was being presided over by an appointee of the member states (Art.109f(1)). The tasks of the EMI included the promotion of co-operation between national central banks; the monitoring of the European Monetary System (EMS); and the co-ordination of the monetary policies of the member states. The EMI was also responsible for preparations for Stage III, such as the development of the necessary procedures and instruments for the successful functioning of a single monetary policy and the specification of the required framework for the effective function of the ESCB during Stage III (Art.109f(3)).

The third and final stage of the Economic and Monetary Union started on 1 January 1999. According to the decision of the European Union political leaders at their summit meeting on 1-3 May 1998, 11 founding members will be part of the EMU (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain)[12]. The decision of which member states would participate in the EMU depended on the progress of the members in fulfilling the so-called convergence criteria,

[11] The government deficit had to be no greater than 3%, and the debt not to exceed 60% of the member state's GDP.
[12] On 17-18 June 2000 Greece became the 12th member state to be part of EMU as it has met all the convergence criteria.

since the Treaty specified that only the members which meet all the criteria would be allowed to participate in Stage III (Art.109j(1)).

The convergence criteria which member states should meet are the following:

- rate of inflation no greater than 1.5 percentage points above that of the three lowest rates in the EU;
- governmental budget deficit less than 3% of the country's GDP;
- overall public debt not to exceed 60% of the country's GDP;
- the member state's currency must have maintained its position within the narrow band of the Exchange Rate Mechanism (ERM) for at least two years without devaluation; and
- average long term interest rates in the country not have exceeded the level of the three lowest rates in the EC by more than 2 percentage points over a period of least one year.

The Treaty on European Union requires, apart from the convergence criteria, that governments of the member states must ensure that the legislation concerning national central banks must be compatible with that of the Community and the Statute of the European System of Central Banks (ESCB), before the start of stage III of the Economic and Monetary Union (EMU). In particular national central banks must be autonomous in the sense that they, as the European Central Bank (ECB), should not seek or take any instructions from the Community institutions or bodies, from any government of a member state or from any other body. The national central banks will be a part of the ESCB and will have to act in accordance with the guidelines and instructions of the ECB (Art.107, 108, 109j(1)). In Article 14 of the protocols of the TEU, there is explicit mention to the term of office of the governor of the national central bank which shall be no less than 5 years. It is stated, as well, that he can be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been found guilty of conducting a serious offence.

Apart from deciding which members would participate in Stage III the EU political leaders also decided, in their May 1998 meeting, on the bilateral exchange rates between the EMU countries, and on the membership of the Board of the European Central Bank (ECB) which took over the tasks of the EMI. The ECB was established at the end of June

1998 and for seven months it prepared the ground for the start of EMU and the introduction of the Euro (the single currency) on 1 January 1999.

It has to be noted that for the member states who failed to meet the criteria for the move to Stage III (member states under derogation), there is a provision to review their progress at least every two years. Until these states become full parts of the EMU they will not participate in the decision-making procedures of the ESCB and ECB, neither to those of the Council in matters which relate to the single monetary policy (Art.109k(2-6), l(3), m(2)).

THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS

The Treaty on European Union and its primary objective the EMU, provides that the conduct of monetary policy, after the start of Stage III, will be controlled no more from the member states but by a single central institution, the European System of Central Banks. The arguments for this transfer are mainly related to the following: the need for a unique monetary policy in the Union, since it is not possible to have simultaneously fixed exchange rates, free capital movements and independent national monetary policies; and the need for an institution which will pursue the objective of monetary stability without the pressure from the politicians and the governments.

The ESCB will be composed by the European Central Bank (ECB) and the member states' central banks (the national central banks). The ESCB will be governed by the decision making bodies of the ECB which will be the Governing Council and the Executive Board (Art.106 (1&3)).

OBJECTIVES AND TASKS OF THE ESCB

The transfer of monetary policy control, in a European Union, to a single institution, the ESCB, requires a clear and specific determination of its objectives and tasks. This is very

important in order, for the EMU, to take full advantage of the benefits of the single currency. In a monetary union the policy-maker must be persistent to its objective in order to achieve it, without being influenced by the various political and economic desires and pressures of the involved members. In contrast to the statutes of most national central banks, which until the Treaty had various objectives, the statute of the European System of Central Banks has a single primary objective. As Article 105.1 of the TEU (supported by Art.2 of the Protocol) states, the primary objective of the ESCB shall be to maintain price stability. The ESCB shall also support the general economic policies of the Community, as long as they do not conflict with the objective of price stability, and act in accordance with the principle of an open market economy with free competition, favouring the efficient allocation of resources.

The Maastricht Treaty provides that the basic tasks to be carried out by the ESCB should be: to define and implement the monetary policy of the Community; to conduct foreign-exchange operations; to hold and manage the official foreign reserves of the Member States; and to promote the smooth operation of payments system (Art.3.1 of Protocol). The ESCB shall also contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system (Art.3.3 of Protocol).

ORGANISATION OF THE ESCB

As stated previously the ESCB will be governed by the decision-making bodies of the ECB. According to the Statute of the ESCB, the ECB, the national central banks, or any member of their decision-making bodies, when exercising the powers and carrying out their duties, should not seek or take instructions from any institution or body of the Community, from any government, or from any other body. Also all the above mentioned should respect the principle of independence of the ESCB and not seek to influence any of its members in the performance of their tasks (Art.107 TEU and Art.7 of Protocol).

The ECB will have legal personality and shall enjoy the most extensive legal capacity in the Member States. It shall implement its tasks either by activities of its own or through the national central banks (Art. 9.1 and 9.2 of Protocol).

The Governing Council and the Executive Board, as already mentioned, will be the main decision-making bodies of the ECB. The Governing Council shall comprise the members of the Executive Board and the Governors of the national central banks. The Governing Council shall act by simple majority and each member will have one vote. In case of a tie the casting vote will be of the President's. Only present members will have the right to vote and a quorum of two-thirds of the members will be needed in order to take decisions. The proceedings of the meetings shall be confidential, except if the Governing Council decides otherwise. The Governing Council should meet at least ten times a year (Art.10 of Protocol).

The Governing Council shall adopt the guidelines and take decisions in relation to the tasks of the ESCB. It should formulate and establish the guidelines for the implementation of the monetary policy, including decisions about the intermediate monetary objectives, key interest rates and the supply of reserves of the ESCB (Art. 12.1 of Protocol).

The Treaty provides that the President of the Council and a member of the Commission may participate in meetings of the Governing Council of the ECB, without having the right to vote. The President can submit a motion for deliberation. Also the President of the ECB shall be invited to Council meetings when the latter is discussing matters related to the objectives and tasks of the ESCB. (Art.109b(1&2)).
The Executive Board, on the other hand, shall comprise the President, the Vice-President and four other members. Its members will perform their duties on a full time basis and will be appointed by the Heads of State or of Government, on a recommendation from the Council after consultation of the European Parliament and the Governing Council. The members of the Board shall be appointed, for 8 non-renewable years, among persons of recognised standing and with professional experience in monetary or banking matters. A member can be compulsory retired, by the Court of Justice, on request by the Executive Board or the Governing Council, if it no longer fulfils the conditions required for the performance of its duties or if he has been guilty of serious misconduct (Art. 11.1,2,4 of Protocol)).

The Executive Board will act by a simple majority of the present votes and each member, if present in person, will have the right for one vote. In the event of a tie the

vote of the President will be the casting one (Art. 11.5 of Protocol). The Executive Board will be responsible for the implementation, following the guidelines and decisions of the Governing Council, of the monetary policy by giving the necessary instructions to the national central banks (Art. 12.1 of Protocol).

Apart from the Executive Board and the Governing Council there is a third decision-making body of the ECB, the General Council, which is comprised by the President and Vice-President of the ECB and the Governors of the national central banks. The General Council is responsible for the preparations for the participation in the final stage of EMU of the member states under derogation (Art.45 of Protocol). It will also contribute in other tasks of the ECB, as in the collection of statistical data, the advisory functions, the financial reporting, etc. (Art.47 of Protocol).

The TEU requires that the ECB must produce reports on the activities of the ESCB. It shall address an annual report on the monetary policy to the European Parliament, the Council and the Commission, as well as to the European Council. The President of the ECB must present the report to the Council and the Parliament, which may hold a general debate on the report (Art.109b(3)). Also the ECB shall draw up and publish reports on the activities of the ESCB at least quarterly and also publish a consolidated financial statement of the ESCB each week (Art. 15.1&2 of Protocol)). Finally the ECB and the national central banks may be subject of judicial review through the Court of Justice (Art.35 of Protocol).

MONETARY FUNCTIONS AND OPERATIONS OF THE ESCB

The ECB and the national central banks, in order to achieve the objectives of the ESCB and accomplish their tasks may make use of various instruments and monetary functions. Such functions could be the open market and credit operations, the requirement for credit institutions to hold minimum reserves, acquire and sell foreign exchange assets and precious metals, conduct banking transactions with third countries and international organisations, or any other operational methods of monetary policy that the Governing Council decides by a majority of two-thirds. (Art. 18,19,20,23 of Protocol)

The ECB and the national central banks will be prohibited though to issue overdrafts or any other type of credit facility to Community institutions or bodies, central

governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States. The same applies to direct purchase by the ECB or the national central banks of debt instruments issued from all the above mentioned (Art.21 of Protocol).

The ECB and the national central banks may provide facilities and the ECB may make regulations, relevant to the clearing and payments systems (Art.21 of Protocol). The ECB may also perform specific tasks related to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings. It may as well offer advice to the Council, the Commission and the member states in legislation relating to the above mentioned matter and the stability of the financial system (Art. 25 of Protocol).

FINANCIAL PROVISIONS OF THE ESCB

The Articles 26 to 33 of the Protocols of the TEU refer to financial matters of the ESCB. There are provisions concerning financial accounts, auditing, capital of the ECB, capital subscription, transfer of foreign reserve assets to the ECB, foreign reserve assets held by national central banks, allocation of monetary income of national central banks, and allocation of net profits and losses of the ECB. All the above mentioned provisions are very important for the operation of the ESCB and have to be carried out with great care and according to the general obligations of the ECB and the national central banks. They are not though of direct relevance to the aim of this research and are not going to be examined in detail.

CONCLUSIONS

This chapter briefly reviewed the historical developments of European integration as well as the objectives and provisions of the Maastricht Treaty for the introduction of the

single currency and the operation of the ESCB. What is clear is that every single stage in the European Union's development can be seen as an effort to make the previous stage work. Since the early 1950s, when the whole process of integration began, the latent motive was to make the European institutional dynamics operational. From the Coal and Steel Community to the Common Agriculture Policy, the Customs Union and the Single Internal Market there was always a need for further integration and co-operation. However, the economic, political and social conditions that determined the policies and the institutional structures to be adopted altered from one stage to the next.

Despite the permanent political motives behind these European developments, the changing economic needs and conditions were clearly dominant in setting the new objectives. At all times, the lack of monetary co-operation and stability enforced new measures in order to make the other sectoral policies operational since the success of Common Agriculture Policy, the Customs Union and the Internal Market all presupposed monetary stability. Unfortunately, the economic and monetary situation since 1970 created problems for all of the above and any attempt for free capital movement was impossible. The necessary arrangements to ensure long-term monetary stability and growth were therefore essential for those who dreamed of a united and efficiently operating Europe. It was in such a climate that the idea for an Economic and Monetary Union with a common currency and an independent central bank arose.

The growing wave of neo-liberalism played an important role in the formation of this idea. European states eventually moved from systems of market regulation to deregulation and to more flexible decision-making processes. In such an environment, Europe's institutional processes, such as majority voting, also changed in an effort to adapt promptly and efficiently to the new demands. By the early 1990s the neo-liberal approach of free-market policies, away from government interference, set up the context within which the Maastricht Treaty was designed and signed by the member states.

Having reviewed the evolution of European integration and the prevailing conditions in Europe in the early 1990s the second part of this chapter referred to the objective, the arrangements and obligations for the European Central Bank and the national central banks. This matching is considered suitable as it reveals the mechanisms and the conditions under which member state governments agreed to surrender so much authority to the ECB and to the national central banks. The analysis concentrated on the

constitutional arrangements of the ECB in order to present not only its exact role and power but also its relationship with the national central banks.

However, although the Treaty sets out the objectives, tasks and arrangements for the ECB with precision it is much less explicit in the arrangements and obligations of the national central banks, which will compose the ESCB. The Treaty states that in order for a member state to be part of EMU it has, apart from the convergence criteria, to grant its national central bank independence. On the particular characteristics of the independent national central banks the Treaty refers only to the very general ones (i.e. act in accordance with the guidelines and instructions of the ECB, take no instructions from anyone, term of office of the governor not less than 5 years, can not issue credit facilities to governments and public institutions) whereas there are absolutely no guidelines on the central banks' objectives, or on the appointment, composition, term, and accountability of the council, etc. One could logically assume that the ECB constitution embodies a consensus about the model of national CBI required. However, since it is not implicitly mentioned in the Treaty and as far it does not come into direct conflict with the objectives of the ECB, national central banks can have different arrangements. The following chapters will concentrate on the exact implications of CBI arrangements in order to understand how they can affect the operations of central banks and to appreciate in the case studies why countries diverged from the ECB model.

Chapter III: The Debate on Central Bank Independence in the Context of EMU

The previous chapter explored the development process of the European Union, from the Treaties of Paris and Rome to that of Maastricht and its objectives - the EMU being the most important - and the Statute of the European System of Central Banks (ESCB). One of the main conclusions was that the decision to create the EMU constituted another attempt to achieve the much desired monetary stability, which would support all other EU objectives, such as further economic and political integration, completion of the single market, and gradual enlargement. According to the supporters of EMU, its creation was to entail many direct economic benefits as well. Others, however, were equally keen to believe that the EMU would amount to an economic failure creating tremendous social disturbances.

Before analysing the concept of CBI and the arguments for and against, it is appropriate to examine the possible costs and benefits of the EMU since CBI constitutes an indispensable part of it. Participation in the EMU and the establishment of CBI, in the European Union, are inevitably connected and therefore any consideration of either of the two brings into mind the advantages and disadvantages of both developments. Any member state's government decision to grant CBI is logically affected by the general attitude towards EMU and therefore in order to understand the exact stance towards CBI it is important first considering the costs and benefits of the introduction of the single currency.

THE COSTS AND BENEFITS OF AN ECONOMIC AND MONETARY UNION

The proposal by the Treaty on European Union for the EMU involved four main provisions: a single market, where goods, services and capital circulate freely; irrevocably fixed exchange rates among participating currencies and introduction of a single currency ('Euro'); a single monetary authority implementing a single monetary

policy (ECB); and binding rules on the size of budget deficits, public debt, and on the financing of deficits of the member states.

This section will analyse the arguments in favour and against Economic and Monetary Union in Europe.

THE ARGUMENTS IN FAVOUR OF EMU

The initial benefit of an Economic and Monetary Union arises from the elimination of the exchange rate related conversion costs within the Union due to the existence of a single currency. The estimates made, by the Commission of the European Communities (1990), suggest that the reduction will be about 0.5 percent of GDP for the whole Community and may rise to 1 percent of GDP for some smaller countries with more open economies.

Another benefit of an EMU, very closely related to the above, would be the elimination of the risk associated to the movements in exchange-rates. This will result in the reduction of the risk premium built in the real interest rates. As a result international trade and direct investment will be benefited and speculative capital movements will be minimised. As Rolf Hasse (1990: 45) points out, capital allocation will be possible wherever, in the currency Union, there exists the highest marginal return. European Commission (1990) estimates that the reduction of risk premiums by 0.5 percentage points is likely to increase income in the Community by 5 to 10 percent in the long run, thus supporting positive welfare effects.

Nevertheless, there is also an opposing argument on the above. Fratianni and J. von Hagen (1992: 405) claim that a monetary union reduces the degree of competition as a single currency and a common monetary policy eliminate product diversification. Together with the threats resulting from the exchange rates variability, an EMU will eliminate the rewards of competition, as it restricts the ability to invest in assets denominated in different currencies. In addition, it is claimed that there are no significant empirical effects of exchange rate variability on investment and therefore the final effect on income may not be as high as suggested by the Commission (De Grauwe, 1992). In the words of Barry Eichengreen (1992: 10), "elimination of exchange-rate uncertainty rather than affecting the level of investment, might influence who invests where".

EMU is more likely to bring about economic benefits by promoting further market integration. Trade between member states will be enhanced, not only because transaction costs and exchange-rate uncertainty will be eliminated, but also due to the abolition of discriminatory pricing and the general benefits of the Single Internal Market. The integration of the national financial markets will increase the ability of the market to deal with monetary shocks from outside since, as Hasse (1990: 45) states, a large common financial market acts like a mutual insurance company. The economic benefits from full market integration, as estimated by the European Commission (1988), could raise the Community's GDP to an extra 2 percent.

Another very important contribution of an EMU is the strengthening of price stability. Monetary unification eliminates the option of devaluation by abolishing the exchange rates and promotes the decline of the inflation rates. The degree of success however, depends on many other factors, such as the institutional design and performance of the new monetary authority. If EMU is successful in promoting price stability, this will amplify the efficiency in resource allocation and contribute to sustained non-inflationary growth.

Finally another benefit which could result from the Economic and Monetary Union is the transformation of the new currency to an international reserve currency. This, however, will depend on whether the single European currency will achieve similar long term credibility with the one that the US dollar currently enjoys.

In conclusion, one can say that although the EMU has the potential to bring about several benefits to the national economies and to the whole Community, the degree of success of these benefits is not in many cases easy to quantify. Much will depend on the integration and co-operation of the national economies in order to promote long-term monetary stability. For this reason, the countries with poorer performance have to strive to converge with the more advanced economies, in nominal as well as actual terms. It is these countries, usually small in size with more closed economies and higher interest rates, which will benefit more by the EMU and the single currency, since they will import a permanent climate in favour of price stability and will be more involved in international transactions.

THE ARGUMENTS AGAINST EMU

The most important cost involved in forming a monetary union stem from the elimination of nominal exchange rates and the abandonment of monetary policy as national policy instrument. Manfred Willms (1993: 100) points out that "in a case of an asymmetric economic shock the result can be a loss of output and employment as well as loss of price stability (for countries with low inflation) or of revenue from seigniorage (for high inflation countries)". These costs however are not inevitable and their occurrence and effect, as Jose Vinals (1994: 219) states, depend on several factors such as "the nature of the shocks; the degree of international factor mobility; the degree of wage and price flexibility; and the degree to which fiscal policy is oriented toward macroeconomic stability".

The absence of exchange rates as an instrument for macroeconomic adjustment is less problematic when shocks are symmetric across the Union and therefore there is less need for exchange rate movement for equilibrium readjustment. Studies by Bayoomi and Eichengreen (1993) and Eichengreen (1992) have found that asymmetric and idiosyncratic shocks in the EC are more frequent than in the US and therefore a currency union in Europe might be more costly. On the other hand, Grauwe and Vanhaverbeke (1993) among others have found that the degree of asymmetric shocks is much smaller in the EU countries which have close relations to Germany. This can prove to be very important since the EMU and its monetary authority, the ESCB, are designed according to the German model which is well known for its stability. However, as European economies integrate and the merging companies are increasing, the danger of a country oriented asymmetric shock declines against the possibility of sectoral asymmetric shocks. The latter is something that concerns more countries like Germany and France that have vast investments in unstable areas such as Eastern Europe.

As far as asymmetric shocks do exist, there is a need for an alternative to the exchange rate adjustment mechanism. The one that was proposed by Mundell (1961) is the mobility of production factors and especially that of labour. According to this view, when there is a reduction in a country's demand and exchange rates are fixed, unemployment will rise unless there is migration towards that country. However, studies by Bini-Smaghi and Vori (1993) and Decressin and Fatas (1992) have found that labour migration in the EU is much smaller than in the US and although it might increase with

the creation of the EMU, for historical, cultural and linguistic reasons it is very doubtful that the situation will alter significantly in the following decades. A factor that might play an important role in the future is the high mobility observed among the non-EU guest workers that are increasing rapidly their presence in the EU labour markets. However, the problem with these guest workers is that they are largely limited to the unskilled, non-unionized segment of the market.

Another factor which could cope with asymmetric shocks is wages and prices adjustments. Although this is not the case today in the EU, some believe that gradually wages and prices will become much more flexible. In order for this to occur a reliable anti-inflationary policy has to be achieved throughout the Union and essential structural changes have to take place.

In the case, therefore, that neither labour mobility nor wages and prices are sufficient instruments to deal with asymmetric shocks what is left is fiscal policy. National authorities will have to take fiscal measures in order to deal with such shocks. Governments will have to follow strict policies and to co-operate at all times with monetary authorities so that they can cope with country-wide asymmetric shocks. As Jose Vinals (1994: 225) states, fiscal austerity in “good times” would be the price to pay in order to have fiscal flexibility in “bad times”.

Balancing the costs and benefits of an Economic and Monetary Union in the European Union, one can conclude that although there is no clear economic case in favour of EMU this scheme has a potential for success, on the grounds that there are measures to prevent the possible risks involved. The significant degree of convergence, which the twelve first member-states of EMU have achieved, is an essential requirement for the success of the single currency. However, convergence efforts should continue in order to integrate the EU economies even further so that the entirety of the benefits are obtained. Nevertheless, the benefits as well as any costs most likely will not be evenly distributed among the member states. For example, in regard to price stability the small countries will probably be more benefited, as these were the ones that usually confronted monetary stability problems. Yet, for these countries there are more risks involved in the case of an asymmetric shock as their labour markets are characterised by structural rigidities and their economies are less diversified and less integrated in commercial and financial

terms. For larger states, Germany in particular, the concerns centre around the strength of the new currency, the harmonisation of fiscal policy, and whether they will continue to be the greater financial contributors in the EU budget than other countries.

The risks and uncertainties that exist and the absence of a clear margin of benefits over costs for economic considerations, reinforces the view that EMU is driven primarily by other, mainly political, considerations (Eichengreen and Frieden, 1997). This view will be examined in the case studies in order to derive if and how it has also affected government's decisions to reform their central bank.

THE CONCEPT OF CENTRAL BANK INDEPENDENCE

Having analysed what the EMU is about and the possible pros and cons, we proceed to the central topic of this research which is central bank independence. The independence of the central banks of the EU member states is an essential condition for participation in the European System of Central Banks (ESCB), which will be responsible for the monetary policy of the Union. As already stated, the independent national central banks will be a part of the ESCB and will have to act according to the guidelines and instructions of the European Central Bank (ECB).

The aim of this section is to examine the concept of central bank independence on a sub-national and European level, in order to provide the broader perspective within which specific issues can later be discussed.

A definition of central bank independence is a prerequisite for a precise understanding of its nature. Most authors and researchers consider a central bank independent if it has the ability to be the only responsible body for deciding and conducting monetary policy. Central bank independence suggests a significant degree of autonomy not only from the policy maker, i.e. the government, but also from any other institution, person or authority, internal or external which can put pressure on the central bank and influence its decisions. It also suggests autonomy in relation to the objectives set for monetary

policy. The central bank has to be committed to its objectives and not be lured from any pressures to satisfy interests contrary to its own. Theoretically, for a central bank to be totally independent it must have the power also to set its objectives on its own, i.e. completely free from political control. However in practice, this is not the case, since even 'independent' central banks have to achieve not the objective that they choose but the one that governments have specified in their statute. Friedman's suggestion (1968: 179) for an independent central bank can still be applied. He suggested that the central bank should be an independent branch of the government which will have a mandate similar to that of the judiciary, it would have as an objective the one decided in its mandate, by the government, but in performing its operations it cannot be interfered with by anyone, except in the case of changing the mandate.

Central Bank independence can be divided into personnel (or organic) and operational (or functional). The former is concerned with the conditions of appointment and the institutional arrangements under which the central bank exercises its duties, while the later deals with the operational freedom of central bank activities. The arrangements for personnel and functional independence are particularly important since they define, albeit in theoretical terms, the degree of central bank autonomy. A central bank might be independent institutionally but not practically. What eventually determines the degree of autonomy depends on whether it has the ability to operate away from external interference. The issues of personnel and functional independence will be fully examined and analysed on the next chapters in order to reveal how particular arrangements can affect the independent operation of central banks.

THE CASE FOR CENTRAL BANK INDEPENDENCE

The issue of central bank independence became extremely popular during the last decade, even though it was not a new concept. There is no single explanation for the sudden popularity of such arrangement as there were various factors that encouraged its prevalence.

The globalisation of financial markets was definitely one of the main underlying reasons behind its popularity. The internationalisation of securities markets, the liberalisation of payments, and the completion of the EU single market, with the abolition of all restrictions on the movement of capital combined with the technological progress, have created a new framework for conducting monetary, exchange-rate and stabilisation policy. Although the benefits of capital liberalisation and international financial integration are beyond dispute (greater competition, flexibility and efficiency have contributed to a better allocation of resources), markets have become more interdependent and fragile as the crises of 1992-1993 in Europe and of 1997-98 in south-east Asia have revealed. As a result, long-term economic and monetary stability is considered essential. In such a framework, however, monetary policy is left with just one basic instrument to ensure price stability and this is interest rates. For this reason, many people believe that monetary policy has a very complicated task and the creation of an independent central bank is the best means to achieve the desired results. Simultaneously, the fact that after the collapse of the Bretton Woods System, inflation became the main global problem encouraged new schemes with emphasis to the fight against inflation.

A second reason, was undoubtedly the creation of the Economic and Monetary Union. The Maastricht Treaty and the prospect of a monetary union with a single currency and an independent European Central Bank, presupposed the independence of national central banks in order to participate in the final stage of EMU. As a result, EU member states one after the other started reforming their national central banks. Such considerations of EU members soon created a debate and in other counties all over the world. Policymakers in Latin America promoted such arrangements to prevent the return to high and persistent inflation rates, while former socialist countries needed to create a stable institutional framework for the smooth functioning of a market economy.

Another factor that encouraged considerations for independent central banks was the prevalence of neo-liberal politics that promoted ideas such as privatisation, deregulation and minimisation of the state's involvement in the economy. Within this framework many independent agencies were set up to take over the responsibilities that were previously managed by governments. Correspondingly, the independence of the central

bank was within this logic considered as a modern and more efficient way to conduct monetary policy.

However, all the above would have had little success to the promotion of independent central banks if the empirical evidence suggested the opposite. The results of extensive studies, as the following section aims to show, have pointed to the negative correlation between inflation and central bank independence. Well-established independent central banks, such as the US Federal Reserve and the German Bundesbank, have achieved over the long term lower inflation rates, an outcome that has definitely promoted the idea of 'independence'.

However, central bank independence is not universally accepted as a superior approach to monetary policy. There are many who oppose such an arrangement not only on economic but also on political grounds. The rest of this chapter intends to identify and analyse the main arguments for and against the establishment of an independent central bank.

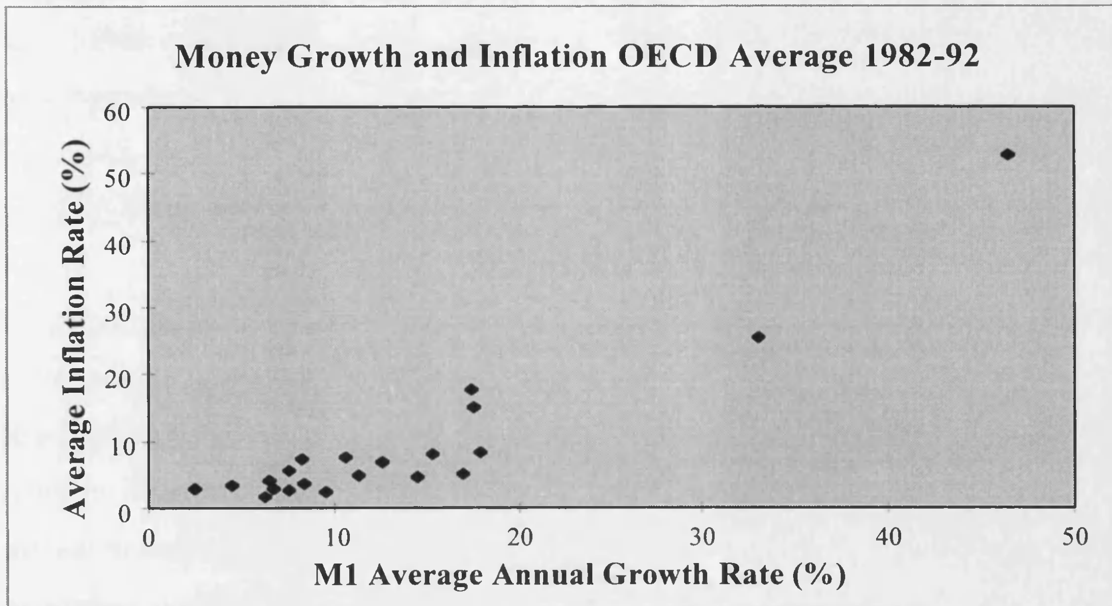
ARGUMENTS IN FAVOUR OF CENTRAL BANK INDEPENDENCE

The 'economic' argument

The main argument of those who support independence is that it can provide greater monetary stability and lower inflation. For many economists, inflation is the worst enemy of the economy. Price stability and low inflation are considered essential components of a sound economy.

Hayek (1976) claimed that governments have misused their monetary policy powers and have created four evils: inflation, instability, undisciplined government spending policies and economic nationalism. Governments are accused for not persisting on monetary stability, especially in periods before elections when monetary expansion is frequently observed. This happens in order to stimulate employment and output. But in the long run it has been observed that money growth causes inflation (see fig.1).

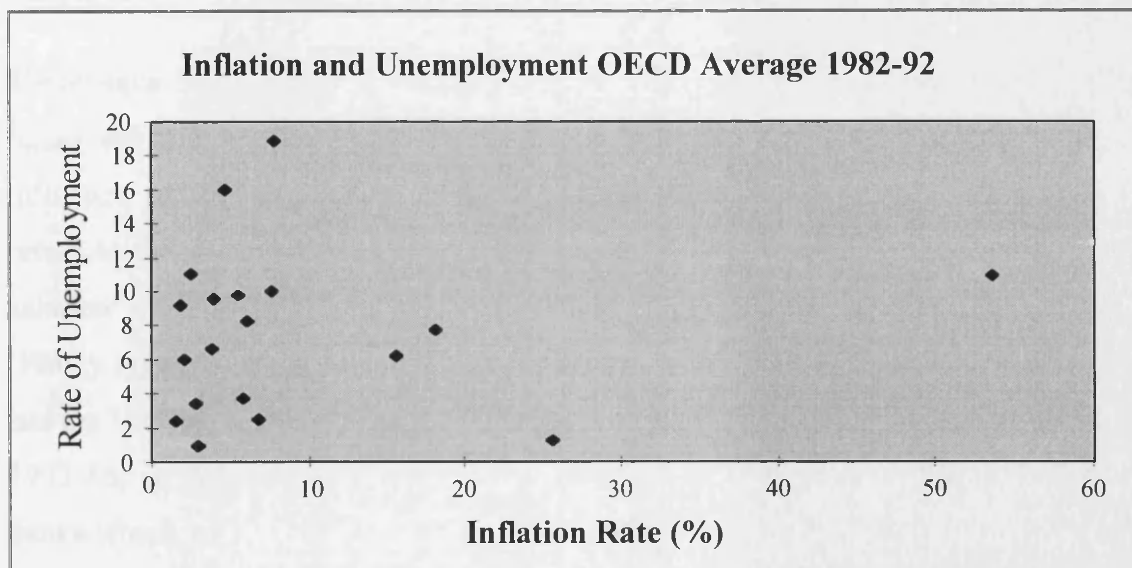
FIGURE 1



Source: IMF

Apart from the relation between money growth and inflation there has been for decades a great conflict between keynesians and monetarists on the effect of monetary policy on the level of output. The former argued that there is a trade-off between unemployment and inflation (i.e. Phillips curve is negatively sloped), whereas the latter believed that there is no trade-off (i.e. Phillips curve is vertical). Today most economists agree that in the long run there is no trade-off (see figure 2) and therefore monetary policy cannot significantly influence the level of output and, subsequently, the level of unemployment. In the short run, however, there is a trade-off between unemployment and inflation and therefore monetary policy can be effective[13].

FIGURE 2



Sources: IMF, OECD

[13] The problem is to determine the actual length of the short run (usually as an average business cycle, 3-5 years).

The above means that a monetary expansion will have a positive effect in employment and output only in the short run. In the long run this action will be transformed into inflation which will offset any effect of the monetary growth. Furthermore, in order to lower this increase of inflation much effort and strict monetary policy will be required, resulting in an initial increase in unemployment and decrease of output.

However, politicians' rarely take such long-term considerations and are principally more interested in dealing with short-term problems. The UK Centre for Economic Policy Research (CEPR), in its report (1993: 14) on the issue of central bank independence, refers to three essential temptations that governments are subject to: the first is to create money in order to inflate away nominal debt; the second is to create money in the hope of bidding down interest rates with the aim of reducing the fiscal burden of servicing a large debt; and the third is to use monetary policy to create a pre-election boom of the economy. The common feature of all these three government temptations have the same result in the long run: inflation.

Having in mind the short term horizon of actions which characterise most governments as well as the consequences of loose monetary policy, it is evident why there are more and more supporters of independent central banks. It is believed that a central bank that is not subject to government guidelines and instructions, and is the only responsible body for conducting monetary policy with no motive for electorate support, can provide significantly better results in the fight against inflation and can achieve price stability.

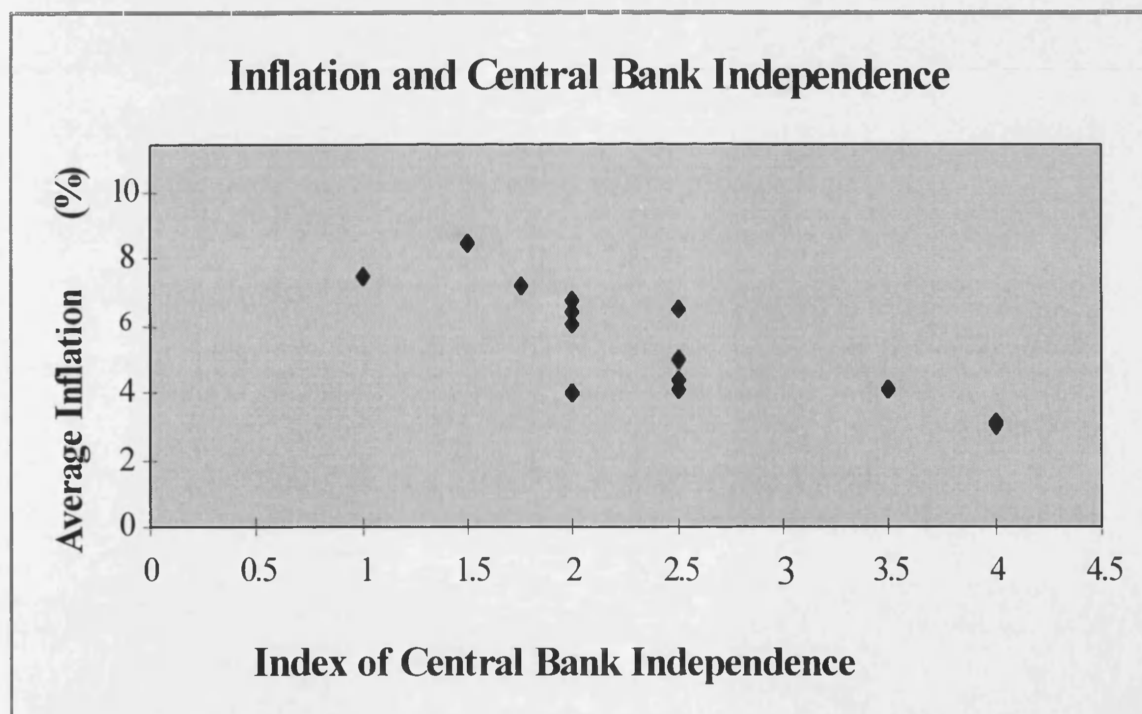
There have been many studies investigating the relation between independent central banks and inflation or unemployment. Bade and Parkin (1988) have divided government influence on central banks into 'financial type' and 'policy type'[14]. 'Financial type' refers to the influence of the government in selecting board members; in setting their salaries; in determining the Bank's budget and in determining who gets the profits. 'Policy type' refers to the influence in board meetings, and on whether the government has the last say in setting monetary policy. What they have found, in the period between 1973-86, is that 'policy type' government influence is very important, as the central banks which were free of that kind of influence had much lower record of inflation than

[14] Similar to the personnel and functional independence we have mentioned before.

the ones which were not. Masciandaro and Tabellini (1988) made a study of five Pacific basin countries (Australia, Canada, Japan, New Zealand and USA) and found that the 'financial type' influence is also crucial in the central bank's decisions. They also found that inflation was lower in the countries where there was no or little external influence on the board's decisions.

Alesina and Summers (1993) have examined the relationship between central bank independence[15] and inflation and economic growth. As we can see in figures 3 and 4 their results are undoubtedly in favour of central bank independence. Figure 3 provides a clear message that the countries with autonomous central banks have on average lower inflation. Figure 4 further shows that there is no statistical evidence that central bank independence has any long-term cost as regards economic growth.

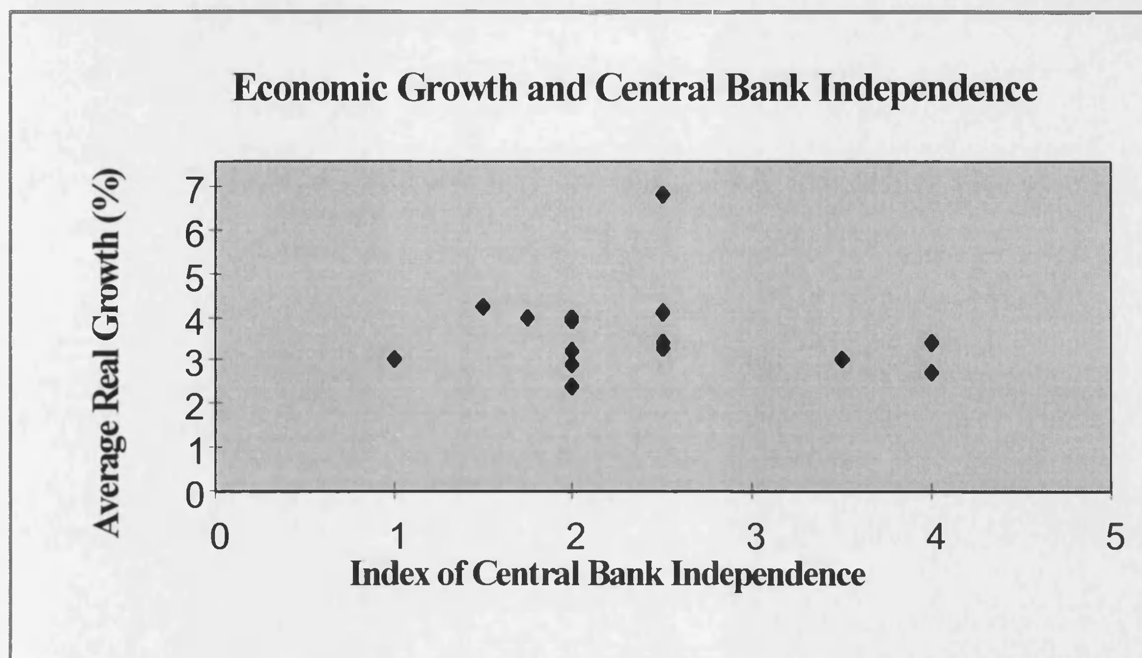
FIGURE 3



Source: Alesina and Summers (1993)

[15] The criteria used to measure independence were: the appointment of the central bank's board members, possibility of dismissals, whether government can give orders, responsibility for setting interest rates and exchange rates, and control of banking and financial markets.

FIGURE 4



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Source: Alesina and Summers (1993)

Wood, Mills and Capie (1993) did a similar study and their results too suggested that countries whose central banks were independent delivered lower inflation than countries with 'dependent' central banks. They are aware however that such a result does not lead directly to the conclusion that only independent central banks can achieve lower rates of inflation. They argue that although independence is a sufficient condition for low inflation it is certainly not necessary, as they claim that the previous economic history of the country contributes to the inflation performance of the central bank.

Whichever the status of the central bank it is generally agreed that the credibility of the Bank is very important. As stated in the report of the CEPR (1993: 11), "the role of expectations is critical, and the public is more likely to judge politicians by what they do rather than by what they say". If the central bank, independent or not, can be reliable on its objectives then the possibility of delivering lower inflation and achieving price stability is most likely. Non-credible central banks need to impose high interest rates, as there is an inflationary bias against them, with a negative result for the investors as well as for the normal borrowers. On the other hand, credible central banks do not have such a problem and use interest rates premiums only in cases of real need.

Credibility, though, is not something that can be achieved overnight. The central bank must convince the public that what it does and what it would do in a crisis is exactly what its statute provides for. This is why, as we will analyse in the next chapter, the Bank's objective has to be clearly defined, so that its actions can be controlled and understood.

The 'political' argument

A second argument in favour of central bank independence is, as Hasse (1990: 124) explains, that monetary policy differs from everyday politics and should therefore remain separate from short-term economic and political issues. The difference of monetary policy decisions, especially compared to those of fiscal policy, is observed both to their form, their effect and the time dimension involved. The ultimate objective of a central bank is long term monetary stability and therefore all actions should concentrate and contribute towards that goal without political interference and everyday political considerations.

The 'technical' argument

According to this argument, an independent central bank is preferable from a technical point of view. It is believed that central bankers have many advantages over politicians in pursuing monetary policy such as: much greater technical knowledge and expertise in monetary matters, much more patience in achieving their objectives, long-term horizons, and much more transparent procedures in exercising their duties. Politicians, on the other hand, even if sometimes acquainted with such personal characteristics have been unable in most cases to follow a reliable and consistent monetary policy. This usually happens because no matter how much they support monetary stability, public pressure for loose policies make them compliant, due to their anxiety to secure re-election.

A final argument in favour of independent central banks is that they can be much more efficient and effective, especially in cases of emergency, because they are not characterised by the bureaucratic procedures and delays that are usually observed in decisions made by politicians.

ARGUMENTS AGAINST CENTRAL BANK INDEPENDENCE

The 'undemocratic' argument

One of the main arguments of the opponents of central bank independence is that such a reform would not be consistent with democratic practices since it is not legitimate to grant to unelected institutions the conduct of such an important component of the economy as monetary policy. According to this view, the public elects the government that is believed to be the most suitable for the country to pursue their policy. Nevertheless, by making the central bank independent there is no guarantee that the policy which will be followed will be the one the public supports. In fact, they argue that in most cases the Bank's policies will be in opposition to those of the government.

The 'accountability' argument

Related to the above is the issue of the accountability and answerability of the independent central bank. This argument originates from the fact that since the Bank is autonomous on its actions and it has not been democratically elected, there is a major problem of accountability. First, there is no guarantee that the central bank will be persistent with its objectives and second that it will not follow policies enforced by various interests which can influence its board. Since the Bank is independent from the government it cannot be accountable to it since this would contradictory the essence of independence. Even if there is a way to make the central bank accountable for its actions, sheltering its independence, there is still a problem of what would happen in the case that the Bank is considered unsuccessful or inefficient. If there is an option of dismissal of the governor or withdrawal from independence then it is most probable that the central bank would be performing, in many instances, according to the will of the government in order to preserve its independence. This argument suggests that there is no way to have a truly independent central bank and accountability at the same time, and therefore for reasons of democratic principles central banks should be controlled by elected politicians.

The 'economic policy' argument

This argument relies on the theory that monetary policy is an important component of economic policy and cannot be separated by it. It is argued that in the case that monetary policy is controlled by the independent central bank while fiscal and exchange rate

policies are controlled by the government, conflict is inevitable. As Mas (1994: 10) states, the conflict can be either passive, as a result of an unclear division of responsibilities, or active, since both are acting in such a way in their attempt to force actions by the other. For example, in a case where the government exercises an expansionary fiscal policy, this is certainly going to be followed by a negative reaction by the central bank which will raise interest rates in order to offset the impact on monetary policy and more specifically on inflation. The same applies and in reverse. In this way each part is trying to get the result it desires, although it is known that this will trigger a reaction from the other side. The result in such a situation would be a sub-optimal achievement of objectives for both sides.

The conflict can also appear between monetary policy and exchange rate policy, as the central bank controls the interest rates and the government the exchange rate. Cottarelli (1994: 331) explicitly mentions that "the reciprocal relationship between monetary and foreign exchange policies and, eventually, their identity, is generally accepted at the theoretical level but often ignored at the institutional level". Since money supply and the exchange rate are interdependent instruments, dividing the two can produce conflicts between monetary and exchange rate targets. In such an occasion one of the two will have to give up its objective, thus actually losing its independence.

The most important factor which determines the degree of the conflict is the existing exchange rate regime (e.g. fixed, float, float within a band, etc.), since under a fixed exchange rate the central bank actually has no real choice in setting its own monetary policy as this is dictated by the 'dominant' country. In such a case, therefore, there is no point in having an independent bank at all. In all other cases the outcome of the conflict which might arise will depend on many other factors, such as the personalities involved, the economic conditions, and the reputation of the bank. The separation of responsibilities and an arising conflict between the government and the central bank is most likely to cause delays and policy inaction, something which, according to the opponents of independence, cannot happen if the government controls monetary policy.

Apart from the problems of democratic accountability and of policy conflicts, the opponents of central bank independence also raise questions over its performance. There are many doubts as to whether an independent central bank provides low inflation. The

argument is that all the empirical studies, which show that the independent central banks tend to have lower inflation, neglect important factors that influence a country's inflation record. It is claimed that independence is not the most important factor for achieving low inflation and price stability. There are other reasons which count much more, such as the personalities involved, the country's inflation history and aversion towards inflation, the general economic conditions, a stable and conducive political system, a conservative fiscal policy and a 'responsible' government.[16] Furthermore, the opponents of independence claim that studies which compare central banks in relation to inflation tend to omit important variables and are not accurate. Mas (1994: 23) states that "quantifying central bank independence involves problems of both definition (listing the inherent characteristics of central bank independence) and measurement (potential lack of observability of these characteristics). The inherent arbitrariness of numerical indices of central bank independence (which can be based on a variety of legal, institutional, and observed behavioural characteristics) further strains causality relationships".

A final point which is often used against central bank independence is that when the government is not responsible for the monetary policy of the country, it is possible to use this situation to justify its own low performance on other policies. Governments often attempt to explain their inability to achieve certain targets and objectives, which they have promised to the public, by using the excuse that they are tied up by factors beyond their competence. Under this pattern they present independent agencies and institutions as responsible for all the difficulties they face. The European Union agreements and its institutions are very often referred to as an excuse for governments of the member states, as is the judiciary. According to the opponents of central bank independence, something similar is very likely to occur if monetary policy is under the sole responsibility of the central bank. The government can very easily claim that its ineffective or strict economic policy is constrained by the fact that the central bank is following an opposing monetary policy and this fact is preventing it from achieving its goals.

[16] Posen (1993) argues that both central bank independence and low rates of inflation are determined by national differences in the political efficacy of financial opposition to inflation.

THE POLITICAL SOURCES OF CENTRAL BANK INDEPENDENCE

We mentioned in the previous sections the reasons and the logic under which the concept of CBI became popular and the economic arguments which support its establishment. However, recently literature has begun to explore the political context under which governments consent to the autonomy of their central bank. Most answers, as Maxfield (1997: 19) analyses, focus on (i) the political strength of different sectoral groups with varying preferences for employment and price stability, (ii) the nature of political institutions and party systems, and (iii) the financial needs of government.

(i) The political strength of different sectoral groups with varying preferences for employment and price stability.

According to this assumption, groups favouring price stability (such as the financial sector) will also favour CBI whereas groups preferring full employment (such as labour unions) will support the governmental control of the central bank. Empirical studies based on sectoral preferences (see Goodman, 1992; Posen, 1993; Clark, 1993; and Franzese, 1995) have produced a mixture of results. Although there is evidence in many studies that the strength of the financial sector and the weakness of the labour unions are factors which facilitate the existence of CBI, researchers recognise that there are multiple causal influences on CBI. Importance is then given to factors which determine the degree of political vulnerability to interest groups pressure (such as the number of political parties and their relative strength, the centralization of decision making, the regime type, the wage bargaining system and the size of the traded goods). An issue that is important however, is the differentiation of results observed among advanced industrial countries and developing ones.

(ii)The nature of political institutions and party systems.

As hinted above, other explanations about sources of CBI put more focus on the nature of political institutions. Most "institutionalist" studies (see Lohmann, 1994; Banaian et. al., 1986; Goodman, 1991, Bernhard, 1995; Alesina, 1988; Cukierman, 1993; Clark, 1994; Zielinski, 1995; Boylan, 1995; Cukierman & Webb, 1994) accept that the higher the political competition the better for CBI. However, there is no agreement on which of the components of political composition (political system, politicians' time horizons, tenure in office, size of electoral mandates, number of political parties and their positions

in policy space, legislative procedures, etc.) are the most important. In these studies there is also a distinction between OECD versus non-OECD countries, as well as between legal versus de facto independence.

(iii)The financial needs of government.

A third set of arguments about the source of CBI focuses on the financial incentives of governments. According to this view (see Maxfield, 1997 & 1994; Cukierman, 1993, Broz, 1994) granting greater central bank independence can reduce the cost of government borrowing by raising government credibility, lowering expectations of inflation, and lowering the risk premium charged. Therefore, as Cukierman (1993) argues CBI is higher the larger the amount of funds that the government plans to borrow on the capital markets. The history and origins of many central banks enforces the above argument however it is more applicable in non-OECD and small-economy countries which are in the process of opening their markets.

CONCLUSIONS

In this chapter we first examined the costs and benefits of the Economic and Monetary Union and then proceeded to an analysis of one of its main features, central bank independence. The aim was to understand the reasons why it became popular, as well as a clear definition of the term together with its implications and repercussions. However, the theoretical presentation of the arguments for and against independence is not sufficient to obtain a general conclusion on whether the autonomy of the Bank is an advantageous arrangement.

The need for low inflation and price stability is indisputable. The question is the framework and the rules under which monetary policy should operate. Even the supporters of central bank autonomy recognised that granting independence to the central bank is not enough to achieve monetary stability. Removing monetary policy from the hands of politicians might be beneficial in regard to avoiding its misuse by the

government and committing it to long-term stability, but this is no guarantee that it will deliver the expected results, nor can it guarantee that the Bank will not be influenced by the government or other pressure groups. Lindgren and Duenas (1994: 309) point this out: "A law calling for an independent central bank does not guarantee that the bank can operate independently, and, similarly, a central bank can operate independently although the law allows for governmental intervention in monetary policy decisions. Although the form of application of a central bank law may be more important than the letter of the law, it is nevertheless important to establish by law the institutional framework necessary for conducting central bank policies".

The argument that it is undemocratic to have an independent agency handle a public task cannot be a decisive one as the central bank is never completely independent for a number of reasons. First of all, the objectives of the bank are being set by the government and therefore the framework of operation of the Bank is precisely specified, usually even more closely than before. The central bank is free only to choose how to achieve its objectives but it is not able to alter them. This freedom can be restricted even further. Goodhart (1993: 6) states that this can be done "either specifically by the retention of certain 'override' powers by the government, though these are intended to be used only in emergencies, or more generally by the central bank's need to retain, if not a political consensus, at least a sufficient degree of political support to maintain their position of independence". Furthermore, as Swinburne and Castello-Branco (1992: 421) maintain, apart from the option of the government to change the legislation, it can always influence the central bank through a variety of formal and informal mechanisms. Finally, it has been claimed that since the statute of the Bank and its obligations and functions are precisely set by a law passed by the government there is no point in talking about undemocratic principles.

One of the most important factors which is crucial to whether the independent central bank achieves its objectives is credibility. It is essential that the central bank is credible on its commitment to monetary stability. Only when the market and the public believe and trust the central bank, does the latter have the appropriate prestige and power to enforce its commands in times of crisis.

Credibility is also very important for reasons of accountability. If the bank's objectives are clearly defined and transparency in operations is achieved, then independence can be a formation by which greater accountability in monetary matters is in place. Majone (1994: 3) provides some requirements in order to reconcile independence and accountability: "richer and more flexible forms of control than the traditional methods of political and administrative oversight, statutory objectives, procedural requirements, judicial review, budgetary discipline, professionalism, expertise, monitoring by interest groups, even inter-agency rivalry, can all be elements of a pervasive system of control which only needs to be achieved". Credibility is very important as well for the central bank to preserve its independence. If the Bank has won public support, via its policies, it is very difficult then for the government to try to enforce its desires or even threaten the central bank that it will change its independent status.

A point where the opponents of central bank independence seem to have some greater justification in denying the reform, is the conflict that might arise from the separation of policies. Actions of the government, which controls exchange-rate and fiscal policies, can in some cases limit the ability of the central bank to achieve its monetary objectives, as may be the case the other way round. Nevertheless, the fact that policies are assigned to two separate authorities does not mean that they cannot co-operate and co-ordinate to some extent. Also, if an emergency arises and there is a major conflict, provisions can be made in order to resolve such instances. Furthermore, the separation of power may in many occasions be beneficial for both monetary and fiscal policy, as a strict monetary policy, followed by the central bank, forces the government to show greater discipline in fiscal matters.

As already mentioned, the benefits claimed to emerge from central bank independence are far from universal. The discussion of the debate has revealed that although everyone agrees that a central bank will not achieve monetary stability just because it was granted its independence, the conditions that bring about low inflation commend the independence of the central bank. Furthermore, both sides accept that there are also other important characteristics and factors that determine the efficiency of monetary policy. Such factors are the historical stance of the country towards inflation, the personalities involved, specific country characteristics, the economic and political conditions, and so on.

As already mentioned, this study is also concerned with the political conditions and the explanations associated to the interest and establishment of CBI. We want to explore whether the efforts of the governments of the three member states to establish CBI, apart from the obvious incentive due to the requirement of the Maastricht Treaty, were also affected by factors such as those analysed in the previous section and which are frequently observed on small developing countries.

The following two chapters will analyse the formulation of the particular characteristics of a central bank which can determine to a great extent the degree of its functional and personnel autonomy and indirectly affect its performance. Through this analysis it will be easier to appreciate in the case studies what were the alternative models that legislators could choose and why certain actors involved in the reform process pressed for specific provisions.

Chapter IV: Institutional Characteristics of an Independent Central Bank: Personnel Independence

ASPECTS OF CENTRAL BANK INDEPENDENCE

It was stressed in the preceding chapter that granting independence to a central bank is not universally accepted as a superior approach for conducting monetary policy. The opposition and the disagreements expressed are based not only on the existence and performance of the autonomous central bank but also on its particular characteristics and functioning. It has also been pointed out that even among the supporters of 'independence' there is disagreement on the way such a central bank should be designed and operate.

Making a central bank institutionally responsible for conducting monetary policy does not guarantee its independence or its effectiveness. Monetary policy and its main objective, price stability, depends on many variables. Statistical analyses suggest that countries with independent central banks have, in general, managed to sustain a more stable currency and lower rates of inflation. However, a key factor to their success is usually that the chosen model of central bank independence takes into account specific country needs and characteristics. As a result, these central banks function in a smooth, credible and transparent way.

Central bank independence has three basic aspects: institutional, personnel, and functional independence. Institutional independence refers to the statutory ability of the central bank to control and conduct monetary policy without any interference from the government, the parliament or any other institution. The interpretation of the meaning of 'central bank independence' and the degree of a Bank's independence are rather vague concepts. However, institutional independence is the minimum prerequisite in order to regard a central bank as an institution with autonomous status.

Personnel or organic independence is principally concerned with the conditions of appointment, employment and accountability under which the central bankers exercise

their duties, while, functional independence refers to the operational freedom of action of the central bank. This includes the choice and the utilisation of the available monetary policy instruments, as well as other central banking responsibilities.

In this chapter we will analyse the personnel independence of a central bank, which includes: nominations of the governors and of the council, composition of the council, mandate security and duration, voting procedures, accountability and answerability arrangements, and overruling options. The goal is to reveal how the underlying characteristics and the different ways of forming an independent central bank may influence its operation, decisions and effectiveness in conducting monetary policy. The examination of personnel aspects of CBI is a topic of particular concern during the reform process. Governmental committees, ministers, central bankers and members of Parliament usually adopt different positions on aspects of personnel independence according to their own interests and beliefs. Therefore, it is important to analyse the exact meaning and practical implications of each of the personnel characteristics in order to evaluate in the case studies the motives and importance of each actor's stance. In order to have an even better understanding of the reality, references will be made to examples and practices of existing independent central banks. We will mainly analyse the most known models of independent central banks such as the German Bundesbank, the United States Federal Reserve, and the Reserve Bank of New Zealand. These comparisons provide a better idea why various governments choose different arrangements, which are usually influenced by its country's particular characteristics and the prevailing political and institutional dynamics.

CONDITIONS OF APPOINTMENT

NOMINATION CRITERIA AND PROCEDURES

When discussing the conditions of appointment for the governors and the members of a central bank's council, the first important question is who is responsible for the nomination and which are the procedures and the selection criteria.

Although this section is titled personnel independence, it seems contradictory that in all central banks, governments have significant power in appointing the members of the council. However, as R.Hasse (1990: 116) states, it is not feasible in practice to exclude government influence completely when appointments are made to such an important public institution. First, since central bankers are not elected individuals and as their task is so important for the whole economy there has to be a guarantee that their actions are accountable to elected bodies. Therefore, parliamentary or governmental participation in the appointment procedure is a necessity for democratic control. Also, the involvement of private bodies does not guarantee any further objectivity and therefore is not considered appropriate. Furthermore, there is always the need for some degree of co-operation between the government and the central bank and thus it is preferable to appoint individuals with views not distant from the governmental ones.

Due to the above reasons, the nominations of the decision-making bodies of the central bank will always, entirely or partly, involve governmental participation. A way to ensure the greatest objectivity possible for the part of the government is to involve other bodies to propose candidates. Of course, the government will usually have the final say in the selection. In this way, if governmental preferences differ significantly from those proposed by the other bodies involved, then the government will be in the unpleasant position of having to publicly justify its choices.

In different countries we observe, as expected, various ways of appointment procedures. In countries with dependent central banks the appointments are made in a way similar to the one for the members of the cabinet. The Prime Minister, usually after consulting the Finance Minister and other members of the Cabinet, takes the decision and makes the appointment of the selected individuals. On the other hand, in countries with more independent central banks, various ways have been established in order to ensure a more objective - non-political - selection.

In Germany, the President and the Vice President of the Bundesbank, are nominated by the federal government which has previously consulted the Central Bank Council (CBC). The latter consists of the Frankfurt-based Directorate and the presidents of the State (Land) Central Banks. The members of the Directorate are also appointed by the federal government, whereas the regional presidents are appointed by the regional governments

after consulting with the CBC. The diverse nature of the Council's membership contributes to the autonomy of the Bundesbank. Members are typically drawn from three broad groups: Career central bankers and officials in government agencies, politicians, and academics.

It should be noted that the majority of the members of the Council usually have close relations and some are members of political parties. Usually the ones who are not openly related to parties are the career central bankers and the academics. Generally it can be said that many of the Bundesbank's Council appointments have a party-political influence. As Rolf Caesar (1988: 187) mentions "the fact that the Central Bank Council voted more than once against a recommended candidate is already an indication of the Bundesbank's politicisation at the personal level".

Another interesting point is the tradition of vice-presidential succession at the appointments of the Bundesbank. With the exception of the present President Ernst Welteke, all previous Presidents (Hans Tietmeyer, Helmut Schlesinger, Carl Otto Pöhl, and Otmar Emminger) were Vice Presidents before taking over as the Bank's head. Although this seems to be a factor emphasising the will of the German politicians for objectivity and continuity of the Bundesbank policies, in practice there are accusations of political appointments. The vice-presidential succession tradition has ended, according to press reports, due to the change of power in the government and the close relations of E. Welteke with the new Finance Minister Hans Eichel. Also, apart from Helmut Schlesinger and Otmar Emminger, who were career central bankers, all other Presidents as well as the predecessor of Otmar Emminger, Karl Klaasen, were closely related to politics and politicians. This, however, has not by any means prevented them to follow a policy according to the Bundesbank's tradition, primarily a commitment to low inflation and a strong Deutschemark.

In the United States, the members of the Board of Governors of the Federal Reserve System are appointed by the President of the United States. The Chairman and the Vice Chairman, have to be among the board members, and are named by the President. All the appointments must be confirmed by the Senate. The nine members ('directors') of each of the Federal Reserve Banks are appointed as follows: three 'Class A' directors, who represent member banks, and three 'Class B' directors, who represent the public, are

elected by the member banks in each Federal Reserve District. The other three 'Class C' directors, who also represent the public, are appointed by the Board of Governors and one of them is designated as chairman and another as deputy chairman. These Class C directors cannot be stockholders of a bank. Both Class B and Class C directors cannot be officers, directors, or employees of a bank.

It should be mentioned here that the majority of the Board members have also close links with politicians. This is a factor which supports declarations that the appointments of the Board members of the Federal Reserve are in some degree political. On the other hand, the background of the regional presidents is usually more related to central banking. This is probably the reason why regional presidents, in general, favour tighter monetary policy.

The confirmation by the Senate is not something typical. The following examples show the Senate's power: In February 1996 President Clinton appointed for a third term (he had served one under R. Reagan and one under G. Bush) Alan Greenspan as a Chairman mainly because he knew that the Republican-controlled Congress would not accept anyone else. At the same time, President Clinton was forced not to name the investment banker, Felix Rohatyn, as Vice Chairman of the Fed, because the Congress disapproved his public comments favouring monetary ease.

In countries which do not have federal government structure, the appointment procedures are usually less complicated. In most countries the Prime Minister or the minister of finance appoint the Governor. His appointment is then typically confirmed by the President (or the Crown). In cases where more independence exists, the nominations are made after consultation and proposals from expert groups, government bodies or by the members of the parliament. Also, depending on the level of independence that the central bank has, the candidates and the members chosen may have different backgrounds. In this way, sectoral and regional representation is achieved.

TERM OF OFFICE, DISMISSALS AND REAPPOINTMENT PROCEDURES

A very important issue, which can affect the degree of independence of the central bank, is the term of office for the governors and the council. The supporters of central bank independence claim that in order to reduce the ability of governments to place quickly their own appointees in a dominating position, the terms of office for the board members and for the governors have to be relatively longer than the government's (longer than the electoral cycle). This would secure that the central bankers can pursue their long-term policies regardless of the government in power.

Of relevant importance is also the possibility and procedure of dismissals. The government should have the capability to dismiss a member of the central bank's council only in extreme circumstances and for very serious reasons. Moreover, the dismissal procedure must be clearly specified and justified in the central bank's statute, in order to prevent misinterpretations and misuse by the government. In this way, the members of the central bank board, and especially the governor, will have the power to exercise their duties without the fear of being removed for political or any other personal reasons.

Another complex issue is that of the reappointment of members of the central bank's board. If the term is non-renewable there are performance disincentives, as members know that they will not continue their duties. Also, it is quite unreasonable and unfair for members who have performed successfully, not to be able to continue their task. On the other hand, in the case that the term is renewable, the members of the board may be more vulnerable to external pressures (i.e. the government, public opinion, private sector) to achieve re-appointment. Therefore a careful examination of what is decided, regarding the length of term and the procedures of appointment, is required.

In Germany, the term of office for the President and the members of the Central Bank Council is eight years and renewable. The statute of the Bundesbank does not mention anything about the possibility of dismissals. However, as R.Effros (1994: 301) explains, the President of the Bundesbank as a member of the bank's Directorate holds office under public law. The latter does not permit the members' removal from office before the end of their term except for reasons which lie in their person and if the initiative comes from themselves or the Central Bank Council.

In the United States, the members of the Board of Governors (seven members) are appointed for fourteen years not renewable, and the seven terms are arranged so that one expires in every even-numbered year. The Chairman and the Vice-Chairman are appointed for four-year terms and they may be re-designated as long as their terms, as Board members, have not expired. In the Federal Reserve's statute there is no specific procedure for dismissals but the President of the United States may remove board members 'for cause'.

In New Zealand, the governor is appointed for staggered five-year terms. He can be dismissed by the Minister of Finance, whether or not recommended by the board, if the agreed targets are not achieved or if the Bank is not utilising its resources effectively. Board directors are appointed for three-year terms and can be removed from office by the government for unsatisfactory performance.

In general, we can say that the intention of most countries with independent central banks is to provide terms of office for at least five years, renewable[17]. With respect to dismissals as M.Swinburne and M.Castello-Branco (1990: 432) state, there is no clear pattern: "Directors or governors can generally be removed for relative technical causes, such as bankruptcy, criminal offences, major conflicts of interest, and so on". It has to be mentioned that the corresponding articles of the Maastricht Treaty (Article 14.2 of the Protocol), as we have stated in the first chapter, provides only a few general guidelines for the term of office of the governor. The term "shall be no less than five years" and the Governor can be relieved from office only if "he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct".

GOVERNING BODIES AND STRUCTURE

Having commented on the procedures of appointment for central bank governors and councils, we proceed to the equally crucial issues of structure, composition and voting processes of the governing bodies. It is very important for a central bank, especially an

[17] Spain is one of the few exceptions with non-renewable term (six-years).

independent one, to have a clearly defined structure and detailed procedure on the way decisions are taken in order to function in a smooth and transparent way.

As we stated on the previous section, the appointment of the governing bodies of the Bank, is either entirely or to a great extent, in the hands of the government. But, in an independent central bank, this is the point were the powers of the government should reach. Otherwise, we cannot talk of real independence. Unfortunately, as we acknowledged in Chapter III, even in the most independent central banks, governments are involved, directly or indirectly, in monetary matters much more than merely appointing the governing authorities. For this reason, the governing structure and the decision making process of the Bank, if set up in the appropriate way, can provide a framework by which monetary policy can be exercised in a more autonomous and credible manner.

A factor which is of significant importance concerns whether power rests on the governor, or the entire board of the Bank. If the former is the case then the importance of the procedure of appointment of the governor by the government is crucial. In order to ensure that the governor, who in this case has all the power, will not be a person closely related to the government, thus yielding to pressures, the appointment process has to be as non-political as possible and not of the form of a direct appointment.

If, on the other hand, authority rests on the entire board then the government's influence on board members might become indirect as there are other variables which have to be taken into account. Such variables are: the number of the governing bodies (is it just the Bank Council?); the number of the members of the governing bodies and the percentage of the members which are appointed by the government; the weight of each vote (has the governor's vote the same power as the ones of the rest of the members?); the possibility of participation of government officials on the board; and finally the capability of the government to overrule or delay a decision taken by the central bank.

In Germany, the governance structure of the Bundesbank, as already stated, is characterised by diversification. This of course, has much to do with the federal structure of the country. In this framework, monetary and credit policy is under the responsibility of the Central Bank Council (CBC). As stated, the CBC consists of the presidents of the

nine German state (Länder) central banks and the Frankfurt-based Directorate (it can have up to eight members). All members of the Council, the president included, have only one vote. The role of the President is seen as one among the rest who happens to represent the Bundesbank internationally. One of the special characteristics that the CBC has developed is its institutional consensus. Even when disagreements do exist among members and whatever opinion might the President try to enforce the final vote has until now been always unanimous. On the other hand, the Frankfurt Directorate is responsible for all administrative and analytic tasks and is the body that runs the everyday business. It requires an administrative decision to be taken by the entire Directorate, while all members must be present and no changes can be made against the President's vote. Finally, E. Kennedy (1991: 18-19), describes the Länder Central Banks (LCB) as main administrative branches of the Bundesbank, as well as listening posts for representative public opinion. She claims that "They differ from the Bundesbank Directorate in having a Managing Board responsible for running the LCB on a daily basis and an Advisory Board made up of representatives of local business, banking, agricultural and labour interests".

Apart from the fact that the German federal government is responsible for the appointment of the Directorate, it has no other direct powers over the conduct of monetary policy. Members of the cabinet have the right to attend the meetings of the Central Bank Council, and make proposals, but they cannot vote. The only 'overruling' power they have is that they (government officials) can veto a decision of the CBC by deferring it for up to two weeks.

An interesting change in the Bundesbank's Council composition was the additional appointment to the Directorate, as of March 1995, of an eighth member. The nomination of former EU Commissioner Peter Schmidhuber, who was a member of the Finance Minister Theo Waigel's party (CDP), was considered by the German press as a political appointment. Reuters News Service (1 March 1995) reported: "Bundesbank officials had been reluctant to see an expansion in the number of top officials but any recommendation from the central bank on appointments of new board members is in no way binding on the government, which has the final say".

The structure of the Federal Reserve System is quite similar with the one of the Bundesbank, in that it is decentralised and that it has three main bodies: the Board of Governors, The Federal Reserve Banks and the Federal Open Market Committee. The Board of Governors has seven members, including the Chairman and the Vice-Chairman, and its principal function is to formulate monetary policy. It has as well, other responsibilities such as supervisory and regulatory policies. The twelve Federal Reserve Banks (FRB), with twenty-four branches, are responsible for the implementation of the Federal Reserve's functions throughout the country. The diversity of representation in the FRB boards ensures their independence from direct political control and justifies them as genuine representatives of the public.

The Federal Open Market Committee (FOMC) is considered to be the key policy-making body since it is responsible for the implementation of monetary policy and the everyday handling of the open market operations. The FOMC is comprised from the seven members of the Board of Governors and five Reserve Bank Presidents, one of whom is the president of the Federal Reserve Bank of New York. The other Bank presidents serve one-year terms on a rotating basis. The FOMC has a regular schedule of eight meetings per year but telephone discussions and unscheduled meetings are held when needed. The votes are of equal weight and usually the majority of the members support the final decision. Although the Chairman's vote is almost constantly among the majority, there have been some instances (Miller in 1987 and Volcker in mid-1980's) where the Chairman was out-voted. However, Governors in regular cases avoid 'offending' the Chairman, as they are quite dependent on him. The Chairman can sometimes make the work of Governors uneasy since the latter need his assistance, as they have no staff of their own.

Finally, we have to mention that no government official can participate in the meetings of the Central Bank Council and no overruling power exists on the part of the government. However, meetings between Federal Reserve officials and administration officials occur regularly and are a matter of public record.

In New Zealand the situation is quite different. The Board of Directors' main role is not to participate in monetary policy formation but to monitor the governor's performance. The Board can have a maximum of ten directors (two of them are Deputy Governors), up

to seven of whom have to be 'outside Directors' (not central bankers) who must form the majority of any meeting. The Governor is the Chairman of the Board with one of the Deputy Governors as Deputy Chairman. The Governor is the one responsible for the conduct of monetary policy and the one who decides and agrees the policy targets with the Minister of Finance. The government has the ability to change the Bank's objective, for a maximum period of twelve months, stating publicly the reasons. It can also remove the Governor from office for failing to achieve the targets agreed. However, it cannot have a representative in the Board's meetings.

In other independent central banks the governance structure and the involvement of the government in monetary decisions is, as expected, diversified. There are central banks where there is corporate (the whole Board) responsibility for monetary policy as in France, Japan, Sweden, Switzerland, Finland, Belgium and Spain. In other countries, like Italy, Ireland and Canada, the responsibility for the conduct of monetary policy is in the hands of the Governor.
occurs

The Treaty on European Union does not provide a provision on this matter but it explicitly states that the national central banks are obliged not to seek or take any instructions from the governments or any other institutions or bodies (Article 107 of the Maastricht Treaty). Therefore, there is no possibility of government participation in monetary policy. Consequently, it has no overruling option. What must be made clear, however, is that by prohibiting a central bank and its members from seeking or taking instructions, does not mean that they cannot have informal means of communication with government officials. This occurs more or less in all central banks regardless of the degree of their independence. Moreover, the Treaty provides that ministers of finance or other representatives of the executive have the right to participate but not to vote in meetings of the Governing Council of the European Central Bank (Article 109b(1) of the Maastricht Treaty). Furthermore, even in countries (as Italy[18], the Netherlands, Australia and Canada) where there is an option for the government, in face of a conflict, to issue directives of what policy will be followed, that option has never in practice been used. Probably, this is happening because a public statement explaining the reasons of the

[18] In Italy, a representative of the Treasury may attend meetings of the Board and the Treasury has the right within five days to oppose the decisions made at the meeting.

issue of the directive, is usually required, something which could be politically costly for the government.

CENTRAL BANK ANSWERABILITY AND ACCOUNTABILITY

The majority of the arguments raised by the opponents of central bank independence are based, as analysed in Chapter III, on the assumption that if the control of monetary policy is on the hands of central bankers, there exists a major problem of accountability. Nobody disagrees that accountability in monetary matters is essential. As Alan Greenspan (1994: 253), the Chairman of the Federal Reserve System, admits "You cannot in a democratic society, have an institution which is either fully or partly dissociated from the electoral process and which has powers that central banks inherently have". The question is therefore, "how one positions the central bank with respect to the issue of disclosure and accountability". In the Federal Reserve Chairman's view the conclusion is that "we should make available to the electorate what it is we think, why we are doing what we are doing and in a general way under what conditions we would behave differently".

Having these views in mind and recognising the fact that this is the belief both of those who are in favour as well as those who are against central bank independence, we can focus with regard to accountability into three main questions: Who is accountable, to whom he should be accountable, and how can accountability be ensured.

The first question, who is the one accountable, depends much on the governance structure of the central bank. In the case where the governor is solely responsible for taking decisions, he is the one (legally) accountable. In the case, that the decisions are taken by the entire board, the situation is more complicated since you cannot hold responsible just the governor or, easily, fire the entire board in a case of failure. That is why, according to Professor Charles Goodhart (1994: 255), "there is greater need for

disclosure, if there is a board rather than if the responsibility lies with the governor individually".

The issue of to whom should the central bank, governor or board, be accountable, is quite simple. Ultimately, it will be accountable to the electorate and practically to an authority such as the executive, the legislative, the judicial, or to a combination of them. More importantly, it is necessary to clarify who will be the one to supervise and to evaluate the performance of the central bank in order for the former to be responsible and accountable to the public as well.

The final question we have raised, how can accountability be ensured, is the most important. There have been in practice four major ways of keeping the bank accountable and these are mostly common both to the independent and non-independent central banks. The first step, which is considered to provide transparency in the operations of the central bank and a way to measure its performance, is to oblige the Bank to announce its monetary targets. By this, it is believed that the Bank is in a way forced to achieve its targets since otherwise, it will be considered as failure. At the same time the public has a clear indication of what the monetary policy goal is and if it has been achieved or not. Of course, from the point of view of the central bank, this is sometimes considered as a limit to its independence since there are many reasons that can make a Bank 'miss' its targets and this is not necessarily an indication of failure. In practice almost all central banks set various targets regardless of whether they have by law to achieve them or not. Moreover, some make them public without being dependent on them.

The second measure, which is used by most central banks in order to enhance accountability and provide information about its actions on monetary and general economic matters, is the periodical reports the publish. All central banks issue an annual report which is usually addressed to the Parliament. Its purpose is to provide a review of the year and to inform about the objectives of the Bank for the following year, as well as present some general economic predictions and evaluations. Apart from that, in many countries there are much more frequent reports (usually quarterly and monthly) in order to inform about the everyday actions of the Bank. Also, many central banks issue various kinds of documentation in order to inform the public about general issues concerning the central bank.

The next provision, which is usually included in most central banks' statutes, is the governor's appearance in front of either the Parliament or a special committee for economic and monetary matters. In many countries the governor has to report, either regularly or on request, on the actions of the central bank and assess the monetary conditions and prospects. The Centre for Economic Policy Research (1994: 55), in its report for an independent Bank of England, has proposed that the committee responsible should call both the Governor and the Treasury minister in order to have from both sides comments on the Bank's activities, as well as for the actions of the government which might have implications for monetary policy.[19] The committee would then make a report to the House of Commons and the latter would then decide if there is a need for further actions. Of course if something like this happens often it would signify interference in the Bank's matters and would actually be a violation of its independence. That is why such appearances should take place only a few times a year or in very extreme circumstances. At the same time the central bank could inform both the government and the committee of its actions, on a regular but informal basis, so that no questions exist.

A final move, which can improve the accountability of the central bank, is to make public the meetings of the board. The supporters of this action believe that in this way the actual opinion and considerations of the members will be revealed and there will be further transparency on the way decisions are made. On the other hand, there are others, as Alan Greenspan (1994: 253), who claim that the immediate publication of certain contingencies instead of increasing stability has the opposite effect. Mr. Greenspan believes that it increases instability in the markets and makes the implementation of policy more difficult. Therefore the decision of whether one publishes those minutes and when is a very delicate matter.

The Maastricht Treaty Protocol requires the European Central Bank (ECB) to draw up and publish reports on the activities of the European System of Central Banks (ESCB). Apart from these quarterly reports the ECB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and the current year to the European Parliament, the Commission, and also the European Council. The European Parliament may hold a general debate on the report, while the President of the

[19] The Bill of May 1998, which established the independence of the Bank of England, did not mention anything about the appearance of the Chancellor in front of the Committee.

ECB and other members of its Executive Board may be heard by the committees of the European Parliament (Article 109b(3) of the Maastricht Treaty and Art.15 of the Protocol). The ECB council has, after its establishment in June 1998, decided not to publish the minutes of its meetings, since central bankers were afraid that in such a case there would be pressures from their countries to follow policies according to national instead of European needs. According to Otmar Issing, the ECB's chief economist, "making individual members' voting behaviour public would encourage undesirable scrutiny of members' voting patterns" something which would encourage external pressure on them (Financial Times, 23 September 1998).

Although the Maastricht Treaty refers to matters of accountability concerning the ECB, there is no reference on the national central banks. In Germany and Switzerland the central banks are not formally accountable to the government or any other authority. However, they publish monetary aggregate targets in order to inform the public. Apart from that, the Bundesbank is required to publish an annual report (but it is not presented to the parliament), whereas the Bank of Switzerland reports to its shareholders (it is not the government). It has to be mentioned that the proceedings of the Bundesbank's council are secret. They are not even recorded electronically and are not published until 30 years afterwards.

In the United States, the Federal Reserve is required to report twice a year to the Congress. Its Chairman and other members of the board may be called to report to various congressional committees. The Federal Reserve announces monetary aggregate targets but is not bound by its statements. The minutes of the meetings of the Federal Open Market Committee are published, but with up to six-week delay. In this way, people are aware of the policy preferences of the members.

In New Zealand, where the governor is the one responsible, the matter of accountability is quite simple. The governor has to succeed in meeting the monetary target set in agreement with the government otherwise he may be dismissed. There is a provision that the target can be varied from the one originally agreed if one of the following occurs: change in indirect taxes, a material change in terms of trade, a major domestic crisis and a significant change in the consumer price index (CPI) arising from changes in house prices or mortgage interest rates. The Bank is also required to issue an annual report and six-monthly policy statements to the minister of finance (tabled in Parliament) explaining

the policy adopted. Finally, as already mentioned, the governor's performance is monitored at all times by the board.

CONCLUSIONS

In this chapter we focused on the issue of personnel characteristics of a central bank, in order to understand what exactly it involves and how it can influence the operation and independence of a Bank. Having in mind the different approaches of personnel independence, as these were revealed from the various interpretations in a number of countries, it is now time to summarise the findings in order to draw some conclusions.

The first element concerning central bank personnel independence analysis is that of appointments. Regarding the question of who appoints the governors and the board members, it was seen that it is, in all cases, the government, wholly or partly. The involvement of the government depends on the degree of independence it desires to confer on the central bank. If the government wants to have as much control as possible then it usually makes the appointments independently. Alternatively, it can either choose from a list recommended by a committee, or else to appoint just a number of the members while the rest are chosen by a committee or even the central bank itself. From the existing experience however, it was observed that it has the final say and, with very few exceptions, it usually appoints the persons it desires in the key positions.

A related matter is the background of the members of the boards. The central bank needs to have a composition of the governing bodies with a mixed representation (both regional and sectoral), in order to be persistent to its monetary objectives and at the same time to have the ability to understand the needs of the general economy and the public. The Federal Open Market Committee, for example, has often been accused of being too technocratic due to the predominance of economists and career central bankers in relation to experienced politicians.

The next important aspect of appointments conserns the term of office and the conditions for reappointment and dismissals. There is a common support for terms of office to be at

least as long as the electoral cycle. Also, the possibility of renewals should follow a pre-specified transparent procedure in order to avoid the possibility of central bankers being tempted to try, by granting appropriate favours, to secure themselves a second term of office. Furthermore, the conditions of dismissal should follow a certain path with clearly analysed reasons. O. Issing (1993: 20) raises an interesting question regarding this issue, which stems from the fact that there never has been a dismissal, at least to the well known central banks. He wonders, "what value as a sanction does the legal possibility of dismissal at any time have, if it has never been used? Is that in turn evidence of the fact that the potential threat has been particularly effective, or rather that governments hesitate to employ this weapon?". Unfortunately, there are no definite answers to the above questions. There have been, in many cases, accusations of central bankers operating in a less independent manner in order to secure their position. Also, the case of the Chairman and Vice-Chairman of the Board of the Federal Reserve who are appointed for four years only and are often renewed is considered as a factor limiting the Bank's independence. The fact is, however, that in order for the central bankers to have real independence there cannot be loose reasons for dismissing them.

The same also applies in relation to the possibility of overruling the Bank's objective or a decision made by the central bank. The Centre for Economic Policy Research (1994: 67) proposed that "overrides of the Bank's objective should require Parliamentary approval, should be for a finite time (e.g. six months) though renewable with further Parliamentary approval, should be referred to as 'temporary suspension' of the Bank's objective, and should be provided for in the initial legislation". Although we believe that something like this should only be allowed in very extreme situations, the provisions for it to happen are believed to be the ones necessary. As S.Fischer (1994: 302) states "The government should have the authority to override the Bank's decisions, but the override decision should carry a cost for the government".

Things are a bit different in the situation, as is the case in New Zealand, where the governor is the main individual responsible for the conduct of monetary policy and he is the one who, in co-operation with the government sets the target to be achieved. In this case it is very specific what the central bank has to accomplish and the government is also involved in the decision. Therefore, an overruling option would be relevant only in a

situation where the government wanted to follow, for an emergency reason, a different objective.

In relation to the composition of the board and the power its members have, there is the issue of voting. The more diversified the composition of the board is, the more independence and wider representation of the electorate is achieved. There is, however the danger if, as in Germany, a percentage is elected from the local governments, that the political influence will be intense. E. Kennedy (1991: 19) claims that "some believe its (the Bundesbank's) federal structure is now outdated, claiming that it is too big and too expensive, and that the post of Länder Central Bank President has become a political sinecure for the party faithful in the Länder".

The final, but by no means the least important issue of personnel independence is that of accountability. It is, by everyone familiar with the subject, believed to be the element which can give to an independent central bank the extra power and credibility, if arranged correctly. In the main section, the issue of accountability has been connected to three questions: who, to whom and how. As mentioned earlier, the first two questions are simpler to answer since the first is either the governor or the whole board, depending on the governance structure, and the second is usually to some sort of government body or directly to the Parliament. The more complicated question is the third one, which relates to the process by which the central bank is held accountable. The methods used by most central banks are the announcing of targets, the publication of the minutes of the board meetings, the issue of reports, and the appearance of central bank top officials before the Parliament or committees. In general, we can say that the issue of accountability is a matter of informing the public and the government, of the central bank's policies. This is particularly important since the central bankers are not elected and in the case of independence, there is a need for credible and transparent ways to accompany the conduct of such an important element of the economy, as is monetary policy. Most central banks are publishing reports which are presented to the Parliament or to a special committee. An exception to this is the German Bundesbank and the Swiss National Bank that do not have any obligation to appear before anyone but nonetheless, issue reports. The interesting thing is that these two central banks are considered to be the most independent and most successful in the fight against inflation, probably owing much to the above fact.

The setting of monetary targets is something that most central banks do, whether they are obliged to or not, as it is a means of checking the efficiency of the policy followed. What is not universal is the announcement of targets. The fact is that for the government and the public such announcements make the central banks more accountable and credible since in a way they oblige them to achieve these targets.

Finally, whether it is preferable to publish the minutes of the board meetings and of any contingencies that occur or not, is something that is still open to discussion. The advantage of such a provision is that the public is aware of the real conditions behind decisions and of each member's position. The danger on the other hand, is that in many cases the publication of certain contingencies can increase instability in the markets. Eddie George, the Governor of Bank of England, is in favour of having these minutes public and provides another side of the issue (1993: 255): "What we had, before we went to publishing the minutes of my monthly meetings with the Chancellor, was a great deal of speculation about the nature of the discussion process which greatly exaggerated the extent of the differences". Of course the difference in this case is that the Bank of England was not independent at that time and a discussion took place between the Bank and the government on monetary policy. The same speculation, however, could occur regarding the positions of the board members of an independent central bank. A solution can be to delay the publication of these minutes for some time.

Personnel independence and the issues it involves are particularly important for a central bank in order to operate autonomously. Nonetheless, issues of functional independence also play a very important role. Functional independence, as will be analysed in the following chapter, is the one which actually tests whether the institutional provisions set for personnel independence are adequate.

Chapter V: Institutional Characteristics of an Independent Central Bank: Functional Independence

CONTENTS OF FUNCTIONAL INDEPENDENCE

Functional or operational independence, as Rolf Hasse (1990: 117) states, refers to the "central bank's room for manoeuvre in the formulation and execution of monetary and foreign exchange policy". This dimension of a central bank is the one which actually tests the level of independence in its every day operations. A central bank is considered truly independent only if it is responsible both for implementing monetary policy and, especially, for determining or formulating its content. Functional independence involves the following issues: specification and narrowness of primary objectives; setting of intermediate targets; choice and utilisation of monetary instruments; and responsibility and implementation of foreign exchange policy.

Apart from the above operational issues, the central bank is also engaged in other activities which can influence the degree of its functional independence, such as managing the national debt, supervising and regulating the banking system, acting as banker to the government and the banks, and managing the currency issue. In this section, these activities will be examined to see whether, and in what way, they can affect the conduct of an independent monetary policy.

The aim of this section is to analyse the different means and practices of monetary policy in order to assess the impact on the degree of central bank independence. References will be made to cases of established independent central banks - in particular to the ones of Germany, of USA and of New Zealand – in order to provide a more empirical evaluation of the way particular functional arrangements secure greater independence in the operation of monetary policy.

STATUTORY OBJECTIVES

One of the most, if not the most, fundamental aspects of the issue of functional independence is that of the goal of a central bank. Most countries have sought to provide some directions or even specific objectives in their central bank's statutes. In these cases there is almost always some reference either directly or indirectly to the objective of price stability. Brian F. Madigan (1994: 112) defines price stability as "a condition where inflation is sufficiently low that is not a consideration in businesses' and households' financial decisions". In practice most contemporary central banks when speaking of price stability they refer to the attainment of a rate of consumer price inflation of two percent, or less.

Also the many central banks' objective 'to preserve the value of the currency' is generally regarded to be equivalent to 'maintain price stability'. In addition to this goal, some countries have also set out in the central bank statutes some other economic goals, such as sustaining maximum employment, promoting development, and maintaining a safe and sound financial system.

The argument in favour of multiple objectives is that monetary policy cannot be separated by the other economic policies, and in particular fiscal policy. As Lord O'Brien of Lothbury (1977: 18-9), a former governor of the Bank of England, stated: "preserving the value of the currency cannot be the only purpose and, I suggest, it should not always be the prime purpose. Other economic purposes of government, such as achieving growth and sustaining employment, are too closely related to the value of money to be seen in isolation. All policy instruments should be used in harmony to achieve a balance of objectives". The problem however that arises in the case of multiple objectives is a very crucial one: does one of these objectives should have precedence over the others in the event of a conflict between them, or is it each time in the discretion of the central bank to decide which should have priority?

There are various reasons, on the other hand, why one would expect more independent central banks to have more narrowly defined statutory objectives (usually that of price stability). Firstly, since price stability requires a stable monetary policy, the central bank

cannot have simultaneously other policy objectives, especially if these often conflict in the short run with firm monetary policy. Secondly, if the central bank has other objectives such as growth and employment, or balance of payments, or even stabilising the value of the currency, this would mean that the central bank has to negotiate at all times with various organs of government and therefore risk being influenced by them. Thirdly, the existence of multiple or unclear objectives would not promote effective accountability of both the central bank and the government. It would be extremely difficult to hold the monetary authorities accountable for their actions if their objectives are not clearly specified and hierarchised. Policy failure with respect to one objective can be very easily excused by accusations of other objectives. Finally, but probably most importantly, there is the issue of credibility. Monetary policy, as we have already mentioned in the previous chapters, is ultimately based on the perceptions of the public. Central bank independence above all else is supposed to deliver advanced credibility and stability. If, however, the objectives of the central bank are multiple and vaguely expressed then the public expects at any time policy reversals and changes in targets, thus making monetary policy credibility very weak. It is for the above reasons that a single and clearly defined price stability objective is considered essential for the effectiveness and reputation of an independent central bank.

However, to avoid neglecting those economic conditions which are not directly associated to monetary policy, the legislators of most independent central banks have ensured that the Bank should also support the general policies of the government without prejudice to the prime objective. The Maastricht Treaty provides that the ESCB shall "define and implement the monetary policy of the Community" and that "the primary objective of the ESCB shall be to maintain price stability" (Article 105.1 of the Maastricht Treaty). Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a" (Article 105.1 of the Maastricht Treaty). On 13 October 1998 the Governing Council of the ECB announced its quantitative definition of the ESCB' s primary objective, namely price stability. Price stability was defined as a year-

on-year increase in the Harmonised Index of Consumer Prices (HICP) for the Euro area of below 2%.

The Bundesbank Law defines that the Bank is responsible for the formulation and implementation of monetary policy with the aim of "safeguarding the currency" (Bundesbank Law Paragraph 3). It furthermore states that "without prejudice to the performance of its functions, the Deutsche Bundesbank shall be required to support the general economic policy of the Federal Government" (Bundesbank Law Paragraph 12). In New Zealand, under the 1989 Reserve Bank of New Zealand Act, the Reserve Bank has as a single objective to ensure price stability, and this is defined in the Policy Targets Agreement reached between the central bank and the government. There is as well some acknowledgement of the need for concern about the efficiency and soundness of the financial system. In the United States the Federal Reserve System has multiple goals. Section 2A of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act) specifies that the Board of Governors and the Federal Open Market Committee are required to "... maintain long-run growth of the money and credit aggregates commensurate with the economy's long-run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates". It is worth mentioning that four of the members of the European Union, Belgium, Italy, Sweden, and the U.K. do not have any specific objective, but they all implicitly conduct monetary policy in such a way as to safeguard the currency and to promote price stability.

INTERMEDIATE-TERM MONETARY POLICY GOALS

Although a clear and single objective of price stability is considered essential for an independent central bank, it is still too vague to direct short to medium-term monetary policy. Most central banks use intermediate-term monetary policy goals or targets in order to promote the attainment of the long-run policy objective. As the CEPR (1993: 21) states "[monetary policy targets] interpret how underlying objectives [e.g. price

stability] should best be pursued in current circumstances and in recognition that different stances of monetary policy have differing short-run implications for the real economy; and they may serve to signal both the Bank's assessment and its determination". The different approaches with regard to monetary policy goals rests primarily on the authority responsible for the choice of the goal, and also on the specific chosen goals or targets.

Central banks that have the authority by statute to determine or formulate alone the content of monetary policy have the freedom to choose both the particular goals they find appropriate as well as their range. On the other hand, central banks which are not independent in choosing their monetary stance have to achieve, formally or informally, the target which has been set by the government.

Various countries use different strategies for targeting. The most common ones are monetary aggregates targeting and direct inflation targeting. Some countries also use exchange rate targets and interest rate targets. The main advantage of monetary aggregate targets is that they clearly indicate the responsibility of the central bank for developments that are both easily observable and under its more direct control. However, there have been many cases in the past where the relationship between monetary aggregates and interest rates or nominal income has been unstable and unreliable.[20] On the other hand, inflation targets have the advantage that they directly stress the responsibility of the central bank for achieving and maintaining price stability. The danger is that monetary policy actions that correspond to inflation developments are usually taken after considerable delay due to the time lags that exist. Exchange rate targets are usually used by countries with weak currencies which peg to an anchor currency to gain from the stability of the strong currency. Finally, interest rate targets although they have the advantage of being closely controllable, also have the difficulty in identifying the equilibrium real interest rate that would be consistent with price stability.

In order to have a clearer assessment of monetary policy, central banks often use as complementary tools indicator and information variables. Indicator variables are not targeted by the central bank, but provide reliable signs as to the stance of monetary

[20] The Bundesbank, which is the main advocate of money supply targeting, has often missed in the past its targets, although just by some decimal points.

policy. Information variables, on the other hand, provide important information about aggregate demand and inflation pressures, but vary considerably depending on economic and financial circumstances.[21] The following are considered indicator and information variables: credit aggregates; the slope of the yield curve; commodity prices; and data on employment, production, and expenditures (see Madigan, 1994).

The choice of the appropriate monetary policy targets for a central bank is influenced by various factors. The EMI in its report on the operational framework for monetary policy in stage three of EMU (1997: 7) states that in choosing a strategy two things must be taken into account: "a set of normative principles designed to guide its actions, and the economic and financial environment within which it [the central bank] is operating". The principles for assessing monetary policy strategies according to the EMI are: effectiveness towards price stability, accountability to the public, transparency of target setting process, medium-term orientation, continuity with gained experience, and consistency with independence.

The Maastricht Treaty has not specified any particular target to be used by the ESCB. Article 109f (3) of the Treaty stipulates in its last paragraph that: "the EMI shall specify the regulatory, organisational and logistical framework necessary for the ESCB to perform its tasks in the third stage. This framework shall be submitted for decision to the ECB at the date of its establishment". The EMI has identified two potential candidate strategies, namely monetary targeting and direct inflation targeting. Furthermore, the EMI (1997: 8) in its assessment of the two strategies states that "the borderlines between the two sometimes are less distinct than in theory. Common to both strategies is the fact that they are based on the same final objective – price stability; they are forward-looking; and in practice a wide range of indicators are employed under both strategies to assess the appropriateness of the monetary policy stance. The main factor limiting the two strategies is the role played by monetary aggregates".

In the most known central banks we cannot distinguish any particular pattern for the choice of targets. Although lately there is support for inflation targeting, following the New Zealand success, three of the most famous independent central banks, the US

[21]The terminology of targets, instruments, and indicators was formalised by Brunner and Meltzer, 1967; Brunner, 1969; and Friedman, 1975.

Federal Reserve,[22] the German Bundesbank, and the Swiss National Bank, target monetary aggregates. It has to be mentioned however that the globalisation of the markets and the complexity that characterises today's monetary policy forces almost all central banks to regularly monitor most of the targets and variables analysed in this section. On 13 October 1998 the Governing Council of the ECB Council outlined the two main elements of the strategy that it will use to achieve the objective of maintaining price stability. First, a prominent role will be assigned to money. This role will be signalled by the announcement of a quantitative reference value for the growth of a broad monetary aggregate.[23] Second, in parallel with the analysis of developments in the monetary data in relation to the reference value, a broadly based assessment of the outlook for price developments and risks to price stability in the Euro area will be undertaken. This assessment will encompass a wide range of economic and financial indicator variables.

MONETARY POLICY INSTRUMENTS

Central banks have enormous power and advantage in their dealings with other banks and financial institutions. Central banks have the money that all other institutions want in order to operate. For this reason, central banks have the ability, at least in theory, to set short-term interest rates at virtually any level they want. In practice, however, they try to keep interest rates around some desired level, due to their longer-term policy objectives. In such a way they intend to avoid or minimise disturbances in the financial system.

By directly or indirectly influencing liquidity conditions and interest rates, monetary authorities seek to control interest rates and the banks' capacity to attract deposits and expand credit. C.J. Lindgren (1990) divides monetary control instruments into direct and

[22] Congressman Stephen Neal proposed in a bill in 1989 a goal of zero inflation by 1995, something that has not been approved.

[23] The reference value will refer to the broad monetary aggregate M3. M3 will consist of currency in circulation plus certain liabilities of Monetary Financial Institutions (MFIs) resident in the euro area and, in the case of deposits, the liabilities of some institutions that are part of central government (such as Post Offices and Treasuries). These liabilities included in M3 are: overnight deposits; deposits with an agreed maturity of up to two years; deposits

indirect according to the way they influence the amount of money and credit, liquidity, and interest rates. Selecting and setting monetary instruments are the minimal features an independent central bank should have under control. The CEPR (1993: 32) has emphasised the above by mentioning that "the essential change that independence would introduce to the daily conduct of monetary policy is that ultimate responsibility for decisions on levels of short-term interest rates would shift from government ministers to the Bank, which would no longer act as their agent in this respect". Even non-independent central banks sometimes have this option since their technical abilities and expertise is considered essential for the conduct of such complicated and delicate tasks.

Central banks usually rely on three different sets of monetary instruments: standing facilities, open market operations, and minimum reserve requirements.

Standing Facilities. The purpose of standing facilities is to absorb or provide liquidity by bounding overnight interest rates. The decisions of the central bank in respect to standing facilities signal the general stance of monetary policy. There are usually two standing facilities that central banks regularly use: the *marginal refinancing facility* and the *deposit facility*. The marginal refinancing facility is used to help the members of the banking system to satisfy temporary liquidity needs. The interest rate set by the central bank on end-of-day lending facilities is usually above market rates, thus providing a ceiling for the overnight market interest rate. The deposit facility permits banks and other financial institutions that are excessively liquid to make overnight deposits with the central bank. Under normal circumstances the interest rate on this deposit facility actually sets a floor for the level of short-term money market rates.

Open Market Operations. Open market operations is the most flexible and market-based instrument for monetary policy. An important advantage from the point of view of the central banks is that they do not imply subsidies or implicit taxes and make use of market mechanisms in distributing liquidity, steering interest rates, and passing policy signals. Most central banks use open market operations on a regular basis as well as for fine-tuning purposes. The most common type of open market operations used by central banks is the *reversed transactions* (also known as "repo operations") in domestic

redeemable at notice up to three months; repos; debt securities with maturity of up to two years; unit/shares of money

securities. Under these transactions the central bank lends to the banking system, using some kind of financial security as collateral. Reverse transactions apart from the above mentioned benefits of general open market operations, are used to provide the majority of refinancing to the financial sector. Longer term liquidity-providing reverse transactions (monthly frequency and three months maturity) usually act not as senders of signals but mostly as rate-takers. Other open market transactions which are basically used as fine-tuning operations to smooth the interest rate effects on unexpected liquidity fluctuations include: outright purchases of securities, foreign exchange swap transactions, issue of short-term paper, and collection of fixed-term deposits.

Reserve Requirements. Reserve requirements are a form of tax on the banking system. Under this arrangement banks and financial institutions in a country are obliged to hold deposits with the central bank. Although a system of reserve requirements is not very flexible and is opposite to the idea of liberal global capital markets it is always considered as a very effective weapon on the disposal of a central bank. Reserve requirements are used mainly to stabilise money market interest rates, to create or enlarge a structural liquidity shortage and to contribute to the control of monetary expansion.

In the Maastricht Treaty there are no provisions for the monetary policy instruments to be used by the ESCB. The ECB has published in September 1998 a report that contained a detailed description of the monetary policy instruments and procedures to be applied by the ESCB in Stage Three of Economic and Monetary Union. The main instruments will be open market operations (the main refinancing operations, the longer-term refinancing operations, fine-tuning operations and structural operations) and two standing facilities (the marginal lending facility and the deposit facility). Also at its meeting on 13 October 1998 the Governing Council of the ECB decided to impose a reserve requirement ratio of 2%.

market funds and money market paper (net).

FOREIGN EXCHANGE POLICY

One of the most important aspects of a country's general economic policy is foreign exchange policy. Today, due to the globalisation of markets, the free movement of capital between countries, and the importance of currency movements, foreign exchange policy plays an even more important role in everyday life. In such an environment, monetary policy and consequently central bank independence depends heavily on the foreign exchange arrangements due to the close relationship between the two policies. The problem is that in no well-known central bank, apart from Sweden's, has the government ever been willing to delegate total control of foreign exchange policy to the central bank.

Carlo Cottarelli (1994: 332) has divided foreign exchange policy into five major responsibilities: the choice of the exchange rate regime (e.g. fixed, float, float within a band, etc.); the choice of the parities in a fixed regime or under a limited float; the setting of 'directives' within managed floating; daily decisions on exchange rate interventions; actual execution of intervention policy.

The choice of the exchange rate regime is of essential importance for the independence of a central bank. As M.Swinburne and M. Castello-Branco (1994: 436) state "the more that the exchange rate is managed, the less the freedom to choose a monetary policy that differs from that prevailing internationally". In a fixed exchange rate system the central bank essentially loses any autonomy of decisions, as it is forced to follow the policy of the 'anchor currency'. On the contrary, under floating rates the central bank retains its monetary powers since it is not constrained by the exchange rate.

Having two independent policymakers – the central bank for monetary policy and the government for exchange rate policy - to achieve two different targets, may create inconsistencies, cause conflicts, and may even force one of the two policymakers to give up its independence. C. Goodhart (1993: 7) argues that "the central banks have only one major instrument, their ability to vary interest rates. As a generality this cannot be used to hit two objectives simultaneously, e.g. an external objective for the exchange rate and an internal objective for price stability, except by a fluke".

The conclusion according to Stanley Fischer (1994: 304) – and many others like C. Cottarelli agree - is that "the government cannot have control over exchange rate policy while the central bank has control over monetary policy. The government should have the authority to choose the exchange rate regime" while the central bank should be responsible for the exchange rates and the parities of the currency.

With the exception of Sweden, no other central bank has ever been given total responsibility for foreign exchange policy. In some countries, like Spain, Austria, Portugal, and Finland, as well as in the provisions of the Maastricht Treaty,[24] the government sets the regime after consultation with the central bank - a provision that is not at all binding for the government. In most other countries the central bank implements exchange rate policy, while the government is the one responsible for the determination of the exchange rate regime and the parity of the currency.

BANK SUPERVISION AND REGULATION

Nobody objects to or underestimates the close relationship between the banking and financial system on one side and the central bank on the other. The actions of central banks with regard to monetary policy determine to a great extent the behaviour and effectiveness of commercial banks and other financial institutions. A very important aspect for the soundness of the banking system is the issue of who is responsible for their supervision and regulation. There has always been a debate on this issue and in particular on the role of the central bank.

According to R.M. Lastra (1996: 108) bank supervision is a process with four stages or phases: licensing or chartering or authorisation for starting operations; monitoring of the soundness and safety; sanctioning; and crisis management. Bank regulation as Lastra

[24] Article 109 of the Maastricht Treaty provides that the European Council in determining and setting foreign exchange policy shall act on recommendation from the Commission and after consulting the ECB. It furthermore provides that the Council's general orientations for exchange rate policy shall be "without prejudice to the primary objective of the ESCB to maintain price stability".

defines it "is the establishment of rules, both acts of the legislator (Congress or Parliament), and statutory instruments or rules of the competent authorities".

Many supporters of central bank independence claim that the central bank should not be the one supervising the banking system, since a central bank responsible for supervision may be tempted or pressed to follow a loose monetary policy if this would facilitate the needs of the banking system. This however, could mean conflict of interest with the requirements for price stability. In an event of bank failure the central bank will be held responsible and will lose its reputation and credibility. The Bank will have to delegate a lot of effort, time and resources to cope with its supervisory and regulatory functions, thus being distracted from its main objective(s). The above claims have also empirical support, as surveys by R. Heller (1990) and C. Goodhart & D. Schoenmaker (1993) have shown that central banks without supervisory responsibility have a better inflation track record.

The main arguments in favour of central banks being involved in supervision and regulation are the following: "the central bank has great concern for the smooth operation of the payments systems and therefore would be logical to supervise and regulate the banks and other institutions with which it does business; There are close links between monetary policy and instruments of supervision, such as liquidity guidelines, accounting standards, and capital adequacy rules; The central bank with its experienced and technically competent staff, as well as with its long tradition in dealing with the banking system is considered the most qualified institution to deal with bank supervision and regulation".

All these arguments clearly have an important point to stress and thus the decision on whether the central bank should supervise and regulate the banking system is not, as expected, the same throughout the world. Some countries have delegated this responsibility to the central bank alone, others to the central bank in co-operation with some private or public agency, while others to a branch of government.

In Germany, banking supervision is delegated to the Federal Regulatory Agency (CRA), an autonomous body in the ministry of economics. In cases of serious banking mismanagement which could affect the German economy, the Federal government is

required by law to seek the opinion of the Bundesbank. The CRA is required by law to manage its oversight of the banks and the other institutions in a way that supports the policy of the Bundesbank. In the United States, the Federal Reserve shares responsibility with the Federal Deposit Insurance Corporation (FDIC), and the Comptroller of Currency, whereas in New Zealand the Reserve Bank has sole responsibility for supervision.

The Maastricht Treaty does not include any specific guidance for supervision. Article 105(5) of the Treaty, mentions that "The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system". Furthermore, Article 25 of the Maastricht Treaty Protocol mentions that "the ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system".

OTHER TASKS AND RESPONSIBILITIES

The purpose of this section is to briefly present and discuss some tasks and responsibilities that are often undertaken by the central bank.

Note-Issue. Note-issuing has always been one of the primary functions of central banking. The overwhelming majority of central banks have a monopoly power over this function, although in some countries they share responsibility with other agencies. As R.M. Lastra (1996: 250) states this privilege of central banks enables them to "control seigniorage (i.e., the margin between the nominal value of the notes issued and the costs of their production) and to determine the volume of note-issue".

Payment System Services. The promotion of the smooth operation of payment systems is another function that the central banks throughout the world undertake. The payment

systems function encompasses the clearing and settlement of cheques and electronic payments. The Maastricht Treaty provides that this function of the ESCB shall be among its basic tasks. (Article 105.2 of the Maastricht Treaty)

Banker's Bank. This role is also a traditional one for central banks. It involves, apart from the acceptance of deposits of prudential bank reserves, the lender-of-last-resort function. This function is essential for the banks since the central banks provide them with "extraordinary" credit or emergency lending when they need it. The lender-of-last resort function is closely related to other central bank functions such as: note-issue, prudential supervision, and setting of discount rates.

Government's Bank. It is a standard practice for the central bank to act as the government's bank. Traditionally, the central bank acted as its direct or indirect lender, its fiscal agent, its adviser, etc, but since the Maastricht Treaty (Article 104.1) the rationale for independent central banks prohibits or limits the overdraft or credit facilities from the central bank to the government. This function of a central bank is closely related to the issue of financial independence, since if the government has direct access to the central bank's credits it can influence the central bank's monetary stance. In order to avoid such possibility many central banks have absolute power over their resources and can enjoy financial and budgetary autonomy. In the US, the Federal Reserve enjoys the above-mentioned privileges, while the German Bundesbank has the ability to prepare and approve its own accounts. Financial independence of the ESCB is also provided in the Maastricht Treaty through articles 26-33.

Official Reserves Management. This task is associated with their monopoly of note-issue. Although the government is usually the one responsible for foreign exchange policy and owns the foreign exchange and gold reserves of a country, the central bank usually holds and manages the official monetary reserves. In the US and in the UK the central bank only manages the official reserves while agents of the Treasury hold them[25]. The Maastricht Treaty, however, specifically provides in Article 105.2 that one of the

[25] In the US gold reserves are held by the Secretary of Treasury for the account of the Exchange Stabilisation Fund (ESF), while some foreign currency reserves are held by the Federal Reserve while others by the ESF. In the UK the official foreign reserves are held by the Exchange Equalisation Account (EEA).

basic tasks to be carried out by the ESCB shall be to "hold and manage the official foreign reserves of the Member States".

Other Tasks. Some other tasks that some central banks undertake are safeguarding financial stability, promotion of financial centre, debt management and exchange controls. However, these tasks, and especially the last two are incompatible with central bank independence and most central banks are abandoning these tasks.

CONCLUSIONS

The issue of functional independence above all deals with the capability of the central bank to concentrate on its primary objective for monetary policy. It allows the central bank to carry out those functions and responsibilities that are absolutely necessary for the achievement of its targets. By its nature, the Bank will communicate at all times both with the banking sector and with the government. The crucial issue, however, is to be able to conduct monetary policy without being influenced by their short-term needs. Success in monetary matters is based on credibility and transparency.

This thesis considers that the central bank arrangements with regard to functional independence have to include above all a single, clear objective, for only then is the Bank able to use its instruments efficiently, accountably and credibly. In a case of multiple objectives it will always have to make compromises and to give way to pressures. Furthermore, only by a clear objective will the public and the markets be able to evaluate the performance of the central bank.

The alternatives of monetary policy targets and instruments are not by themselves issues which can influence the independence of the central bank. Rather, this is determined by the ability of the central bank to make its choices of targets and instruments independently. If the government or any other body are allowed to intervene or even

determine the targets to be achieved and the instruments to be used, then the central bank cannot be truly independent.

The same applies to the issue of foreign exchange policy. The arrangements for the regime, the parities and the exchange rates can all nullify the meaning of independence. Since most governments, however, are unwilling to delegate all foreign exchange responsibility to an independent agent they should at least co-operate with it on the issue of the regime and let it control all other aspects. The potential conflict between monetary and exchange rate policy is otherwise very likely to arise.

All the other issues of functional independence we have analysed might be significant for the proper functioning of the banking and financial sector but they are essentially tasks which can be exercised by other agencies or institutions, public or private. Whatever the choice of the legislators, central banks will always have some formal or informal involvement in issues like bank supervision, payment system functioning, note-issue and lender-of-last resort since they are closely related to their monetary operations. The best possible solution would be for the bank to be involved only in cases of emergency and at all other times to have some other agency conducting everyday operations.

The crucial issue, however, is that even if the central bank is in all respects independent it will always be affected by the rules and conditions prevailing in the country. A central bank is not isolated from the rest of the social, economic, and political institutions with which it comes into contact through its policies. The purpose of making it as much independent as possible is not to create an un-elected and untouchable superpower that will determine the course of a country's fortune, but to protect it from everyday politics in order to achieve the essential long-term economic goal of price stability. In order to achieve this, the necessary functional independence arrangements have to be carefully and precisely specified.

Chapter VI: The Independence of the Bank of France

Having analysed what central bank independence is about, how particular characteristics can influence the course of monetary policy-making and the power balances between the central bank and the government, we now proceed to the core subject of this study: the process, motives, provisions and implications of the French, Greek and UK central bank reforms.

The Bank of France is an institution that has always played a significant part in France's economic policy management despite the fact that for most of its history it has been under the, direct or indirect, control of the government. This chapter aims to identify and analyse the reasons, conditions and importance of the decision of the French government to grant in 1993 independence to the Bank of France.

The chapter first examines the historical role, organisation and independence of the Bank of France in order to obtain an idea how the Bank operated before the reform and consequently understand how the change affected it. The second section analyses briefly the economic and political developments in France during the 1980s and early 1990s. This examination is considered essential as it provides the general national and international policy environment and philosophy of the French politicians in the period before and during the reform. It is suggested that the idea, acceptability and character of the Bank of France's reform has been significantly affected by the general political, economic and institutional framework prevailing at the time. The above is proven by the examination in the third and fourth sections of the idea, the plans and eventual adoption of the Bill by the French Parliament. The study of the course of events reveals the stance and views of the main actors since the first time the subject of independence was raised thus providing all the necessary information for the analysis and extraction of conclusions, which is done in the final two chapter sections.

ROLE, ORGANISATION AND INDEPENDENCE OF THE BANK OF FRANCE

A HISTORICAL OVERVIEW OF THE ROLE OF THE BANK OF FRANCE

The Bank of France was created on 18 January 1800 by the then First Consul Napoleon Bonaparte, to promote economic growth after the deep recession of the Revolutionary period. The initial task of the Bank was to issue bank notes (restricted only to the city of Paris) payable to the bearer on sight in exchange for discounted commercial bills. Under its original statute of 13 February 1800, the Bank of France was a private enterprise that remained independent of the government.

The initial independence of the Bank lasted only six years as Napoleon introduced in 1806 reforms that gave the government more influence over the management of the Bank. He replaced the Central Committee, which governed the Bank until then, with a governor and two deputy governors appointed all by him. After only two years Napoleon defined with an imperial Decree dated 16 January 1808 the "Basic Statutes" of the Bank of France, which were to rule its operations until 1936. The emperor declared that he wanted the Bank "in the hands of the State but not completely!". (Le Nouvel Observateur, 29 April – 5 May 1993)

For over a century the Bank of France remained a private establishment. Gradually the Bank expanded its operations to other towns and after 1848 it took over the right of note issue from the local banks. The political and economic crisis in 1848 led to the establishment of the Bank's notes as legal tender that the government and individuals had to accept as means of payment (until then it was not obligatory). By 1928 the Bank had expanded its branch network significantly reaching 258 sites. Also the Bank was charged with new missions such as assistance in the financing of the economy through moderate interest rates and discount facilities, advances against securities, intervention in the foreign exchange markets to maintain the value of the currency and finally handling the Treasury's cash transactions.

In 1936, the new government of "Popular Front" under the Act of 24 July 1936 reformed the Bank in order to have a more direct influence over its management. Twenty Councillors replaced the fifteen Regents who sat on the General Council, administering

the Bank. Although the Bank remained private the shareholders elected only two Councillors, the Bank's personnel one, while all the rest were government appointments to represent economic and social interests as well as the general interest of the nation.

The actual nationalisation of the Bank of France came with the Act of 2 December 1945 when its capital was transferred to the State. The government became responsible for all nominations but recognised some autonomy in the management of the Bank.

The statutes of the Bank of France were reformed once more with the Act of 3 January 1973 due both to the organisational changes that have occurred after its nationalisation as well as to its new activities and in particular the control of credit. The Act defined the Bank's main objectives and responsibilities so as to allow enough flexibility in its operations and intervention in the markets. The powers of the General Council were also enhanced and its members were no more appointed on the basis of the various economic and financial sectors they represented but solely on their personal competence.

In general, although the Bank of France has been under the shadow of the Treasury since its nationalisation, its governors have tried to manifest their spirit in favour of independence vis-à-vis the government and conduct the Bank's affairs regardless of political pressures. The autonomy of the Bank in monetary matters has increased considerably since the mid-eighties together with the deregulation and liberalisation of financial markets and was finally established by law in December 1993.

THE STATUTE OF THE BANK OF FRANCE BEFORE INDEPENDENCE

The statute of the Bank of France[26] until the Act of 4 August 1993 (n° 93-980), amended 31 December 1993, which changed its status provided the following main provisions:

The Governing bodies of the Bank of France are: the Governor, two Deputy Governors and the General Council. The General Council includes the Governor and Deputy Governors (appointed by the President of France on a decision by the Government) and ten Councillors (nine appointed by the Minister of Economic Affairs

[26] The legislation under which the Bank of France was regulated until the reforms of 1993 was based on the Act of 3 January 1973 and by the Decree of 30 January 1973. Furthermore, there was other legislation which applied to the Bank of France such as the Banking Act of 24 January 1984, the Act of 30 April 1983, the Act of 24 July 1966 and some other Decrees.

and one by the personnel of the Bank). The General Council's main task is the general administration of the Bank and the use of its funds. There is no fixed term for the Governors whereas the Councillors are appointed for six years. A representative of the Minister of Economic Affairs attends the meetings of the General Council and has a suspensive veto.

According to Article 1 of the 1973 Act, "the Bank of France shall be the institution to which the State assigns the general task of watching over the currency and the supply of credit within the framework of the economic and financial policies of the nation. In this connection, it shall ensure the proper functioning of the banking system". In practice, the most important decisions are often taken jointly by the central bank and the Minister of Economic Affairs, although the Minister generally has the last word.

The Bank of France operates in close co-operation with the National Credit Council (Conseil National du Credit) and the Bank's Supervisory Commission (Commission du Controle des Banques) in implementing Government credit policy. The National Credit Council (NCC) has powers to implement monetary policy.[27] The Minister of Economic Affairs is chairman of the above institutions, but in practice the meetings are normally chaired by the Governor of the Bank of France in his capacity as Vice-President.

The Bank's main tasks are to implement the exchange rate policy, administer the foreign exchange reserves of the country and state finances, monitor the credit expansion, issue bank notes, regulate and supervise the banking system, and ensure the smooth operation of the payment systems.

NEW DEVELOPMENTS FOR FRANCE AND ITS CENTRAL BANK

FRENCH ECONOMY AND POLITICS IN THE 1980s AND EARLY 1990s[28]

The election of Francois Mitterrand as President of the French Republic on 10 May 1981 and that of the 'Parti Socialist' (PS) as government a month later signalled a significant

[27] The powers of the NCC have been transferred to the Banking Regulation Committee (Comite de la Reglementation Bancaire) which has been constituted within the NCC according to the Banking Act of 24 January 1984.

transformation in French politics. After decades of right wing governments in power the socialists regarded their victory as a great chance to "break with the capitalist system and to construct a new social and economic order in accord with its 1972 slogan of 'changer la vie'" (James McMillan (1992: 206)). According to the socialist programme France's prosperity would be best achieved through three major reforms: nationalisations of industrial groups and major banks, labour reforms to strengthen workers rights and decentralisation of public administration. (See Daley, 1996)

In 1981, however, France was trying to overcome the world recession of the previous decade. Although the previous conservative government of Raymond Barre had adopted between 1976 and 1981 a fairly austere macroeconomic stance, designed to reduce inflation and spending on imports, it did not have much success. Inflation had reached 13.4 percent in 1981, growth was just above one percent, rising unemployment was 7.5 percent and the current account deficit was 2.4 percent of GDP.[29]

The new French government believed that the role of the state had to be dominant and that public sector expansion would restore economic growth. Barre's austerity programme and his faith in market forces were replaced by expansionary fiscal policy, increased expenditure in social welfare and efforts to redistribute wealth. The policy of 'redistributive Keynesianism' as Peter Hall (Hall P. et al., 1994) called it included increases in the minimum wage, massive public sector hirings, reduction of the working week, forty nine nationalisations of banks and industrial firms, expansive financial aid to industry, increases in family allowances and housing subsidies and strengthening of the workers rights in the negotiations with the employers. The above measures and many more were financed by higher social insurance and taxes on employers, a wealth tax on the rich and a budget deficit which was allowed to increase. (See Machin H. and Wright V., 1985)

Unfortunately for President Mitterrand and the government, forecasts for an end of the world recession and especially a change in the American monetary policy did not come true. Although French growth had increased temporarily in 1982 as a result of fiscal

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[28] For discussions of the economics and politics between 1980 and 1994 see among others Flockton C., 1990; Friend J-W., 1989; Godt P., 1989; Guoyomarch A. & Machin H., 1992; Guoyomarch A, et al., 1996; Hall P., et al., 1994; Hayward J., 1995; Ross G., et al.,1987; and Wright V., 1992.

[29] Statistical sources: IMF, World economic outlook. OECD, Economic outlook. Various issues.

stimulation (2.5 percent), private investment did not increase, and the balance of payments deteriorated even further despite the devaluation of the franc twice since the elections[30]. Furthermore high interest rates required to reduce inflation and sustain the value of the franc in the ERM[31] increased financial charges for the already indebted firms. Under these conditions the French government and President Mitterrand faced a real dilemma when the franc came once more under pressure from speculators in March 1993. There were two options considered at the time. The first was to devaluate the franc and take it out of the ERM in order to follow an independent monetary policy accompanied by controls against imports to stabilise the trade deficit, lower interest rates to stimulate investment and introduce a bargaining system between employers and unions to restrain wages. This option ('l'autre politique') was supported by many important figures of the socialist party – most notably Laurent Fabius, Minister of industry; Pierre Beregovoy, Secretary-General of the President; and Jean-Pierre Chevenement, Minister of the State and Minister of Research and Technology. The second option was to negotiate devaluation within the ERM and reduce the budget and trade deficit by strict macroeconomic measures. Mr. Mitterrand was pressed by other dominant individuals within the socialist party – such as Prime Minister Pierre Mauroy; Jacques Delors, Minister of Finance; Jacques Attali, the President's closest counsellor; Michel Camdessus, director of the Treasury – of the possible adverse consequences of a withdrawal from the ERM (abandonment of the process towards European integration, rising inflation, soaring international debt, dependency upon IMF for borrowing) and finally decided to choose the second option. After long negotiations with the Germans on the level of devaluation French ministers approved a total adjustment of 8 percent (mark 5.5 percent appreciation and franc 2.5 percent depreciation). Most importantly, however, they accepted German demands for 'supplementary guarantees' of fiscal measures (foreign currency restrictions, higher payroll contributions, compulsory loan on taxpayers and reduce expenditures). (see Cameron D. (pp.56-82) in Daley A., 1996).

[30] The franc was devalued on 4 October 1981 and 11 June 1982 but the rate was considered inappropriate as it was not enough to eliminate the cumulative difference between French and German inflation rates. The second devaluation was accompanied by a programme of rigour : freezing prices and salaries for four months, cutting expenditures, a lower target for growth.

[31] France has entered the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) since its establishment in 1979 in an effort to curb inflation by pegging the franc to other European currencies and essentially to the German Deutschemark.

The devaluation of 1983 and the measures imposed by the Germans signalled the end of socialist policies and a significant U-turn in economic and social policy in France. The firm came to the centre of economic activity and policies aimed to preserve the value of the franc, stabilise public spending and budget deficit, achieve price stability, stimulate private investment and increase profitability. Measures adopted were the increase of interest rates, deindexation of wages, deregulation of industrial prices, reduction in certain tax charges and some initial steps towards deregulation.

Paradoxically, the implementation of more rigorous policies was intensified after the European Parliament elections of June 1984 when the trend against the socialists was confirmed. President Mitterrand replaced Prime Minister Mauroy, who did not agree with the new direction of economic policy, with Laurent Fabius who supported the modernisation of the French State through more liberalisation reforms. Under such conditions the split between the Communists and the Socialist government in 1984 was inevitable.[32]

Between 1984 and 1986 the Fabius government turned decisively towards the market in order to improve the competitiveness of French firms. Public enterprises were given more autonomy and could lay off workers and sell subsidiaries more easily, corporate taxes were reduced and the regulatory framework was loosened in order to enhance profitability. By 1986 the country's economy had improved considerably in many respects. Inflation dropped below 5 percent, growth was increasing by more than 2 percent (2.5 % in the end of 1986), exports were rising and the balance of payments had returned positive, and enterprises profitability was growing. Nevertheless, unemployment greatly affected by the liberalisation reforms was at its peak above 10 percent.

Despite the progress in the economy and although the policies of Laurent Fabius aimed to some extent to compensate the losses from the left by attracting some centre and even right-wing voters, the Socialist Party lost power in the March 1986 elections.[33] The Gaullist 'Rassemblement pour la Republique' (RPR, right) and the 'Union pour la

[32] While the Socialists had achieved parliamentary majority in the elections of 1981 they had relegated to the Communists four minor ministries to assure their co-operation.
[33] The Socialist Party maintained its position as the biggest party (206 seats) mainly due to the introduction of a proportional representation system.

Democratie Francaise' (UDF, centrists) managed with the help of the 'Front National' (FN, extreme right) and some other small right wing groups to win a vote of confidence for Jacques Chirac who became Prime Minister.

During the period of 'cohabitation' with President Mitterrand the government of Chirac continued the policy of budgetary and financial rigour that Mr. Fabius has reinforced. The new government opened the economy even more to the markets with a series of privatisations and measures such as reduction of corporate tax, deregulation of prices, new competition regulations, labour market flexibility, deregulation in various sectors as in banking, transport, telecommunications and energy. Regarding monetary policy, the government continued the policy of the 'strong franc' and expanded the financial system structural reforms of the previous government. In January 1987, France adopted a mechanism based on indirect instruments aimed primarily at influencing the level of interest rates. Furthermore, the elimination of credit controls was replaced by operations in the interbank market through interest rate. (See IMF, 1990)

The liberalisation of the market and the budgetary rigour were helped by the international recovery and as a result business profitability accelerated the expansion of the French economy. By 1988, growth was 4.5 percent, inflation had dropped to 2.7 percent, industrial production grew by 8 percent, while investment was rising in the competitive sector by 5 percent. Still, though, unemployment was 10 percent and there were no particular signs of significant reduction despite the high levels of growth.

The unemployment problem and some tough measures taken by Mr. Chirac on law and order issues (visa for foreigners, greater power to the police, identity checks and tighter immigration controls) cost him the votes of the centrists in the Presidential elections of 8 May 1988. As a result Francois Mitterrand who had distanced himself from the Socialist Party and presented himself as the most reliable choice retained his seat. Right after his re-election Mr. Mitterrand took advantage of the favourable conditions and decided to end the experiment of 'cohabitation' by announcing early parliamentary elections for 5 and 12 June 1988. Although the Socialist Party did not manage to achieve parliamentary majority it easily won the elections and returned to power with Michel Rocard as Prime Minister. In order to ensure, however, parliamentary approval almost half of the cabinet members were non-socialists.

Despite his lack of majority, within two years, Mr. Rocard managed to become extremely popular as his left-centrist policies confronted many of the economic and social problems that France was facing. His government did not return to the practices of the first socialist experiment but persisted in a policy of rigour with emphasis on the reduction of the deficits and the preparations for the modernisation of the economy towards the single European market. Growth despite slowing somewhat continued to expand fairly sharply (4.3% in 1989 and 2.5% in 1990), inflation was kept moderate despite a small increase since 1988 (3.1% in 1990 from 2.7% in 1988), but unemployment remained high despite a decrease (8.9% in 1990 from 9.4% in 1989).

Since the late 1980s one of the most important determinants of the French economic policy has been the prospect of the single European market and eventually the Economic and Monetary Union. The 'franc fort' policy has been an almost indisputable practice of all governments, despite having many opponents, as it was believed that it was the only way to challenge the predominance of Germany in the construction of the 'new Europe'. However, the establishment of EMU presupposed a series of restrictive policies leaving few resources for reform and social measures. Nevertheless as long as the economy was in an upturn there were no serious objections of the followed policies.

The objections to these policies and the problems for the Rocard government turned up in 1991 with the emergence of a new recession in Europe, mainly due to the implications of the German unification and the crisis in the Persian Gulf. The slowdown of economic activity, the rise in unemployment combined with a series of domestic scandals (over contaminated blood, party funding and share dealing) found the government and especially the Prime Minister under mounting criticism. Under such conditions President Mitterrand considered in May 1991 that the replacement of Mr. Rocard would change the negative climate for the socialists and regain him the political initiative required in the campaign for the 1995 presidency. Unfortunately, the appointment of the first French female Prime Minister, Edith Cresson, proved an unfortunate choice as she proved to be "somewhat incompetent and prone to frightful gaffes", according to George Ross (1996: 50). Mr. Mitterrand indirectly admitting his mistake replaced Mrs. Cresson in less than a year with Pierre Beregovoy who was in turn charged to lead the PS in the 1993 general elections.

The task of Mr. Beregovoy was particularly difficult because the aggravation of the European recession had a dramatic effect on unemployment and on economic activity. The situation worsened further during the speculative attacks on the franc and the other currencies of the ERM in September 1992. Although, the French monetary authorities with the help of the German central bank managed to confront the pressures, the exit of the British pound and the Italian lira from the system intensified the anti-European protests just a month before the referendum for the ratification of the Maastricht Treaty (20 September 1992).

Since 1983, France has been committed to developing further European integration and public support has been high relatively to other states throughout the 1980s. However, the above mentioned economic and social problems, the turn against the Socialist Party and also the unexpected Danish 'No' to Maastricht in June 1992 changed the French consensus towards Europe. The Gaullist RPR, the Communist Party, the National Front and many individuals from all political sides started a campaign against the ratification of the Treaty. Complaints of Brussels bureaucracy, threats to French identity and sovereignty, and questions on economic benefits from EMU were threatening the whole European development. Fortunately, for Mr. Mitterrand and the pro-Europeans, the Treaty was ratified by the marginal 51 percent 'yes' against 49 percent 'no' owing much to late efforts of the leaders of the opposition (Mr. Chirac and Mr. Giscard) who persuaded many centre-right voters.

After the ratification of the Treaty it was evident that the PS would lose the forthcoming elections and the centre-right would return to power. The prospect, however, of a government dominated by members of the RPR, who were not so keen to the 'franc fort' policy, gave new incentives to speculators who attacked the currency in December 1992 and January 1993. The reassurance from top members of the right wing coalition that they support the parity between the franc and the mark and a common announcement of the monetary authorities of France and Germany for their determination to defend the franc managed to overcome a potential crisis.

After the March 1993 elections which confirmed the total electoral humiliation of the socialists (lost 80 percent of their power) and the victory of the right (the RPR came first whereas the pro-European UDF second), President Mitterrand made clear to the new

Prime Minister, Mr. Edward Balladur, that during their cohabitation he expected a continuity on European policy. Although, the new government seemed determined to support the 'franc fort' policy, pressures from within the ruling parties for lower interest rates (needed to maintain the franc's parity) to stimulate the declining economy and reduce unemployment (11.6 %) instigated further attacks on the overrated franc in July 1993. The refusal of the German central bank to cut its interest rates to ease pressures, left no alternative to the European Community Finance Ministers and central bankers but to agree on 2 August 1993 to widen fluctuation margins in the ERM to ±15% (from ±2.5%) and effectively float their currencies.

Since August 1993, the French economy has managed gradually to overcome the recession and by the end of 1997 has achieved all the convergence criteria[34] for entry to the final stage of EMU. As the European Monetary Institute has reported to its March 1998 report and the European Union political leaders confirmed at their Brussels summit between 1-3 May 1998, France was one of the eleven members of the European Union which would take part to the single currency from 1 January 1999.

TABLE 1

TABLE 1: PROGRESS OF THE BASIC FRENCH ECONOMIC FIGURES (% annual change)

France	1990	1991	1992	1993	1994	1995	1996	1997
1. GDP	2.5	0,8	1,2	-1,3	2,8	2,1	1,5	2,4
2. Inflation	3,4	3,2	2,4	2,1	1,7	1,8	2,0	1,2
3. Unemployment	8,9	9,5	10,4	11,7	12,3	11,6	12,3	12,6
4. Unit Labour Cost	4,1	3,6	2,7	3,1	-0,3	1,8	1,4	1,3
5. Budget Deficit (% GDP)	1,6	2,1	3,9	5,8	5,8	4,9	4,1	3,0
6. Primary Surplus (% GDP)	1,4	0,9	-0,7	-2,4	-2,2	-1,1	-0,3	0,6
7. Public Debt (% GDP)	35,5	35,8	39,8	45,3	48,5	52,7	55,7	58,0
8. Current Account Surplus / Deficit	-0,8	-0,5	0,4	0,9	0,6	0,7	1,3	2,9
9. Mean Annual Interest T-Bonds	9.6	9,1	8,8	6,8	7,3	7,4	6,3	5,6

Source: National Accounts – Eurostat - EMI.

[34] Although at a cost of high unemployment (12.6% in 1997).

Overall, one could argue that French economy and politics of the last two decades have been marked by the decision in early 1980s to remain in the ERM and the associated U-turn that followed. Irrespectively of whether this was the only real choice or not[35], it was clear thereafter that France could hardly implement a truly national economic policy, as it was always dependent on the 'franc fort' and the tight monetary policy of the German Bundesbank. Eventually, however, with the establishment of the single currency and the subsequent limit of the Bundesbank's powers the French hope to enjoy greater influence on the direction of economic policy (through collective decisions in the European Central Bank) on both a European and a global level.

THE IDEA AND THE PLANS FOR AN INDEPENDENT BANK OF FRANCE

The first move for an independent Bank of France was made in late 1985 a few months before the general elections of March 1986. One of the engagements taken by the time by the common platform RPR – UDF was to grant independence to the central bank. Such a move was seen as part of their overall policies of financial and banking liberalisation and deregulation as well as a means for reducing France's dependency in the interest rates of the German central bank. Apart from that provision there has also been, at the time, a plan provided by the member of the RPR Mr. Charles Pasqua, which also proposed the independence of the Bank of France. However, after the win of the centre-right coalition in the elections the project was totally forgotten. Mr. Edward Balladur, as Prime Minister in 1993, admitted that this was one of his two mistakes[36] as Minister of Economic Affairs and Finance during the first 'cohabitation'. His excuse was that it did not have urgency at the time (Le Point, 3 April 1993).

The debate on the issue came up again during and after the agreement in the Maastricht Treaty for the establishment of independent national central banks that will be part of the

[35] Details on various interpretations for the turnabout in policy can be found in Loriaux M., 1991; Cameron D., 1988; Hall P., 1986; Hayward J., 1986; and Cerny P., 1988.
[36] The other was the abolition of tax on big fortunes.

independent European Central Bank (ECB). Just before the signing of the Treaty a study on the demand of the National Assembly Financial Committee on Economic and Monetary Union (EMU) strongly supported an independent statute and a mandate of price stability for the central bank (see L' Agefi, 11 December 1991). Despite its initial reservations over such provisions the French government finally agreed and so paved the way for the creation of an independent Bank of France. However, the change of the Bank's statutes did not require immediate action as according to the Treaty that could be done any time before the start of stage three of Economic and Monetary Union (EMU), in 1997 or the latest in 1999. Also, the announcement of the Minister of Economic Affairs and Finance, Mr. Pierre Beregovoy, during the Maastricht Summit that the French central bank would be independent before the creation of the ECB, basically implied that it was not going to happen until the last moment.

Nevertheless, the speculative attacks on the franc and the other European currencies in September 1993 initiated calls for an immediate change of the Bank's statute. The strengthening of the Bank's powers was considered by many politicians and economists as a move that would convince the markets of the determination of the French monetary authorities to support the 'franc fort' policy and establish permanently monetary stability. The first critical statement in favour of central bank independence was by the former Finance Minister and eventual Prime Minister Mr. Edward Balladur on 12 December 1992. Mr. Balladur said that after the general elections the Bank of France should be made independent from the government and make sure that it has good co-operation with the German central bank (Reuters News Service, 13 December 1992). A few days later the leader of the UDF and former President Valery Giscard d'Estaing defended the government's strong franc policy and revealed that he has asked his party to prepare a bill to reform the Bank of France's statute and guarantee the central bank's independence (Reuters News Service, 18 December 1992). He said that the bill would be ready for debate after the change of majority in March and claimed that it would be the best political and technical signal to give of their will to have a sound currency policy. He also mentioned that the UDF was looking at ways to bring a regional element to the Bank, as in Germany's Bundesbank.

With the franc under renewed speculative pressures during the first week of 1993, the French Minister of Economic Affairs and Finance, Mr. Michel Sapin, decided to join his

voice to those calling for an early independence for the Bank of France. He claimed (Radio Station Europe One, 4 January 1993) that "the French, by voting for the Maastricht Treaty last September, voted for the modification of the Bank of France's statutes". However, Mr. Sapin explained that although "to propose immediately the independence of the Bank of France would be an elegant way to challenge what could be the policies pursued by another majority" this could be also considered as a panic reaction, thus reinforcing the pressure on the franc. Mr. Sapin argued that since "on this point, the opposition is on the same line as us" it would be better not to do it before the elections.

In 5 April 1993, shortly after the centre-right alliance had come to power, the new Prime Minister Mr. Edward Balladur gave to the Finance Minister, Mr. Edmond Alphandery, the task of preparing a bill to reform the statutes of the Bank of France to give it greater degree of autonomy. The fact that the Prime Minister used the term 'autonomy' and not 'independence' as had been the practise until then surprised many people and was considered an attempt by the government to keep some of its powers over monetary policy and the supervision of the banks. Some economists explained that probably the change in wording had been just cosmetic, used by the government to satisfy many members of the Gaullist RPR party who were against the strong franc policy and Maastricht. One of them, the new Chairman of the National Assembly, Mr. Philippe Sequin, had applauded the change of vocabulary declaring that granting total independence would "hand over exorbitant power to a group of technocrats who could breed terrible crises without having to account to anyone" (Le Monde, 5 April 1993). Furthermore, the new Interior Minister Mr. Charles Pasqua claimed on his part that such a project should not be considered immediately.

From then on until the 20 April 1993 when the Minister of Economic Affairs and Finance, Mr. Edmond Alphandery, presented the draft law on the reform of the Bank of France the debate was focused on two issues: whether the Bank should be 'independent' or 'autonomous' and whether it should be the Bank or the Treasury to supervise the banks. On the first issue the division within the RPR party was clear (the UDF supported 'independence'). Mr. Alphandery spoke for 'independence' whereas the Prime Minister for 'autonomy'. Both in public denied that there was any difference, but it was obvious that Mr. Balladur's words-playing was to persuade the anti-Maastricht members of its

party that the reform does not surrender total control. On the issue of banking supervision some initial attempts of the Treasury to take control from the central bank and hand it over to a grand committee seemed to be abandoned.

On both the above issues the position of the commercial banks was also divided. Some bankers found it dangerous to de-connect totally the actions of the Bank from the government policies and also have accused the recent central bank's supervision performance. Another issue that concerned the bankers was the continuation or not of the Bank of France's commercial activities and the associated issue of its number of employees.[37] As the president of the French Banking Association (AFB) affirmed "The Bank of France is one of the biggest banks in the world and one day this problem has to be tackled" (Tribune, 16 April 1993). As expected within such conditions, the employees of the Bank who were afraid that independence and abandonment of commercial activities would lead to firings organised large manifestations against the reforms.

The presentation of the draft law seemed to satisfy almost everyone within the RPR. The government avoided using the word 'independence' as well as 'autonomy', which did not appear in the text, but ensured that the Bank should not receive instructions in the conduct of monetary policy. Also it was decided to keep banking supervision under the responsibility of the central bank. Mr. Charles Millon, president of the group UDF, affirmed that he remained in favour of independence of Bank of France and the respect of Maastricht, but he said he was satisfied with the announcement of the draft law (Les Echos, 21 April 1993). The model chosen was in general well received by the press and the banking sector but faced a sudden increased criticism by the Socialist Party. The latter announced two days after the presentation of the draft law that it "opposes any change of statute" of the Bank of France "that does not clearly link to the European objective". The PS claimed that it was surprised by the Prime Minister's immediate change "without guaranteed link with the EMU and in risk of the reinforcement, without counterpart, of the weight of big financial interests in the conduct of our currency" (Le Monde, 24 April 1993). The Communist Party and the Greens also opposed the reform as both expressed the view that it surrendered the conduct of the monetary and exchange rate policy to bureaucrats not directly controlled by democratic institutions.

[37] The Bank of France had in 1993 around 17000 employees and 212 branches.

The most critical statements by individuals against the proposals came from the anti-European former socialist Minister of Defence, Mr. Jean-Pierre Chevenement, and the former socialist Prime Minister Michel Rocard. Mr. Chevenement declared that the government's plan would be "a kick to democracy" since the Bank of France would be "independent from the people and universal approval but dependent on the financial markets" (Le Monde, 23 April 1993). Mr. Rocard declared that although as Prime Minister he "accepted the idea of the independence of the ECB and therefore that one of Bank of France the independence of the central bank has no sense if not within the European perspective". He added that Mr. Balladur in his address did not even mention the Treaty or indicate a desire to pursue the European construction, and claimed that "without the perspective of a common currency, the independence of the central bank does not serve anything. It is unacceptable and dangerous since it leads to a surrender of monetary policy to the interests of finance" (Le Nouvel Observateur, 29 April – 5 May 1993).

Two weeks after the presentation of the draft law by the government the financial section of the Economic and Social Council presented a study suggesting the independence of the Bank of France.[38] According to the editor of the study, Mr. Maurice Gousseau, the independence of the Bank appeared inevitable, since not only was entailed by the Maastricht Treaty but would also be a favourable element for the good conduct of monetary policy. For Mr. Gousseau, the principle of independence was written in the Treaty, a text that has taken the authority of an amendment of the Constitution and which was approved by referendum (Le Monde, 5 May 1993).

On 6 May 1993 the State Council advised that the first article of the draft law which defines the principle objective of the Bank of France should be modified in order to be compatible with article 20 of the Constitution[39]. The Council suggested that the term 'taking into account the general policy of the government' should be changed to 'support the general policy of the government'.

[38] The Economic and Social Council's study was based among other sources on interviews of the following personalities: Mr. Patrice Cahart, General Representative of the French Banking Association (11 March 1993); Mr. Yves Ullmo, General Secretary of the National Credit Council (11 March 1993); Mr. Jacques de Larosiere, Governor of the Bank of France (31 March and 5 April 1993); and Mr. Jean-Claude Trichet, Director of Treasury (31 March and 7 April 1993).

[39] Article 20 of the Constitution states that "the government defines and implements the policy of the nation".

On the 11 May 1993 the draft law was adopted by the Council of Ministers, but there were reservations from the President of the Republic, Mr. Francois Mitterrand, on whether it was constitutionally right. Mr. Mitterrand pointed out that "the text could be under discussion if it is not consistent with the Constitution, which was revised to take into account the Maastricht Treaty".[40] According to Mr. Mitterrand there were three objections: the Treaty, although ratified by France, has not been ratified by all other states and therefore has not come into force; the project of law does not make any reference to the Treaty; and the Treaty does not provide for the independence of the central banks before 1 January 1994 when stage two starts (Liberation, 11 May 1993).

Having been adopted by the Council of Ministers, even with some reservations for its legitimacy, the draft law was then passed for further debate to the Financial Committee of the National Assembly.

THE BANK OF FRANCE BILL AND ITS ADOPTION IN PARLIAMENT

THE BANK OF FRANCE DRAFT LAW OF 12 MAY 1993

The main provisions of the 'Draft law on the status of the Bank of France and the activities and supervision of credit institutions' as presented to the Financial Committee of the National Assembly on 12 May 1993 included the following:

The Bank of France has the objective of formulating and implementing monetary policy with the aim of ensuring price stability within the framework of the general economic policy of the Government (article 1). Its main tasks are the conduct of monetary and exchange rate policy; the management of official reserves; issuing notes; and the safeguarding of the smooth operation of the payment system. Also other tasks are conferred on the Bank under specific legislative provisions, which include balance of payment statistics, and prudential supervision is entrusted to a Banking Commission

[40] The Constitutional law of 26 June 1992 authorised the government within the prospect of Monetary Union to delegate its powers to institutions created under the Maastricht Treaty.

chaired by the Governor of the Bank to which the Bank provides administrative support (article 21). The Bank conducts exchange rate policy in the context of the exchange rate regime and parities of the franc, which are determined by the Government (article 2). The Bank can use a variety of monetary policy instruments, including the establishment of minimum reserves (article 7).

The governing bodies of the Bank are the Monetary Policy Council (MPC) and the General Council. The General Council administers the Bank and decides in any matter beyond the competence of the Monetary Policy Council that has responsibility for monetary policy functions.

The Monetary Policy Council is responsible for formulating and implementing monetary policy (article 7). In exercising its duties it can neither seek nor accept instructions from the Government or any other person (article 1). The Monetary Policy Council includes the Governor, two Vice-Governors and six other members chosen for their competence in economic and monetary matters (article 8). The Governor and the two Vice-Governors are appointed by decree of the Council of Ministers for a renewable term of six years. The Governor chairs the Bank's decision-making bodies (article 13). The six other members are appointed by decree of the Council of Ministers for a non-renewable term of nine years. They shall be chosen from a list comprising three times as many names as the number of members to be appointed. This list shall be drawn up by mutual consent by the president of the Senate, the president of the National Assembly, the vice-president of the State Council, the president of the Economic and Social Council, the first president of the Supreme Court of Appeal and the first president of the Audit Department (article 8). Members of the Monetary Policy Council cannot be dismissed before the expiry of their term except for reasons of incapacity or serious misconduct and they are subject to a strict regime of professional exclusivity (article 10). The Minister for Economic Affairs and Finance (or his representative) may attend meetings of the Monetary Policy Council. They may present proposals but have no voting rights (article 9).

The General Council governs the Bank's activities other than monetary policy. The General Council includes the members of the Monetary Policy Council plus one member elected by the employees of the Bank. A censor or his alternate, appointed by the Minister of Economic Affairs and Finance, attends the General Council meetings. He may submit proposals for the approval of the Council and oppose any decision taken by it (article 11).

The Governor must present at least once a year to the President of the Republic a report on the operations of the Bank (article 7).

THE DEBATES IN THE PARLIAMENT

On 12 May 1993 the Finance Commission of the National Assembly gathered for the first time to debate the draft law on the reform of the Bank of France. The Minister of Economic Affairs and Finance, Mr. Edmond Alphandery, presenting the governmental position denied that the reform was due to the speculative pressures on the franc and declared that it is "an autonomous decision of the government taken in regard to the intrinsic interests of the reform". He also mentioned that it is an obligation for the participation of France in the common European currency and that it would be best to do it as soon as possible. Mr. Alphandery stated that numerous studies have suggested the benefits of an independent central bank and claimed that it will allow eliminating the risk premium which still exist in French interest rates and which is not justified by the economic fundamentals.

Mr. Jean-Pierre Chevenement (app. PS) mentioned the contradiction of the two first paragraphs of article 1 since the first stated that the Bank of France "formulates and implements monetary policy with the aim of ensuring price stability within the framework of the general economic policy of the Government" while the second prohibits any influence on the Bank which should "neither seek nor accept instructions from the Government". He also claimed that the reform is totally opposite to article 20 of the Constitution and for that reason he has laid down an objection. On this terrain some members of the majority joined forces with the opposition. Mr. Devedjian (RPR) asked why the government did not make any reference to article 105 of the Maastricht Treaty that defined the future European System of Central Banks and which inspired the reform. The President of the Commission, Mr. Jacques Barrot (UDF), replied that he did not understand these "constitutional doubts" since the Constitution was revised exactly to permit the ratification of the Treaty. Furthermore, he claimed that the reform turned a new page to create a modern way of conducting monetary policy.

Under the threats of an appeal to the Constitutional Council, the Commission's general reporter on the reform, Mr. Philippe Auberger (RPR), finally proposed to alter the formulation of article 1.

On the 20 May 1993 the syndicate F.O. (Force Ouvriere) of the Bank of France made eight proposals for amendments to the Parliament (Les Echos, 21 May 1993). According to the F.O. the mission of the Bank should also include the safeguarding of the credit and the good functioning of the banking system. Also it suggested that the governor should address at least twice a year the Finance Commission of the Assembly and the Senate the policy of the Bank. Moreover, it proposed, in order to reinforce the independence of the Bank, to abolish the article that provided the participation of the Minister of Economic Affairs and Finance (without vote) in the meetings of the Monetary Policy Council. For the General Council the FO proposed that one of the two deputy governors should come from the personnel. Finally, the remaining amendments referred to the commercial activities of the Bank, which according to the FO should be continued to be exercised and in some cases should be expanded.

The Finance Commission adopted the draft law on the 3 June 1993, but with many modifications. Only the representatives of the majority adopted the text, as the socialists and communists were absent during the vote. Members of the minority as Alain Rodet (PS) and Jean-Pierre Chevenement (app. PS) expressed their opposition to the text – due to insufficient reference to the Maastricht Treaty and democratic and Constitutional deficiencies – but the divergences among the majority were restrained.

The Commission rejected the amendment of the general reporter, Mr. Philippe Auberger (RPR) that enjoined the Bank to "co-ordinate with the government" in exercising monetary policy – as it would undermine its independence. However, it agreed to an amendment pressed by Patrick Devedjian (RPR) and Jacques Barrot (UDF), president of the Commission, which provided that the Bank accomplishes its mission within the "framework of the general policy of the government and the respect of international treaties". The Commission proposed that the list of candidates for the MPC should be made only from the presidents of the National Assembly, the Senate, and the Economic and Social Council and not include the State Council, the Audit Department, and the Supreme Court of Appeal. This was considered necessary in order to give a less

technocratic character to the designation method. Also, it limited the list to twelve names from eighteen. Another amendment reduced the mandate of the governors from six to five years and renewable just one time. Also the Commission added a disposition so that the governor appears before the National Assembly's and Senate's Finance Commissions at least once a year. Finally the Commission decided that the Prime Minister or the Minister of Finance could not be replaced by a representative at the meetings of the MPC.

Between the 8 and 11 June 1993 the draft law was debated in the plenary session of the National Assembly.[41] During the first day the deputies instead of debating the reform of the Bank of France were most of the time discussing the maintenance or not of the strong franc policy. Presenting the project for the Bank the general reporter, Mr. Philippe Auberger, declared that it was a compromise between two preoccupations: giving to the institution a larger autonomy, while avoiding harm to the general policy of the government. Mr. Edmond Alphandery, Minister of Economic Affairs and Finance, said that the return in confidence in the markets was partly due to the desire of the government to guarantee the independence of the Bank in the conduct of monetary policy. Mr. Alphandery stressed that the reform had as objective to define a central bank model that corresponded to the culture and the way of government of France. Finally he declared that the key of the reform is the clear objective of the Bank: to assure price stability.

The speech of former President, Mr. Valery Giscard d'Estaing (UDF), emphasised his party's strong support for the reform. Mr. Giscard d'Estaing estimated that the reform would be one of four big dates in the history of the Bank of France. He said that the experience shows that it is preferable, in order to achieve price stability, that the central bank has independence in the conduct of monetary policy. He claimed that this independence must only be limited by parliamentary control through auditions of the governor. Finally he criticized the opposition's stance towards the reform since as he said it is incoherent to be in favour of the Maastricht Treaty and against the independence of the Bank of France. Speaking for the opposition the former President of

[41] On the first date of the debate in front of the National Assembly 70 percent of the Bank of France's personnel protested for the evolution of the Bank's activities and in particular the preservation of its commercial businesses. It was the biggest strike in the history of the Bank, according to Les Echos, 9 June 1993.

the Assembly, Mr. Henri Emmanuelli (PS), claimed that the markets are not as monetarist as the Minister of Finance. He argued that the reform involved a danger for the democratic sovereignty, an error of orientation for the fundamental economic policy and a risk of incoherence in the organisation of control and regulation of the money and credit.

Although the debate was not the big parliamentary quarrel that the media expected, during the vote for Mr. Jean-Pierre Chevenement's objection, regarding the constitutional validity of the draft law, the division in the majority benches was evident. The move was rejected by 456 votes against 82 but twenty RPR deputies did not participate in the vote and six others abstained. Also from the UDF group one voted for (Mrs. Issac-Sybile), one abstained (Mr. Philippe de Villiers), and one did not participate (Mr. Alain Griotleray). Furthermore, after Mr. Chevenement's intervention some RPR deputies, among which Mr. Alain Mazeaud and Mr. Jean de Gaulle applauded together with the socialists. Mr. Chevenement, defending his objection, claimed that the reform was contrary to the constitution and in particular article 2 of the fundamental law related to the 'Unity of the Republic' and in contradiction to article 20 of the Constitution. Mr. Chevenement stated that the denationalisation of the Bank of France is part of the continuing movement that tends to abolish any substance of democracy and citizenship.

Mr. Francois Guillaume (RPR), a former Minister of Agriculture, claimed that the reform was premature since the European Central Bank (ECB) would not be created immediately. He was also worried that independence posed more problems than it solved since there would be conflicts between the government and the leaders of the Bank. Mr. Michel Hannoun (RPR) in his part criticised the organisation of parliamentary control on the Bank of France. On the contrary Gilbert Gantier (UDF) considered the project to be too timid, as he would prefer due to France's bad tradition a clearer reference to the independence of the Bank.

During the second date of the debate, on 9 June 1993, the RPR deputies who were against Maastricht manifested once more their opposition to the reform of Bank of France. For the 33 articles of the draft law there have been proposed 150 amendments, most of them coming from the RPR deputies. Mr. Daniel Garrigue (RPR) presented an amendment which provided that the Bank of France 'accomplishes its mission within the

framework of orientations which the governments gives to it' instead of 'within the general policy framework of the government'. The amendment failed to be adopted although the left supported it. Similarly the Minister of Finance, Mr. Alphandery, opposed the reference 'in respect of the international treaties' that the Finance Commission has introduced. That made the President of the Commission, Mr. Jaqcques Barrot, to admit at the end of the session that this episode proved that "the actual fragility on European positions" is everywhere and showed the cohesion and organisational problem of the majority (Le Monde, 11 June 1993).

The National Assembly finally adopted the draft law, in first hearing, on 11 June 1993 by 433 votes against 90. Nevertheless, forty RPR and eight UDF deputies have abstained or have not participate in the vote expressing in this way their opposition to the 'Maastrichtian' tone imputed to the reform. There were two UDF members who voted against (Mr. Daniel Mandon and Mr. Philippe de Valliers) as did the majority of socialists and communists. The pro-Europeans socialists were absent whereas Mr. Guy Hermier (PC) decided alone not to take part at the vote. Finally the Party for the Republic and Liberty showed a profound division with nine members voting for, nine against, and six abstained.

Although the critical first article that defines the Bank's objective was not altered the deputies adopted some of the numerous proposed amendments. The Assembly agreed to the reduction of the list of candidates from eighteen to twelve and to cut off the presence of the presidents of the Audit Department and the Supreme Court of Appeal from the authorities to compose the list. It was also specified that the candidates should be chosen for their competence and professional experience' in the domain of economic and monetary matters. Mr. Alphandery has also managed to convince the Assembly to allow a representative of his to attend the meetings of the Monetary Policy Council. Finally, in relation to the parliamentary control, the deputies have decided that the governor of the Bank should address a report to the President of the Republic and to the Parliament 'at least once a year' and should be obliged to appear before the Finance Commissions of the Assembly and of the Senate.

The draft law was subsequently passed for adoption to the Senate on 1 and 2 July 1993. During the first date the general discussion has revealed a number of points of

disagreement between the Senators and the Minister of Economic Affairs and Finance, Mr. Edmond Alphandery. Although two procedural motions against the legitimacy of the reform defended by the opposition were rejected, the Senate brought forward many amendments on the text adopted in the National Assembly. The general reporter on the reform, Mr. Jean Artuis, pressed for the adoption of the fifty amendments proposed by the Senate Finance Commission despite the opposition of the Minister. The most critical ones were: the affirmation in an additional article on the top of the text that 'the Bank of France is the institution charged for the safeguarding of the currency and credit; the withdrawal of the president of the State Council from the list of authorities appointing the candidates for the MPC; the abolition of the possibility of the Minister of Economy to be represented at the MPC meetings; the maintenance of particular commercial customer accounts; and the reaffirmation of the prudential control of the Bank in the establishment of credit.

The conflict between Mr. Alphandery and Mr. Artuis was avoided due to last minute bargaining. The Minister abandoned the blocking vote that he threatened to use, whereas Mr. Artuis pulled off some of his amendments. The general reporter, however, pushed the Senate to adopt the second and fifth of the above amendments despite the objections of the government. The draft law was finally adopted by 225 votes against 89, with the RPR and UDF voting for, whereas the PS and PC against. During the debate there was not as in the Assembly a real separation between the pro-Maastricht and anti-Maastricht members of the majority. Most of the criticism was more technical than political. Only Mr. Emmanuel Hammel (RPR) expressed his refusal to "abandon the governmental prerogatives, a progress of the regrettable road to Maastricht". On the other hand the socialists and communists expressed their political hostility to the reform as they claimed it is undemocratic, against the constitution, premature, and would create policy conflicts. According to Mr. Paul Loridant (PS) the initial statute of the Bank was much better, as he claimed that it is not proven that independence guarantees effectiveness in the battle against inflation. On the other hand, Mr. Robert Vizet (PC) claimed that the supposed independence would produce dependence upon the financial markets and the Bundesbank.

On the 8 July 1993 the draft law having been elaborated by a Mixed Joined Committee (CMP) of deputies and Senators has returned to the National Assembly for its final

adoption. However, the proposals of the CMP were modified by the government – with the demand of a blocking vote - which accepted only that the president of the State Council should not be among the authorities appointing the members of the Monetary Policy Council. This attitude from the part of the government provoked the protestations of the general reporter, Mr. Philippe Auberger (RPR), and the president of the Finance Commission, Mr. Jacques Barrot (UDF). Both claimed that these practices were not advancing the prestige of the Parliament and were not far from an abuse. The draft law was eventually adopted by 466 votes (RPR and UDF) against 95 (PS and PC).

On 13 July 1993 the draft law was finally adopted by Parliament as it was also adopted in the Senate by 223 votes (RPR and UDF) against 89 (PS and PC). In spite of the acceptance from the government of more than 70 amendments the major provisions of the initial text were preserved. However, the surprise came from the socialist Senators who announced that they would make an appeal to the Constitutional Council to declare the reform as non-legitimate. The socialists claimed that the government could not surrender monetary control to an independent institution until the Maastricht Treaty is ratified by all member states and consequently come officially into force.

On 3 August 1993 the French Constitutional Council justified the socialist objections as it ruled that the law to make the Bank of France independent could not be implemented until the Treaty came into force. The Council said that according to the French Constitution until then the government is responsible for the nation's policies. The Government replied that it is a matter of few months until all member states have ratified the Treaty and that it would reintroduce the draft law in the next parliamentary session.

The ratification of the Maastricht Treaty by Germany in October permitted the French government to reintroduce the draft law to Parliament. The act on the status of the Bank of France was finally adopted on 18 November 1993 and took effect from the 1 January 1994.[42]

On 12 May 1998 the French Parliament adopted an amended version of the Act of 31 December 1997 in order to make the Bank of France's statute fully compatible with the

[42] Act Nb 93-1444 of 31 December 1993, Act on the status of the Bank of France and the activities and supervision of the credit institutions. This Act amended the Act Nb 93-980 of 4 August 1993.

one of the European System of Central Banks (ESCB) to which the Bank would be part.[43]

THE ROLE OF THE PARTICIPATING ACTORS IN THE REFORM PROCESS

The reform of the status of the Bank of France towards a more independent one was achieved within a period of approximately one-year. During this period various personalities and groups were involved in an effort either to promote the reform or to delay or even cancel it. Having examined in the previous sections the historical political and economic course of events it would at this point be appropriate to have a deeper analysis not just of the role of the participating actors in the reform process but also of their motives and expectations.

PARTICIPANTS WITHIN THE GOVERNMENT

The President of the Republic[44]

Mr. Francois Mitterrand, the French President of the Republic during the establishment of the independence of the Bank of France, had a significant influence on the reform. President Mitterrand's involvement in the change of the Bank's status had definitely not been as direct as the government's one but it could be argued that it had been equally influential. Mr. Mitterand during his fifteen years in the Presidency had never expressed a support for the independence of the Bank of France and had not even made any public comment on the issue until 1994. However, he has been the person who through his actions and policies led France to consider seriously such a reform. It was his decisions in 1981-83 not to withdraw the franc from the ERM that caused the unavoidable economic policy turn and the definite embrace of Europe as the centrepiece of France's long term policy. The abandonment since 1993 of the 'dirigiste state'[45] and the gradual

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[43] Act Nb 98-357 of 12 May 1998.
[44] The President of the Republic is considered as a 'participant within the government' as he has a significant influence in the nation's policies.
[45] 'Dirigiste state' means interventionist state.

acceptance of monetarist and rigorous policies paved the way for the liberalisation and deregulation of markets, the establishment of EMU and also the creation of an independent central bank.

Mr. Mitterrand did not sympathise the concept of central bank independence, as his stance during the approval of the draft law from the Council of Ministers in May 1994 showed. Nevertheless, he knew that in order to establish a monetary union the independence of the ECB was unavoidable and consequently the Bank of France should also be out of governmental control. Yet he would have preferred to see the Bank free in a later stage most preferably just before the creation of the ECB.

The Prime Minister

The two French Prime Ministers since the idea of the Bank of France's independence was for the first time seriously considered have shown quite different attitudes. Nevertheless, their position was of extreme importance as without their will it would be particularly difficult for anyone else to establish the reform.

Mr. Pierre Beregovoy, the socialist Prime Minister between 1992 and 1993, has had little involvement in the progress towards independence. Although, he had declared his determination not to devalue and his support for the strong franc policy, he had surprisingly not made any particular reference to central bank independence in a period during which the issue was gaining more and more support. It is believed that, although he would prefer to make the reform in a later stage, as he had declared in Maastricht in December 1991, the pressures on the franc in January 1993 would have probably forced him to proceed earlier if he had won the elections. The above conclusion is supported and by the fact that he did not reacted negatively, at least publicly, on declarations by members of his cabinet that the Bank of France had to be independent after the 1993 elections.

In contrast, Mr. Beregovoy's successor, Mr. Edmond Balladur, had been one of the initiators and most supportive individuals of the Bank of France's reform. Having admitted that it was one of his biggest mistakes not make the reform as Minister of the Economy in 1986-88, he did not lose any chance to declare his determination to proceed

immediately after he would take office. For Mr. Balladur the independence of the Bank was not just a measure to stop the attacks on the franc but mainly an actual belief on the advantages of such a measure. Having proved as Minister of the Economy his support for liberalisation and deregulation in the economy he considered independence as another method of taking everyday politics away form the government. Unfortunately for Mr. Balladur's credibility it was exactly those everyday politics, within his own party, that initially forced him to replace the word 'independence' with 'autonomy'. Finally, he managed through the avoidance of using any of the two words to satisfy all sides as well as provide a trustworthy model of central bank independence, as he always desired.

The Minister of Economic Affairs and Finance

The French Ministers charged with the nation's economy have undoubtedly played a significant role in the attempts for the reform of the status of the Bank of France. They had not only participation in fostering the idea but had also formulated the plans for the model that would be established. At the same time it would be a part of their power that would be transferred, something that made every component of the future relationship between the Ministry of Finance and the independent Bank of France a particularly delicate matter.

The Socialist Minister Mr. Michel Sapin had expressed publicly his support and desire to grant independence to the Bank of France but the time he did so shows it was more a tactical move than real support. Mr. Sapin although he was not in any particular way against independence knew that it would not have any significant effect on the way monetary policy was conducted since he was himself committed to low inflation and the strong franc. Mr. Sapin's declaration in favour of granting to the Bank independence after the elections had a twofold motive. First, it would ease speculative pressures on the franc as it guaranteed that after elections the policy of the strong franc would not change. Second, it would oblige the new right wing Minister of Economy – it was certain that the RPR-UDF coalition would win the election – and not him to have to cope with an independent Bank of France, something not so pleasant for any Minister.

The successor of Mr. Sapin in the Ministry of Finance, Mr Edmond Alphandery, had not been particularly involved in the debates on the issue of central bank independence until

after he took office. Mr. Alphandery had kept a low political profile, though he had been a strong supporter of Maastricht and the 'franc fort'. However, from the moment Prime Minister Balladur assigned him the task of preparing the reform of the Bank's status he made it his first priority and worked hard to persuade the public and the other members of the Parliament for the necessity and the benefits of such change. Mr. Alphandery even came to a sort of a conflict with the Prime Minister when he refused to change the term 'independence' to 'autonomy' despite the denial of many members of RPR to accept a reform which would surrender total control to the Bank of France. Eventually, Mr. Alphandery showed extreme political manoeuvrability as he managed finally to avoid the clash in his party without, however, actually altering the spirit of the reform. He also did not refrain from denying the amendments of the Mixed Joint Committee in order to deliver a model of central bank independence in accordance to his preferences and not the ones of the anti-Maastricht block. The only change he did not manage to achieve was the transfer of supervision of the banks from the Bank of France to the Treasury. Having already disputes on the political side he probably did not wanted to press for another with the Bank.

The Rest of the Government

During the Socialist governing the majority of ministers had not made any particular comments for or against the issue of independence. That could be for two reasons. First, although the socialists had accepted in Maastricht the fact that the Bank of France would at some time become independent most members never liked it and agreed only to satisfy the Germans and proceed with the monetary union. Therefore, even at a time of speculative pressures ministers did not had the will and enthusiasm to promote such a reform. Second, the issue became popular at a time when it was certain that the socialist party would lose the elections and therefore there was no particular point in making promises that in few months would be out of their hands.

The stance of the non-economic conservative ministers had been of similar character. They had not expressed, at least publicly, any particular interest for the reform and had not taken active part at any of its stages. Of course the fact that the reform had been introduced right after the elections did not leave much room for active participation. Even ministers who did not favour EMU avoided during the ratification in the Parliament

to express opposing views as they probably did not want to cause problems to their own newly elected government, especially at a time of currency difficulties. The only member of the government who clearly opposed the reform was the Interior Minister, Mr. Charles Pasqua. Mr. Pasqua's position was however, particularly delicate as he was the one who in 1985 has proposed the reform of the Bank of France. At that time he was in favour, as he believed that a more autonomous Bank could provide a counterweight to the dominance of the German Bundesbank over French monetary policy. In 1993, however with the issue of independence dictated by Maastricht he could not be supportive as a reform in this framework would surrender France's monetary policy to the ECB. Due to his earlier position and to his ministerial standing Mr. Pasqua could not express his genuine arguments against the reform and tried to convince the Finance Minister that such change was premature.

PARTICIPANTS OUTSIDE THE GOVERNMENT

The Bank of France

The Bank of France played a particularly discrete role in promoting or supporting its independence. This of course had much to do with the fact that since the mid-eighties it enjoyed much more functional autonomy. The relations between the Bank and the government were established within a climate of mutual respect since both sides agreed on the policy of the strong franc and the reduction of inflation. It is characteristic that when in 1985 the opposition provided a plan to reform the Bank's statutes the then governor, Mr. Michel Camdessus, reacted less enthusiastically than expected. He declared that "the relatively recent law (Jan 1973) which established the statute of the Bank of France gives me sufficient independence", adding that in his opinion no central bank is absolutely independent or dependent (Le Monde, 14 September 1990). Mr. Jacques de Larosiere who succeeded Mr. Cambessus has also expressed his satisfaction for the autonomy he enjoyed in interest rate handling but was much more supportive to the establishment by law of the Bank's independence. He claimed that "it would reinforce the continuity and credibility of the French monetary policy" (Tribune, 7 April 1993). Finally, the Bank of France showed its increased power and authority when it managed to stop early any consideration of transferring its supervision powers to the Treasury.

The Political Parties and their Members

The stance of the political parties on the issue of independence has not been consistent and depended heavily on the external and internal conditions affecting the country. The attitude of the parties and their members were particularly affected by their positions on the European issues as the independence of the central bank was considered by many a direct result of the Maastricht Treaty.

The Rassemblement pour la Republique (RPR) although as a party has been since 1985 in favour of the Bank of France's independence, many of its members were clearly against it. The division between its members was almost directly connected with the position over the creation of the single currency and the policy of the strong franc. High ranking members as Mr. Phillippe Seguin who have campaigned passionately against the ratification of the Maastricht Treaty have expressed their discontent for the reform and have urged many traditional members of the party to oppose it during the Parliamentary debates. With such clear opposition within the party, the task of the Prime Minister and the Minister of Finance in the promotion of the reform was a particularly difficult one. They had on the one side to reassure the markets that the Bank would enjoy real independence and on the other the 'anti-Maastichtians' that such a reform would allow the Bank to lower interest rates and perform independently from the Bundesbank.

The second of the two governing parties, the Union pour la Democratie (UDF), had a much more favourable position. That of course had mainly to do with the party's support for the creation of the EMU. However, its members had also a deeper belief on the benefits of such a way of central banking. It is characteristic that the former French President and leader of the party not only was one of those who first initiated the change in December 1992 but also has revealed that when he was Minister of Economics and Finance in 1973 he had then prepared a similar reform (Les Echos, 13 January 1993).

The Socialists were, similarly to the RPR, divided on the issue of central bank independence. Although there were few who really believed in the independent Bank's benefits in the conduct of monetary policy, those who were in favour of Maastricht acknowledged that it was a necessary reform. The ones who were against Maastricht and those who have voted for without being really in favour have tried to stop the reform or delay it. Their excuses for incompatibility to the Constitution were not so convincing and

the only result they got was to delay the reform for a few months. Those members who were against, most of them following the arguments of Jean-Pierre Chevenement, should have probably achieved more if they had put more emphasis on the disadvantages of independence and the negative outcomes of the strong franc policy.

The position of the Communists was as expected always negative. Their commitment against the EMU, the free market and any form of power transfer away from the government was clearly presented during the parliamentary debates.

The Media

The Media have played a particularly significant role before and during the reform process. The extended coverage of the issue has promoted the issue as one of the biggest debates in the country, despite the length of the process. In general, press remarks were favourable to the reform as they considered it as a means to stop the attacks on the franc and enhance the credibility of monetary policy. Most of the reports presented the independence of the Bank as a highly prestigious event, which would introduce a French alternative to the Bundesbank. Nevertheless, they also presented all negative arguments and were particular caustic when the Prime Minister tried to change the 'independence' to 'autonomy'.

The Financial and Business Sector

The financial and business sector were in general in favour of the reform of the Bank, as they considered that it would help eliminate the risk premium on the French interest rates. This support had not been, however, manifested in any particularly pressing way. The French Banking Association's comments focused on the issue of banking supervision and the commercial activities of the Bank as most of its members agreed with the essential characteristics of independence. One of the few opposite positions was that of the president of the Societe Generale bank, Mr. Marc Vienot, who had declared that he had "philosophically, strong reservations in seeing a Bank of France too independent" (Tribune, 16 April 1993). On the part of the business sector although the majority believed that the reform would bring lower interest rates and thus promote investment, there were some voices, as that of the chairman of Peugeot, Mr. Jacques Calvet, who claimed that independence would result in an even tighter monetary policy.

The Trade Unions

The French syndicates were a group that put a lot of pressure upon the government's plans to change the status of the Bank of France. However, as usual the manifestations of the trade unions had little to do with the essential components of the reform. The Bank's syndicates were little concerned with who conducts monetary policy and which will be the policy of the franc. Their only worry was the preservation of the commercial activities of the central bank in order to keep their jobs. Although, this was a normal reaction on their behalf, such activities and of that size had nothing to do with the functions of modern central banks and were reasonably put in question. Finally, the trade unionists had managed to achieve their goal and in the new statute there were no references of reduction in the Bank's commercial businesses.

CONCLUSIONS

The establishment of the independence of the Bank of France in December 1993 was not simply the result of an attempt to achieve greater monetary policy credibility under continuous currency pressures. Admittedly, the speculative attacks were the motive that forced the government to change the Bank's status at the specific period of time but the underlying reasons were present even before. The independence of the central bank was the outcome of a series of economic, political and institutional policies of successive French governments.

The economic aspect, as already stated, was evident by the persistence of the French authorities, for more than a decade, to sustain the franc in the ERM. France did not need the independence of the central bank to achieve low inflation - this was already achieved - but to persuade the markets that its monetary and exchange rate policy would be always tight. France's position in the international economy depended heavily on the competitiveness of its products. The strength of the Franc and the level of interest rates have always played a very important role for the economic prosperity of the country. France was paying, in 1992-3, an interest rate risk premium despite the fact that it had

lower inflation than Germany and a sounder economy, exactly because the markets were not trusting its governments' long term policies. Thus, independence was presented by some French politicians as a means to eliminate these doubts since monetary and exchange rate policy would be under the responsibility of non-political individuals with long-term views.

From this point of view, the considerations for the Bank's reform, which would help ensure monetary credibility, appeared to be an economically-driven outcome. However, such an alternative might never have been considered if successive French governments had not been devoted to European developments and eventual unification. The French dream of the 1950s for closer European integration was saved by Mr. Mitterrand's decision in 1983 and was definitely secured with the signing and ratification of the Maastricht Treaty. French politicians believed that France through EMU would be able to influence more the European and international developments since it would limit the power of Germany. However, among the commitments the French signed for the establishment of EMU was the independence of the European Central Bank and that of the Bank of France. Despite the fact that the socialist government, during the Maastricht negotiations, did not initially agree with such an arrangement that was the political price to be paid by France in order to get Germany's agreement. Thus, the independence of the Bank of France was something that had anyway to be established, at the latest in 1999, if France wanted to make her forty-year European dream come true.

The political character of the reform in France was also confirmed by the sudden cross-party desire, at the end of 1992, to reform the Bank's status after the forthcoming 1993 elections. Even members of the socialist party, who until then did not show any sympathy for independence, expressed their support. This was primarily a political move, not an economic one. The attacks on the currency were instigated mainly by political and subsequently by economic uncertainty. The markets feared that the new French government to be elected would not be committed to price stability, low inflation and a strong currency, and would soon change to more expansionary monetary and fiscal policies. The opposing views within the right-wing coalition increased uncertainty for future policies, and as a result the markets were reacting negatively. In such a framework, declarations in favour of central bank independence were seen as a good opportunity to ease pressures. The French, whether pro-European or not, were not

sympathetic to central bank independence as it was clear during the Maastricht Treaty negotiations. The early establishment of CBI by the Balladur government was therefore done on the European level, as a compromise in order to promote France's broader European plans, and, on the national level, as a means to convince the markets of its political commitment to price stability.

Finally, in the decision to change the Bank's status one must also consider a sequence of reforms that had taken place since the early 1980s. After the famous U-turn of the socialists in 1983, the decentralisation and transfer of power away from the government was followed by successful attempts for liberalisation of the markets and financial deregulation. The gradual abandonment of most pure socialist policies, the reduction of the state's involvement in the economy and the reliance on market forces formed a completely different institutional model than the traditional French centralised one. In such a setting the independence of the Banque de France was not perceived as an isolated decision but instead another move towards a more modern, transparent and reliable way of conducting monetary policy in accordance with the general global trends.

Nevertheless, in most people's minds, central bank independence has been directly connected to EMU with all the negative consequences that this entailed for the Euro-sceptics. Even so, the newly elected government of Mr. Balladur taking advantage of the need for monetary credibility at the time and using the vast parliamentary majority it enjoyed found the perfect opportunity to introduce, with the minimum possible political cost, a model of independence which while it followed the Maastricht guidelines it also reflected the general French institutional patterns and traditions.

Chapter VII: The Independence of the Bank of Greece

The establishment of the independence of the Bank of Greece in December 1997 was an essential institutional reform that the great majority of the Greek Parliament supported. However, the reasons behind this support were quite ambiguous. This chapter aims to reveal the logic and the conditions under which this significant reform emerged, spread and was eventually adopted.

As in the French chapter, the present one first examines the historical role, organisation and independence of the Bank of Greece. Subsequently it analyses briefly the economic and political developments in Greece during the 1980s and 1990s and it then examines in the third and fourth sections the idea, the plans and eventual adoption of the Bill by the Greek Parliament. Having in mind the course of the reform and the general economic, political and institutional framework which prevailed, the fifth section analyses the stance, motives and ambitions of the main actors in order to draw in the last section the final conclusions of the efforts to establish an independent Bank of Greece.

ROLE, ORGANISATION AND INDEPENDENCE OF THE BANK OF GREECE

A HISTORICAL OVERVIEW OF THE ROLE OF THE BANK OF GREECE[46]

The Bank of Greece was established in 1928 in accordance with the Geneva Protocol[47] of 15 September 1927. The proposal to create an independent Bank was put forward by the foreign creditors of the Greek State in order to support the economic efforts of the Greek Government which was trying to overcome the monetary instability and the budgetary problems of that decade. The National Bank of Greece, which until that time was both a commercial and a central bank, opposed the change but without success.

[46] For more details see Alogoskoufis G.,1996; Garganas, 1994; and Halikias D.; 1978.

[47] The Geneva Protocol defined the preconditions under which the League of Nations would aid the Greek Government in economic matters.

The Bank of Greece managed to sustain a significant degree of independence for more than two decades since its establishment. During that period, Greece achieved a notable monetary stability, although the 1930s were characterised by significant global disturbances. The success of the Bank of Greece was accomplished both by its appropriate constitution, as well as by the talents of its Governors who were committed to monetary stability and managed to follow an independent policy. Of course, there were always conflicts between the Governors of the Bank and the governments, since many Greek politicians did not welcome the establishment and independence of the Bank of Greece. On three occasions before World War II, the independence of the Central Bank was called into question, forcing its Governors to resign.

After the end of the war, the Bank of Greece confronted a different framework. The economy and the financial system were in a completely disorganised state. The situation became even worse due to the Civil War that took place immediately after liberation from the Germans. Under these conditions the government decided that there was need for greater co-operation with the Bank of Greece. In 1946, a Currency Committee was created. The Committee comprised of the Minister of Co-ordination (president), the Minister of National Economy, the Governor of the Bank of Greece and two foreign representatives, one from England and one from the United States.[48] The Currency Committee was, in practice, a government committee since it decided on the formulation of monetary, credit and foreign policy, as well as on interest rates. In such a framework, the independence of the central bank was effectively abolished and the domestic credit system was highly restricted.

The devaluation of the drachma and the participation in the Bretton Woods System[49] in 1953 helped Greece to sustain a remarkable monetary stability until 1973. The contribution of Professor Xenophon Zolotas, the Governor of the Bank of Greece at that time, was another significant factor in that achievement. Due to his strong personality, Mr. Zolotas managed to influence the decisions of the Currency Committee and as a result achieved the consolidation of monetary stability and economic growth.

[48] In 1951 the Minister of Agriculture and the Minister of Trade replaced the two foreign representatives. Also it was decided that there was no more need for a unanimous decision but instead simple majority.

[49] The Bretton Woods System was an informal international currency regime in which participating countries maintained more or less stable exchange rates. The Bretton Woods Conference resulted in the creation of the International Monetary Fund and the International Bank for Reconstruction and Development (the World Bank), to provide respectively short and long term credit for the world economy.

With the collapse of the Bretton Woods System in 1973, Greece regained its monetary independence but the Bank of Greece did not. The change in the exchange rate regime coincided with the collapse of the dictatorship of the Greek Generals, which brought about significant changes to the country. The Currency Committee retained its powers and followed expansionary policies, although the Bank of Greece often protested and indicated the possible negative outcomes of such policies. The governments after 1974 accommodated the funding of public deficits and wage increases. As a result, the fiscal situation worsened significantly during the early 1980s and at the same time inflation remained steadily high. In 1982, the Currency Committee was abolished and most of its responsibilities were transferred to the Bank of Greece, consequently strengthening its independence. Nonetheless, the Government was still responsible for formulating overall economic policy while the Bank of Greece was the one to implement monetary and exchange rate policy.

The role of the Bank of Greece was upgraded again after 1985 when moves were made to deregulate the financial system and the exchange rate policy started to have a positive effect on inflation. The upgraded role of the Bank of Greece proved to be crucial during the period of 1989-90 when there was political instability in the country and there were significant pressures on the national currency. The same applied during the two European monetary crises in 1992 and 1993. After 1990, there was a gradual reduction of fiscal deficits and at the same time some steps were taken to liberalise even more the domestic credit system. The gradual abolishment of the obligation of the Bank to fund the public sector increased significantly its economic independence and credibility, a fact that facilitated its efforts to overcome the drachma crisis of May 1994.

After the ratification of the Maastricht Treaty in 1992, the relations between the Bank of Greece and the governments became more vague. On the one hand, governments (New Democracy (ND) from 1990-93 and PASOK from 1993-) were obliged by the convergence criteria to follow a strict monetary and exchange rate policy and therefore there were no conflicts with the policy of the Bank of Greece to reduce inflation. On the other hand, a sequence of administrative developments created doubts about the degree of independence of the central bank. Two successive Governors were forced to resign in less than two years, proving that the political independence of the Bank of Greece was almost non-existent.

THE STATUTE OF THE BANK OF GREECE BEFORE INDEPENDENCE

The Statute of the Bank of Greece, until the Law of 2 December 1997 that consolidated its independence, provided the following:

The governing body of the Bank is the General Council. The General Council consists of the Governor, the two Deputy-Governors, and nine non-executive Councillors. The General Council is entrusted with the general operational, administrative and financial affairs of the Bank. The Governor is responsible for all issues relating to monetary and exchange rate policies. In his decision-making tasks, the Governor consults his Deputy-Governors, the Economic Adviser, the Legal Adviser, and the heads of divisions. An internal Committee on Monetary and Credit Affairs is responsible for the authorisation and supervision of banks.

The General Council is accountable to the General Meeting of shareholders, which has the power to approve the annual report and the accounts of the Bank, to appoint the members of the General Council and to propose amendments to the Statute, which, subsequently, must be ratified by Parliament as a Law. The Governor and the Deputy-Governors are appointed by the President of the Republic of Greece, after a proposal by the General Council that is endorsed by the government, for renewable four-year terms. The nine Councillors are elected by the General Meeting for renewable three-year terms.

The statutory objective of the Bank of Greece is to control the currency in circulation and credit[50], and its main tasks are the implementation of monetary and exchange rate policies. The Bank of Greece formulates monetary policy in accordance with the government's macroeconomic objectives, particularly those for inflation, output and exchange rate policy. It also implements the exchange rate policy that is formulated by the government in consultation with the Bank. Interest rates of government paper are set by the Government, albeit in consultation with the Bank.

A non-voting Government Commissioner may attend the General Meeting and the meetings of the General Council. He can veto decisions if he/she considers them to

[50] That is considered to be equivalent to monetary stability. It has to be mentioned that according to article 4 of the Bank's statute, officially, the main objective of the Bank was until 1998 "to preserve the stability of the gold value of its bonds" since although it has been amended it has not been replaced in the statute.

be contrary to the Statute or any other laws of the State. Further accountability is ensured by the publication of the Bank's Annual Report and other financial statements.

NEW DEVELOPMENTS FOR GREECE AND ITS CENTRAL BANK

GREEK ECONOMY AND POLITICS IN THE 1980s AND 1990s[51]

The economics and politics of the 1980s were characterised by the efforts of the governments of PASOK (Pan-Hellenic Socialist Movement) to show a profile with more emphasis on welfare policies. Andreas Papandreou, the founder and leader of PASOK, dreamed to create a country where social justice, equality and people's supremacy would prevail. During his first two terms as Prime Minister (1981-1989) he succeeded to alter significantly the pre-existing social balances but with a cost to the economy. His early economic policy was based on expansionary fiscal and monetary policies that gave emphasis to income redistribution. In addition, the nationalisation of big firms that has begun in the 1970's has been promoted further, forming a huge and dysfunctional public sector. As a result, the already high public deficits and debts got out of control and the government, after winning the 1985 elections, was forced to change its economic policy. In the face of a balance of payments crisis, the government devalued the drachma and imposed a two-year wage freeze. At that time, some first steps towards liberalising the financial system and capital flows were also taken. However, despite the fact that fiscal deficits remained largely uncontrollable at the end of 1987 with a view to the 1989 elections, the Papandreou government switched again to expansionary fiscal, monetary and incomes policies.

The critical economic situation and a big economic scandal were the main reasons for the defeat of PASOK in three consecutive elections between 1989 and 1990. Due to the electoral system, however the winner of the elections, the right-wing New Democracy (ND), could only achieve a one-vote majority in Parliament in the third election. During the period of political instability and government coalitions (1989-90) the country experienced another balance of payments crisis as public deficits and debts rose

[51] See for details Alogoskoufis G.(1995), and OECD: Greece: Economic Outlook (issues from 1980-95).

significantly. At the same time, inflation soared (22%) making the economic situation even more difficult.

In such a framework, the new government in 1990, led by Constantine Mitsotakis, concentrated on the economic issues. In order to cope with the problems of public finances and the balance of payments, it followed a completely different approach from that of PASOK. The new economic policy was based on a series of privatisations and the liberalisation of markets. However, during its first two years, the government proved to be equally slow and ineffective in tackling with the structural weaknesses of the economy.

At that time, the ratification in Parliament of the Treaty on European Union (Maastricht Treaty) was a significant landmark for Greek politics, since both big parties supported it and therefore agreed more or less for the course that the economic policy should follow. In 1992, Mr. Stephanos Manos, the third Minister of National Economy under New Democracy in two years, under pressure to meet the Maastricht criteria, announced measures that aimed to full liberalisation of prices, deregulation, tight control of government enterprises, social security reform, numerous privatisations and infrastructure investment. The opposition parties, the labour unions and a significant percentage of the general public, however, opposed these moves, as it was considered that Mr. Manos's policies led to a general sell-out of the country's assets and to mass dismissals.

Mr. Manos was not able thoroughly to implement his over-ambitious programme due to developments in the area of foreign policy. During the early 1990s, the dispute between Greece and the Former Yugoslav Republic of Macedonia (FYROM) about the name of the latter and some other constitutional issues, became a very serious issue in the country. The resignation of Mr. Andonis Samaras, an ex-Minister of Foreign Affairs, from the New Democracy party due to disagreements on the issue with FYROM, forced Mr. Mitsotakis to call new elections since he lost the Parliamentary majority. In the elections of October 1993, PASOK took advantage of the economic discontent of the people and the problems in foreign policy, and as a result another Papandreou government was brought in with a large majority.

This PASOK government followed quite a different economic policy than those in the 1980s, probably due to the convergence criteria of the Maastricht Treaty. Even Mr. Papandreou, who had protested forcefully against the entry of Greece in the EEC in 1980, was, by 1993, convinced that the interest of Greece was to be part of the Economic and Monetary Union (EMU). The Papandreou government continued the anti-inflationary monetary and exchange rate policies of its predecessor, and took some extra measures in order to control fiscal deficits. However, PASOK abandoned, reversed or interrupted many of the privatisations and contracts of the previous government, especially the ones that encountered public opposition. This new economic policy started to show some positive signs, especially regarding inflation and growth, although there were no significant measures on the fiscal side to cope with the everlasting structural problems of the economy.

In January 1996, Mr. Papandreou's ill health forced him to resign from Prime Minister. In his place, PASOK's members of the Parliament elected Mr. Constantinos Simitis. The predominance of Mr. Simitis, who had often disagreed with Mr. Papandreou's policies in the past, was considered a major opportunity for Greece to follow a modern way of governing with a more European profile. Unfortunately for Mr. Simitis, within his first week as Prime Minister, a major dispute with Turkey broke out over the ownership of an islet in the Aegean. Although a military clash was finally avoided, the government was forced to change its immediate priorities. During the same period (January 1996-June 1996), the questions about the role of Mr. Papandreou, who was still Chairman of PASOK, and his ability to still exert some power did not allow Mr. Simitis to make any bold moves. As a result, important decisions in most areas were delayed significantly and the new government was characterised by irresolution. The death of Mr. Papandreou in June 1996 and the election of Mr. Simitis also as Chairman of PASOK consolidated him as the indisputable leader of the governing party. Mr. Simitis, with the excuse of the necessity for a strong government to take the big decisions that the country needed, called early elections in September 1996. Having as his main slogan the need for "modernisation of the state", Mr. Simitis was re-elected as Prime Minister with a significant parliamentary majority. In November 1996, he presented a tough budget with the aim to achieve the country's place in the Single Currency by year 2001.

Although the economic indices improved significantly during 1997, the country was still distant from convergence with other European countries. The entire economic effort was based on the 'hard-drachma' policy neglecting necessary measures on the fiscal side. In order also to decrease the payments for the public debt, the government was reducing interest rates much quicker than was appropriate. As a result in October 1997, the Asian crisis helped induce a drachma crisis in Greece. Speculation about a devaluation of the drachma was widespread but the Bank of Greece with prudent moves managed to overcome the crisis, as it has done in 1994. In December 1997, the government presented another tough budget in its attempt to meet the Maastricht criteria by 1999, in order to participate in the Monetary Union with the second wave countries.

In the first days of 1998 some pressures on the drachma re-appeared, convincing the government that the speculative moves were not just due to the Asian crisis, but had more to do with the fiscal infrastructure of the Greek economy which was considered problematic by foreign investors and speculators. Although the government claimed that the main reason behind the attacks on the currency was the uncertainty about which countries would participate in the Single Currency and the exchange rate parities with the countries that will stay out, it decided in March 1998 to devaluate the drachma by 12.3% in order to join the Exchange Rate Mechanism and increase its ability to sustain a stable currency. At the same time a series of structural measures such as denationalisations, liberalisation of the labour market, modernisation of the pension system and re-evaluation of the strategic programmes of big national enterprises were considered necessary in order to gain the full benefits of this move.

As mentioned, the Greek economy although it is not considered totally sound, has shown some positive and encouraging signs during the last decade and especially after 1993. The problem, however, has been that it depended primarily on exchange rate and monetary policies, and less on fiscal and incomes policies. This was done mainly because governments were unwilling to take the necessary structural measures due to the political cost these entailed. Unfortunately, at some point this policy has reached its limits and could not contribute any further to the reduction of inflation and the expansion process. The decision to devaluate the drachma and simultaneously to join the Exchange Rate Mechanism has proven to be extremely successful, since from that date the

economy has improved significantly and the drachma has gained the credibility it lacked in the past. As a result, in June 1999, the European Council accepted Greece as the twelfth member of EMU since it has achieved all the relevant convergence criteria. Nevertheless, there are still many bold decisions to be taken in the fields of structural reform, the reconstruction of public administration and denationalisations, in order to create the necessary conditions for long-term economic growth and real convergence with the other countries of the European Union.

TABLE 2

TABLE 2: PROGRESS OF THE BASIC GREEK ECONOMIC FIGURES (% annual change)

GREECE	1991	1992	1993	1994	1995	1996	1997	1998*	1999*
1. GDP	3.1	0.7	-1.6	1.7	1.8	2.6	3.5	3.5	3.7
2. Inflation	19.4	15.9	14.4	10.9	8.9	8.2	5.9	4.5	2.5
3. Unemployment	7.3	7.6	7.1	7.2	7.9	9.1	10.1	9.8	9.3
4. Unit Labour Cost (%)	9.3	12.6	12.7	11.7	11.3	9.9	7.6	3.5	1.5
5. Budget Deficit (% GDP)	11.5	12.8	13.8	10.00	10.3	7.6	4.2	2.4	2.1
6. Primary Surplus (% GDP)	-2.1	-1.1	-1.0	4.1	2.6	4.4	6.2	6.7	6.6
7. Public Debt (% GDP)	92.3	98.8	11.6	109.3	110.1	111.6	109.0	107.8	105.8
8. Current Account Surplus / Deficit	-11.5	-12.8	-13.8	-10.00	-10.3	-7.5	2.5	2.7	2.7
9. Mean Annual Interest T-Bonds	25.1	23.7	22.6	20.5	14.8	12.6	9.8	9.5	7.5

Source: National Statistical Service of Greece (NSSG) – National Accounts 1996-1999 Estimations and Projections Directorate for Macroeconomic Analysis; The 1998 Update of the Hellenic Convergence Programme : 1998-2001.

* According to the revised Convergence Programme for the period 1998-2001.

THE IDEA AND THE PLANS FOR AN INDEPENDENT BANK OF GREECE

The idea of an independent Bank of Greece was proposed at the start of 1992 shortly after the ratification of the Maastricht Treaty by the Greek government (New Democracy). The then Minister of National Economy, Euthimios Christodoulou (an ex-

member of the European Parliament) and a strong supporter of EMU, was considering at the time the change of the status of the Bank in order to increase the credibility of monetary policy and meet the relevant criterion in the Treaty. In February 1992, he became governor of the Bank and Mr. Stephanos Manos was appointed in his place as Minister of National Economy. From the start, the collaboration between the two was not ideal, due to some comments made by Mr. Manos that the previous years were "lost years" for the Greek economy as well as disagreements on the proper time to join the ERM and the liberation of capital movements. Furthermore, their approaches on the way that economic policy should develop were quite different.

Mr. Christodoulou, as a governor of the Bank of Greece attempted to modernise the Bank and enforced some revolutionary changes in the way banking activities were conducted. At the same time, whenever he had the chance, he called for the independence of the Bank.

In June 1993, a decision by the Bank of Greece to raise the limit on the credit cards, (while Mr. Manos was hostile to such a move), created a new clash between the two men and became a serious issue in the media. Mr. Manos denied the accusation that there were problems between the two of them and revealed that he had a meeting with Mr. Christodoulou and representatives of the International Monetary Fund (IMF) in which they discussed the independence of the Bank of Greece. In order to prove his full support of the idea, Mr. Manos commented that only with independence could monetary policy be safeguarded in the long run against both politicians and inflation. (Eleftherotypia, 18 June 1993)

In July 1993, the Bank of Greece presented a draft law for the independence of the Bank, but the plan prepared by the Ministry of National Economy in September was quite different. The main differences were that in Mr. Christodoulou's plan the Governor retained (directly or indirectly) more administrative power than the other members of the council, and also that in the ministerial plan the government had more influence through the appointment process, the composition of the council and the accountability procedure. In the meantime, the announcement of national elections interrupted all discussions and the whole issue was forgotten since the government decided not to include it in its economic manifesto.

In October 1993, New Democracy lost the elections and PASOK came once more into power. Mr. Giorgos Yenimatas became the new Minister of National Economy, while Mr. Christodoulou remained governor of the Bank of Greece until the end of November when Mr. Yiannis Boutos replaced him. Mr. Boutos was an ex-Minister of National Economy with New Democracy who had left the party and thereafter developed close relations with the entourage of Andreas Papandreou, the president of PASOK and once more Prime Minister.

On 1 January 1994, stage two of EMU came into effect and from that time on the Greek government was prohibited to borrow on preferential terms from the Bank of Greece, while at the same time the Bank was not allowed to finance the public sector deficit. This was an obligation that significantly altered the relationship between the Bank and the government. Moreover the Treaty provided that during this stage the government had to grant the Central Bank its independence by law.

In April 1994, Mr. Boutos had a dispute with the under-secretary of National Economy, Mr. Yiannos Papandoniou, over the interest rates of the commercial banks. A few days later, Mr. Boutos in his annual report called for independence and revealed the characteristics of the model he proposed to the government. This was the first time a Governor of the Bank of Greece was declaring so clearly his support for central bank independence.

In the first days of May 1994, exchange rate pressures emerged since there were speculations that the drachma would be devaluated. That was due to the expected abolition of all capital restrictions in the movements of capital and exchange rate actions, after 1 July 1994. The government, in co-operation with the Bank of Greece, decided to precipitate the liberation of short-term capital movements and significantly raised interest rates in order to discourage speculative moves. This successful facing up to the significant disturbance of the markets in the period from 11 May until 17 June 1994 showed the determination of the Greek authorities to support the policy of the strong drachma and boosted the credibility of the Bank of Greece.

Unfortunately, the satisfaction for the successful co-operation between Mr. Boutos and Mr. Papandoniou, who in the meantime became Minister of National Economy after the

demise of Mr. Genimatas, did not last for long as Mr. Boutos was 'forced' to resign in October 1994. The exact reasons for his resignation were never made public. According to the press, the motive was a decision of the Governor to remove the commissioner of the Bank of Crete from his position, despite the opposition of the Prime Minister and his entourage. Mr. Boutos was asked to call off but he refused and thus decided to resign. In his comments in the media he claimed that it was a matter of principle for him and also mentioned with bitterness that "until the Bank of Greece becomes independent it will always have to act according to the government's will"(Ependytis, 15-16 October 1994). However, apart from the above incident there were widespread rumours that the real problem was Mr. Boutos's bad relations with Mr. Papandoniou, Mr. Mirkos (the Governor of the National Bank of Greece), and many other members of the governing party.

Mr. Lucas Papademos, the deputy-governor, was appointed to replace his former superior as Governor. Mr. Papademos, from the start of his term, called for monetary stability, co-operation with the monetary and other authorities, as well as for central bank independence. In an interview, in January 1995, he revealed that Mr. Papandoniou said that "independence will be realised before the end of 1996..." (Eleftheros Typos on Sunday, 15 January 1995). He mentioned however that the Bank of Greece has, in general, a significant degree of independence in determining its targets and in conducting monetary policy.

In February 1995, the daily newspaper "Adesmeutos Typos" published an article on the questions and anxiety of European officials regarding the delay of the independence of the Bank of Greece. The author of the article, commenting on the independence that the Bank of Greece enjoys, mentioned caustically that "it depends on the patriotism and consciousness of each Governor".

During the next year there was no particular change in the matter, probably due to the transitional stage that the country, and especially PASOK, went through after the death of Mr. Papandreou.

The only specific and significant mention of the issue until August 1996 was a publication in January 1996 from Giorgos Alogoskoufis, an academic and ex-president

of the economic experts in the ministry of national economy during the New Democracy government. Mr. Alogoskoufis was the person most heavily involved in the preparation of the draft plan of the Ministry of National Economy under Mr. Manos. In his publication, Mr. Alogoskoufis was concerned with the Bank of Greece, inflation, central bank independence and democratic accountability. He proposed a model of independence for Greece (actually the same model he had prepared two years earlier) and 'accused' PASOK that instead of granting the central bank its independence it had changed the Governors twice in two years (Alogoskoufis G., 1996).

In August 1996, the Bank of Greece sent to the Ministry of National Economy a new plan for its independence (with no considerable differences from the one of Mr. Boutos). Mr. Yiannis Stournaras, the Chairman of the Council of Economic Experts of the Ministry of National Economy, confirmed that "the Minister (Mr. Papandoniou) was considering the details and that the bill would pass through Parliament immediately after the September elections" (Interview Stournaras Y., 29 August 1996).

PASOK did win the September 1997 elections with a reasonable parliamentary majority and from that date the reform of the Bank of Greece was under way, even though with slow steps. The decision of Prime Minister Mr. Simitis not to substitute, as was the usual practice after an election, the governor, Mr. Papademos proved significant. The governor continued his calm co-operation with Mr. Papandoniou, inflation was reduced to its lowest point in the last 27 years, and the government was convinced that an independent Bank under Mr. Papademos could operate effectively and co-operatively.

In January 1997, according to press reports, the delay on the matter of independence was due to the fact that the Bank of Greece was waiting for the approval of its plan by the European Monetary Institute (EMI), the predecessor of the European Central Bank (ECB). According to central bank officials, the government wanted to be sure that the model to be chosen would be compatible with the one described in the Maastricht Treaty. The reports also mentioned that within February of the same year the bill would be ready to pass through Parliament.

Unfortunately, these predictions were inaccurate once again since it was not until the end of March 1997 that some official conversations and meetings between Mr. Papademos,

Mr. Stournaras and the general secretary of the Ministry of National Economy, Mr. Apostolos Fotiades, were held. The impact of these meetings and the details described in the press reports showed that, finally, something more than considerations and intentions for an independent Bank of Greece were taking place. The press reports mentioned that during May the bill would be tabled in Parliament.

In April, there were some rumours and press reports that when the new bill would come into force there would be changes of governors. This has been denied from government officials who said that in the new bill it is specifically mentioned that the current administration's contracts would be allowed to run their course.

At last, in 30 May 1997 the Minister of National Economy, Mr. Papandoniou, tabled in Parliament the plan for the independence of the Bank of Greece. The only significant change from the previous plans was that the term of office of the newly established monetary policy council would be turned from four to five years. According to the reports the plan would be discussed in the parliamentary committee for economic affairs and would then come into voting during the summer term of Parliament (which begins on the 1st of July). Mr. Papandoniou also mentioned that the terms of the current governor and two deputy-governors would be renewed for another term (6 years).

The press covered the issue for a couple of days but there were very few comments on its implications and real intention. The great majority of the articles published were much in support of the principle of the change but there was some criticism on the particular arrangements of the plan. The most important objection was that of Mr. Alogoskoufis and Mr. Manos who not only defended their own old plan but also took the opportunity to accuse the government of PASOK of a four year delay and the dismissal of two governors since it came in power.

On 12 June 1997, the draft law was taken to the Central Legislative Council for an opinion regarding its constitutional and legislative qualification. On 11 July 1997, after some minor corrections, it was sent once more to the European Monetary Institute (EMI) for a final examination on the compatibility with the Statutes of the forthcoming European System of Central Banks. The EMI returned its opinion on 28 August 1997. Its

main objections related to the fact that the draft law should refer in more details to the responsibilities and integration of the Bank of Greece in the ESCB.

During the summer of 1997 there were some meetings between government officials and members of the New Democracy party in order to eliminate the differences on specific articles of the draft law. The aim of the government was to pass the law in Parliament unanimously, since in principle the two major parties agreed with the reform. The newspaper "Kathimerini" on 27 July 1997 pointed out in its main articles this significant and unprecedented attempt in Greek politics to put aside the party differences and reach an agreement in such a crucial issue. It pointed out that "after seventeen years of conflicts in relation to the Bank of Greece, such moves defended its credibility and improved the quality and prestige of the Greek political life".

The result of these meetings was obscure however, since although there were some modifications in the new draft law that Mr. Papandoniou presented on the 25 September 1997, disagreements still existed. The discussions thereafter were continued in the Parliamentary Committee for Economic Affairs and then in the plenary session of the Parliament.

THE DRAFT LAW AND ITS ADOPTION IN PARLIAMENT

THE DRAFT LAW OF SEPTEMBER 1997

With the final draft law, "Settlements for the Bank of Greece", of 25 September 1997, the Greek government promoted the independence of the Bank of Greece and established its integration in the ESCB. The main provisions of the draft law were the following:

The primary objective of the Bank of Greece is to maintain price stability and, without prejudice to the objective of price stability, the Bank supports the general economic policy of the government. (article 1.1)

When exercising their powers and carrying out their tasks and duties, the Bank of Greece and the members of its bodies shall not seek or take instructions from the government or any other institution. (article 1.2)

The basic tasks of the Bank of Greece are the following: to define and implement monetary policy (this includes credit policy); to conduct the foreign exchange policy of the drachma against the other currencies, consistent with the framework of the foreign policy that the government favours after consultations with the Bank; to hold and manage the official reserves of the country; to promote the smooth operations of the payment systems and to supervise all financial and credit institutions; to issue bank notes; and to act as the cashier and agent of the state. (article 2.1 & 2.2)

The Bank of Greece participates in the ESCB from its establishment. Upon the adoption of Euro as the national currency of the country, and when exercising its duties the Bank of Greece acts according to the instructions of the European Central Bank (ECB). (article 2.3)

The Bank of Greece shall address an annual report on monetary policy to the Parliament and the Cabinet. The Governor shall inform the Parliament whenever called and can also ask the Parliament for a hearing, as well as participate in the Cabinet meetings when matters related to the objectives of the Bank are discussed.

The basic bodies of the Bank are the General Meeting of shareholders, the General Council, the Governor and the Deputy-Governors and the newly established Monetary Policy Council (MPC). The MPC decides on the definition and the implementation of monetary policy, as well as on the matters related to the conduct of exchange-rate policy, the operation of the payment systems and the issue of bank notes.

The MPC is comprised by the Governor, the Deputy-Governors, and three[52] other members. The Governor and his Deputies are appointed by a Presidential decree on a Cabinet recommendation and after the proposal of the General Council. The other three members of the MPC are appointed by a Presidential decree on a Cabinet recommendation and after the consultation of the Governor. The members of the MPC shall be persons of recognised standing and professional experience in monetary or banking matters and will be appointed for a full time renewable six-year term of office. They can be removed from office only if they permanently become incapable to conduct their duties or if they have been guilty of serious misconduct.

The General Council retains its responsibilities, under the Bank's constitution, as long as they do not refer to issues that are under the duties of the ESCB, in which case

[52] The draft law of May 1997 provided for two other members in the MPC. The government decided to make them three so that the number of the 'internal' central bankers, i.e. the governor and the two deputies, is the same with the number of the 'externals', the ones the government appoints more directly.

responsibility rests with the Governor. With the exemption of the issues that are assigned to the MPC, the Governor has the responsibility for all other issues under the present legislation.

THE DEBATE IN THE PARLIAMENTARY COMMITTEE

On 9 October 1997, the Parliamentary Committee of Economic Affairs met to discuss the draft law of the Ministry of National Economy, "Settlements for the Bank of Greece". At the meeting there were present the Minister of National Economy, Mr. Yiannos Papandoniou, the under-secretary of National Economy, Mr. Alexandros Baltas, and twenty five members of the governing party PASOK, eighteen members of the New Democracy party (ND), two members of the KKE (the Greek Communist party), two members of Synaspismos (SYN - a left wing party) and one member of DIKKI (a left wing party whose majority of members were ex-PASOK members).

The first to open the discussion was Mr. Georgios Anomeritis, the speaker of the majority. Mr. Anomeritis stressed the significance of this draft law since according to him, the concern of the government was to find the golden mean between the necessary independence of the Central Bank and the required control, from the side of the political authority. The aim, he claimed, of this draft law was to harmonise the national legislation with the statute of the ESCB and to make the Bank of Greece independent from any kind of interference, but simultaneously to ensure democratic control from Parliament. Mr. Anomeritis, having briefly analysed the topics that were included in the draft law, expressed his certainty that in principle there would be no differences, at least not among those who have as their basic position the European orientation of the country. According to his view the discussion should concentrate on the relationships between the Bank, the Parliament and the government, as well as on the issues that refer to the Monetary Policy Council.

The speaker of minority (ND) Mr. Ioannis Joannos, began his speech also by stating the importance that the independence of the central bank plays for a country's stability (economic and political). According to him, his party regarded the consolidation of the independence of the Bank of Greece as compelling and that the draft law is in the right direction, although the government has delayed a great deal. Mr. Joannos agreed with

Mr. Anomeritis that the Committee should focus on the issues of democratic control, the role and appointment procedure of the MPC, and also the issue of the primary objective. He stressed that these matters had to be clarified since a lot of powers would be transferred to the European Central Bank when Greece joins the single currency, giving rise to the danger that there would be no control at the national level.

Mr. Achilleas Kantartzis, the principal speaker of KKE, expressed his complete disagreement regarding both the Maastricht Treaty as well as such a reform, by stressing that under this draft law, in reality, the country ceded a sovereign right to the 'Brussels directorate' and transformed the Bank of Greece into a branch of the ECB. He claimed that the Bank's efforts would concentrate on the implementation of monetary and credit policy, that the European Union would determine in principle of the interests of the monopolies and the multinational companies, and not the interests of the country and its people. Mr. Kantartzis mentioned that the role of the state should be dominant in the effort to serve the people's and the country's interests and that the Bank of Greece should have a pivotal part in such a policy.

The following speaker, Mr. Evagellos Apostolou, chief speaker of SYN, had no objection to the central bank not being used as an instrument for the party needs of each government in power, as was often the case in the past. Nevertheless, he expressed his worries that under the proposed arrangement the Bank of Greece would not be independent from external (EU) interests and would eventually serve a monetary superpower (the ECB) that will ignore even the Greek Parliament. Mr. Apostolou presented some amendments in order to secure democratic control, that according to his party's views, were absent in the draft law. He proposed five year terms of office instead of six for the members of the MPC; appointment of the Governor and the Deputy-Governors from the Parliament and then ratification by the Cabinet; and submission of report from the Bank to the Parliament semi-annually and not annually.

The final speaker, Mr. Anastasios Intzes of DIKKI, also stressed the significance of the proposed reform since the Parliament withdrew from the control of an institution responsible for the implementation of monetary policy. According to Mr. Intzes, under the proposals, the people's sovereignty and the independence of the state would vanish, since the most important instrument to exercise power would not be controlled by an

authority within the state, but from another in Frankfurt. Mr. Intzes stressed his party's opposition to the draft law not only because substantial national interests would be at stake but also because in their view such an arrangement is against the Constitution.

The second meeting of the Parliamentary Committee was held on the 15 October 1997, with the following present: Mr. Lucas Papademos, Governor of the Bank of Greece; Mr. Demetrios Kouselas, President of OTOE (Greek Banking Employees Federation); Mr. Georgios Kaskarelis, President of the Bank of Greece Employees Association; and Mr. Ioannis Mourgelas, Legal Advisor of the Greek Banking Union. Mr. Euthimios Christodoulou, ex-Governor of the Bank of Greece, ex-Minister of National Economy and Member of the European Parliament (ND), although invited, could not attend and sent a memorandum.

It must be mentioned that Mr. Georgios Alogoskoufis (ND) and some other members of the Committee, insisted that Mr. Yiannis Boutos, the previous Governor of the Bank of Greece, should have been called as well since he had also prepared a plan for the independence of the Bank of Greece. The members of PASOK, however, denied these demands, pleading that it was not proper to equate the present administration with the past and also that Mr. Boutos did not represent any particular body anymore. Opposition accused the government that it was afraid of Mr. Boutos' presence due to the conditions under which he was forced to resign in 1994.

The first representative to express his views on the issue of the independence of the Bank of Greece was the Governor of the Bank, Mr. Lucas Papademos. The Governor emphasised the importance of the draft law for the Bank of Greece, especially due to the creation of the Monetary Union. Mr. Papademos presented a different view from those expressed by most MPs during the first meeting. He stated that the proposed draft law would create close relations between the Bank of Greece and the Parliament since the democratic control of the Central Bank would be exercised by the Parliament and not by the government. Mr. Papademos also claimed that the old framework of the Bank was neither adequate for the efficient operation of the Bank, nor in agreement with the Maastricht Treaty. He explained that the Statute of the Bank, although repeatedly amended, did not specify with clarity and completeness the objectives, duties and businesses of the Bank. He claimed that the new draft law would form a modern

operational framework which would contribute to the efficient implementation of the Bank's duties.

Mr. Papademos pointed out that the independence of the central bank, as international experience has proved, may contribute to the efficient practice of monetary policy but only under the condition that the direction of the general economic policy would be consistent with the monetary one. He made clear, however, that the enactment of autonomy would not be by itself a sufficient condition for a more effective exercise of monetary policy. The Governor, mentioned that what was required was the implementation of an economic and monetary policy mix, co-ordination by monetary and fiscal authorities and the assurance of autonomous action in practice. He asserted that the independent Bank would be neither uncontrolled nor unaccountable for its actions and choices. He referred to the provisions of the draft law under which the Bank would support the economic policy of the government and stated that he and the Monetary Policy Council (MPC) would be judged by the politicians and the public, by their effectiveness to achieve their objectives. He added that the democratic control would be furthermore guaranteed by the reports to the Parliament and the discussions in the relevant committee. Finally Mr. Papademos also stressed the significance of the new arrangements for the supervision of the commercial banks.

Following the speech of the Governor the members of the Committee raised some questions. Mr. Papademos, answering the questions, claimed that although there would always be the possibility of a conflict between monetary and fiscal policies, during that phase something like this seemed unlikely since the general government policy goals were consistent with the ones of the Bank. Apart from that, he reminded that this possibility of a conflict would only be temporary since in 3–4 years, after the adoption of the Euro, everything would be different since responsibility would rest on the European Central Bank. He made clear however, that in the case of a conflict the Bank would have to give priority to the objective of monetary stability and not to the economic policy of the government. Answering another question, Mr. Papademos said that during his term of office the governments had not interfered in his duties and the Bank of Greece enjoyed a significant degree of independence.

In the observation of Mr. Alogoskoufis (ND) that with the proposed legislation the MPC will not have equal members, since the Governor and his deputies will have also administrative powers, Mr. Papademos said that he did not believe this would be a factor that could influence the decisions in monetary matters. He also mentioned that the Bank of Greece was ready to accept any change in such a matter as well as on issues of democratic control, such as the Parliamentary Committee approving the appointments of the Governors, evaluating the performance of the MPC or addressing two reports.

Following Mr. Papademos' answers, the Minister of National Economy Mr. Papandoniou, intervened to present the official governmental position and to answer some of the questions that concerned the government. Mr. Papandoniou declared that the aim of this reform was firstly typical, since it harmonised the statute of the Bank of Greece with that of the ESCB, and secondly essential, as it promoted the credibility of monetary policy. He claimed that this credibility would contribute to the consolidation of low inflation, lower interest rates and eventually higher growth. Mr. Papandoniou mentioned that the political range of this reform was smaller than it seemed for two reasons: firstly, the independence of the Bank of Greece already applied de facto, since the Bank was governed by capable and authoritative governors who did not seek or accept advice; and secondly, due to the short time horizon of the reform, as in 3-4 years there would be no drachma but the Euro and there would be no national exchange-rate and monetary policies.

In regard to the terms of office of the present administration, Mr. Papandoniou, said that the government had decided to reappoint the Governor and the Deputy-Governors all for the same duration, even for the first term, since that would assist its authority and its unity. For the other members of the MPC, he mentioned, that their first terms would be different in order to ensure the piecemeal renewal of the Council's composition after the first terms. Finally, concerning the democratic control he agreed to change the relevant article so to ensure that the Governor would be called before the Parliamentary Committee every six months.

After Mr. Papandoniou, it was the turn of the representative of the Greek Banking Union, Mr. Mourgelas, to present his position. Mr. Mourgelas made some comments not on the general effects of the reform but mostly in regard to specific provisions related to the

banking sector. He mentioned the need to have a settlement in the draft law to clarify that the central bank will not exercise business-banking operations[53], since that would not fit with its regulatory and stabilising role. Mr. Mourgelas also wondered whether the primary objective of the Bank should also include the provision to 'preserve the smooth operation of the markets'.

The next speaker, Mr. Kouselas, the president of OTOE (Greek Banking Employees Federation), declared that OTOE supported the independence of the Bank of Greece but stressed that the democratic control from Parliament should be strengthened. He furthermore presented three proposals for the functionality and efficiency of the Central Bank: the MPC should have seven members in total, with the members that the Parliament selects to be the majority in order to improve the democratic control; the terms of office for the Governor and the Deputy-Governors should be five years and not six and for the other four members it should be three years (as in France); and the General Council of the Bank to have broader responsibilities so that it does not constitute an ornamental body.

The final speaker was Mr. Kaskarelis, the president of the Bank of Greece Employees Association. Mr. Kaskarelis expressed the view that under the provisions of the draft law the problem of democratic accountability was not solved since the appearance of the Governor in front of a Committee does not guarantee the necessary control. Mr. Kaskarelis proposed to increase the number of members of the MPC so that the 'independent experts', which would be appointed by Parliament for three year terms, to have the majority. He also suggested that in the General Council there should be a representative of the employees, as in the Bank of France. Mr. Kaskarelis mentioned however that the independence of the Bank would not have any effect on the Bank's employees since the administrative policy would not change.

At the end of the debate the draft law was put to vote, by hand raising, and the majority welcomed in principle the reform.

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[53] The Bank of Greece is one of the very few Central Banks in the world that operates as an enterprise and participates in the Greek Share Market. In theory it has the ability to conduct operations as any other enterprise.

In the third meeting the Committee concentrated on the articles of the draft law for the independence of the Bank of Greece. The Minister Mr. Papandoniou made some additions in accordance to the recommendations made in the previous meetings. More specifically he added that the Bank should address a second report to Parliament and also he equated the authority of the simple members of the MPC with the one of the Governor and the Deputies, by promoting them also to members of the General Council, with broader responsibilities and duties. He also accepted the participation of the representative of the employees to the General Council.

During the discussion of the articles the members of the Committee made various proposals, in order to improve the functionality and accountability of the Bank. Mr. Anomeritis (PASOK), expressing the view of many members, said that the democratic control could be strengthened if the Committee approved the Bank's appointments. Mr. Joannos (ND) demanded that the current administration, except for the Governor, should not be appointed for another six year term but only until the end of their current term. The representative of KKE just repeated his party's general opposition to the reform and stated that for this reason the KKE could not support any of the articles. Mr. Dragasakis of Synastismos asked for a settlement that would guarantee that the reports of the Governor would not just be addressed to the Parliament but would be discussed in detail and commented by experts. Finally, Mr. Alogoskoufis (ND) proposed that the Parliamentary Committee should vote on the Bank's performance, in case that the Bank fails to meet its objective.

Mr. Papandoniou answering to the above requests was very clear. He said he would consider having the members of the MPC, who are not Governor and Deputies, approved by the Parliamentary Committee, although, he ruled out the request for a 3/5-majority approval of the appointments; he said that in a small country with a small Central Bank like the Bank of Greece there is no need for large councils as an increase in the members of the MPC (from 6 to 7) could create functionality and administrative problems[54]; on the issue of democratic accountability Mr. Papandoniou said that if the Committee could express a negative opinion regarding the Bank's performance then there was the danger

[54] The Deputy-Governor of the Bank of Greece, Mr. Nicolaos Garganas, has also explained (interview of 16 April 1997), that the Bank of Greece should not have a large council since first there would be cohesion problems and second in Greece there are few distinguished individuals in monetary matters.

that the latter would start to compromise and would then be influenced by politicians, something which would be against the idea of independence. The Minister emphasised that if the Governor was involved in politics that would harm his prestige and his ability to exercise uninfluenced and objectively his duties; finally, he was reserved on the issue of the first appointments of the Deputies and said he would give his final answer at the plenary session of the Parliament.

At last, the articles of the draft law were voted by the majority, again by hand raising, and the debate in the Parliamentary Committee of Economic Affairs was brought to an end. The draft law was then passed to the Plenary Session of Parliament.

THE DEBATE IN THE PLENARY SESSION OF PARLIAMENT

The discussions in the plenary session of the Greek Parliament of the draft law "Settlements for the Bank of Greece" took place on the 20 and 25 November 1997. During that first hearing of the draft law the representatives of each party presented their general stance on the proposed reform[55]. In general, the speakers' positions were a repetition of what was heard during the first session of the Parliamentary Committee.

The representatives of PASOK and New Democracy declared their support for the independence of the central bank in principle but stressed the need for democratic control. The speaker of Synaspismos mentioned that although his party was in favour of the independence of the Bank of Greece, it was against this draft law because it contributed to the uncontrolled activity of the European Central Bank. The representatives of the KKE and DIKKI expressed their total disagreement towards the reform since as they claimed it surrendered a very important element of economic policy to an independent institution that would not serve the interests of the country and Greek people.

During the second hearing on 25 November 1997, the Minister of National Economy Mr. Yiannos Papandoniou presenting the government's position repeated that this significant reform was not only a requirement for European integration, but also an essential transformation towards a more credible monetary policy, away from political influences.

He also reminded that the Parliament and the public should not have the impression that with the proposed legislation there would be a revolution in the exercising of monetary policy, since the Bank of Greece enjoyed a significant degree of independence. Mr. Papandoniou also repeated that the duration and the real range of the reform was much smaller than many believed, since from 1 January 2002 Greece would participate in the single currency and therefore there would be no national monetary and exchange-rate policies. The impact of the Bank of Greece in the common European monetary policy, he added, would depend more on the personality and prestige of its Governor and less on the economic power of Greece.

Subsequently, Mr. Papandoniou presented some of the amendments that he has made in certain articles, in accordance to the proposals made during the Parliamentary Committee sessions. He accepted that the Bank should address two reports (instead of one) to the Parliament, and the Governor would present himself in front of the competent Parliamentary Committee to give explanations in matters of his authority. Mr. Papandoniou refused to accept the proposals for appointment approvals and further accountability measures, although in the Committee's sessions he gave the impression that he would do so, since as he said that would promote neither its independence nor its authority. The Minister provided that the members of the MPC would be as well (as the Governor and the Deputies) members of the General Council of the Bank, in order to participate in the administration of the Bank. Finally he stated that the terms of office for the first MPC would be as follows: the Governor and one Deputy-Governor for six years, the second Deputy-Governor for five years and the other three members for four, three and two years. Mr. Papandoniou claimed that the above formation preserved the unity and continuity of the administration and at the same time it guaranteed the gradual renewal of the Council. He also revealed that in this decision he took into consideration the recommendations of Ex-Minister Mr. Manos (ND).

Finally, Mr. Papandoniou expressed the wish that the draft law would be voted by everyone both in principle and regarding the articles, since the proposals he had made expressed the views of all parties as presented in the extremely constructive debate in the Standing Committee.

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[55] Due to lack of time the representatives of New Democracy and DIKKI spoke during the second hearing.

After Mr. Papandoniou's comments the members of the Parliament had the opportunity to express their views. Most of them almost repeated the position of their parties, with opposition asking for even more democratic control measures. The comments of Mr. Alogoskoufis (ND), however, had a bigger impression as he accused the government of timidity and delay in making the Bank of Greece independent, although the particular reform had the support of the large majority of the Parliament and therefore did not entail any particular political cost. Mr. Alogoskoufis claimed that due to this four-year delay the country had experienced two monetary crises since 1994 and the consequences for many enterprises were significant. He also mentioned that the amendments made by the Minister were not satisfying since in the crucial issues for democratic control there was no particular change. Mr. Alogoskoufis repeated the requests of most opposition parties, first for appointments to be approved by the Parliamentary Committee with a majority of three-fifths and second for more intense questioning of the Bank's administration in case of divergence from its objectives. Mr. Alogoskoufis finally, mentioned that the terms of office of the then Deputy-Governors should not be renewed for six more years but only until the expiration of their term.

Consequently, the Chairman put the draft law for a first reading (in principle) in which the majority of the members of the Parliament voted in favour (by hand raising). Thereafter, the representatives of the parties presented their position on each article and made some proposals for amendments. The Minister of National Economy Mr. Papandoniou, at the end made some minor technical changes and then the majority of the members of the Parliament voted also in favour of the proposed articles (again by hand raising).

Finally on the 2 December 1997, the draft law "Settlements for the Bank of Greece" became a law (Law 2548/97) as in the third reading (both in principle and for the articles) the majority of the Greek Parliament voted (by hand raising) in favour.

THE ROLE OF THE PARTICIPATING ACTORS IN THE REFORM PROCESS

The establishment of the independence of the Bank of Greece was achieved, as already shown, through a long process. Since the first time the idea was raised until the adoption of the law in the Parliament, the 'independence' issue has passed through various stages with many different actors involved. The role of these actors is of particular importance in explaining the reform process as it determined both the progress of the idea as well as its final outcome. The exact stance of each actor was in turn defined by his or her particular interests, which the prevailing economic, political and other conditions imposed.

This section will try to identify the position and the interests of each participant throughout the reform process.[56] We can divide the participating actors into those which are 'within the government' and those 'outside', in order to have a clearer idea of each one's influence in any stage of the process.

PARTICIPANTS INSIDE THE GOVERNMENT

The Prime Minister

The three Greek Prime Ministers since the idea of an independent Bank of Greece was first suggested had little direct involvement and their position on the issue is not clear. However, it is certain that whenever the Ministers of National Economy made a move for independence they had the approval of the Prime Minister. Mr. Constantinos Mitsotakis, the Prime Minister between 1990-93, did not publicly express his view but the fact that during his government the first plans for independence were presented indicates that he had no objection, at least in principle. However, one can not easily expect that Mr. Mitsotakis during his first year in power would be very hurried to surrender a crucial element of economic policy, especially after eight years in opposition. Nevertheless, the significant increase of inflation in 1990-91, the Maastricht Treaty obligation and his general belief in less state intervention are factors that could have diminished his hesitations.

[56] The period of examination is considered from 1990 until the establishment of CBI.

During Andreas Papandreou's government (October1993-January1996), as already mentioned there was almost no progress at all. Mr. Papandreou, like his predecessor, never referred officially to the issue of independence but he showed no signs of particular sympathy. Mr. Papandreou's conviction that Greece should participate in the EMU was not enough to make him grant the Bank of Greece its independence, at least not before the end of Stage Two. Furthermore, the fact that Mr. Papandreou did not hesitate to oblige two Governors of the Bank of Greece to resign, proves that his perception on the relations between the government and the central bank were not the ones dictated by 'independence'. Nevertheless, as Mr. Papandoniou revealed "even though Mr. Papandreou was not very keen on having an independent Bank of Greece he was not an opponent of the concept" (Interview Papandoniou Y., 2 April 1997).

The third Prime Minister, Mr. Constantinos Simitis, was considered a supporter of central bank independence although he as well never publicly declared his opinion. However, it was well known to those involved in the issues of the Bank of Greece that the Prime Minister was among the first to reinstate the matter of independence. Also just after the resignation of Mr. Papandreou he has revealed his intention to go for independence if he became Prime Minister. Mr. Simitis' stance as Prime Minister also promoted the Bank's independence since he enjoyedgood co-operation with the Governor of the Bank of Greece and did not interfere in monetary matters. (Interview Simitis C., 5 January 1996). The above suggests that although the independence of the Bank was always on his governmental agenda other priorities did not allow him to proceed earlier.

The Minister of National Economy

Between 1991 and the end of 1998 Greece has changed four Ministers of National Economy. Their role on the progress of the independence of the Bank of Greece was probably the most crucial one, since they were involved in all stages of the reform process. Furthermore, the Minister of National Economy is the one who has absolute responsibility for granting the independence of the Central Bank and therefore is the one with a great interest on the final outcome. As the Minister responsible for the course of economic policy, the loss of an important policy tool could make his job much more complicated.

Mr. Euthimios Christodoulou, the National Economy Minister until just after the Maastricht Treaty, as already mentioned, was very much in favour of Central Bank independence and was one of the first to consider the autonomy of the Bank of Greece. However since the Treaty had not been ratified in Parliament there was no chance for him, even if he had wanted, to prepare the necessary legislation, something he did as soon as he became Governor.

Mr. Stephanos Manos who took over Mr. Christodoulou in January 1992, was the first Minister to prepare a plan for independence. Mr. Manos, as a strong supporter of minimal state intervention and freedom of markets, believed that the independence of the Bank of Greece had to be established but did not support Mr. Christodoulou's (then Governor) plans. Mr. Manos did not want to risk having an independent Bank of Greece with a very powerful Governor (especially since it would probably be Mr. Christodoulou) and therefore tried to establish a Governing Council, comprised from the Governor and four Deputy-Governors, that would have broad responsibilities. In his model he also provided for accountability and appointment procedures through which the government retained some influence. The decision of Mr. Manos and his colleagues not to include the independence of the Bank of Greece in their election manifesto suggests that they were unsure of the impact of such a move on the electorate. The majority of the public was opposed to Mr. Manos' privatisation policies and therefore handing over an important economic tool to independent authorities could have a negative effect at that time.

The return of PASOK into power and the economic situation called off Mr. Manos' plans for good, as the next Minister of National Economy Mr. Giorgos Yenimatas set other priorities and also did not have the direct approval of Mr. Papandreou. Mr. Yenimatas' position on the issue is completely unclear, as during his short-lived term he never expressed any opinion.

Mr. Papandoniou who succeeded Mr. Yenimatas is without doubt the one who has put his mark on the issue of independence, as it is his draft law that was finally voted in Parliament. Like most Ministers of National Economy however, he was not in great hurry to make the Bank of Greece independent since its policies could make difficult the attainment of some other fiscal goals. Although he was arguing for the independence of

the Bank and had a draft law ready since August 1996, the ratification of the legislation was achieved just before the end of the Maastricht deadline in December 1997. Mr. Papandoniou was more interested to achieve his other policy priorities than to introduce a reform that, no matter how important it is, would not provide any immediate return. As long as he was not obliged to pass the legislation and managed, with the co-operation of the Bank, to achieve his objectives he did not feel any urgency to take action. In this way, Mr. Papandoniou managed not only to have some control in monetary matters and to get most credit for reducing inflation, but also eventually to connect his name with a significant and historical reform. Mr. Papandoniou claimed that the delay occurred not because of other economic priorities but due to the fact that "for so long the 'conditions' were not the appropriate ones", without further explaining what he meant (Interview Papandoniou Y., 2 April 1997). On the other hand, from the moment he decided to grant the Bank of Greece independence, he attempted to deliver a model which would preserve best the autonomy of the Bank and which would have widespread approval. In this effort he made several amendments according to the suggestions of the other parties and eventually the press and most politicians considered the final outcome very satisfactory, despite some minor disagreements mainly for political and personal reasons.

The Rest of the Government

Apart from the Prime Ministers and the Ministers of National Economy very few of the other members of the governments have ever shown any interest in the issue of independence. The discussions in the Cabinet were minimal since the issue did not seem to concern or affect the rest of the government members. As Mr. Christodoulakis, the under-secretary of Finance, explained, most of the Ministers perceived the independence of the Bank of Greece as a typical obligation of the country, which would not alter notably the existing exercise of monetary policy. However, Mr. Christodoulakis, mentioned that for the Ministry of Finance the new practices may have some implications, as the interest-rate policy of the independent Bank might alter to some extent the borrowing methods of the state. (Interview Christodoulakis N., 16 April 1997)

Governmental Committees and Advisors

The participation of advisors and governmental committees in any policy change is always of significant importance since they are involved in almost all stages of the

reform process. In many cases it is the advisors of Ministers or special committees that conceive an idea and spread it around until it becomes a serious consideration. These actors also have a leading role in examining the applicability and the suitability of a proposed change as well as measuring the possible political cost it entails. Finally they are the ones responsible for preparing the plan or the draft law that the Minister tables in Parliament. In few words, government advisors and committees are in most cases the main responsible for significant changes introduced by Ministers.

In the case of the independence of the Bank of Greece three-four such people were the key players in the introduction and formulation of the draft law. The first is Mr. Georgios Alogoskoufis, an Economics Professor and Chairman of the Economic Experts Council (SOE) of the Ministry of National Economy during New Democracy's government. Mr. Alogoskoufis was the one who prepared in September 1993 the draft law for Mr. Manos, then Minister of National Economy. His influence on that plan was so big that we can say that it was almost his draft law and not Mr. Manos'. Mr. Alogoskoufis has noted, that although the establishment of independence is considered a typical institutional measure, it is important in order to increase the long-term credibility of the whole Bank, which until then depended only on the personality of the Governor. He also explained, that the problem with Mr. Christodoulou's plan was that the Governor would keep all the legislature power he enjoyed in the past, something that they (SOE and Mr. Manos) wanted to avoid by creating a Governing Council with shared authority. (Interview Alogoskoufis G, 27 December 1996).

The successor of Mr. Alogoskoufis as Chairman of SOE when PASOK came to power was Mr. Yiannis Stournaras, another Professor of Economics. Mr. Stournaras together with the General Secretary of the Ministry of National Economy, Mr. Fotiades, had a significant contribution to the promotion and formation of the final draft law. The above two as well as the Economic Advisor of the Prime Minister, Mr. Yiannitsis, were also the ones who organised some meetings with the representatives of the Bank and members of the opposition in order to reach a compromise on the details of the draft law. Mr. Stournaras, one month before the draft law was tabled in Parliament, expressed the view that the opposition should not have objections with the new plan since under its provisions the Governor of the Bank is weakened, as the decisions are taken by the Monetary Policy Council. He also confirmed that Mr. Christodoulou wanted to have

more authority by approving himself most of the members of the council and not the government. (Interview Stournaras Y., 14 April 1997)

PARTICIPANTS OUTSIDE THE GOVERNMENT

The Bank of Greece

The Bank of Greece and more specifically its Governors and Deputy-Governors had a very delicate and discreet role throughout the reform process. Everyone understood that the establishment of the independent Bank would benefit above anyone else its future administration. Most Central Bank Governors dream to chair an independent Bank with no governmental interference. On the other hand the big hesitation of politicians is having a Central Bank that is completely uncontrolled.

Due to the above reasons all the Governors of the Bank of Greece were very careful whenever they referred to the issue of independence. They did not want to be accused that they ask for autonomy simply to secure a post in the independent and non-removable council of the Bank. Whenever they mentioned independence they did it either in the name of the Maastricht obligation or as a measure for increased credibility. Of course the fact that the last three governments respected to a great extent the informal autonomy of the Bank was appreciated by the Governors and so they did not feel an urgent need to ask for independence. However, conflicts always exist between the Bank and the government even though most times they are kept secret. The only case in which a Governor directly accused the government for intervening in the Bank's issues and loudly called for independence was after Mr. Boutos disagreed with Prime Minister Papandreou and was forced to resign (October 1994). In most other times the Governors seemed to accepted the fact that the government had the final say and preferred not to express publicly their desire for independence in the few cases of conflict.

The influence of the Bank of Greece was more evident on the model of independence the country has adopted. The three plans that the Bank has produced and submitted to the Ministry of National Economy have all, despite their differences, been based more or less on the French model. Upon these plans the committee of the Ministry of National Economy made all necessary amendments in order to create a model which would best suit Greece. The present administration of the Bank although it was the one most

concerned on the final chosen model, was however very flexible and receptive on proposed changes, as Mr. Papademos' stance in the Parliamentary Committee proved.

The Political Parties

The role and influence of the political parties was not the one someone would expect for such a crucial transformation. Especially prior to the debates in the Parliament there were minimal comments even by the parties that finally voted against the legislation. During the debates in the Parliamentary Committee of Economic Affairs and in the plenary session, the political parties analysed their views with excessive passion but always giving the impression that they have accepted the forthcoming reform. Their efforts were focused more on ensuring how they (through the Parliamentary Committee) and not the government would retain some control on the appointment and accountability procedures, than on the implications this might have on the Bank's independence.

New Democracy could not have any objections for the particular reform, as it was the first to propose the independence of the Bank. It wanted, however, to ensure that the newly established MPC would include some individuals that come from its side. The members of ND were afraid that if they allowed the government to reappoint the old administration for another full term, then there would be the possibility to come in power and have to face an independent Bank totally controlled by PASOK. It was primarily for this reason they claimed that the proposed legislation does not guarantee the democratic control of the Bank.

The KKE was the only party that had a clear reason to be against the independence of the Bank of Greece, since it is fanatically against the Maastricht Treaty. Their opposition was not so much against the independence of the Bank from the government, which is something they would desire, but more against Maastricht. They believe, however, that by making the Bank of Greece a part of the European Central Bank the country's sovereignty would vanish since the Bank will be obliged to preserve not the national interests but those of 'big capital'.

The position of Synaspismos was somehow different. Although the party has voted for Maastricht, it has great scepticism on how the EMU will function. The logic of SYN's

members was that the independence of the Bank of Greece has to be established not only against the Greek government but also against any other body. SYN claims that the Bank of Greece should exercise monetary policy in accordance to the country's interests and should be accountable primarily to the Greek Parliament. According to the above view, the members of SYN argued that the proposed legislation of the government did not guarantee the democratic control by the Parliament and would transform the Bank into an uncontrollable and mighty authority. Despite their general attitude against the proposed draft law, the members of SYN made some propositions for further parliamentary control in order to achieve some participation in the appointment and accountability procedures.

DIKKI followed a stance that lies between the one of KKE and Synaspismos. Its members although they claimed to have in general a European orientation have opposed from the start the proposed draft law as a reform which is against the Constitution, since it assigns sovereign rights of the country to a foreign institution (ECB).

Finally, the stance of the members of PASOK was very attentive. They declared their full support on the idea for an independent Central Bank but mentioned the need for effective democratic control. In that way they persuaded, together with their ND colleagues, the Minister Mr. Papandoniou to make some significant amendments to strengthen the accountability of the Bank.

The Media

The establishment of the independence of the Bank of Greece was an issue that the Greek media overlooked in a surprising way. The references on the issue were minimal and with very few comments on its implications. It is characteristic that the television stations did not even mention the ratification of the new legislation. The press covered the issue as any common new topic and presented it as another obligation of the country for the participation in the EMU. The editor-in-chief of the biggest Greek economic periodical 'Oikonomikos Tachidromos', Mr. Demitris Stergiou, admitted that "unfortunately in Greece most major economic issues are neglected". He mentioned that although the issue of independence is very important, the press does not deal with it because the public does not understand it (Interview Stergiou D., 2 January 1998). Mr. Christos Papadimitriou, the monetary editor of the leading Greek Sunday newspaper, 'To

Vima', explained that most issues related to Maastricht are considered technical and thus the general public is not interested. Unfortunately he said issues of national obligation does not concern the Greek media and he reminded that for the ratification of the Maastricht Treaty there was analogous indifference (Interview Papadimitriou C., 3 January 1998). Mr. Nicos Nicolaou, an economic editor of newspaper, Ta Nea, mentioned that although the above observations are right, the ratification of the draft law was always seen in Greece somehow as an inevitable obligation without substantial economic or political impact since the Bank enjoyed a significant degree of autonomy (Interview Nicolaou N., 5 January 1998).

The Banking and Industrial Sector

The banking and the industrial sectors had limited participation both in the promotion of the idea of Central Bank independence as well as in the elaboration of the details of the draft law. The two sectors are probably the ones that would be most affected by a possible change in the exercise of monetary policy, as their policies depend heavily on changes in interest-rates. Nevertheless, in very few cases did their members bother to refer to the implications of such a reform. Even in the Parliamentary Committee the representative of the Greek Banking Union was more concerned with the details of the legislation in relation to the payment systems and the supervision than with the general transformation in the exercise of monetary policy. The Governor of the National Bank of Greece, Mr. Thodoros Karatzas, expressed the view that this apathy of the bankers for the autonomy of the Bank of Greece stems from the fact that they do not believe that something radical is going to change in monetary policy. He claimed that the problem in Greece is not so much monetary policy but the other economic policies and especially fiscal policy (Interview Karatzas T., 30 December 1996). On the other hand, the industrial sector through its representative body SEB (Greek Industrial Association) has in many cases expressed its support for a strict monetary policy but has rarely mentioned the advantages of Central Bank independence. Mr. Provopoulos, General Director of the Institution of Economic and Industrial Research (IOBE), which has called in difficult monetary situations for the establishment of the autonomy of the Bank of Greece, declared the Institution's support for independence but mentioned as others that they do not expect any significant changes in the way the Bank exercises monetary policy. He

expressed also the opinion that the government will always have a way, through the press and the media, to influence the Central Bank. (Interview Provopoulos, 8 April 1997)

The European Union and International Institutions

The European Union did not played any direct role in the promotion of the issue of independence. Nevertheless, the fact that it is one of the requirements for the participation in the EMU was a fundamental reason to stimulate action. Apart from that however the European Union or any other of its institutions did not exert any particular pressure to the Greek governments to grant the Bank of Greece autonomy. The only European body that from time to time made some comments on the issue was the European Monetary Institute (EMI), which as the predecessor of the European Central Bank was obliged to report on the progress towards convergence (both legal and economic) of the member states. The involvement of the EMI was more direct after the composition of the draft law, as it has pinpointed to the Greek government various incompatibilities with the Treaty and made some suggestions for improvement. Among the international organisations, the only institution which showed some minor interest was the International Monetary Fund (IMF) as through its annual reports advised the Greek governments, among other measures, to grant central bank independence.

CONCLUSIONS

The establishment of the independence of the Bank of Greece was characterised, by all Members of the Parliament, as one of the most significant laws of the 1990s. Even the Minister of National Economy admitted that with this law one part of the sovereign rights of the country is transferred to an independent institution. Although this fact alone would be enough to explain the reason why this reform had been postponed for more than five years, it is considered that further economic, political and institutional considerations were key parameters for the late adoption.

As analysed in the previous section, with the exception sometimes of the Bank itself, no other person or body pressed in any particular way for a quick change of the Bank's statutes. Most of the mentioned participants were, at least in theory, in favour of the change but none was so anxious to see the Bank of Greece independent. The reason for this is that there was no specific economic or political gain for anyone to call or achieve the autonomy of the Bank. Furthermore, the prevailing conditions and contingent parameters were particularly decisive, as they did not create any opportunities for action and in some occasions they facilitated further delays.

In Greece, the political elite, the business and financial sectors as well as the majority of the public considered the European orientation of the nation an essential factor with regard to the economy. Nevertheless, this was not enough for a quick adoption of the Maastricht Treaty's requirements. During the early 1990s, the independence of the Bank of Greece from an economic point of view did not constitute a particularly pressing reform. Although Greece had a relatively high level of inflation compared to the rest of the EU, all Greek governments after Maastricht were committed to reducing it in order to participate in the EMU. Monetary policy would be strict regardless of the status of the central bank and therefore there were not any exceptional economic benefits from this viewpoint. Of course, one could argue that despite commitment of all Greek governments to achieve the Maastricht criteria, a change of the Bank's status would send a much clearer message to the markets for long-term commitment to achieve monetary stability. But since the early-nineties, the Bank of Greece was enjoying a significant degree of autonomy, which helped to increase the Bank's credibility and performance against inflation. In the few instances of exchange rate pressures, the Bank of Greece responded successfully, thus proving its commitment for stability. In any case, the independence of the Bank of Greece was not considered at any particular time as an imminent economic measure for the achievement of monetary stability and that partly justifies the continuous postponement of the reform's implementation.

From a political perspective the establishment of the independence of the Bank of Greece was perceived as an inevitable, technical obligation of the country in order to participate in the EMU. As previously mentioned, the issue of central bank independence was never seen in Greece as a decisive reform that would change the way monetary policy was conducted. There was no belief that the change of the Bank's status would restrain the

government from having some influence on the course of monetary matters. This had occurred for two reasons. The first stemmed from the fact that for at least three decades the political manipulation of monetary policy had been so strong that it had been difficult for anyone in Greece to understand how the government would suddenly allow itself to be totally ignored on such issues. It was a common belief that the government through direct or indirect channels would manage to influence the decisions of the Bank of Greece. The second reason relates to the public's and in part many politician's ignorance of the issue of central bank independence. With the exception of a few academics, economists and politicians, most other people in Greece could not realise how autonomous the Bank of Greece would actually be after the passing of such a bill and the participation in the ESCB.

Another constraining political factor in the introduction of the bill, even though it seems paradoxical, was that both leading Greek parties were in favour of EMU and central bank independence. The government even though it knew that there would be no political cost in passing the necessary legislation, also understood that it would get no benefit either. Hence, since there was no pressure for immediate action, the government preferred to keep the slight influence on monetary policy, in order to accommodate its deficit and debt payments, and at the same time get most of the credit for the reduction in inflation. The issue of independence was of course always in the governmental agenda but as long as there was no particular interest or conditions to enforce it, it did not get any priority. The issue became a topic of serious concern only when the deadline of the Maastricht Treaty was approaching. The new Simitis government, taking advantage of its recent election and majority, tabled the draft law and praised the significance of the reform since as it claimed represented the new, modern way of conducting monetary policy in the global economy. The enactment of CBI at the end of 1997, even though the government in reality could wait until 1999, when it expected to meet the remaining criteria, was first to show to its EU partners that it had at least accomplished its institutional obligations for entry, and second, to demonstrate to the markets its political agreement for long-term monetary stability. (Interview Papademos L., 30 December 1997)

However, the reform of the Bank of Greece was not simply the outcome of the above-mentioned economic and political conditions. Through a wider perspective one can

observe that the reform of the Bank followed the international trend of the two last decades for greater decentralisation of power, liberalisation of markets, deregulation, and limitation of the involvement of the state in many aspects of the political and economic life. Therefore, the emergence, diffusion and establishment of an independent central bank in a broader way also reflected the degree that the country accepted the above mentioned trends and gradually modified its institutional patterns.

The Greek political and economic elite, since the Maastricht Treaty, gradually approved of most transformations, reforms and measures required for Greece to be part of the EMU. This was mainly done since the majority of Greek politicians and businessmen understood that if the country stayed away from the European developments it would be completely isolated both economically and politically. However, the majority of the politicians accepted the independence of the central bank on theoretical terms but not on practical ones. It was at first difficult for the Greek government and especially for the Minister of National Economy to get used to the idea of having a separate institution with absolute authority upon matters that until then were under the direction of the government. Although it was more acceptable to surrender power or to receive instructions from the EU or other international organisations, it was unthinkable to grant so much power to a national institution. This was not so much due to the actual restrictions that would be imposed in the conduct of the government's other policies but because of the loss of power and status that the government feared it would suffer. This fear had its roots in the fact that the Greek model of governing was, until the early nineties characterised by significant centralisation. The government directed almost all levels of policy through its branches and any attempt to bypass it was usually rejected. However, since the mid nineties there has been considerable effort to modernise the state and avoid most bureaucratic procedures. Transfer of power from the central administration to other agencies and local authorities is attempted with every opportunity and a more efficient idea of which should be the government's role has finally being established. The independence of the central bank is thus no longer regarded today as a threat to the government's status or as an involvement to its policies but merely as a modern way of conducting monetary policy. When the Greek Minister of National Economy, Mr. Yiannos Papandoniou, stated a few days before the presentation of the draft law, that "the country was now ready for such a change", he most probably referred to the above progress. (Interview PapandoniouY., 2 April 1997)

Chapter VIII: The Independence of the Bank of England

The Bank of England has a long tradition in the United Kingdom's economic management. However, its role and influence has been altered significantly since its establishment, and especially after its nationalisation in 1946. On May 6 1998, the government decided to give to the Bank operational independence in monetary matters. The aim of this chapter is to examine the economic, political and institutional aspects that led to this significant reform and to assess the role and motives of the main participants involved.

The chapter has the same structure as the two previous ones. It first reviews the historical role and character of the Bank of England, it then analyses the economic and political developments in the UK during the last two decades and finally it examines the purpose, the debates, and outcome of the reform.

ROLE, ORGANISATION AND INDEPENDENCE OF THE BANK OF ENGLAND

A HISTORICAL OVERVIEW OF THE ROLE OF THE BANK OF ENGLAND

Established by Act of Parliament and operating under a Royal Charter, the Bank of England opened for business on 27th July 1694 with a staff of nineteen in rented premises. Its primary function was to lend money to King William III who needed a lot of cash to fund his war with France. Its capital - Bank of England Stock - represented the start of the Funded National Debt. In 1734, the Bank moved to a specially designed building in Threadneedle Street in the City of London.

For the first 250 years of its existence, the Bank of England was a private bank whose original shareholders or 'subscribers' were the City men of the time. From its very beginning, the institution had concentrated on issuing notes for deposits made with it and these were the forerunners of today's bank notes. It also acted as banker to the

Government and to most departments of state, as well as managing and acting as registrar of government securities.

The Bank Charter Act of 1844 tied the note issue to the Bank's gold reserves. Under the Act, the Bank was required to keep the accounts of the note issue separate from those of its banking operations and to produce a weekly summary of both sets of accounts. The Act, however, had to be suspended during several financial crises in the nineteenth century when the Bank began increasingly to eschew commercial banking and instead sought to control the level of interest rates and acted as the lender of last resort to cope with these crises. By the time of the Baring crisis in 1890, when a threat to the entire banking system was successfully weathered through the leadership of the Bank of England, its techniques had developed to the point where they became the pattern for other central banks.

During the First World War, the National Debt jumped from under £1 billion to over £7 billion. As in earlier wars, one of the Bank's main functions was to manage the government's borrowing. The start of the Second World War led to the introduction of exchange controls under the Defence (Finance) Regulations, which were replaced in 1947 by the Exchange Control Act. The Bank administered exchange controls until 1979, when restrictions were lifted.

The Bank was nationalised by a Labour government under the Bank of England Act in 1946, and ownership of its capital stock was transferred to the Treasury Solicitor. However, for many years before that, the Bank had seen itself and behaved as a public institution carrying out public functions.

The Bank was, from its earliest days, a political creation and the special character of what began as a private bank derived from the privileges granted by the government. The success with which this 'private bank' had overcome a series of financial crises gave it such pre-eminence that in 1781 the Prime Minister, Lord North, described it as 'part of the constitution'. Since the 18th century, there have been numerous unofficial attempts to take the Bank under governmental control since most governments came to rely heavily upon the Bank of England, which provided them with funds. The political tensions between the Bank and the State became aggravated during the First World War

after disagreements between the governor of the Bank, Walter Cunliffe, and the Chancellor, Andrew Bonar Law. The Prime Minister, David Lloyd George, invited Cunliffe to sign a memorandum that, while the war lasted, the Bank would act on the direction of the Chancellor. Cunliffe refused and Lloyd George threatened to 'take over the Bank'. In practice, however, the governor was subservient to the Treasury from then on, until the post-war Labour government removed by law the governor's sole control over monetary policy. Winston Churchill, as leader of the Opposition at the time of nationalisation, has recognised that the Bank had lost its power to the Treasury many years before the reform. Nationalisation, he said, raised no question of principle (The Daily Telegraph, 7 May 1997).

After the collapse of a number of "fringe" banks (the secondary banking crisis) legislation was revised by the Banking Act 1979 that gave the Bank legal powers to supervise the activities of what became known as "Recognised Banks and Licensed Deposit Takers", which accepted deposits from the public. In 1984, Johnson Matthey Bank, a large bank and an important member of the London Gold Market, got into serious difficulties. As a consequence, it was decided that revisions could be made to the existing form of supervision and a new Banking Act was introduced in October 1987.

In general, the Bank of England, after nationalisation, mostly had a typical advisory role in monetary matters, since it was the Chancellor of the Exchequer who decided on the course of interest rates. The Bank's influence depended on the respective personalities of its governor and the Chancellor of the Exchequer and the relationship between the two. During the last decade, the Bank of England has managed, due to the nature of its governors, to establish a new 'modus vivendi' in monetary matters which combined the policies imposed by the government together with some autonomy in implementing its objectives.

THE STATUTE OF THE BANK OF ENGLAND BEFORE INDEPENDENCE

The main provisions of the statute of the Bank of England[57], until the 6th of May 1997 when the Chancellor of the Exchequer announced several reforms covering the United Kingdom's monetary policy framework, noted the following:

The governing body of the Bank is the Court of Directors, which is responsible for the managing of the Bank's affairs and its internal administration. The Court of Directors consists of the Governor, the Deputy Governor and sixteen Directors, up to four of who may have executive responsibilities within the Bank.

The Governor, Deputy Governor and Directors are appointed by the Crown on the advice of the Prime Minister. The Governor and Deputy Governor are appointed for renewable five-year terms and Directors for renewable four-year terms. A Governor may be dismissed during his/her period of office under certain, specified conditions.

Members of the Court of Directors are not individually subject to instructions from political authorities. However, the Treasury has the legal power to issue 'directions' to the Bank 'in the public interest' after consultation with the Governor, although this power has never formally been exercised.

There are no explicit statutory objectives in the monetary policy field.[58] The Banking Act 1987 gives the Bank, in its role as banking supervisor, the objective of protecting the interests of depositors. The Bank's overall objectives, in practice, are to maintain the integrity and value of the currency; to maintain the stability of the financial system, both domestic and international; and to seek to ensure the effectiveness of the United Kingdom's financial services.

The main tasks of the Bank are to formulate advice on monetary policy; implement monetary policy; issue the currency; manage official reserves; supervise banks; and promote sound and efficient payment and settlement systems.

Monetary policy is determined with reference to the Government's target for retail price inflation. Monetary policy is effected through short-term interest rates, the Bank being responsible for advising on the appropriate interest rate level which will be required to achieve the inflation target. In the light of the advice received from the

[57] In reality there is no complete statute. The provisions listed below are a combination of legislations amending and supplementing the Bank of England Act 1946, the Banking Act 1987, the Companies Act 1989, the Financial Services Act 1986, the Banking Act 1979 and the Exchange control Act 1947.

[58] According to the original Royal Charter of 1694 the Bank's role is "to promote the public Good and Benefit of our People".

Governor, the Chancellor of the Exchequer takes decisions on any changes to the interest rate.

The Bank also acts as fiscal agent of the Government. Foreign exchange market activities are conducted by the Bank as agent of the Government within the guidelines set by the Treasury.

The Bank presents an Annual Report to Parliament containing its accounts for the previous year. It also presents a second Annual Report to Parliament describing its conduct of banking supervision. In addition, the Bank publishes a quarterly Inflation Report, which describes progress towards achieving the Government's inflation target and the Bank's views on the future prospects for inflation. The Governor frequently appears before Committees of Parliament. Formally, however, the Chancellor of the Exchequer, or another Treasury Minister, answers for the Bank in Parliament.

NEW DEVELOPMENTS FOR THE UNITED KINGDOM AND ITS CENTRAL BANK

UK ECONOMY AND POLITICS IN THE 1980s AND 1990s

The victory of the Conservative Party in the May 1979 elections signalled a significant change in British politics. The three successive administrations of Mrs. Margaret Thatcher (now Baroness) followed quite a radical approach to economic, political and social issues. The cornerstone of Mrs. Thatcher's policies was the acceptance of the market as indispensable to prosperity and the downsizing of the state. However, her persistent attempt to promote the 'free market' had not the expected outcome in sectors such as the social welfare, education and health.[59]

The most urgent economic problem of the late 1970s and early 1980s was that of inflation and thus monetary policy took centre stage. The conduct of monetary policy was profoundly influenced by the views of monetary economists who believed that the cause of inflation was an excessive rate of growth of the money supply. Mrs. Thatcher's

[59] See Rowthorn Bob (1992) for an account on government spending (emphasis on health and education) in the Thatcher Era.

government approach to the issue was to tighten monetary policy through interest rate increases, in order to reduce the rate of growth of the money supply (and consequently inflation), with little consideration of the effects on other objectives (such as growth and employment, at least in the short-run). At the same time, Mrs. Thatcher was promoting her other two major goals, namely the promotion of the international competitiveness of the 'City' and the shift of national wealth away from public ownership to the private sector (See Coakley and Harris, 1992). The former was pursued through excessive financial services deregulation, while the latter through privatisation and regulatory and taxation measures. During the same period, the Conservative government brought forward some structural reforms to improve the efficiency of resource allocation and the labour market, such as changes in the wage bargaining system, reduction in the influence of the unions and removal of restrictive work practices. (See Lane and Samiei, 1996).

During the 1979-1982 period, the effects on the economy were not the ones expected by the Thatcher administration. In a progressively deregulated economy, prices and money wages showed an accelerating increase which raised the demand for credit to cover working capital needs. The rise in the money supply led the government to raise interest rates to unprecedented heights, driving the exchange rate up to unrealistic levels. As a result, the loss of competitiveness for the manufacturing sector had disastrous effects on output and unemployment.

After 1982, the effect of tight monetary policy and structural reforms brought down inflation (from 19.7% in 1980 to 4.8% in 1984) and started to show their impact on productivity which after 1983 started to improve significantly (from –9.5% in 1980 to +4.1% in 1984). In the mid-80s, however, unemployment rates remained regularly above 10 per cent (from 4.3% in 1979 to 11.2% in 1985-6) despite continuous increases in annual growth since 1982 (average 2.9% in the period 1982-86).[60]

Between 1985 and 1989, Britain experienced a remarkable economic boom which was dominated by the extremely rapid growth of consumers' expenditure. The deregulation of credit and mortgage market (relaxation of lending criteria and right-to-buy

[60] Statistical sources: IMF, World economic outlook. OECD, Economic outlook. Various issues.

legislation) and the income tax cuts fuelled a construction boom, improving consumer and business confidence and surging investment. Real growth rates were well above 3%, productivity was steady and significantly positive and unemployment was gradually declining (7.3% in 1989). However, the supply-side response was not sufficient, inflation had risen again (7.9% in 1989) and the current account deficit of the balance of payments had also increased significantly (-3.4% in 1989). (See Mansley N. et al., 1992). The reason for the latter development was in part due to high imports but also to the rising interest rates which forced the appreciation of the currency (by 14% in Britain in the two years to the end of 1988). (See Smithin J., 1990: 103)

A very crucial shift in the conduct of British monetary policy during the mid-1980s was the abandonment of the money supply targets and the medium-term financial strategy (MTFS),[61] which had been the main tactic since 1980. Instead, in 1986-7, the then Chancellor Mr. Nigel Lawson (now Lord Lawson) followed a policy of shadowing the Deutschemark (DM), as he was in favour of a fixed exchange rate and the entry of the pound into the European Monetary System (EMS). However, in 1988, when the sterling broke the DM 3.00 barrier, the Prime Minister Mrs. Thatcher publicly took the view that the value of the currency should follow the rules of the market and as a result she ended any immediate prospect of Britain joining the EMS. The continuing confrontations between the two individuals was terminated when Mr. Lawson resigned in October 1989 due to Mrs. Thatcher's refusal to sack her economic adviser, Sir Alan Walters, whose views on the EMS she clearly preferred.

As Coakley J. and Harris L. (1992: 38) argue, "Mrs. Thatcher's general antagonism towards the European Community and her continual opposition to monetary union ran counter to her objective of promoting the international competitiveness of the City". These were the reasons (together with poll tax policy) that eventually forced her to resign in November 1990.

However, one month before Mrs. Thatcher's resignation, sterling finally joined the Exchange Rate Mechanism (ERM) of the EMS, under the pressure of the business community. However, it did so at the rate prevailing at the time, between the pound and

[61] The MTFS proclaimed the government's determination to follow an independent monetary policy irrespective of the policies pursued by other major industrial countries.

the Deutschemark, which was very high. That rate did not reflect the competitive strength of the two economies or the real purchasing power of the two currencies, but rather the UK's monetary policy, which was tighter than the other industrial countries. In order therefore to sustain that rate, the government was obliged to keep interest rates even higher than German ones in order to attract foreign capital. The high interest rates had a knock-on effect in consumption activity and consequently to output, investment, debt servicing and exports. Unfortunately for Britain and the rest of Europe, the German economy needed high interest rates in order to overcome the difficulties of the German reunification, thus limiting the room for manoeuvre of the British authorities who saw their economy entering into the second recession in ten years.

In December 1991, Mr. John Major, the ex-Chancellor who took over as Prime Minister, agreed on the Treaty on European Union in Maastricht after long hours of negotiations and having achieved significant 'op-outs' on economic and monetary union and social policy for the United Kingdom. Mr. Major called the Treaty 'very good for Britain and good for Europe, a contrasting statement to the one of Mrs. Thatcher who attacked it as 'an idea from yesterday', and one diametrically opposed to British national interests.

Despite the division over Maastricht and their continuing unpopularity, the Conservatives were able to turn the tables on Labour and win a fourth victory in the April 1992 general election. However, the period that followed proved to be extremely troublesome for Mr. Major's administration. The government gradually acquired a reputation for arrogance and a lack of understanding as the economy was deteriorating despite its opposite claims. Measures like the closure of coal-mines, railway privatisation and imposition of VAT on domestic energy backfired. A number of social policies were also confronted with extreme criticism and opposition, such as educational testing, health reforms, sentencing policy, social security philosophy and university admissions. Policy over Europe, however, proved to be the new government's most difficult task. The country developed an anti-Maastricht position, which was more evident within the Conservative Party. In such a framework, the ratification of the Maastricht Treaty proved to be extremely humiliating for the Government. There were a series of retreats and tactical evasions until the government managed, with the support

of the Liberal Democrats and after tabling a vote of confidence, to pass the Ratification Bill in the summer of 1993.

On the economic front, since the second half of 1990 until at least the second half of 1993, Britain experienced a decline in most sectors: output growth was –2.1% in 1991; investment was –9.5% in 1991 and –4.5 in 1992; unemployment reached 9.2% in 1992 and 10.5% in 1993, and the balance of payments remained negative at around -1.7%. The only exception was in inflation that benefited by the high interest rates and was reduced to 3.0% in 1993.[62] The climax of Britain's economic policy deadlock was validated on 16th September 1992 when Mr. Major's Conservative government was forced by speculative pressures on the sterling to suspend it from ERM and effectively devaluate it by around 13%.

The exit of sterling from ERM and the correction of its exchange rate did, however, signify a change in the course of monetary and exchange rate policy. The pound was free to fluctuate and there was therefore no more need for interest rates to be in the previous levels. Moreover, the authorities abandoned the shadowing of the Deutschemark as the main objective and were instead conducting monetary policy in relation to the achievement of an inflation target set by the government.

By the second half of 1993, there were some signs that the recession was easing as output growth returned to positive and most other economic figures were gradually improving. On the fiscal side, despite a significant reduction in the Public Sector Borrowing Requirement since 1993, the overall performance has not been the one estimated in the budgets (See Samiei H., 1996). Nevertheless, until 1997, Mr. Major's administration, under the instructions of Mr. Kenneth Clarke as Chancellor since June 1993, managed to alter the economic situation significantly. Real output was steadily above 2.5 per cent, unemployment fell to 7.0 per cent and just before the May 1997 elections inflation hit the government target of 2.5 per cent. However, by the end of 1996, it was clear that the economy was in danger of overheating since growth was projected to be 3.5% in 1997 and even higher in 1998. Moreover, the Bank of England was calling for interest rate increases (as it has done unsuccessfully in the previous

[62] Statistical sources: Central Statistical Office, Economic Trends. Department of Employment, Employment Gazette. CSO, Financial Statistics.

years) to ease inflationary pressures. Mr. Clarke resisted those pressures since the general elections were approaching and the Conservative Party seemed to be losing the support of the electorate despite the improvements in the economy. An increase in interest rates would make the already strong pound soar, thus damaging exports, and would also make mortgage payments more expensive, inducing the opposition of the public.

The May 1997 elections were a complete disaster for the Tories and a triumph for the 'new' Labour party of Mr Tony Blair, taking 418 seats out of 650 in the House of Commons. The defeat of the Conservative Party was attributed mainly to their unclear policy over the European Union, to the loss of the support of the City and to the disbelief of the British people that the Tories could achieve a sustainable long term growth for the country after 18 years of successive boom and bust policies. On the other hand, the Labour party based its victory on the charismatic personality of Mr. Blair who persuaded both the general public and the business community that his policies would achieve the social prosperity that the nation desired through long term economic stability. Although the Labour party did not make any pre-election commitment over Britain's participation in the European Monetary Union (EMU), it was clearly more favourable to it than the Conservatives were, resulting in the support of the majority of the financial and business community.

From the start of its term, the Blair administration showed a remarkable determination and boldness to implement its new ideas, especially in the economy. The new Chancellor Mr. Gordon Brown surprised everyone with his quick decisions, such as the independence of the Bank of England, the creation of a new super-regulator for financial institutions, the cut in corporate tax, and the new welfare-to-work plan. In October 1997, Mr. Brown announced that Britain was generally in favour of EMU, but the decision for its participation depended on five economic conditions: whether EMU will have positive effects on employment, investment and financial markets; whether the problem of the different economic cycles of Britain and continental Europe can be resolved; and whether Europe can respond to the need for greater flexibility of its economy, in order for EMU to function properly. Mr. Brown mentioned that any decision on Britain's participation in the single currency would be taken after the next general elections and after the conduct of a referendum.

Mr Brown inherited an economy with vanishing spare capacity and an overvalued pound. His first Budget modestly tightened fiscal policy, leaving consumers relatively unharmed. The burden of slowing the economy fell on interest rates (five interest rate increases in the first six months since the election of the Labour government) and an exchange rate, which continued the rapid appreciation it had begun in August 1996. Manufacturers suffered as their competitiveness in international markets eroded, while domestic spending remained robust.

The overall conclusion is that by 1999 despite the above-trend growth and relatively low inflationary pressures, the UK economy continued to suffer from a number of fundamental weaknesses. Over the past 25 years, GDP growth has been slower in the UK than in any of its major competitors. The level of GDP per head in the UK is below the level in all other major industrial (G7) countries, and the UK has failed to narrow the gap with the OECD average since the 1970s. The level of productivity in the UK has also been lower than that in other G7 economies since the early 1970s. Weak growth performance has at least partly reflected under-investment. The UK's ratio of investment to GDP is low by both historical and international standards, and this has been associated over the cycle with similarly low domestic saving. The investment ratio gap with other industrialised countries has been widening in recent years. The economy has suffered from a high degree of instability. In the past 25 years, the UK has suffered the two deepest and longest recessions in post-war history; its record on growth stability has been one of the worst in the G7; and inflation has been more volatile than in any other G7 country.

Nevertheless, the UK has managed to meet all the Maastricht Treaty criteria and the decision on whether and when to join in the Monetary Union is today more a political than an economic matter. Despite the five economic conditions which will supposedly determine the UK's stance, the main task for the Labour government will be to change the negative attitude of the British people towards Europe and convince them that the country's interests rest within the EMU.

TABLE 3

TABLE 3: PROGRESS OF THE BASIC UK ECONOMIC FIGURES (% annual change)								
UK	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
1. GDP	0.4	-2.1	-0.5	2.1	4.3	2.8	2.3	3.5
2. Inflation	8.1	6.7	4.7	3.0	2.3	2.9	3.0	2.8
3. Unemployment	5.8	8.0	9.7	10.3	9.3	8.2	7.5	5.8
4. Unit Labour Cost	10.1	7.1	3.2	0.4	-0.4	1.4	2.1	1.9
5. Budget Deficit (% GDP)	0.9	2.3	6.2	7.9	6.8	5.5	4.8	1.9
6. Primary Surplus (% GDP)	2.2	0.4	-3.5	-5.0	-3.6	-2.0	-1.1	1.6
7. Public Debt (% GDP)	-	35.6	41.8	48.5	50.5	53.9	54.7	53.4
8. Current Account Surplus / Deficit	-3.4	-1.4	-1.7	-1.6	-0.2	-0.5	-0.3	0.4
9. Mean Annual Interest T-Bonds	11.9	10.4	9.3	7.9	8.7	8.2	7.9	7.1
Source: UK CSO – Eurostat - EMI.								

THE IDEA AND THE PLANS FOR AN INDEPENDENT BANK OF ENGLAND

The first serious effort for an independent Bank of England after its nationalisation in 1946 occurred in 1988. The then Chancellor of the Exchequer, Mr. Nigel Lawson, wanted to control inflation, as low budget deficits had failed, but he was not allowed to put the pound into the ERM and he could not persuade Mrs. Thatcher that interest rates should occasionally go up as well as down. As a result, Mr. Lawson had commissioned a secret Treasury study of the pros and cons of central bank independence. As the study came in favour, Mr. Lawson passed the plan to Mrs. Thatcher who immediately rejected any such thoughts. As Mr. Lawson was to reveal later, the exact reaction of Mrs. Thatcher was "I DO NOT want you to raise the subject again. I must prevail" (The Daily Telegraph, 2 October 1992: Interview with Mr. Nigel Lawson). Mrs. Thatcher

said that if it handed over the job of controlling inflation to the Bank it would be like acknowledging her defeat (The Sunday Times, 21 January 1990). This plan was kept secret until Mr. Lawson revealed it in his resignation speech in October 1989.

Due to the above announcement and the considerations for an autonomous European Central Bank, the issue of central bank independence became among the main topics of debate. One of the strong supporters of an independent Bank of England was Mr. Michael Heseltine, ex-Secretary of Defence and Environment in the 1980s. During the candidacy for Mrs. Thatcher's position at the end of 1990, Mr. Heseltine passionately advocated the reform of the Bank, as he believed that central bank independence would be the first step towards greater monetary co-operation in Europe. However, Mrs. Thatcher's eventual successor, Mr. John Major and his new Chancellor, Mr. Norman Lamont, did not show the enthusiasm of either Mr. Lawson or Mr. Heseltine on the issue and as a result they did not make any moves towards central bank independence. In the meantime, sterling's participation in the ERM since October 1990 provided a framework, which in the eyes of the government substituted the supposed stability that an independent Bank of England would provide.

Unfortunately for sterling, its participation in the ERM did not last for long and after the 'suspension humiliation' in September 1992; there was growing pressure for Britain's central bank to be freed from political control. For almost a year, arguments for and against independence, from various sources, were dominating monetary policy debates. In January 1993, Prime Minister John Major appointed two supporters of an independent Bank of England - the deputy Governor Mr. Eddie George as Governor and the editor of the Economist magazine Mr. Rupert Pennant-Rea as deputy Governor - but he made it clear that his government was not yet prepared to surrender political control over British interest rates. Mr. Major believed that the setting of interest rates was too sensitive an issue to be taken out of political control in a country where millions of homeowners with mortgages were affected by every change. (See Reuters News Service, 25 January 1993)

In his resignation speech at the House of Commons in June 1993, Mr. Lamont surprised his audience by stating that: "nothing would be more effective in establishing the government's credibility than if [John Major] had the courage to establish an

independent central bank in this country... It is my greatest regret that after two-and-a-half years I have failed to persuade the Prime Minister of this essential reform". In response to Lamont's comments, Mr. Major said "he saw the case for an independent central bank" but he was worried that it would lack accountability through the elected Parliament (See Reuters News Service, 25 January 1993). In practice however, Mr. Lamont, as Chancellor, did gave the Bank a nudge towards independence. First, by pressing for the appointment of two strong advocates of the Bank's independence, Mr. George and Mr. Pennant-Rea. Second, by giving them for the first time something close to a written mandate saying their 'central responsibility' was to achieve a long-term reduction in inflation. And finally, by introducing in October 1992 the publication of a quarterly Bank report on the government's inflation record.

Despite the continuous pressure and calls for central bank independence, the successor of Mr Lamont, Mr Kenneth Clarke, took a neutral position from the start. He claimed that he would listen carefully to the arguments before making up his mind, adding that "nothing would happen in a hurry on the central bank front". (Financial Times, 25 June 1993:Interview with the Chancellor, Mr. Kenneth Clarke).

On December 16th 1993, the Commons Treasury Select Committee published a report calling for the Bank to be given full responsibility for the operation of monetary policy, while being made directly accountable to Parliament for its actions, for the first time. According to the plan, the Bank would be legally required to aim for stable prices as its primary objective and would set the level of interest rates. The report's recommendations were signed by all but one of the all-party committee members, Mrs. Dianne Abbott (Labour) (See Reuters News Service, 16 December 1993). However, it explicitly rejected the German model of a fully independent central bank because of the lack of democratic control of the Bundesbank. A proposal for full independence had been made a month before by a report of the Centre for Economic Policy Research (CEPR), comprising a panel of academics, City figures and former Treasury and central bank officials, chaired by Lord Roll. (CEPR, October 1993)

Following the recommendations of the Commons Treasury Select Committee, one of its Conservative members, Mr. Nicholas Budgen, came top of the ballot for Private

Members' Bills[63] and had introduced a Bill calling for the autonomy of the Bank of England, based on the committee's report. On the debate in the House of Commons, Mr. Budgen's Bill was 'talked-out' by other members of the ruling party and failed to get a second reading. The Financial Secretary to the Treasury, Mr. Stephen Dorrell, said the proposals were a case too far and questioned whether the MPs and the public would accept unpopular decisions taken by an unaccountable Bank. He furthermore mentioned that the Chancellor's new measure, which gives the governor some discretion in the timing (though not in the level or direction) of interest rate changes, was a step towards more transparent Treasury-Bank dealings. The Labour party did not support the Bill despite the fact that most Labour MPs in the committee supported its recommendations. The official position of the party was that although the Bank needs to be reformed, the suggested Bill did nothing to reform the Court of the Bank, whose directors it regarded as insufficiently representative of industry - as opposed to finance – and of the regions. Furthermore, the Labour plan favoured a separate body for supervision and more adequate democratic accountability from Parliament. Finally, the Liberal Democrats supported the Bill as they were always in favour of central bank independence.

After the defeat of Mr. Budgen's Bill in the Parliament, the pressure for independence somehow abated, not only because of the clear reluctance of the government but also due to the economic recovery and the calmness on the inflation front. However, a decision by the Chancellor Mr. Clarke in April 1994 to accept a recommendation of the House of Commons Treasury Committee, to begin publishing, with a six-week delay, the minutes of his meetings with the governor, significantly increased the power of the Bank. From the first published set of minutes, it was clear that the governor wanted a slower reduction in interest rates than the Chancellor, something that eventually led to compromises.

The disagreements between the two individuals over interest rates continued over the next years, undermining the credibility of British monetary policy. However, the minutes of the monetary policy meetings were not sufficiently detailed to reveal why the Chancellor was often rejecting the Bank's advice to tighten monetary policy. Consequently, there was growing speculation that Mr. Clarke's motivations were more

[63] The top six MPs are guaranteed a day's debate on their chosen Bills.

political than economic. This has resulted in a new series of calls for the Bank to be independent. In May 1995, the shadow Chancellor, Mr. Gordon Brown, declared that a future Labour administration would maintain a tight hold on monetary policy but it was prepared to grant the bank greater freedom to operate within targets set by government. However, the fact that the Chancellor proved to be right in his interest rate decisions during 1995, lowered the calls for de-politicisation of monetary policy decisions.

The issue became once again a main topic of debate in the second half of 1996, as new disagreements between Mr. Clarke and Mr. George emerged over the course of interest rates. The conflict between the two authorities had become regular during their meetings and as a result the press referred to them as the 'Ken and Eddie show'. Although Mr. Clarke finally decided in October 1996 to raise interest rates by 0.25 per cent, this had not been considered enough and the Chancellor was, in the following months, accused of political manipulation of monetary policy.

In February before the May 1997 election, Mr. Gordon Brown declared that, once elected, he planned to reform the Bank in order to take the 'personalisation' out of the monetary policy process. He said that there would be a Monetary Policy Committee (MPC), while the Bank's Court would "reflect a wider range of interests from the city, both sides of industry, and the regions". He also stressed that if the MPC "demonstrates a successful track record in its advice and builds greater credibility", the proposals would result in eventual independence (Reuters News Service, 26 February 1997). Likewise, the Labour Party business manifesto stated: "For the Bank of England, we propose a new Monetary Policy Committee to decide on the advice which the Bank of England should give to the Chancellor to ensure that decision-making on monetary policy is more effective, open, accountable and free from short-term political manipulation". However, in a television debate one month before the election when the Liberal Democrat Mr. Malcolm Bruce challenged Mr. Brown and Mr. Clarke on the issue of central bank independence, neither of the two revealed any specific plans. (British Broadcasting Television 2, 6 April 1997)

It was therefore a big surprise when only four days after the election, on May 6, Mr. Brown, as the new Chancellor of the Exchequer, announced that the Government was giving the Bank of England - with the creation of a Monetary Policy Committee-

operational responsibility for setting interest rates and would introduce legislation as soon as possible. The Chancellor explained that he was convinced that the existing framework was unstable and that these reforms would "put the arrangements for monetary policy-making on a sound and stable footing for the long term".[64] Mr. Brown said that until the legislation comes into force, all aspects of the new arrangements would operate de facto. Finally, he also made proposals relating to the Court, the Bank's role in debt management and the foreign exchange reserves; he also initiated a review of the Bank's finances.

The unexpected decision was in general welcomed by the business world, media, academics, confederations and many politicians who thought that such a move would provide the long-term stability framework that British monetary policy was lacking. However, there were many others, especially Euro-sceptics, who condemned the decision as they regarded it as a further step towards EMU, a surrender of power to unaccountable central-bankers and a start of unnecessary interest rate rises.

On 20 May 1998, the Chancellor made his second surprise as he announced that responsibility for banking supervision would be transferred from the Bank to a new body, subsequently named the Financial Services Authority (FSA), comprising of the Securities and Investment Board (SIB) and other regulatory bodies. Mr. Brown declared that since the current system of splitting responsibility between the SIB and the self-regulatory organisations was "inefficient, confusing for investors and lacked accountability and a clear allocation of responsibilities", there was a strong case for "bringing the regulation of banking, securities and insurance together under one roof". He concluded that a simpler system would "reduce compliance costs and increase public confidence in the regulatory regime". (Universal News Service, 20 May 1996)

The new change had also been welcomed by the financial industry but it created a friction with the Bank of England, which almost forced its Governor, Eddie George, to resign. The reason was not so much the removal of one of the Bank's essential functions, as the fact that Mr. George was not consulted or even notified by the Chancellor of the change.

[64] Letter from the Chancellor of the Exchequer to the Governor of the Bank of England, 6 May 1997.

The Bank of England Bill was published by the Chancellor in the House of Commons on 28 October 1997 after long negotiations, on the exact drafting, between Treasury and Bank officials.

THE BANK OF ENGLAND BILL AND ITS ADOPTION IN PARLIAMENT

The Bank of England Bill of October 1997

The main provisions of the Bank of England Bill as presented to the House of Commons on 28 October 1997 include the following:

The Bank of England will have statutory operational responsibility for monetary policy and the Treasury is prohibited to give directions to the Bank in relation to monetary policy (Clause 10). The monetary policy objectives of the Bank will be to maintain price stability (as defined by the Government's inflation target) and, subject to that, to support the Government's economic policy including its objectives for growth and employment (Clause 11). The Bank will have operational responsibility for setting short-term interest rates to achieve an inflation target which the Government will determine (Clause 12). If, in extreme economic circumstances, the national interest should demand it, the Government will have the power (exercisable through subordinate legislation approved by Parliament) to give instructions to the Bank on interest rates for a limited period (Clause 19). The Government will be responsible for determining the exchange rate regime. The Bank will have its own separate pool of foreign exchange reserves, which it may use at its discretion to intervene in support of its monetary policy objective.

There will be a Monetary Policy Committee (MPC), which will have responsibility within the Bank for formulating monetary policy. The Committee will comprise of the Governor, his two Deputies and six other members (Clause 13). The Governor and his Deputies will be appointed by Her Majesty (on the advice of the Prime Minister) for renewable five-year terms. Two of the other members will be appointed by the Governor (after consultation with the Chancellor) and the others by the Chancellor, for renewable three-year terms. The decisions will be made by a vote of the

Committee, with each member having one vote. If there is no majority, the Governor will have the casting vote. The Treasury will have the right to be represented in a non-voting capacity.

The Monetary Policy Committee will meet on a regular monthly basis. Any decisions on interest rates will be taken by the Committee and announced immediately after the Chancellor has been notified of the decisions and proceedings of the Committee. The meetings will be recorded and the minutes, including a record of any vote, will be released no later than six weeks after the meeting (Clauses 14 and 15).

The Bank will be required to publish a quarterly Inflation Report in which it will account for its monetary policy actions, set out and justify its analysis of the economy and explain how it intends to meet the Government's inflation target and support the Government's economic policy (Clause 18). The Bank will also publish an annual report to the Chancellor and the Parliament (Clause 4).

There will continue to be a Court of Directors of the Bank, which will consist of the Governor, his two Deputies and sixteen non-executive directors of the Bank, all of whom will be appointed for three-year terms by her Majesty (on the advice of the Chancellor). The non-Executive Members will be appointed for their expertise, will be representative of the whole of the United Kingdom and will be drawn widely from industry, commerce and finance. The non-Executive Members will review the performance of the Bank as a whole, including the Monetary Policy Committee. They will have particular regard to whether the Bank is collecting proper regional and sectoral information for the purposes of monetary policy formation. In addition, they will be responsible for ensuring that the internal financial affairs of the Bank are properly conducted (Clauses 1-3).

The Bank's functions in relation to the supervision of banks will be transferred to the Financial Services Authority (Clause 21). Also, the Bank's role as the Government's agent for debt management, the sale of gilts, oversight of the gilts market and cash management will be transferred to the Treasury (Clause 33).

THE DEBATES IN THE PARLIAMENT

One day after the publication of the Bank of England Bill from the Chancellor, the Commons Treasury Select Committee, in its first report on the accountability of the

Bank, demanded the right to hold 'confirmatory hearings' on those nominated on the Monetary Policy Committee. The committee said it also wanted the Bill to increase the term of office for the 'outside' members of the MPC to at least five years, in order to avoid political manipulation of the appointments. The report mentioned that these measures would enhance the accountability and answerability of the newly independent central bank since "under the present proposals the involvement of the executive in the selection process appears to be considerable".[65]

On 5 November 1997, Mr. Alistair Darling, Chief Secretary to the Treasury, said in reply to the Treasury Committee's call, that although the government had an 'open mind' on allowing the committee to vet appointments, he doubted it would accept such powers to be included in the Bill. Mr. Darling told the committee that allowing it to hold 'confirmatory hearings' would have implications for a range of other government appointments. He stressed that "before we decide to go for this procedure for one set of appointments we have to look at whether we would do it across the board".[66] Mr. Darling also mentioned there was a danger that the hearings might stray beyond questions on the member's economic competence and into their personal background. Finally, he defended the length of appointments saying it was a matter of fine judgement and denied it would lead to political interference if an appointment came up near a general election.

On 11 November 1997, the House of Commons held the second reading debate on the Bank of England Bill.[67] Opening the debate, Treasury Chief Secretary Mr. Alistair Darling claimed that the Bill was a further step in the government's determination to modernise the British economy. He claimed that the Bill underpinned Labour's economic approach to secure long-term stability and promote high and stable levels of growth and employment, through the "most open, accountable set of procedures of any central bank in the world". Mr. Darling claimed that the country experienced two of the deepest recessions since the war due to misjudgements of the previous government and successive boom and bust policies. He also declared that until that Bill, there had been only theoretical accountability in relation to the objective of price stability and interest

[65] First Report from the Treasury Committee on Accountability of the Bank of England (HC 282), 29 October 1997.
[66] Minutes of Evidence taken before the Treasury Committee (HC 309), 5 November 1997.
[67] House Of Commons Debate – Hansard, Bank of England Bill, 11 November 1997.

rates, but no real one.

Shadow Chancellor, Mr. Peter Lilley, said that the bill reflected some of the government's most worrying characteristics. First, it showed their contempt for parliamentary processes, since the Chancellor not only announced such a significant reform when the House was not sitting, but "nor does he even deign to introduce the Bill himself – a Bill that hands away his most important responsibility". Secondly, the principal components of the Bill show a "cavalier disregard for assurances given" before the election, since the Chancellor had assured that before considering operational independence, the Bank should establish a good track record in its advice and build greater credibility. Finally, Mr Lilley said that the Bill proved the government's desire to remove power from the House and from elected representatives and to give it away to appointed officials. The government, according to Mr. Lilley, wanted to "escape the blame for difficult decisions". Mr Lilley also declared that Conservatives could not support a measure that transferred powers from a Bank of England "deliberately made less independent" with a committee largely appointed by the Chancellor for just three years. And he concluded that "the worst of worlds would be a bank that was influenced by the Chancellor, but for which he would not take responsibility to the House".

As for the Liberal Democrats, Malcolm Bruce supported the Bill saying it would bring the UK into line with every other developed country, although he too accused the government that its proposals in their manifesto did not mention anything about operational independence. Mr. Bruce also demanded the lengthening of the terms of tenure for the members of the MPC and the conduct of confirmatory hearings by the Commons Treasury Committee.

The previous Chancellor, Mr. Kenneth Clarke, defended his policies and insisted that economic conditions in May did not warrant the rapid increase in interest rates. Mr Clarke warned that "if you keep raising interest rates in an economy that is actually on the point of slowing down, it will slow down a lot faster that you actually anticipated". According to the ex-Chancellor, confirmatory hearings are not a perfect answer to accountability since such a system might be used for political influence by the opposition. Finally, he strongly declared that "the new system is less open than the

system before the election" since the exact opinions of each individual could not be identified by the minutes.

The Chairman of the Treasury Select Committee, Mr Giles Radice (Labour), congratulated the government for their courage to reform the bank and stressed that the new system provided increased openness. However, he mentioned that it would be even better if, as the committee report suggested, there were confirmatory hearings and longer terms of office.

In contrast with Mr. Radice's compliments, three Labour backbenchers attacked the government for its decision and declared that they could not support it. Former Labour Treasury minister, Mr Denzil Davies, said that the clear message to voters was "don't trust us with your money, we are just politicians". Mr Davies claimed with irony that if politicians cannot be trusted with monetary policy, then why should they be trusted with fiscal policy. He suggested instead to "transfer all the power to boards, so that we have that marvellous system of accountability and modernisation". Moreover, he claimed that the Bank had been asked to make inflation bias its priority, although monetary and fiscal policy can not be divided.

The second Labour member who disagreed with the Chancellor's decision was Ms Diane Abbott, a left-winger who had expressed her opposition to central bank independence repeatedly in the past. Ms Abbott condemned ministers for handing over "one of the most important levers of economic policy to an unelected quango" and said that "the wrong decision has been taken for the wrong reasons, and announced in the wrong way".

The third Labour dissident, Mr Austin Mitchell, said that Bank of England independence would "inevitably increase the value of the pound" and that would have a damaging effect on the economy. To prove the above, he referred to evidence from what he called the "best study" (by Eigffinger and deHaan) on such matters which showed that central banks overkill the economy and that their management of the economy produces deeper recessions. He finally wondered how the government could manage the economy since it has committed not to raise taxes and has lost control of monetary policy.

At the end of the debate, the Bill was given a second reading by 365 votes to 139, a government majority of 225 and was subsequently committed to a Standing Committee. (Standing order No.63).[68]

The Standing Committee D of the House of Commons met eight times, between 18 November 1997 and 11 December 1997,[69] to discuss the clauses of the Bank of England Bill. During its proceedings, the members of the opposition, especially the Conservatives, presented various amendments but the government did not accept any, although for some it gave reasonable and convincing explanations.

Opposition parties insisted on the need for confirmatory hearings from the Treasury Select Committee, for the members of the MPC and for the directors of the Court. They also insisted on lengthening the term of office of the MPC members from three to six years. Members of both the Conservative and the Liberal Democrat Party claimed that confirmatory hearings would strengthen accountability and would enhance the credibility of those appointed. It would also provide assurances to the House that the members are competent. They stated that virtually all MPC members would be direct government appointments, thus entailing the danger of political meddling, especially since the term of office of the non-executive members had been set up to only three years. Members of the opposition suggested that the term should be longer than the life of a Parliament, as was the case in the other countries with an independent central bank. The Paymaster General Mr Geoffrey Robinson replied that the credibility of the new arrangements should depend not on the length of the appointments but on how well the members performed. He also said that there could always be re-appointments and that the three years term would be consistent with the recommendations of the preliminary report on corporate governance of the Hampel Committee.[70]

The Conservatives also presented an amendment, which required that the publication of the minutes of the MPC minutes would not include just a general summary of the discussions and the votes, but a more detailed report on the views of individual members.

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[68] It should be noted that the three Labour members who declared their opposition did not vote.
[69] House of Commons Standing Committee D, Debates on the Bank of England Bill, 18, 20, 25 and 27 November 1997 & 2, 4, 9 and 11 December 1997.
[70] The report recommended that all directors of companies should be required to submit themselves for re-election at regular intervals and at least every three years.

However, the Economic Secretary of the Treasury, Mrs. Helen Liddell, did not accept it as she said that it would inhibit free and frank debate at the MPC. She claimed that it was necessary for the meetings not to be personalised or create restrictions on the views expressed by members, something that has been observed in the United States Federal Reserve Bank.

In general, the debates on the Standing Committee were characterised by the denial of the government to accept the amendments made by the opposition. It is also interesting to note that Labour members did not present any amendments. The Conservatives, as was expected, dominated the criticism of the Bill since the members of the Liberal Democrats were very often absent from the meetings. The Conservative members accused the government that it had deliberately excluded from the Committee the three Labour members who opposed the Bill at the Second Reading, and as a result there was not enough pressure on the government. Finally, as Mr. Nick Gibb (Tory) stated, the government was "choosing the easy option in every case", implying that the model of independence was selected in such a way as "to keep everything under the thumb of the Chancellor and the Treasury".

On 22 January 1998, the Bank of England Bill was brought back in the plenary session for a third reading. The debate was once again dominated by discussion on the issue of confirmation hearings. The Labour Chairman of the powerful Treasury Select Committee, Mr. Giles Radice, pressed an all-party amendment that would give the committee say in senior appointments to the Bank and the Monetary Policy Committee. Mr. Radice stressed that he was not seeking a veto for his committee over such appointments but said that the committee should be able to examine the competence of candidates, endorse them or ask the Chancellor to reconsider them. But Mr. Alistair Darling, the Chief Secretary to the Treasury, said that the government had a number of concerns. Above all, he said, it would be wrong to introduce hearings for members of the monetary policy committee and not for other public appointments. He repeated that it was a matter that the House as a whole had to consider right across the board. Mr. Darling said that the government was also concerned that confirmatory hearings might deter some potential candidates from putting themselves forward. He finally claimed that, under different political circumstances, the treasury committee might also use the hearings to "have a go" at the government of the day. Nevertheless, Mr. Darling

welcomed the decision of the Committee to call members of the MPC before it on non-statutory basis. Following that statement, Labour members who tabled the amendment abstained from vote, an act that was strongly criticised by the opposition. The move was defeated by 252 votes to 143, a government majority of 109.

The government also came under attack by Labour's Mr. Austin Mitchell who disagreed with the way the economy should be run. Mr. Mitchell tabled amendments that would make the Bank take into higher consideration the level of employment, the exchange rate and inflation, but he was forced to withdraw them due to the government's opposition. The Bill eventually gained a third reading by 207 votes to 116, a government majority of 91 and was then passed to the House of Lords.

On 13 February 1998, the Bank of England Bill was backed in the House of Lords,[71] gaining an unopposed second reading and was subsequently passed to a Lord's Committee. Lord McIntosh of Haringey, speaking for the government, said that the Bill was "a further step in our determination to modernise the British economy to equip the country for the new global economy". He told peers that "the Bill underpins our economic approach, which is to secure long-term stability and the promotion of high and stable levels of growth and employment. It will increase confidence in this country's commitment to low inflation". However, former Labour Cabinet minister and Euro-sceptic, Lord Shore of Stepney, attacked the Government's decision to give the Bank the prime role in setting interest rates on the grounds that it abandoned "very important controls over the economy". He warned that the change would give the Government less freedom to respond to the strength of the pound, which he said had seriously damaged the manufacturing industry. In general, there was support for the Bill, but most peers agreed that independence could not be regarded as a panacea. The Lords also agreed that the new supervisory body required improved information collection in order to be successful.

The discussions of the House of Lords Standing Committee on the Bank of England Bill took place on the 3 and 4 March 1997. Most of the amendments discussed were similar

[71] The First Reading in the House of Lords took place on 26 January 1998, with no debate.

to those debated in the House of Commons and there were no essential amendments agreed to, except on some technical issues.

On the 23 and 30 March 1997, the debate was brought back to the plenary House of Lords[72]. Although the previous discussions had shown that the Bill would not come under any serious attack, an unexpected amendment introduced by Tory frontbencher, Lord Mackay of Ardbrecknish resulted in an embarrassing defeat for the government. The amendment, which provided that one of the MPC members should be appointed on the advice of the First Minister of the Scottish Assembly (after devolution), had passed by 93 votes to 90, a majority of three for the opposition.[73] Lord Mackay of Ardbrecknish said that those on the committee had to understand the needs of the whole economy of the United Kingdom, since the economies of the nations that make up the United Kingdom could be very different, especially in the case of Scotland after devolution. Minister Lord McIntosh of Haringey claimed that he opposed the amendment, as a requirement of this kind would frustrate the fundamental objective of forming the Monetary Policy Committee from the best and most highly qualified people for the job.

Having passed the House of Lords, the Bill was returned to the Commons with amendments on 20 April 1998 for a third reading.[74] During the debate, the Shadow Treasury Chief Secretary, Mr. Heathcoat-Amory, supporting the Lord's amendment that the government opposed, said that the Chancellor had a monopoly of patronage and that a Scottish member would enhance the decision-making process of the MPC. He also claimed that it would add "an element of devolution to the Committee" since until then, the representatives were exclusively from the South East of England. Mr. Edward Davey for the Liberal Democrats also agreed and said that the change would guarantee a voice for Scotland at a time when Britain was fully committed to devolution in all respects.[75] However, the Treasury Chief Secretary, Mr. Alistair Darling told the Commons that the amendment was unnecessary, since the Bill was to ensure that the Court of the Bank would specifically monitor the way in which the MPC took into consideration the whole

[72] House of Lords Report Stage Debate, Bank of England Bill, 23 March 1998 & House of Lords, Bank of England Bill Third Reading, 30 March 1998.
[73] As a spokesman for Lords Leader Lord Richard stressed, of the 93 peers who voted for the amendment, 53 were hereditary. If the life peers alone had voted the Government would have won the vote by 77 to 40, a majority of 37 (Associated Press News, 24 March 1998).
[74] House of Commons Debate, Bank of England Bill, 20 April 1998.
[75] It has to be noted that in the House of Lords the Liberal Democrats voted against the amendment.

of the UK economy. After those comments, the amendment was reversed by 231 votes to 107, a government majority of 124. The government, however, accepted other Lords' amendments that were of a more technical and descriptive nature, and had nothing to do with the government's power over appointments.

The Bank of England Bill, under the name Bank of England Act 1998, received a Royal Assent on 23 April 1998, after the House of Lords accepted the reasons of the Commons[76] for rejecting their amendment.

THE ROLE OF THE PARTICIPATING ACTORS IN THE REFORM PROCESS

The establishment of the 'operational independence' of the Bank of England by the government of Mr. Tony Blair cannot be regarded as a simple institutional policy reform towards a different way of conducting monetary policy. The announcement of the Chancellor of the Exchequer only four days after coming to power was a move very much related to the broader political, economic and institutional ideas, interests and influences that have accumulated over a period of more than two decades. At the same time, various individuals and groups, with sometimes-conflicting concerns, were involved in the reform process, thus affecting the route of the final outcome. Having examined the historical course of events, as well as the broader political and economic conditions during which Bank of England independence became an issue of serious consideration, it is now appropriate to analyse in greater depth the exact role, influence and objectives of the various participants involved.

[76] The Commons disagreed to the amendment for the following reason—(5A) Because the members of the Monetary Policy Committee of the Bank of England are appointed solely for their monetary policy expertise. It is for the Committee to collect from across the whole of the United Kingdom the information it needs for monetary policy purposes, and for the court of directors of the Bank to ensure that it does. House of Lords Debate, Bank of England Bill, 23 April 1998.

PARTICIPANTS INSIDE THE GOVERNMENT

The Prime Minister

Since 1988, when there was the first considerable attempt for the establishment of an independent central bank, each of the three Prime Ministers has played an essential role, for it is the Prime Minister who must give the final approval for such a reform to take place. The three UK Prime Ministers have shown quite different attitudes towards such a reform.

Mrs. Margaret Thatcher, who was Prime Minister from 1979 until 1990, was clearly and decisively against an independent Bank of England. However, her opposition had more to do with political that economic reasons. From the start of her term, Mrs. Thatcher showed a firm anti-inflationary attitude and although she was forced from time to time to act oppositely, she could not have been against the basic principle of an independent central bank, i.e. to sustain price stability. Mrs. Thatcher's hostility was due to reasons of power. She could not accept that she would surrender one of her basic economic tools to a group of unelected officials who would act completely independently of her will. She also associated the issue of Bank of England autonomy with the prospect of a united Europe and an independent European Central Bank that she also opposed.[77] Moreover, one must not neglect that when Chancellor Nigel Lawson made the proposals for the Bank's independence, his relationship with Mrs. Thatcher was having difficulties, and this did not help the plan to be discussed further.

Mr. John Major, the successor of Mrs. Thatcher from 1990 until 1997, kept a low profile on the issue of independence. Mr. Major avoided to take a definite position for or against, as he did with the single currency, although during his term the calls and pressure for granting the Bank of England independence were numerous and continuous. Mr. Major had various reasons to consider the issue, such as the exit of sterling from the ERM, the process towards EMU and the global trend towards independent central banks, but he preferred to insist on the limited democratic accountability, which an independent central bank would involve. In reality, the main hesitation of Mr. Major had little to do with accountability but more with the fact that such a move would be considered among the Conservative Euro-sceptics as a change in attitude towards EMU. In his comments

[77] As a Senior Fellow at the Institute for International Economics Mr. John Williamson stated, Mrs. Thatcher's EMU opposition was based "on romantic concerns with sovereignty, not on economic cost-benefit calculus" (The Guardian, 21June 1989).

right after the Labour government made the Bank of England semi-independent, Mr. Major added some new counter-arguments, saying that the Chancellor has "damaged his choices in managing the economy, ensured unemployment will grow and growth will be held back" (Associated Press News, 14 May 1998). The fact that Mr. Major never used in office such arguments against independence most probably shows a desire tc attack not the decision as such, but the government's new policies in general, whatever they involved.

Mr. Tony Blair, the first Labour Prime Minister after eighteen years of Conservative governments, was the one under whose leadership the Bank of England was granted operational independence over monetary policy. Mr. Blair described the move as the "biggest decision in economic policy since the War" and said that it confirmed the government's determination to act in the best long-term interests of the country (Associated Press News, 6 May 1998). Although Mr. Blair did not make any specific comments regarding independence when in opposition, he is supposed to have always been in favour of reforming the Bank. His desire to convince the financial markets and the rest of Europe that even if the UK would not participate from the start in EMU it would achieve monetary stability made the case for independence more than appealing. Mr. Blair also saw the case for reforming the Bank as another step towards his goal of modernising and reforming the state and the country. At the same time, he wanted to make it clear that his policies were far different from the ones of the 'old Labour' and that he aimed at long term policies with transparent and accountable procedures. Of course, the initial plan, as was described in Labour's business manifesto, did not include operational independence for the Bank but just a MPC to give advice and also greater regional and sectoral representation in the Bank's Court. However, Mr. Blair did not have any particular objection to the final plan, which gave his new government a significant boost of credibility on the monetary policy front and proved the government's promises for quick and substantial changes.

The Chancellor of the Exchequer

The role and impact of a Chancellor of the Exchequer when discussing a reform that transfers economic power is fundamental. The Chancellor, as most opponents of independence claim, is the person who loses one of his economic policy weapons and is

therefore the one mostly affected by the reform. The paradox, however, is that it is effectively his own decision to give away such power to the Bank. The five UK Chancellors since the issue first came up have not confronted, as expected, the idea of an independent Bank of England with similar attitudes. Moreover, many of them have changed their stance significantly over the years.

Mr. Nigel Lawson was the first politician in the UK to make the issue of independence a major topic of debate. However, he did that only after he left office, a fact that shows that even he, as Chancellor, could not proceed with his plans while the Prime Minister opposed them. The involvement of Mrs. Thatcher in interest rate setting was, on the other hand, the main reason for Mr. Lawson's support for independence. After he left the Treasury, Mr. Lawson became one of the most prominent figures pushing for the Bank's reform and certainly contributed significantly to the process towards independence.

Mr. John Major, who succeeded Mr. Lawson as Chancellor, did not show any particular desire to change the status of the Bank and, given Mrs. Thatcher's strong opposition, he ignored all calls for change during his short term as Chancellor.

Mr. Norman Lamont who took over from Mr. Major developed a somehow odd attitude towards independence. During his first months as Chancellor, he ruled out the possibility of giving the Bank independence as he claimed that "in the UK, the position is that ministers are accountable to parliament for economic policy" (Financial Times, 31 December 1991: Interview with the Chancellor Norman Lamont). On the other hand, Mr. Lamont's actions during his term strengthened the independence of the Bank. He appointed in the Bank two strong supporters of independence, he gave them an objective for low inflation and allowed them to publish a quarterly report without the prior approval of the Treasury. Mr. Lamont then surprised everyone as he revealed in his resignation speech that he too, as Mr. Lawson in the past, failed to persuade the Prime Minister to make the Bank of England independent. After his resignation, Mr. Lamont became one of the most passionate supporters of independence, revealing that while he served as Chancellor, the timing of interest rate changes had been decided for political reasons (The Sunday Times, 14 November 1993). After the announcement of May 6 1997, Mr. Lamont said that "this change is right, should have been done by Conservative governments, and Gordon Brown deserves full credit. Interest rates should not be in the

hands of politicians subject to all sorts of political pressures"(Associated Press News, 7 May 1997).

The increasing calls for independence, however, by previous Chancellors did not persuade the last Conservative Chancellor, Mr. Kenneth Clarke, despite his known support for the UK's participation to the EMU and his subsequent acceptance of the independence of the European Central Bank. Mr. Clarke tried to balance the calls for the Bank's formal independence by accelerating moves which gave it greater say in the setting of interest rates through more transparent and accountable procedures. However, Mr. Clarke's insistence to ignore, in some occasions for political reasons, the calls for monetary tightening and his disputes with the governor of the Bank have definitely undermined those moves and played an indirect role in establishing a consensus that those arrangements needed urgent reform.

Mr. Gordon Brown was the Chancellor who ultimately linked his name with the decision of the Bank of England's independence. He is thus the person who carries the ultimate responsibility not just for the correctness of such decision in principle, but also for the chosen model of independence. The historical course of events has shown that Mr. Brown did not always favour complete surrender of the Treasury's power in interest rate setting. He was convinced only few months before the election and that had much to do with his visit to the independent US Federal Reserve Bank. He was very much impressed by the achievements of its Chairman Alan Greenspan not just on the fight against inflation but also with the overall way he managed the US economy (See The Guardian, 7 May 1997). Apart from the influence of that visit, Mr. Brown discovered before the elections some other tempting reasons for giving the Bank immediate operational independence. First, such a move would relieve him of the burden of taking the blame for the necessary interest rate increases, especially since he had promised not to raise consumer spending taxes in his July 1997 Budget. Second, he would make a first move towards the EMU, which he clearly favoured, since central bank independence is a requirement for entry.[78] Third, he would take, as he finally did, all the credit for proving that he is a bold Chancellor who follows long term economic policies away from political influences. Fourth, he could concentrate on the fiscal and income front of the

[78] The government will have to give to the Bank of England even more (functional) independence in order to meet the relevant Maastricht criterion.

economy, with a guaranteed simultaneous prudent monetary policy from the Bank of England. Fifth, he would prove the government's determination for essential reforms. And finally, he would be able to resist any pressures from spending departments, with the excuse that the Bank would immediately raise interest rates, and therefore would be able to cure the everlasting problem of past Labour governments, that of fiscal overspending. Mr. Brown made a bold decision that he hoped would personally distinguish him from past Chancellors and eventually would enable him to achieve the UK's long term economic objectives.

The Rest of the Government

During the Conservative governments all the discussions for an independent Bank of England were restricted to the Chancellors and the Prime Minister and therefore there was not any direct involvement by other members of the government. Moreover, ministers were very cautious in expressing their independent views since it was an issue that both Mrs. Thatcher and Mr. Major did not support. It was a move that most people, especially in the Conservative Party, were regarding as a step towards EMU, with all the sovereignty-related objections that it entailed.

Members of the Labour government did not have the chance to express their views since the decision was taken only days after the election and they therefore did not influence the final outcome. However, according to press reports there were several ministers who were irritated by Mr. Brown's unexpected decision, which was taken with hardly any consultation. (See Financial Times, 7 May 1997)

Governmental Committees and Advisors

Governmental Committees and personal advisors to ministers always have some involvement in any governmental decision, not only because they often influence ministerial judgement by their own comments and input, but also because they are the ones which prepare the final Bills.

According to press reports, both Chancellors Lawson and Lamont have set up some secret Treasury committees to investigate and prepare plans for the independence of the

Bank of England. However, their composition and exact recommendations still remain hidden by the Treasury.

It is well known that Mr. Brown's decision was influenced to a substantial degree, by his personal economic advisor, Mr. Edward Balls. Mr. Balls, an ex-Financial Times leader writer and a former student of the US deputy Treasury Secretary Larry Summers, was always a strong supporter, as Mr. Summers himself, of central bank independence. Mr. Balls has made many publications in favour of the Bank's independence and accompanied Mr. Brown to his vital, as it had proven, visit to the US where he met Mr. Greenspan and Mr. Summers. Mr. Balls was also the one who together with the Chancellor on the eve of the election prepared the model that was announced on the 6 May 1997. (See The Sunday Times, 11 May 1997)

PARTICIPANTS OUTSIDE THE GOVERNMENT

The Bank of England

The stance of the Bank of England in relation to the issue of independence, as its governors and other top executives expressed it, has always been a favourable one but rarely pressing. The benefit of independence for the people of the Bank would be substantial as they would be able to pursue the objective of price stability without political and any other interference, and they would also personally gain much prestige and authority. However, all Bank executives understood that in order to achieve independence the best route would be through the continuous, indirect presentation of its advantages.

While in office, the governors of the Bank tried to avoid calling for the Bank's independence. They made it clear, however, that they favoured it and that it would enhance monetary policy's credibility. As Mr. Robin Leigh-Pemberton, governor from 1983 to 1993, stated, "one must not say an independent central bank is capable of magic but it is likely to produce more consistent results in terms of monetary policy, interest rates and therefore influence over growth or recession in the economy" (British Broadcasting Radio, 22 June 1993: Interview Robin Leigh-Pemberton). His successor Mr. Eddie George was also cautious during his early days. He claimed that "we've not

campaigned for independence. We have campaigned for stability... Of course, the arrangement that we have would be more secure if it were embedded in statute" (The Daily Telegraph, 27 July 1994: Interview Eddie George). Nevertheless, after 1995 Mr. George became more demanding on the issue of independence, as he had many conflicts with the Chancellor over interest rates setting. Overall, Mr. George changed the image of the Bank's governor towards a more independent one and convinced the Labour government that he would be the appropriate person to govern the newly reformed Bank of England.[79]

The Political Parties

The UK's political parties were highly involved in the debate for the independence of the Bank of England. However, their position has not been steady throughout the ten years that the issue was debated. The Liberal Democrats were the only political formation that held a constant position in favour of an independent Bank of England. That had, of course, much to do with the fact that they were faithfully in favour of EMU, which is connected with central bank independence.

The Conservative Party has officially been opposed to the idea of independence, but a significant number of its members had on many occasions pressed for the reform of the bank and has kept the debate running. Moreover, it was during a Conservative government that a Parliamentary Committee was set up to examine the issue of independence and finally came up in favour. The main reason for the Conservative members' opposition was the worry about democratic accountability of an independent Bank of England. This, however, reflected their broader concern about the threat to sovereignty, a cause also for their division over Europe. Conservative members have been very active during the debates in Parliament although the government did not accept any of their numerous amendments.

The Labour Party's position until 1994 was one of great concern about the issue of accountability and it thus officially rejected the idea of an independent central bank. From then on, however, it started considering the issue and as the old arrangements were proving to be ineffective it changed its stance and declared that it would reform the Bank. Nevertheless, until the day of the official announcement of the independence of

[79] Mr. Eddie George was re-appointed for another term on 18 February 1998 (starting June 1998).

the Bank of England, concerns about the accountability of the 'unelected central-bankers' did not permit Labour members to consider more than a slight increase in the Bank's say over interest rate setting. Yet, the determination and quickness of the Chancellor's announcement surprised even his own colleagues who did not have the chance or the strength at the time to raise any objection. Labour members who were still concerned about the issue of accountability and transparency, proved to be similarly ineffective in passing amendments during the Parliamentary debates. Even in two, three cases in which they presented changes and had the backing of the other parties, they eventually preferred to abstain than vote against their own government's official position.

The Media

The influence of the media and especially of the press was essential in the progress of the issue of independence. Press coverage was from the very start broad with analytic and critical comments that provided all aspects and consequences of such a reform. In general, the editors of the articles adopted a sympathetic attitude in most cases, although they made it clear that such a reform would not cure all problems of the UK economy and should not be regarded as a panacea. The majority of the press also criticised the government for the manner of the reform's introduction, as the idea for operational independence was not included in the party's manifesto.

However, the stance of the press became more negative after the five increases in interest rates by the Bank of England and the problems that the manufacturing industry experienced due to the strong pound. Press reports started wondering about the consequences of Mr. Brown's reform and warned that monetary tightening could lead to a recession if misused.

The Financial and Manufacturing Sector

The financial and manufacturing sectors did not play a decisive role in the establishment of the Bank of England's independence but they always supported a reform that would stop boom and bust policies. Since the exit of sterling from the ERM, financial and manufacturing boards and institutions expressed from time to time the benefits of an independent central bank but they were not particularly pressing. Companies saw the

independence of the Bank as a mean that would bring long-term monetary stability and lower interest rates.

The announcement of the Bank's reform was positively welcomed by the British Institute of Directors and the Confederation of British Industry, as they considered that it would reduce the cost of finance for industry (Associated Press News, 6 May 1998). However, there were some manufacturing firms that confronted the move with caution as they feared that independence would strengthen the pound even more and thus damage exports.

CONCLUSIONS

The Bank of England Act 1998, which established the operational independence of the Bank of England in conducting monetary policy, was the result of a series of economic, political and institutional changes, in and out of the United Kingdom, during the last two decades.

The economic aspect of these changes has been identified as successive UK governments were trying to find a 'method' in order to permanently confront inflation and achieve long term monetary stability. The UK economic track record during the last 30 years has been worse than most of its competitors mainly because British policy makers have not achieved the necessary monetary and exchange-rate stability to sustain long term growth. The weight of the financial and manufacturing sectors in the UK economy is significant and therefore the value of the pound and the level of interest rates are crucial. Since the early 1980s, the UK has changed numerous monetary policy tools (money supply targeting, shadowing the D-Mark, participation in the ERM, inflation targeting) with limited and not particularly lasting success. Within such a framework, some British policy-makers presented independence as a panacea to the everlasting problem of monetary stability. However, those opposed to the EMU regarded it as another example of surrendering power. Furthermore, the opponents of independence claimed that the

reform of the Bank would not guarantee any success since it would probably be so obsessed with inflation that it would neglect all other aspects of the economy, in a period during which the main priority was to foster growth. The abandonment of the idea by Mr. Major, as was the case in 1988 by Mrs. Thatcher, proved that despite the obvious problem of monetary and exchange rate policy the country was not ready to welcome such a radical reform. Independence for the Bank of England was considered, at that time, as another European-related measure, something that after the ERM humiliation and given the general British distrust over Europe could not be seen then as a suitable solution.

Given the above considerations, the establishment of CBI in the UK has to be justified mainly by other political developments and mostly by the policy shifts that gradually occurred, especially towards Europe, and ultimately by the change of administration in 1997. During the 1980s, as long as Mrs. Thatcher was in power, there was blatant contempt in the United Kingdom for European processes and prospects. However, by the end of that decade, as the rest of Europe was making plans for the future monetary union and the country was getting into a second recession, the climate towards Europe started to change. Although there was still clear opposition by the majority of British people, UK policymakers started engaging in much greater participation in European developments. The participation of sterling in the ERM was not just an economic measure, but a result of the above-mentioned trend. With the resignation of Mrs. Thatcher, there was an even bigger step towards European integration. Mr. Major's government signed the Maastricht Treaty, even though with an opt-out choice. For almost six years, the Conservative government was divided, as was the whole nation, on Europe and most matters affected by it. Although the Prime Minister was not himself a supporter of the idea of independence, he understood that there could be some significant advantages in the fight against inflation and in the elimination of the risk premium on UK interest rates by the implementation of such a reform. Nevertheless, he knew that, especially after the ERM defeat, most members of his party who were against EMU, would never agree. The danger of a governmental humiliation in Parliament was notable and Mr. Major was not inclined to take that risk. Furthermore, the Prime Minister was a strong believer in the peculiarity of UK interest rates setting, and he did not want to face the public's discontent in the event that the policies of an independent Bank of England would make mortgage payments more expensive. In addition, at that time the British

economy needed a boost in order to exit from the recession. Yet, if the Bank of England was made independent it could well follow a much stricter policy than needed, due to its obsession with inflation. This could well lengthen the uncertainty period and eliminate the competitive advantages of the sterling's depreciation. Such considerations proved to be critical in Mr. Major's decision to reject the idea of an independent Bank of England. However, the gradual changes that took place in the following years towards greater autonomy paved the way for a different administration, under a different political climate and global framework, to introduce the independence of the Bank of England in interest rate setting. After being only a week in office the new Labour government announced the significant reform. This early, bold move was not only an indication of the government's desire to mark its administrative difference from the Conservatives and its will to promote broader policy reforms, but also a first step or even a test in a series of political moves towards EMU, which it favoured even if it did not officially declared it. The latter had been confirmed six months later when the Labour government announced its desire to participate in the Economic and Monetary Union, under some economic conditions. In reality, the conditions were not just set up for economic reasons but also in order to buy time to persuade the majority of the British people.

Even though the political parameters had played the critical role in the government's decision to transform such a traditional institution, there were also successive institutional changes, especially in relation to the way the Bank functioned, that paved the way for the final reform. In the U.K., despite significant reforms of most practices of state intervention since the mid-eighties, the aversion of the majority of the British people towards most issues that were related, directly or indirectly, to the European Union, constituted an essential constraint for the Bank of England's reform. The British have been very prudent on matters of national sovereignty and delegation of power. Trust in national governance and parliamentary procedures have always been particularly preserved and any other method has been confronted with extreme scepticism. Most British people have associated the issue of central bank independence with the image of the German Bundesbank which many viewed as more powerful than its own government. The British people always saw the Bank of England as an institution with a long and respectful tradition. However, reality has shown that it had more or less always been under the directions of the Treasury. The British tradition of the Treasury's authority in monetary policy and interest rate setting could not be reversed too suddenly

regardless of the monetary situation that the UK faced after its exit from the ERM. The UK's institutional framework and customs needed moderate changes in order to adopt new policy practices with the minimum disturbances. This was proven in the following years by the gradual moves (quarterly inflation reports, unofficial mandate, publication of minutes, timing of interest rate changes, etc.) of the Major government, which gave to the Bank more authority and significantly increased its autonomy. Eventually, the return of Labour to power after eighteen years was accompanied by a fierce desire for change in all aspects. The establishment of the independence of the Bank of England, even only in interest rate setting, within Labour's first week in power, was to signal that the Blair government would be different from the Conservatives in all aspects: politically, institutionally and economically.

The establishment of the operational independence of the Bank of England should not, however, been seen as a series of independent economic, political and institutional developments. The above-mentioned parameters and the combination of conditions that prevailed should be regarded as interrelated factors which after the change of administration enabled the Blair government to undertake such a reform. Nevertheless, one should not also ignore the particular political and personal indirect benefits that the government and the Chancellor would gain from such a quick reform. That last point had been characteristic during the discussions in Parliament. The model that was finally chosen and the denial of the government to accept amendments in Parliament, especially in relation to the appointment and accountability procedures, indicates that although the government declared the significant independence and accountability of the new reforms, its hidden agenda, as members of the opposition claimed, was to keep, as much power as possible.

Chapter IX: Central Bank Independence: The Importance of Established Institutional Patterns

The aim of this concluding chapter is to bring together all the findings of the different parts of the thesis and to locate them within the theoretical framework defined at the start of the thesis. The aim is to understand how ideas permeate the political elites and are then transformed into policies.

Central banks are key institutions in the process of economic policy making and their principal concern, whether independent or not, is the conduct of monetary policy. However, monetary policy is also one of the fundamental components of any government's overall economic policy. Therefore, since there are two institutions with overlapping responsibilities for the same issue, disagreement is almost inevitable. The appropriate relationship between central banks and governments has been a subject of countless studies and debates ever since the establishment of the first central banks. As was analysed in Chapter III, there are two opposing views. On one hand, there are those who believe that the central bank should only be an advisory and administrative arm of the Treasury with no significant decision-making powers. On the other hand, there are the supporters of central bank independence who hold that the Bank should enjoy considerable autonomy both in formulating and in implementing monetary policy.

After concluding in Chapter III that central bank independence can generally provide a more reliable framework for the achievement of low inflation and long-term monetary stability, we analysed in Chapters IV and V, the significance of the particular characteristics of independent central banks. The outcome was that all the functional and personnel arrangements of the central bank have to promote its credibility. The success of an independent central bank depends heavily on its ability to persuade the markets of its commitment to long-term monetary stability, regardless of short-term political influences. The success of independent central banks is due largely to the freedom of action provided in their statute.

During the 1990s, the idea of central bank independence as a means to achieve long term monetary stability, spread all over the globe with considerable speed. This was mainly

the result of the conclusions of numerous empirical studies about the economic advantages of independent central banks, the reputation of the Bundesbank, and also due to the arrangements for the independence of the European Central Bank (Chapter II). The fact that countries outside the European Union considered the reform of the status of their central bank shows that this concept did not only emerge from the requirements of the Maastricht Treaty, even though this helped make the issue extremely popular and fashionable. The point is that there were further political, economic and institutional factors that played a significant role in promoting the concept, as can be firmly concluded by the examination of the three case studies presented in this research. Nevertheless, the implementation of such a reform involves political difficulties for most governments. The majority of governments that granted independence to their central bank during the last decade succeeded in doing so only after strong opposition and significant delays.

However, this is a study of European Union states and it does not provide an analysis of general relevance to central bank independence in any country in the world. The research focused on the attempts of three members of the European Union, France, Greece and the U.K., after the Maastricht Treaty, to make their national central bank independent. Our question is why there were considerable differences among these three member-states' approaches regarding the emergence and acceptance of the idea, and the timing, and eventual pattern of central bank independence. The analysis exposed the following major differences between the countries. First, the idea of an independent central bank emerged at different times. Second, the reform proposal did not gain the same popularity, and the governmental efforts for and approach to its eventual parliamentary approval differed notably. Finally, the models of central bank independence that the three countries chose to adopt have many differences despite the guidelines of the Maastricht Treaty.

The basic argument of this thesis is that in all three cases the emergence, acceptance and final adoption of central bank independence was heavily affected by three institutional factors: the position of the country in the international political economy, the established patterns of political competition, and the institutional politics of appointments that prevailed in each country. The differences in the timing and popularity of the idea and in the models of independence that the three countries have favoured can be best explained

if one takes into account politico-institutional factors rather than purely economic ones. These factors were critical in shaping the preferences and influencing the timing and goals of the main actors involved in the reform process.

The process of establishing central bank independence has been examined both through a broader country-oriented perspective and through a narrower personal-oriented one. The former contributed significantly to our understanding of the factors that affected the timing and the degree of acceptability of the reform, while the latter revealed how institutional politics affected the preferences of the main actors about the arrangements for their independent central bank.

Explaining the Differences

Having analysed the patterns of adoption and the form of Central Bank Independence in each country let us now review in a more systematic and detailed fashion the precise differences between the three approaches. The differentiation between the three cases emerges in the following terms: period of emergence and receptivity, time of establishment, and model of adoption.

The first major difference between the three cases concerns the period when CBI came under serious consideration for the first time. The French centre-right coalition, just before the 1986 elections, had been the first group in these three countries to declare the aim to make the central bank independent. The goal was to strengthen monetary policy credibility and influence, which had hitherto been extremely dependant on the German monetary decisions. In the UK, the first moves occurred in 1988 by Chancellor Lawson, who prepared a plan to make the Bank of England independent. He did so in a period of inflationary pressures and exchange rate instability, which were partly due to non-participation in the ERM. By contrast, in Greece CBI became an issue of consideration only after the Maasticht Treaty, even though the country had eternal monetary and exchange rate policy problems.

The popularity of the reform also varied considerably among the three cases. In France, the topic had been an issue of debate for many years due, not only to the Maastricht requirements, but also the pressures on the 'strong franc'. However, in France there were not the same media coverage and intense debates as in the UK, where CBI had been for almost a decade a topic of serious dispute. In Greece, on the other hand, popular interest in CBI had been limited and the debate had been minimal possibly because the two major parties were in favour of the reform and therefore there was no serious opposition.

The differences observed in the time of establishment is closely related to the previous question. The independence of the Bank of France occurred relatively early, a few years after the Maastricht Treaty, in a period of currency pressures, with a new government in power and after some objections during its ratification. In the UK, it was also a new government which implemented the reform, in a period of relatively healthy economic conditions but after serious disagreements on both CBI and EMU. In Greece, also a relatively new government established CBI only a few months before the Maastricht Treaty's deadline, but in a period of continuous economic improvement and within a relatively calm ratification procedure.

Finally, there are considerable differences between the functional and personnel CBI characteristics of the three models, as shown in Table 4. The most important difference between the three cases is that in contrast to the Bank of France and the Bank of Greece, the UK central bank does not have 'real' statutory independence but only operational autonomy, since it is the government which sets the monetary target that the Bank must achieve. Furthermore, since the UK will not be part of EMU, the Bank of England's statute does not provide any provision for the Bank to participate in the ESCB. Moreover, the Bank of England, unlike the other two central banks, has no responsibility under the new statute for banking supervision, which has been transferred to a separate independent agency (FSA). With respect to personnel independence, the differences concern the nomination procedure (less direct political involvement in appointments in France, more in Greece, and much more in the UK), the terms of office (longer in France, a bit less in Greece and much less in the UK), the participation of public authorities in the MPC meetings (not existent in Greece, existent in France and the UK, but with no vote), and the accountability provisions (more openness of decisions in the UK, but less parliamentary control compared to France and Greece).

TABLE 4: INSTITUTIONAL CHARACTERISTICS OF CENTRAL BANKS

	Bank of France	Bank of Greece	Bank of England
PERSONNEL INDEPENDENCE			
Nomination of governor(s)	The governor and the two deputy governors are appointed by decree of the Council of Ministers.	The governor and the two deputy governors are appointed by Presidential decree on a Cabinet recommendation and after the proposal of the General Council of the Bank.	The governor and his deputies are appointed by Her Majesty (on the recommendation of the Prime Minister).
Members of Mon. Policy Council	Monetary Policy Council (9 members): governor + 2 deputy governors + 6 members.	Monetary Policy Council (6 members): governor + 2 deputy governors + 3 members.	Monetary Policy Committee (9 members): governor + 2 deputy governors + 6 members.
Nomination	The 6 members, apart from the governors, are appointed by decree of the council of ministers, from a list comprising three times as many names as the number of members to be appointed, drawn up by the presidents of the Senate, of the National Assembly, and of the Economic and Social Council. They shall be chosen for their competence in monetary, financial and economic matters.	The other three members are appointed by Presidential decree issued on a Cabinet recommendation following an opinion of the Governor. They shall be persons of recognised standing and professional experience in monetary or banking matters	Two members are appointed by the Governor after consultation with the Chancellor (one shall be a person who has executive responsibility within the Bank for mon. policy analysis, and the other shall be one who has executive responsibility within the Bank for mon. policy operations), and four members are appointed by the Chancellor for their expertise in mon. policy.
Mandate security	A MPC member may be removed before his term of office expires only if he is no longer capable of performing his duties or if he is guilty of serious misconduct. (Required a reasoned submission from the MPC acting on majority vote).	The Cabinet, on a recommendation of the Minister of National Economy, may relieve a member of the MPC only if he is no longer capable of performing his duties or is guilty of serious misconduct. For the removal of the governors the General Council's approval is also required.	A MPC member can be removed if he has been absent from the MPC's meetings for more than 3 months without the Committee's consent, if he has become bankrupt, or if he is unable or unfit to discharge his functions as a member.
Mandate duration	6 years renewable once renewable for the governors & 9 years non-renewable for the other 6 MPC members.	6 years renewable for both governors & MPC members.	5 years renewable for the governors & 3 years for the other MPC members.
Participation of public authorities in directing	The minister of economic affairs & finances or his representative can participate at the MPC. They may present proposals but have no voting rights.	No	A representative of the Treasury may attend, and speak at any meeting of the Committee. (No vote)
Accountability	The Governor must address a report to the President and the Parliament at least once a year & must appear before the Finance Commissions of the Assembly and the Senate. The Governor can also ask for a hearing by the Parliament.	The Bank must address twice a report on monetary policy to the Parliament and the Cabinet. The Governor must appear before the competent Parliamentary Committee whenever called and can also ask for a hearing, as well as participate in the Cabinet meetings when matters related to the objectives of the Bank are discussed.	The Bank must make an annual report to the Chancellor on its activities & publish a report on mon.policy decisions every 3 months. The MPC must publish minutes of its meeting (including member's voting preference) within a period of 6 weeks from the day of the meeting. The Court of Directors of the Bank must review the processes followed by the MPC.

TABLE 4: INSTITUTIONAL CHARACTERISTICS OF CENTRAL BANKS

TABLE 4	**Bank of France**	**Bank of Greece**	**Bank of England**
FUNCTIONAL INDEPENDENCE			
Principal objective	Ensure price stability within the framework of the government's overall economic policy.	Maintain price stability & without prejudice to this objective to support the general economic policy of the government.	Maintain price stability, and subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment.
Formal competence in monetary matters	In exercising its duties the MPC can neither seek nor accept instructions from the government or any other person.	In exercising their powers and carrying out their tasks and duties, the Bank and its members of its bodies shall not seek or take instructions from the government or any other institution.	The Treasury must not give directions to the Bank in relation to mon.policy. It can specify what price stability is to be taken to consist of, or what the economic policy of Her Majesty's Government is to be taken to be. Only in extreme economic circumstances and in the public interest the Treasury, after consultation with the Governor, may by order give the Bank directions with respect to mon. policy. (approval by the Parliament needed).
Internal mon. policy: *1. Settling of primary objective(s)*	Yes	Yes	No - Government
2. Settling of intermediate objectives	Yes	Yes	Yes
3. Modify principal rates	Yes	Yes	Yes
Instruments of monetary policy: *1.Choice of Exch. Rate Regime & Parities*	No - Government	No - Government	No - Government
2. Execution of Exch. Rate Policy	Yes	Yes	Yes
Budgetary autonomy	Yes	Yes	Yes
Responsibilities: *1.Application of monetary policy and exchange rates*	Yes	Yes	Yes
2. Services connected with the system of payments	Yes	Yes	Yes
3. Bank of banks and of State	Yes	Yes	Yes
4. Supervision of financial institutions	Yes	Yes	No - FSA
5. Management of foreign reserves	Yes	Yes	Yes
6. Bank-Note issue	Yes	Yes	Yes
Participation in the ESCB	Yes	Yes	No

An Economic Alternative, a Political Move or the Result of Previous Choices?

In order to reveal the principal reasons behind the differences between the three countries' attempts to change the status of their central banks, the examination of the reform process inevitably commences by analysing the prevailing economic, political and institutional conditions. The reform of a central bank involves a significant transfer of decision-making power from the government to the central bank, which inevitably alters the status of the two long-established institutions. Due to this, such a change is viewed by many people with suspicion or hostility and there may be notable resistance, regardless of the economic advantages that it is expected to provide.

As mentioned in the introductory chapter and in the previous section this thesis considers that there are three variables which shaped and influenced why, when and how the three member-state governments implemented CBI in the 1990s. Those variables are the position of the country within the international political economy, the established patterns and conditions of political competition within each country, and finally the established patterns of post distribution and democratic control.

The position in the international political economy and the impact of new ideas.

The position of the country within the international political economy is an important variable. The consideration for CBI depends on the broader politico-economic preferences and international position of the country since these always influence the general policy choices. In a period of increasing global economic interdependence, any decisions which concern monetary and exchange rate policy choices are heavily determined by the position of the country in the international economic system. Political authority and influence at the international level is associated, today more than ever, with economic prosperity and stability. Big advanced economies which depend heavily on trade and the financial markets compete with each other to provide the markets with the most stable economic environment in order to attract investors and increase their power. On the other hand, smaller economies which also

try to advance and attract foreign investors, consider adopting new policy methods to overcome the long-lasting instability problems which often characterise them. Central bank independence has been presented by many studies and economic academics as a solution to monetary problems, and policy makers in many countries started considering such a reform. European countries, within a general framework of debates and efforts for monetary stability and unification, have considered such an option either as a supplement or even as an alternative to the ERM.

The fact that the three countries of this study are members of the European Union signifies a specific position they have within the international scene. In all three cases the establishment of central bank independence was undoubtedly closely related to the developments towards European integration and stability, regardless of whether it was explicitly admitted or not. However, the fact that discussions about an independent central bank had begun in France and the UK well before the Maastricht Treaty shows that the idea of such a reform is also influenced by other variables. Elites in France and the UK considered CBI in the late 1980s, not just because of the creation of the ECB (this had not even been decided officially at that time) but mainly because of their inabilities to follow consistent and reliable monetary policies to promote their standing in the European and international economic system. Both France and the UK are two of the biggest economies in the world and their economies depend heavily on trade and the financial and capital markets. Those patterns of trade and the international exposure influenced how people perceived policy ideas in the context of European developments.

France's traditional position as one of the main pioneers of EU developments and one of the biggest European players always meant that its leaders could accept without great difficulty ideas that promote co-operation and integration in monetary matters. Since 1974, France has been part of all European mechanisms to provide monetary stability and notably the ERM. French economic policy-makers had been unable to sustain a credible independent monetary policy and hence they had been obliged to follow the decisions of the German Bundesbank with all the consequences this involved both on economic and political terms. The initial idea to make the Bank of France independent had been considered as a way to increase the Bank's credibility and therefore provide a counterweight to the German dominance in

European monetary and consequently political matters.

The UK, in contrast had a completely different starting international position and that influences the stances of its policymakers towards EU. Some British elites have always been sceptical about European integration since views that Britain is more an international player than a European one have often been widely held. Those 'institutional' views have roots in the close relations of the UK with the USA, the importance of the City as the biggest international financial centre, and the high volume of trade with non-European countries. The 'internationalisation' of British interests and the associated sensitivity of the British economy to interest rates have made policy makers very careful about monetary policy decisions. However, UK economic authorities during the 1980s had not managed to sustain a consistent monetary and exchange rate policy and as a result inflation and the value of the pound were extremely unstable. As a result there were significant problems for the cost of living as well as for the manufacturing and financial sectors. The fact that the then Prime Minister Mrs Thatcher did not want sterling to join the ERM had forced monetary authorities to seek other methods to achieve a stable balance for inflation and the exchange rate. These considerations combined with the involvement of Mrs Thatcher in interest rate setting, encouraged Chancellor Lawson to consider the solution of making the Bank of England independent.

Greek policy makers, on the other hand, had not considered such an idea before the Maastricht Treaty mainly because Greece until the early 1990s largely functioned as a closed economy under direct state control. Hence, considerations like those formed in the other two cases did not arise. In Greece factors such as the main trade partners, the direction of money inflows and outflows, the sources of investment and the economic and political links with other countries had much less impact on the economy. Monetary policy decisions depended instead on domestic parameters and often on partisan political aims. Therefore, it is not surprising that the issue of CBI emerged only after the ratification of the Maastricht Treaty. Indeed, discussion of all the other economic policy reforms necessary to bring the Greek economy to a compatible level with the rest of the EU, begun at the same time as the debate about CBI.

In short, the greater the exposure of an economy to global economic pressures and financial market flows, the more likely were its elites, in seeking monetary stability and credibility, to consider the idea of CBI and to bring it onto the political agenda.

Domestic Political Competition and the Importance of the Electoral Cycle

Although the extent of exposure to the global economy can explain why in some countries the idea of CBI was considered earlier than in others, it did not by itself explain the other differences. In order to explain the variations in our three cases about the exact times of implementation and the particular CBI structures adopted, one has to take into account mainly domestic institutional parameters. Of course that does not mean that international parameters did not affect domestic policy processes, since as noted, the international position of a country affects domestic elite and interest group preferences.[80]

However, the key parameter in any government's decision about when to proceed with such a reform is the prevailing conditions of political competition. The potential costs, the methods and capacity to neutralise hostile groups and get media support, the power and talent to take full advantage of the benefits, and the credibility and 'political maturity' of existing related policies are factors which shape political attitudes towards a reform and determine the stance of the government.

The histories of developments in the three case studies showed that it is one thing to make plans for CBI and quite another to implement them. In all three cases the time of enacting CBI was considerably later than the time when the idea first emerged. The provisions of the Maastricht Treaty in relation to CBI undoubtedly provided the incentive for more intense debates in all three countries. However, the facts that member-states (except the UK and Denmark) had a formal obligation to reform their central banks in order to participate in EMU and needed to strengthen their monetary credibility were not enough to force them to surrender, under any conditions, such an important policy tool as monetary policy. Each government evaluated the reform

[80] See also J. Frieden (1994 & 1997).

with regard to its associated economic, political and institutional circumstances and potential advantages or disadvantages in terms of national political competition.

Regardless of the underlying reasons for the reform no government is willing to risk a Parliamentary humiliation or to enact a change which will provoke public opposition. Therefore, each government proceeds only when it has the capacity to pass a bill successfully, with the minimum political cost and the maximum advantage. Elections and public reactions are always taken into account by policy-makers – at least in respect of timing. The research of the case studies revealed that each of the three governments tried to find a window of opportunity which would enable it to proceed, either with low political costs or, ideally, with some political benefit.

In all three cases the common aspect of the time of establishing CBI was the election of a new government with vast Parliamentary majority. To explain when the reform of the central bank took place, the crucial factor is the existence of a new government with a desire to bring about significant policy reforms. A new government in power, whether from a different partisan group than its predecessor or from the same party but with a different policy approach, wants to show its determination and ability to innovate and to act decisively. Furthermore, a newly elected government, during its first year, usually enjoy a 'grace period' – or 'honeymoon' with the public and the Parliament. Hence, often it tries to take advantage of this 'grace' by passing reforms that would in other instances provoke considerable resistance. In the case (as in all our case studies) that the government has a huge Parliamentary majority its task is even easier since it is not even afraid that some of its own-party members might vote against. Electoral cycles are therefore considered as a very important parameter by governments wishing to make major policy shifts and reforms.

The study of the three CBI reforms confirmed the above pattern. In all three cases the establishment of CBI was enacted by newly elected governments which enjoyed significant Parliamentary majorities. Furthermore, all of three governments wanted to show their difference and their effectiveness in policy-making, in comparison to their predecessors. Experience in all three countries since the 1970s has been that when distinct new governments have been elected, they have tried to mark the change by

adopting significant packages of reforms. The establishment of Central Bank Independence had been one of the significant reforms that the new governments of Balladur, Simitis and Blair introduced as soon as they came to power. Others included privatisations in France, tax and structural reforms in Greece, and constitutional reforms in the UK. The logic is that governments choose to bring about significant reforms when they are at the peak of their power, and this is usually immediately after they are elected with a considerable majority.

In France, the desire to proceed at the specific time was the consequence of the change in government and the vast majority it enjoyed, in the Assembly. M. Balladur and the minister of Finance, M. Alphandery, wanted to show from the start of their tenure their determination to preserve monetary stability and the value of the Franc, their decisiveness to meet the requirements of EMU and finally their capacity- unlike their left predecessors - to implement effective and bold reforms. Of course, their plans were facilitated by the fact that they had the required Parliamentary majority not only to pass the bill but also to offset any Anti-European or hostile members which could vote against the reform. If the government had only a marginal majority or if it had not proceeded at its initial year there is a big chance not only that it would had difficulty to pass the bill but also that it may not even had considered it at that time of serious opposition in the European front. The size of the majority the government enjoyed also made easier the task of the Finance Minister to confront the pressures for various amendments which would have threatened the actual independence of the central bank.

In Greece this pattern seems less clear since the Simitis government had been in power for more than two years when the independence of the Bank of Greece was enacted. However, when he first took over as Prime Minister Costas Simitis was not elected by the public but replaced Andreas Papandreou after his illness. For almost a year he did not had the same authority as a normal elected Prime Minister has, and this was clear in his cautious decisions. Mr Simitis became the indisputable leader the country needed only after Mr Papandreou died. He won election as President of PASOK, and then dissolving Parliament for early elections in September 1996 he triumphed with a significant majority. From that point, the Simitis government increased its pace and started implementing its programme in order to achieve the

participation of the country in the EMU. From then, too, the government wanted to mark its distinctiveness in comparison to both the right opposition, and to the old leftist PASOK. Under Papandreou, PASOK had been characterised by its inability to carry out essential structural reforms, the prevalence of every-day political considerations in economic matters, and the ineffective implementation of EU decisions. After years of discussions and postponements, and having achieved a positive public consensus for monetary stability and independent policy institutions the government decided that the time and the circumstances were appropriate for the establishment of such an important institutional reform as granting independence to the Bank of Greece.

Finally, in the UK the change of government was clearly critical for the date of the reform of the Bank of England. The main aim of the new Labour government had been to show its determination and effectiveness in policy-making decisions and to mark the difference, as in Greece, not only with the Conservatives but also with the 'old-Labour' tactics. The Chancellor of the Exchequer could not find a better moment to reform the Bank of England than immediately after he took office. This sudden move caught everyone by surprise, did not leave much time for protest or lengthy discussions, emphasised the government's determination to achieve permanent monetary stability, and proved that it can if necessary change long-standing institutions and traditions. Possibly, more importantly of all the government took an initial step towards Britain's eventual participation in EMU. For Britain, such a reform had been particularly important and sensitive due to the previous tradition in handling monetary affairs. Nevertheless, the Labour government, by taking advantage of the euphoria after its recent election, succeeded in making a reform which no previous government had dared to propose.

Creating institutions which follow the established patterns of appointment

The aim of creating an independent central bank is to take monetary decisions away from day-to-day political influences. The intention of policy-makers is to provide the independent central bank with the necessary institutionally-protected tools - but not at any cost and not by creating structures whose unfamiliarity is dysfunctional.

Governments are constrained by the prevailing institutional patterns. They find it difficult and politically costly to introduce institutions that do not follow those existing patterns. In all three countries, the selected appointment procedures, the composition of the MPC, the term of office of the members and all the other arrangements reflect to a point the established patterns of post distribution and of democratic control.

The analysis of the institutional characteristics of the three Banks under review has shown that the UK model is very different to the French and Greek ones, which have many similarities. The Bank of England model is characterised by the involvement of the government (represented by the Treasury) in setting the monetary targets. That feature alone leads most observers to categorise the UK model as semi-independent. The British government, with no immediate intention to join the EMU and therefore no binding obligations, decided to make only half the step towards full CBI. The form chosen was more appropriate to the country's needs and traditions. In Britain, even the operational autonomy in setting interest rates was widely regarded as a revolutionary reform.

In France, the fact that, since 1986, political power is shared (in 'cohabitation' or coalition governments) has altered the traditional way of post distribution. There has been a trend away from partisan appointments and towards lengthy non-political appointments by means of various committees and independent personalities. Therefore, the fact that such a pattern was adopted for the MPC appointments reflects the new and distinctive approach. Nevertheless, the selection of the MPC members is based on the logic of having people who will be both competent and politically sympathetic. Their partisan aspect proves that traditional habits are still present. Similarly, in the British model the background of the MPC members (the majority are either Bank insiders or academics) represents the traditional British pattern of post distribution in senior positions. The fact that the Bank of England MPC meetings are published, that the government retains many overruling options, and that the Bank is accountable to the Chancellor rather than to Parliament (unlike the other two central banks) has much to do with the customary dominance of the UK Treasury in monetary policy. The same also applies to the term of office of MPC members which is usually less than the term of government, and to the exclusive power of

appointment that the government retains. Finally, in Greece the arrangements established follow the logic and tradition of political appointments which characterise all Greek top posts. The intention is to have most members politically close to the government. However, due to the lack of monetary specialists in the country, there is an effort to appoint those people who have as much expertise as possible. The lack of competent people also explains the choice of a small MPC. In contrast, in France and the UK there are big groups of specialists and therefore larger committees are possible.

Some similarities between the central bank structures in France and Greece reflect the decision of both states to participate in the ESCB and the fact that their traditional policy-making processes have more in common. French and Greek legislators, have tried to meet the requirements of the Maastricht Treaty. Nevertheless, the Treaty, as analysed in Chapter II, explicitly requires only a few basic features for national central banks and leaves considerable room for differences in personnel characteristics. French and Greek legislators adopted models which were, on the one hand, compatible with the statute of the ESCB and, on the other, as near as possible to the traditional institutions and customs in their respective states.

The Importance of Institutional Politics

Granting central bank independence constitutes a significant institutional change that is based on economic reasoning while having a strong political character. It is a reform that appears to be motivated by economic concerns, but is eventually directed by political and institutional factors that have no direct association with economic issues.

This thesis aimed to account for the different ways in which the dominant political elites of three EU member–states dealt with CBI after the Maastricht Treaty. It examined the main factors which help explain the origins, the extent of support for,

and the process of establishing an independent central bank. This study suggests that the position of each economy within the international political economy, the domestic conditions of political competition and the established national patterns of post distribution and accountability, are the key variables which explain the stance of the three member-state governments. Within the European environment of continuous change and pressure for co-operation and integration, the progress of central bank reform was largely affected by elite assimilation of and familiarity with, the changing economic, political and institutional framework. In all three cases, the establishment of CBI was possible only when established national politico-institutional frameworks were already undergone changes and elites were ready to accept the latest international developments and practices.

This study has confirmed John Goodman's (1991: 346) argument that "necessary to the creation of more independent central banks are societal coalitions favouring price stability. Such coalitions need not be formal; indeed all that may be necessary to enact an institutional change is the simultaneous, but unconnected, efforts of dominant groups of societal actors". In all three cases, central bank independence was established only after support for monetary stability and credibility, and closer European integration became a more conscious concern of political elites. Furthermore, although Sylvia Maxfield's (1997: 34) argument that the more internationally financially integrated the economy, the more likely it is that governments will grant CBI, explains why governments seek independence, this factor alone does not clarify the differences in timing and model of CBI.

Furthermore, those differences can not be explained with institutional variables such as the nature of political institutions and party systems (analysed in Chapter III). In our case studies, such factors did not play any particular role. Partisan factors, such as the greater propensity of the Right to adopt CBI (than the Left) does not appear as significant, as Zielinski (1995) claims. Although it is suggested that the left is more statist and the right more in favour of market solutions and consequently CBI, in Greece and the UK the opposite proved to be the case. Only in France did a government of the right replace one of the left and then introduce the reform. In all three cases, therefore, the policy direction is the same but new governments and majorities, whether left or right, appear to wish to demonstrate the superiority of their

approach to economic management. Equally, the institutional variable of presidential or parliamentary system does not appear to be relevant here. Although France has a semi-presidential system, in reality, and especially on economic matters, it operated in a parliamentary manner. Furthermore, the argument of Banaian et al. (1986) that central bank independence is correlated to federal systems, whatever its merits, nevertheless does not exclude non-federal systems from establishing CBI, as our three cases showed. Finally, in our findings there was no evidence for of Goodman's (1991) second condition, - that to grant central bank independence, political leaders must expect a short tenure in office; Rather, we found that political leaders established independence shortly after being elected and whilst in a position of considerable power.

The introduction of central bank independence in the three cases we examined depended heavily on the degree of acceptance and familiarity of each country's leaders and societal actors with the new European developments, and especially with Economic and Monetary Union. In the Maastricht Treaty, Bundesbank policies and the ethos of monetary stability and low interest rates, had been approved by most governments as the means to create EMU. However, the history of European integration shows that governments sign treaties which they approve in principle, but implement them only when there is an actual change of public and elite opinion. Public acceptance of international obligations requires a lot of time. Politicians realise this and postpone implementation until there is a consensus that enables them to proceed with minimum political cost or even some political gain. In all three cases, governments in favour of CBI largely promoted the reform domestically on the basis of the orthodox economic case (CBI produces lower inflation with no output or other costs) and in fairly unexciting, apolitical terms. This strategy seems to have been particularly successful during the ratification process since the opposition from antagonistic interest groups was minimal. Among the societal actors (finance and business sector, media, trade unions, etc.) there was no particular pressure once the government decided to go on with the reform.

In all three countries, the majority of people in the financial and business sector were in favour of independence as they considered it a tool for ensuring monetary stability and a step towards EMU, which they clearly favoured. However, their contribution to

the Bank's reform was mostly indirect. The financial and business community played a very important role in establishing the broader changes that occurred before the considerations for an independent central bank. Financial deregulation and liberalisation, privatisations, and reduction of state involvement in the economy were embraced by the financial and business sector, paving the way for reforms which would ensure stability within the new economic environment.

In the establishment of the economico-institutional arrangements which prevailed throughout Europe during the nineties, the contribution of the media had also a catalytic effect. The reduction of inflation was the main economic concern since the early eighties and the media played an essential role in emphasising the importance of achieving price stability. The Bundesbank's ethos against inflation became a concept that was reproduced on a daily basis by the media, without necessarily supporting it, and so central bank independence gradually became a natural and desirable arrangement. The media presented independence as the modern way in central banking based on the success of the Bundesbank and the US Federal Reserve in their fight against inflation. Although, there were also extended reports of the disadvantages and dangers of independence, the general climate of media reporting was one that promoted the idea.

The above-mentioned general acceptance of the importance of monetary stability has affected even the trade unionists who usually oppose any attempt of economic strictness. In all three cases, there was no official reaction to the consequences of the reform from any syndicate, except from those of the Bank of France. However, their protestations did not relate at all to the principle of independence, but to the reduction of the central bank's branches that perform commercial activities. The syndicates were indifferent to the body responsible for monetary policy; their concern was to preserve their positions, regardless of the Bank's status.

The only group that imposed profound influence over the enactment of the Bank's statute were members of Parliament. There were many MPs (especially in France and the UK) who were in principle against the reform and criticised strongly the governmental attempts. However, members of the majority, due to the time that the reforms were introduced, did not have the will and the courage to reject them. Most

members of the ruling parties who were against the reform did not want to reject a bill introduced by their recent elected governments. They preferred just to state their discontent and their worries but most of them finally voted for or abstained. In general, the opposition of MPs reflected their attitude towards EMU. It is characteristic that whereas in Britain and in France there were governing euro-sceptic MPs who declared publicly their opposition to the reform, in Greece where there was no organised opposition to EMU especially among the MPs of the two big parties, there was not a single member of the governing party to vote against the reform. However, in all three cases, MPs examined very carefully the draft law presented by the Treasury and managed to introduce many amendments.

Undoubtedly, all actors concerned (whether politicians or societal actors) tried either to promote or to resist the reform according to their anticipated eventual positions. The power of each actor depended not only on his or hers own status and influence, but also on the authority of the other actors involved and on the interest coalitions that emerged. This whole struggle for power affected not only the eventual ratification of the reform, but also specific features of the adopted model.

In all three cases examined, the stance of the participating actors towards the issue of central bank independence reflected their personal perceptions. Those views were shaped by the economic, political and institutional developments in each country. Those in favour of EMU accepted central bank independence as a necessity for a strong Euro. This acceptance was achieved mainly through a long process of political and institutional developments rather than through economic commands. Those who opposed CBI expressed either opposition to the European Union, or ideological objections to the 'non-accountable' policy processes. However, in determining the characteristics of the new Bank statute, the common feature of proponents and opponents alike was the attempt either to retain some authority or at least to minimise the potential disturbances to existing duties and interests.

However, although specific actors (especially the Prime Ministers and Ministers of Finance) had significant influence on the general direction and the timing of the reform, one can not claim that the establishment of central bank independence was

determined by self-interested actors' actions. The stance of the main actors had been determined by the broader institutional politics that prevailed in each country.

In all three case studies, the differences in governmental perceptions of Europe played a very important role in deciding central bank independence. The three governments started considering independence from different positions and this factor clearly influenced the timing and the characteristics of the reform. In France, despite the fact that at the time of the reform there were signs of public anxiety about Maastricht , the vast Parliamentary majority enabled the pro-integration government to act quickly and to establish full independence. In contrast, Greek governments, until the mid-nineties, despite declaring full commitment to EMU, faced a public opinion which was generally enthusiastic about the general idea of European integration but ignorant of the policy implications of the Maastricht Treaty. Hence, they confronted problems in implementing the essential policy reforms. The establishment of full independence for the Bank of Greece just before the Maastricht deadline was typical of Greek delays in adopting European models. Finally, in the UK, after years of debate, the adoption of a semi-independent model reflected the elite's continuing dilemma over Europe.

Elite sympathy for new policy practices and the European developments proved to be critical parameters for the governments in considering the change of central bank status. The decisive factor that allowed the three governments to proceed was the change in government and their strong majorities in Parliament.

The fact that most European states that have proceeded with the reform have done so mainly because of the requirements for the establishment of the ECB, does not guarantee a real commitment to the Bank's independence. As repeatedly noted, the benefits of central bank independence can be realised only if the Bank demonstrates its long-term commitment to price stability. But this requires time and practical evidence. Until that happens popular perceptions of central bank independence might remain ambiguous, thus jeopardising the whole EMU success. The worst scenario would be to have an independent central bank in theory but not in practice. In such a case, the Bank would be an informal 'servant' of the governments or the markets, taking all the blame for other's decisions.

Although the successful introduction of the single currency on 1 January 1999 initially provided some extra strength and prestige to the European Central Bank and the Euro, the political disputes and the differences among the member-states that arose later put their credibility in question. The years just before the start of EMU have been characterised by a massive change of political behaviour in Europe. The existence in power of centre-left governments in eleven out of the fifteen European Union countries has shifted the political balances within the Union. The achievement of low inflation in almost all EU states and the simultaneous high levels of unemployment permitted centre-left governments to call in question the priority given throughout the nineties to the fight against inflation, and also to question the power and accountability of the ECB. It is ironic that after such focus on, and faith in, central bankers for more than a decade, and after the establishment of the EMU, politicians have started to express their desire for more say on the economic fate of Europe. The formal founding of the ECB provided by the Maastricht Treaty is not enough to establish its institutional role as the indisputable, responsible actor in monetary matters. The pattern of behaviour which both central bankers and politicians were promoting and following throughout the decade in order to create and sustain a strong single currency is now being questioned as political beliefs have shifted significantly and many economic elements have improved. Policies that have been followed for so long with considerable success do not seem to have been accepted as a permanent, reliable approach for the long run.

These latest developments give rise to a number of questions: When do successful patterns of behaviour become established institutional patterns? If seven years of successful efforts to improve the economic fundamentals were not enough to establish the followed approach as a permanent policy path, can it be expected that policy priorities might change in the following years, until the final disappearance of national currencies? Does Europe needs another round of elections before it can bring forward the essential structural reforms which will strengthen the credibility of the euro?

These concerns are however issues for further research.

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