



Project no. CIT1-CT-2004-506392

NEWGOV

New Modes of Governance

Integrated Project
Priority 7 – Citizens and Governance in the Knowledge-based Society

**The politics of central banking
in the United States and in the European Union**
reference number: 19b/D04

Due date of deliverable: June 2005
Actual submission date: June 2005

Start date of project: 1 September 2004

Duration: 48 months

Organisation name of lead contractor for this deliverable:
Fondation Nationale des Sciences Politiques (CERI): Nicolas Jabko

Project co-funded by the European Commission within the Sixth Framework Programme (2002-2006)		
Dissemination Level		
PU	Public	X
PP	Restricted to other programme participants (including the Commission Services)	
RE	Restricted to a group specified by the consortium (including the Commission Services)	
CO	Confidential, only for members of the consortium (including the Commission Services)	

Summary

As a result of their established status and the sheer weight of the US and EU economies, the US Federal Reserve and the European Central Bank are the two most powerful central banks in the world today. Not only do they both play virtually the same role in their respective economic areas, but their internal governance structures look strikingly similar and they are independent from elected political bodies. It is therefore very tempting to analyze American- and European-style central banking as the functional expression of modern economic rationality in the world's two biggest and most advanced economies.

Based on a comparison of money and central banks in the European Union and the United States of America, this chapter calls into question this idealized vision of central banking as a self-contained universe with its own functional logic. It argues that similarities between the two frameworks can actually be read as the outcomes of similar political dynamics and concerns, rather than of an overwhelming economic rationality. In addition, certain key differences remain that can be interpreted as the products of enduring institutional differences between the US and the EU. Whatever the future may hold for the Fed and for the ECB, a comparative analysis of the US and EU frameworks of monetary governance as they stand today can thus serve to reveal political dynamics.

Contents

0. INTRODUCTION.....	3
I. THE POLITICAL ROOTS OF STRUCTURAL SIMILARITIES	3
FROM ROUGH-AND-TUMBLE POLITICS TO THE COMMON MOLD	4
II. DIFFERENT RELATIONSHIPS TO GOVERNMENT – DIFFERENT STAGES OF FEDERALIZATION	7
POLITICAL VS. EFFICIENCY CONSIDERATIONS.....	9
III. DIFFERENT PATTERNS OF CENTRAL BANK ACCOUNTABILITY AND BEHAVIOR – DIFFERENT RESPONSES TO THE CHALLENGE OF DEMOCRACY.....	10
DIFFERENT RESPONSES TO THE CHALLENGE OF DEMOCRACY.....	11
IV. CONCLUSION	12

0. Introduction

The US Federal Reserve was created in 1913 and has become one of the most established and well-respected public institutions in America. It is arguably the only example of a Weberian bureaucracy in the US federal government. In Europe, the protracted birth of Europe's Economic and Monetary Union (EMU) created turmoil for central bankers through the advent of the euro in 1999. Yet the newborn European Central Bank has quickly adapted to its role and has become the staunchest defender of the new institutional order around the European Union's official currency. As a result of their established status and the sheer weight of the US and EU economies, the US Federal Reserve and the European Central Bank are the two most powerful central banks in the world today. Not only do they both play virtually the same role in their respective economic areas, but their internal governance structures look strikingly similar and they are independent from elected political bodies. It is therefore very tempting to analyze American- and European-style central banking as the functional expression of modern economic rationality in the world's two biggest and most advanced economies.

Based on a comparison of money and central banks in the European Union and the United States of America, this chapter calls into question this idealized vision of central banking as a self-contained universe with its own functional logic. The US dollar and the Federal Reserve appear quite established today, yet they are the product of a long and contentious history. On the other side of the ocean, Economic and Monetary Union was not preordained, and the EU has become increasingly subject to debates and tensions similar to those that marked the United States' political development as a federal polity. This chapter argues that similarities between the two frameworks can actually be read as the outcomes of similar political dynamics and concerns, rather than of an overwhelming economic rationality. In addition, certain key differences remain that can be interpreted as the products of enduring institutional differences between the US and the EU. Whatever the future may hold for the Fed and for the ECB, a comparative analysis of the US and EU frameworks of monetary governance as they stand today can thus serve to reveal political dynamics.

In the following three sections, this chapter develops a comparative perspective on the politics of central banking in the European Union and the United States. First, it highlights the political origins of key similarities of EU and US central banking frameworks, including central bank independence. Second, it points out that the different relationships between central bankers and governments in the US and the EU can be analyzed as different stages of federalization. Third, it suggests that different patterns of central bank accountability and behavior reflect different responses to the common challenge of democracy as it has emerged in the course of US and EU political development.

I. The political roots of structural similarities

The US Federal Reserve and the European Central Bank are in the business of modern central banking. Through a variety of technical instruments, they provide financial institutions with short-term capital against a certain interest rate, which in turn directly impacts the rent cost that every business or person has to pay for borrowing money in the economy. For our purposes, however, how exactly this function is performed is arguably not the most interesting commonality between the Fed and the ECB, since it is after all common to all modern central banks. More intriguing are the rather striking structural similarities between these two central banks. On the face of it, the Fed and the ECB appear to be cast in roughly the same mold – both from an internal and from an external perspective.

Internally, the US and EU governance structures of central banking are strikingly similar, since both systems are based on a duality between central and decentralized bodies. In the

United States, the most important decision-making body is the Federal Open Market Committee. Twelve people sit on the FOMC – the seven members of the Washington-based Board of Governors of the Federal Reserve System (including its chairman); the president of the Federal Reserve Bank of New York; and four of the 12 the presidents of the regional Reserve Banks (who serve on the FOMC on a rotating basis). The organization of the Fed is therefore an attempt to strike a balance between a national orientation – embodied by the Board of Governors – and a regional representation of interests – through Federal Reserve regional district banks. The European Union’s central banking structure closely resembles that dual structure. The functional equivalent of the FOMC is the Governing Council of the Eurosystem. Currently, the Governing Council has 18 members – the six members of the European Central Bank’s Executive Board (including its chairman), and the governors of national central banks in the twelve countries that have adopted the euro. Unlike the United States, the national central bank governors are a majority on the Governing Council of the Eurosystem, but in any case decision-making is by “consensus” in both cases and the federal inspiration is the same.

Externally, the relationship of both central banks to political bodies is similarly distant. Both the Fed and the ECB are independent central banks. Their executive officers – the Governors in the US and the members of the Executive Board in the EU – are political appointees, but they are entrusted with complete freedom in the fulfillment of their assigned tasks. The members of the Executive Board are appointed by Europe’s heads of government for a period of 8 years. In the United States, the chairman and vice-chairman of the Board of Governors are appointed for a mandate of four years, but only among Board members who themselves enjoy a 14-year tenure in office. The governors must be confirmed by Congress, but this occurs only at the beginning of their mandates. As for the ECB’s Executive Board members, the European Parliament is entitled to conduct “hearings”, but is not legally able (strictly speaking) to invalidate the governments’ choices or to dismiss central bankers in the course of their mandate. In addition, the independence of the ECB is particularly entrenched, since the Statute of the European System of Central Banks is a European treaty that can only be modified if all EU member states agree to it. In both cases, then, American and European central bankers are purposefully removed from the mire of everyday politics.

From rough-and-tumble politics to the common mold

How can such striking structural similarities be interpreted? One approach is to consider these similarities from the perspective of economic rationality. This is a standard approach in economics. Typically, economists who study central banking ask whether institutional structures and policy choices are “optimal” for the task of monetary governance and macro-economic steering of the economy. For example, central bank independence can be seen as a way of “tying one’s hands” in the face of a “time consistency” problem; one way for governments to credibly establish their commitment to fighting inflation is to step out of monetary management altogether.¹ From this perspective, the US Federal Reserve (like the German Bundesbank) can be seen as merely a precursor in the global movement toward central bank independence. More generally, this line of inquiry is very useful if the analyst’s ultimate goal is to improve the economic performance of central banks in achieving aggregate social welfare or maximizing other economic criteria.

¹ For seminal articles on the “time consistency problem” and “tying one’s hands”, see Finn E. Kydland and Edward C. Prescott, “Rules Rather Than Discretion: The Inconsistency of Optimal Plans,” *Journal of Political Economy*, vol. 85, no. 3, pp. 473-91 (June 1977); Francesco Giavazzi and Marco Pagano, “The Advantage of Tying One’s Hands: EMS Discipline and Central Bank Credibility,” *European Economic Review* vol. 32 (1988): 1055-1082.

But whether this is a suitable approach in order to understand the *actual* development of central banking is debatable. Some scholars envision the US Federal Reserve System and the Eurosystem as relatively self-contained monetary orders that were purposefully designed with a view to maximizing economic performance. The euro and the dollar are both managed by independent institutions, removed from everyday politics. The creation of the Federal Reserve System in 1913 can be interpreted as the ultimate step of a rationalization process. Even after the gold standard was established in 1879, the US banking system still faced important financial imbalance and moral hazard problems, and the Federal Reserve was in a sense a way to solve these problems.² Likewise, in the 1980s and 1990s, Europe's policy-makers were struggling to come to terms with a new era of capital mobility and inflation. Thus, the creation of an independent central bank at the European level can be seen as the expression of functional economic requirements.³ This interpretation is, in fact, perfectly consistent with a view of the European Union as a limited albeit particularly strong international regime, whose primary function is to further the economic interests of its member states.⁴ And of course, in both cases, it is impossible to deny the existence of functional economic reasoning behind some of the key features of the Fed and the ECB.

Yet the central banks with which we have become familiar in the EU and the US also have political roots and cannot be interpreted as pure products of economic rationality. In addition to being a currency, the euro is the most widely tangible manifestation of Europe's political unification process so far. This is not to say that Europe's system of political and economic governance is anywhere as unified as the United States of America. The United States is fully established as a federal system and the US dollar and the Federal Reserve are just two manifestations of that federal system among many others. But even the familiar American federal institutions that we now take for granted actually took more than a century to emerge. The fact that the Federal Reserve was created only as late as 1913 illustrates the oft-forgotten difficulties of state-building in American history.⁵ The currency was the object of intense social unrest in the post-Civil War era and the establishment of the Fed in 1913 came after several decades of political struggles over the centralization of economic and monetary powers. From this perspective, the very existence of the euro signals the existence of an embryonic federal state in Europe, which may or may not develop into a full-fledged European version of political federalism.

In fact, many of the common features of the Fed and the ECB can be traced to distinctive dynamics of currency federalization that are shared by the United States and the European Union. In both cases, the historical emergence of America's and Europe's systems of monetary governance went hand in hand with a process of political unification and federalization. Internal and external structural similarities, then, do not reflect only a concern with economic effectiveness. More accurately, they express a pervasive dialectic between the appeal of centralized monetary policy powers and the discomfort with potentially excessive concentrations of powers – which happens to be a trademark of federalism. Underlying the structural similarities that we observe today, there is a common political subtext of balancing efficiency and

² The most influential treatment in this vein is Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States* (Princeton: Princeton University Press, 1962).

³ On central bank independence as a facet of a "regulatory state" or as a consequence of the need to establish "credibility", see for example Giandomenico Majone, *Regulating Europe* (London: Routledge, 1996); Sylvia Maxfield, *Gatekeepers of Growth* (Princeton: Princeton University Press, 1997)

⁴ See for example Moravcsik, *The Choice for Europe* (Ithaca: Cornell University Press, 1998)

⁵ Stephen Skowronek, *Building a New American State: the Expansion of National Administrative Capacities, 1977-1920* (Cambridge: Cambridge University Press, 1982).

representation. In turn, that political subtext played itself out differently in the historical processes that led to the birth of the Federal Reserve and of the European Central Bank.

In the US case, historical scholarship strongly suggests that the political subtext of federalism in central banking initially materialized in the form of class politics. In the late 19th century, the tide of populist discontent was swelling against big corporations that were accused of stifling small entrepreneurs and other economic freedoms. The currency had become an important focus of protest with the movement for “free silver”. According to historian James Livingston, the creation of an independent Federal Reserve was essentially the class reaction of a rising national corporate elite to the political challenge posed by the populist movement.⁶ Faced with growing political threats to their interests, prominent members the new corporate elite started to draw plans for a reform of the banking system that would create the conditions for financial stability and continued control of the system at the same time. Other historians, like Richard Timberlake or Gabriel Kolko, emphasize the prominent role of local interest groups like Wall Street.⁷ In this line of argument, there was no unity among the financial elite. The Federal Reserve is seen as the outcome of a political struggle among different groups of financiers as much as a class response to the challenge of the populist movement.

While historians debate the question of which class or social group was most influential in engineering the Federal Reserve System, there is little doubt that class interests played a prominent role. “Big business” reacted against the risk of “big government” by entrenching a banking system that secured financial stability while at the same time ensuring that the new system would not interfere with the interests of business. First, the gold standard and the centralization of monetary policy at the national level enabled the new corporate elite to ensure a certain stability and effectiveness of the national banking system – something that the American public demanded because the self-regulating market was seen as ineffective in preventing financial crises.⁸ Secondly, the independence of the Federal Reserve, in combination with a structure that empowered regional Federal Reserve banks controlled by local bankers, ensured that the new system effectively remained in the hands of the corporate elite. Elected officials were kept at bay both by the dual structure of the Federal Reserve System – which practically meant that political appointees would remain a minority within the system at large – and by the independence provision – which cut the umbilical cord between these appointees and the politicians who appointed them.

Just like in the United States, the federalization of central banking in the EU did not primarily stem from economic considerations – even though economic considerations were obviously not absent from the design of Europe’s Economic and Monetary Union (EMU).⁹ In the EU case, the dialectic of federalism was born out of international political consideration as well as bureaucratic politics. Even though this is sometimes forgotten today, the appeal of sovereignty for the member states of the European Union played an important role in the birth of

⁶ James Livingston, Origins of the Federal Reserve System: Money, Class, and Capitalism, 1890-1913 (Pirinceton: Cornell University Press, 1986)

⁷ Gabriel Kolko, The Triumph of Conservatism: A Reinterpretation of American History, 1910-1916 (New York: Free Press, 1963); Richard H. Timberlake, Monetary Policy in the United States: an Intellectual and Institutional History (Chicago: University of Chicago Press, 1993).

⁸ This is also Polanyi’s interpretation of the emergence of modern central banking. See Karl Polanyi, The Great Transformation (Boston: Beacon Press, 1944), pp. xxx

⁹ For a very complete history of Europe’s march toward monetary union, see Kenneth Dyson and Kevin Featherstone, The Road to Maastricht: Negotiating Economic and Monetary Union (Oxford: Oxford University Press, 1999).

the euro and the ECB.¹⁰ As it had developed since 1979, the status quo of the European Monetary System was difficult to sustain in countries like France and Italy. In effect, the Bundesbank had become the “bank that ruled Europe”.¹¹ Very concretely, the Bank of France and the Bank of Italy were forced to align their monetary policies with that of the German Bundesbank. This subordination affected governments’ degree of freedom in a variety of ways. In particular, fiscal policy was constrained for fear of triggering higher interest rates and/or currency speculation. For relatively small states like Belgium or the Netherlands, the status quo was acceptable because they discounted the political costs of subordinating their monetary policies to Germany. For bigger countries like France and Italy, however, this was not the case.

Unless we take into account France’s and Italy’s sense of sovereignty, it is impossible to understand why EMU became such a high political priority for these countries in the late 1980s. In this sense, EMU was especially attractive for political rather than for economic reasons. This is not to say that EMU was economically irrational for France and “weak-currency” countries. It did carry the promise of lower interest rates and of a more balanced monetary policy that would take their interests into account. But from a “pure” perspective of economic rationality, a strategy of tying France’s hands to the EMS was arguably a much less risky and less costly way to achieve the same outcome. The important fact is that many politicians (and voters) saw the status quo as unbearable, not because its economic costs outweighed its benefits – this was actually far from obvious – but because it involved an obvious subordination to the will of Germany and to the markets. The context of German reunification started only after EMU was well on tracks, but it certainly heightened the stakes of EMU and the widely shared sense that it was important for Germany to reaffirm its commitments to the EU.

The paradox is that this political drive to regain a sense of sovereignty actually led to a transfer of sovereignty toward the ECB and the European level. The birth of the euro and the ECB was a way to allay this crucial concern for sovereignty while at the same time entrenching an orthodox monetary policy at the EU level. For those who were most concerned about sovereignty, this was the price to pay in order to get Germany on board. The structural characteristics of the ECB can thus be seen as the expression of a compromise between two political aspirations. To those who were most concerned about sovereignty, the euro was offered as shield against currency crises and against the tyranny of the markets. Just as importantly, the supranational nature of the independent ECB, with the important role reserved for national central banks at the Governing Council, was intended to guarantee equality among member states and to end the disproportionate power of the Bundesbank. Meanwhile, Germany successfully insisted on entrenching an independent European Central Bank with a primary mission of fighting inflation squarely in the Maastricht Treaty. Whereas the US Federal Reserve Act of 1913 can be repealed or changed simply by an act of Congress, it would take a unanimous agreement among EU member states to revoke the independence of the ECB or to change its statute.

II. Different relationships to government – different stages of federalization

While the Fed and the ECB appear to be cast in the same mold, this is not the case for the ways in which they relate to their respective political systems. The Fed’s relationship to the US administration is strong and rather balanced. The Federal Reserve is independent, but its

¹⁰ For a more developed version of this argument, see Nicolas Jabko, “In the Name of the Market”, *Journal of European Public Policy* vol. 6, no. 3: 475-495 (September 1999).

¹¹ See especially David Marsh, *The Bundesbank: The Bank That Rules Europe* (London: William Heinemann, 1992).

Board of Governors sits in the nation's capital and is constantly interacting with policy-makers in the Administration on an informal basis.¹² Of course, the Fed makes its own independent monetary policy decisions on the basis of its board's judgment of the best course of action. But the administration constantly feeds the Fed with its own statistics and there is a constant two-way dialogue between the Fed and the administration on economic policy. Even if the Fed and the administration disagree on the best course of action, the Fed makes its decisions in full awareness of the US government's policy priorities, which in turn increases the likelihood of a coherent macro-economic policy mix between fiscal and monetary policies.

The issue of the dollar's exchange rate policy stance is particularly revealing of the balance between the Fed and the US government. While the Fed makes interest rates decisions completely on its own, it leaves exchange rate policy to the US government. The Fed chairman generally refrains from making declarations on the relative value of the US dollar to other currencies; this is seen as a prerogative of the administration and the Secretary of Treasury more specifically. This is an important restraint of course, because the value of the currency has repercussions for the level of employment and for the price of imported goods and thereby on domestic inflation. But the value of the dollar is considered politically too sensitive to be left to the Federal Reserve and the US government has insisted on keeping this prerogative since the end of the Bretton Woods system of fixed monetary parities in 1971. Thus, the US government has often resorted to a strategy of "talking up" or "talking down" the dollar, depending on economic and political circumstances. In addition, the US treasury is able to intervene directly on foreign exchange markets on its own initiative – although most of its interventions are carried out in coordination with the Fed.

By contrast, the relationship between the ECB and other economic policy-makers is lopsided simply because the ECB does not face a unified political counterpart responsible for other aspects of economic policy-making. From this perspective, the institutional architecture of EMU does not seem economically rational or even logically coherent. On the one hand, the framework of monetary capacity is entirely centralized in the hands of the European Central Bank. Eurozone member states are all subject to the same interest rates set by the ECB. This centralization of monetary policy powers in Europe is very similar to the centralization of monetary powers in the US Federal Reserve. Yet aside from monetary policy, the broader framework within which economic policy is made in Europe has not radically changed. While common fiscal rules were introduced in the form of the 1997 Stability and Growth Pact, fiscal policy has remained mostly in the hands of the member states. Different member governments have different priorities and are therefore unlikely to adopt the same fiscal policy stance. In addition, the Pact's rules were both very rigid and not extremely far-reaching, since individual member government were not subject to any serious sanction mechanisms as long as their fiscal deficits remained under 3% of national GDP. The psychodrama of the fall of 2003, with Germany and France both breaching this limit without suffering any serious consequences, showed that the Pact lacked teeth and is arguably not the most appropriate tool for achieving good macro-economic policies in the eurozone.

The fact is that today the ECB stands in remarkable isolation from the rest of the political system. Of course, this was the whole intent behind the strong independence provisions of the ECB. But in Europe this logic is pushed so far that it may be economically counterproductive. With its seat in Frankfurt, it is relatively removed from the hustle and bustle of Brussels' as well as national politics. Central bankers and politicians do talk on a very regular basis, espe-

¹² Joseph Stiglitz mentions the fact that, as chief economic adviser to President Clinton, he had weekly lunch meetings with the Fed. See his chapter on "the all-powerful Fed" in Joseph E. Stiglitz, *The Roaring Nineties*, New York: W.W. Norton, 2003, pp. 56-86.

cially within the context of the Eurogroup – the body that gathers the finance ministers of the eurozone member states – and at more technical levels. But these discussions do not take place between two unified actors with clear priorities as in the US, but between a unified central bank and a largely artificial cohort of governments. This is clearly revealed by the ongoing behind-the-scene contest between the ECB and the government for the right to speak on behalf of the euro on the international scene. Thus far, both Wim Duisenberg and Jean-Claude Trichet, the first two successive ECB presidents, have claimed the title of “Mr. Euro”. The issue of the external representation of the euro is actually a gray area in the Maastricht Treaty, so this is perhaps not so surprising. Yet the contrast with the United States is striking, since EU governments have been unable so far to assert their voice in this area – although this may change with the appointment of Jean-Claude Juncker as first non-rotating chairman of the eurogroup.

Political vs. efficiency considerations

Why are the Americans apparently so much more adept in the management of the relationship between the Fed and the US government? Why did the Europeans choose such a lopsided design for EMU in the first place, and can it be changed? In fact, these differences are not really a result of incoherent European thinking. Rather, they are best explained by the fact that the EU and the US today find themselves at very different stages of federalization. If we take a comparative federalism perspective, then, the lopsided design of EMU becomes easier to understand.

It is easy to fault the EU for the incoherent design of EMU, but the US system that we see today did not emerge all at once. In the US case, fiscal federalization took place before monetary federalization. Both processes were intensely political and chaotic. Despite two important precedents with the First Bank of the United States and the Second National Bank, genuine monetary federalization was only achieved with the creation of the Federal Reserve in 1913. The centralization of fiscal as well as monetary policy met a huge opposition, except in times of national crisis. Up until the mid-19th century, the US federal government was unified but its budget was virtually non-existent. In a recent paper, Kathleen McNamara highlights the importance of the US Civil War as a crucial impetus that led America on the path of centralizing economic policy-making.¹³ The rapidly expanding financial needs of the American federal government in fighting the southern states provided an urgent security rationale for improving the extractive capacity of the American state. By the time the Fed was created a half-century later, it was facing an already well-developed federal government, with unified fiscal policy powers – which further expanded in the 20th century in the conduct of two world wars and with federal programs like the New Deal.

In the EU, the situation is completely different, since the federalization of monetary policy means that fiscal policy has become the last bastion of national economic powers. The political opposition to the centralization of fiscal policy in Europe is very strong in Europe. As mentioned above, the member states decided to centralize monetary policy to a large extent because they wanted to regain some freedom in the determination of their fiscal policies. Counting on the member governments’ rational recognition of the economic benefits of a more centralized fiscal policy is beside the point, since there are deep collective action problems in this case. The Maastricht Treaty’s provision for national fiscal autonomy was designed to reassert political discretion over the parameters of economic policy. This situation may change over time, but it may take an economic or a political crisis. The member states

¹³ Kathleen McNamara, “Making Money: Political Development, the Greenback, and the Euro,” UC Berkeley Institute for European Studies Working Paper, February 2004.

are unlikely to give their fiscal sovereignty away to central institutions merely on grounds of superior economic rationality. Everybody recognizes that some sort of collective fiscal rules like the Stability and Growth Pact are needed, but in hard times member states are naturally tempted to defect. In addition, the EU is unlikely to follow the US trajectory of fiscal federalization through the build-up of defense expenditures, since the member states also remain responsible for defense and foreign policy. Therefore, it may take quite some time before the ECB face a political counterpart in the same way that the Fed faces the federal government in the United States – if it ever happens.

III. Different patterns of central bank accountability and behavior – different responses to the challenge of democracy

So far we have seen that many of the similarities and differences between central banking in the EU and the US can be traced back to an underlying political dialectic between federalization and state rights in the emergence of the two systems. But normal political life can also affect the political framework of central banking over time. Both the Europeans and the Americans ascribe value to the deepening of democratic ideals and this creates a challenge for central banking. Even independent central banks like the Fed and the ECB are subject to accountability and behavioral standards. Yet responses to the challenge of democracy have been different in the US and in the EU.

In the United States, the Federal Reserve is independent from the government yet accountable to the US Congress. The Federal Reserve exists by virtue of Congressional act, namely the Federal Reserve Act of 1913. The Federal Reserve Reform Act of 1977 reasserted Congress's oversight role and redefined the Fed's mandate. The meaning of central bank accountability in the US is far-reaching, at least in theory. Congress has the power to confirm or invalidate the appointment of the Fed's chairman and can monitor its behavior or even change the Fed's mandate at any time. In practice, of course, this is done very rarely and the Fed actually has huge clout in macro-economic policy-making and on the markets. Critics of the Fed's powers and actions always question whether it is held to a sufficient level of accountability.¹⁴ Yet at least on a symbolic level, there is a strong relationship of accountability of the Federal Reserve vis-à-vis the US Congress.

In the European context, the issue of accountability has also been raised and the US accountability framework is often taken as a reference point. According to two ECB Executive Board members, "independence and accountability are two sides of the same coin" and the ECB has the ambition to become "the most transparent and accountable central bank in the world".¹⁵ Ultimately, however, patterns of central bank accountability and behavior are quite different in Europe and the ECB does not always stand the comparison with the Fed. Consider for example the difference between Congressional hearings of the Fed and hearings of the ECB at the European Parliament. In the US, the power of Congress can be felt in the staging of Congressional hearings. The chairman of the Federal Reserve stands in the witness box and must answer questions asked by a small number of Congressmen who sit above him like judges. These hearings last as long as the people's representatives deem necessary. In the EU, the president of the European Central Banks addresses members of the European Parliament from above. He sits on a platform, next to the chair of the Economic and Monetary Affairs Com-

¹⁴ See for example Stiglitz, *The Roaring Nineties*, p. 85. For a frontal critique, see William Greider, *Secrets of the Temple: How the Federal Reserve Runs the Country* (New York: Simon & Schuster, 1987)

¹⁵ Otmar Issing, "The eurosystem: transparent and accountable or 'Willem in Euroland'", *Journal of Common Market Studies*, vol. 37, no. 3 (1999): 503–19 (p. 505); Tommaso Padoa-Schioppa, "An institutional glossary of the eurosystem", *ZEI Policy Paper B 16* (2000), p. 28.

mittee, and takes questions from the floor. The hearings only last two hours and MEPs are only allowed to ask two questions, which are therefore not very difficult to fudge. The contrast with the US situation could hardly be more striking.

If we now compare the two central banks' mandates and patterns of behavior, important differences also stand out. The Fed's mandate is extensive, since its task is not only to fight inflation but also to pursue growth and employment. This contrasts with the ECB's treaty-defined much narrower objective of "price stability", with other objectives like growth and employment only permissible "without prejudice" to price stability. On the one hand, it could be argued that in practice these different definitions do not matter much.¹⁶ The Fed's defense of its growth-enhancement mandate is often largely a matter of rhetoric. There were times when the Fed acted as a very hawkish inflation fighter – especially under Paul Volcker in the 1980s. The Fed can always argue that it is impossible to make progress on all fronts at the same time, and thus evade its responsibility. Conversely, ECB officials never miss an occasion to say that they pursue their "secondary objectives" whenever possible. And the ECB has certainly demonstrated that it cares about growth, not just inflation – e.g., cutting rates when the euro was first introduced to a much greater extent than most observers expected.

On the other hand, behavioral differences remain between the Fed and the ECB, especially in the pace of monetary policy adjustment. Most observers would say that the US Federal Reserve is very responsive to cyclical developments. (Its critics say that the Fed is "fickle".) By contrast, the ECB's monetary policy is seen as very cautious and much less prone to dramatic changes in its monetary policy. (Critics would say "overly conservative".) Caveats are necessary of course, since the ECB has only been active since 1998 and the European economy has undergone much less pronounced cyclical upturns and downturns than the US economy in that period. But in comparison to Alan Greenspan's explanations of the Fed's monetary policy stance, the discourse of European central bankers is much more focused on inflationary risks and much less on the requirements of economic growth. Although it is still very early to judge, the ECB's cautious behavior does seem to reflect its narrower mandate.

Different responses to the challenge of democracy

The relatively stronger patterns of parliamentary accountability and responsiveness to political preoccupations in the US so far can be explained by the fact that the EU and the US polities have a very different experience of the challenge of democracy. The Fed is more immersed within the US political debate, whereas the ECB is much more aloof from politics. This basic difference is expressed both in the formal institutional status of each central bank vis-à-vis the rest of the body politic and in the central bankers' conception of their own role within it.

First, the institutional status of the Fed leads to a stronger pattern of accountability to Congress than the accountability of the ECB to the European Parliament. After almost a century of existence, the Federal Reserve is a well-respected public institution in the United States, yet it has no constitutional status whatsoever. As former chairman Paul Volcker famously put it, "Congress has made us, Congress can unmake us." In Europe, the situation is almost reversed. Because the ECB was created as a result of the 1992 Maastricht Treaty, it is particularly entrenched. Treaties are the functional equivalent of constitutional documents for the EU and it requires a unanimous agreement between the member states to change them. And yet

¹⁶ In response to a question about the ECB's accountability relative to the US Federal Reserve, former ECB President Wim Duisenberg declared, "Politically speaking, I do not think there is much difference in the degree of accountability vis-à-vis the Parliaments of the countries or the areas involved." (Hearing of W. F. Duisenberg, president of the ECB, European Parliament, February 17, 2003)

the ECB is part of an EU political system that still lacks the historically produced power and legitimacy of its constituent member states. All EU institutions remain relatively weak, including the ECB itself but also the body to which it is accountable, namely the European Parliament. Despite the continuous upgrade of its powers since the 1980s, the European Parliament does not in any sense match the power and prestige of the US Congress. The European Parliament gained its oversight role over the ECB only by courtesy of the member states and, furthermore, this oversight is limited to mere “reporting requirements”. All this explains the weaker patterns of accountability in the EU case.

Secondly, the self-definition of their role by central bankers in the EU is different in Europe and in the United States. While the Fed is an independent central bank, it has had to live with a particularly broad mandate that includes growth and employment as well as low inflation. In order to be effective, monetary policy must gain the confidence of financial market actors who have clear preferences and expectations. At the same time, America’s central bankers have to live with the administration and Congress within a context of partisan politics. Thus, the Federal Reserve cannot really pretend to never be making trade-offs among its different objectives. While the breadth of its mandate makes the Fed vulnerable to political criticisms, it also enables it to claim credit in times of economic growth. In Europe, the situation is very different because the ECB’s mandate is narrower – with price stability defined as a “primary objective”. But arguably even more important is the fact that central bankers have come to see a narrow technical definition of their task as a guarantee of their hard-won independence. Unlike their American counterparts, they are in an EU sphere where no body has sufficient legitimacy to make clear – let alone partisan – policy choices. The consequence is that central bankers attempt to escape political debate and hard choices altogether.

The question is whether the EU patterns of central bank accountability and behavior will converge on the US model. It may be just a matter of time, since the situation that we now take for granted in the US took a long time to solidify. Many politicians, especially among the Left in the European Parliament, want to increase the accountability of Europe’s independent central bankers. They can be counted on to work toward that goal, at least within the framework of the treaties. Meanwhile, the US model of accountability is not without flaw from a democratic perspective. The absolute independence of central banks may have become a necessary fiction, to paraphrase Hobbes – it may be best to accept the utopian premise that central bankers operate truly above the fray. But if the fiction is pushed too far, it tends to backfire. As long as the ideal of democracy remains a core concern, the frameworks that govern central banking will probably continue to evolve not only in the EU, but also in the US.

IV. Conclusion

The preceding comparison of the politics of central banking in the US and in the EU has served to highlight three important points. First, the structural similarities between the two systems – central bank independence and the dual structure of governance – cannot be explained merely in terms of functional economic requirements. In both cases, these structures have political roots; they can be explained in terms of class politics in the US, whereas they can be seen as a result of international politics in the EU. Second, the different relationships that central bankers have with government officials reflects the fact that federalization has gone much further in the United States. Unlike the Fed, the ECB does not face a truly unified economic government with clear policy priorities – which in turn makes it probably more difficult to achieve a coherent policy mix. Third, patterns of central bank behavior and especially of accountability differ in ways that are not merely the result of different economic circumstances and legal frameworks. These patterns can also be seen as the expression of different and very timely responses to the challenge of democracy as it emerged in each polity.

More broadly speaking, the comparison carries important lessons for the way in which we study political economy and also, more specifically, the EU and the US. Like all studies of comparative political economy, it is a welcome antidote against the widespread temptation to naturalize the established dichotomy between “economics” and “politics”. Central banks are economic institutions that obviously perform similar function, but they also have political origins and do not all belong in the same stock. The EU was born and remains a strange creature of international politics with its own developmental logic, so there is no strong reason to expect a complete convergence between the political practices of central banking across these two cases. Yet the comparison also suggests that the dichotomy between “international” and “domestic” politics is not always so stark. When we look at the US federal government today, we tend to forget that America’s political development was long and rather chaotic. In the European Union, federalization has gone the furthest in the realm of money and is probably the clearest sign of the European Union’s potential for developing into a full-fledged federal state.