Special issue: Central Banking in the 21st Century - A Crisis of Accountability?

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Forthcoming, European Journal of Political Economy

Introduction:

The last few years has delivered a number of economic challenges. In only a short period of time, major economies around the world have faced mass unemployment risks due to the COVID-19 pandemic, global supply chain difficulties, growing inequality, the great resignation, and most recently, escalating energy, food, and housing costs.

Most important for central banks, inflation in many advanced economies is now at a 40-year high causing concerns to peoples' livelihoods and to central bank credibility. Looking ahead, how can modern central banks manage accountability and legitimacy concerns that may arise from these unprecedented economic times? What tools do central bank have at their disposal? How are these tools deployed and to what effect?

Fortunately, recent empirical research contained in this special issue demonstrates the multitude of ways central banks can manage legitimacy and accountability. Many of the papers contained here are therefore useful for understanding the future of central bank policy making as we enter more challenging economic times. In order to broadly organize the findings presented, we adopt terminology from previous literature on "input" and "output" legitimacy (Scharpf 1999; 2009; Burgoon et al. 2012). Input legitimacy implies that the interests of those for whom decisions are being made should be *represented* in the decision-making process and involved in the feedback and scrutiny processes to which decisions are subjected (Scharpf 2003). Central bankers can increase input legitimacy by ensuring representation in decision-making bodies and subjecting decisions to outside scrutiny from a variety of different sources and perspectives. Output legitimacy, by contrast, focuses on the *effectiveness* of the policy choices made by central banks in the eyes of those for whom the decisions are made (Scharpf 1999). Central bankers can increase output legitimacy by following their mandates and/or meeting their targets, or clearly communicating the reasons why this may not be possible. These terms provide a useful yardstick against which to assess how trust in central banks might come under pressure as well as how it might be managed and repaired to strengthen the legitimacy of central banks in the eyes of the public (Jones 2009; Macchiarelli et al. 2020; Bergbauer et al. 2020).

Input legitimacy:

One way that input legitimacy matters is thinking about who the central bank is (its composition), who it represents (the nation, the district, the supranational area), and to whom it is accountable to (the public, the government, markets). Individual and institutional level factors are shown to matter for representation including the gender composition of its leadership (Bodea and Kerner, this issue), the relative policy preferences of committee members (Baerg and Kranin, this issue) as well as whether or not committee members represent their constituency's characteristics (Ferrera et al, this issue). Other channels that can work to increase input legitimacy include engagement with the public and public opinion (Ferrera et al, this issue), central bankers dealings with elected officials (Schonhardt-Bailey et al, this issue; Fraccaroli et al, this issue) and finally, market reactions to pronouncements (Parler, this issue). Perhaps unsurprisingly, central bank communications are found to be fundamental to central banks' efforts to gain trust. Central banks are shown to build trust through social media, official speeches, press releases, and parliamentary hearings. In support of previous literature, their pronouncements are used to inform, guide, and also legitimize policy actions and central banks are shown to speak to a multitude of audiences and disparate actors with varying degrees of effectiveness (Andreas et al 2021; Baerg, 2020; Blinder 2009; Haldane 2017; Haldane & McMahon 2018; Cross & Greene 2019).

Output legitimacy:

Distinct from input legitimacy, central banks can increase output legitimacy by fulfilling their mandate and targets, and through the provision of forward guidance. Forward guidance has been widely viewed as being useful for managing market and household expectations across a wide variety of contexts (Baerg, 2020; Blinder et al. 2008; Holmes 2013; Beckert 2016; Beckert & Bronk 2018; de Hann & Sturm 2019; all Jansen & de Haan 2007; Moschella & Pinto 2018; Van Der Cruijsen & Demertzis 2007). While electoral accountability is absent by design, clear and effective communication of the logic behind central bank decision-making can facilitate output legitimacy. This is because the justifications for, and logic of decisions can be demonstrated and assessed. This process can in turn increase trust in the central bank as a legitimate policy-making institution taking decisions in the interests of those it is mandated to make policy for.

Forward guidance is no panacea, however. Take for example the most urgent concern for central banks at the moment which is the trajectory of inflation. Not only is inflation above targets but the inflation outlook is uncertain, which makes forward guidance difficult, with central banks struggling to provide reliable guidance on their monetary policy plans. Fortunately, research by Brouwer & de Haan (this issue) shows that rather than focusing on policy decisions, central banks can also clearly communicate about the powers that they have and do not have, i.e. demarcating the things under their control. By doing so, they can increase public knowledge about their role in economic governance and potentially shield themselves from some of the blame for policy failures that lie beyond their control. Finally, robust accountability might need to be balanced with other mechanisms such that central banks are protected from political pressures (Binder 2021) and can preserve their operational independence.

The next section describes each contribution to the special issue in detail to demonstrate how they each provide new insights into the sources of central bank legitimacy.

Structure and Contributions:

Central banks have several features that consistently raise accountability concerns, with the effect that their legitimacy as policy-making bodies has been called into question (Jones 2009; Macchiarelli et al. 2020). First, they have significant policy-making powers. Despite their technocratic nature, their actions have far-reaching redistributive consequences (Mundell 1965; Rodrik 2000; Romer & Romer 2000). Second, individuals at the helm of the central bank are usually appointed rather than elected. The fact that they are unelected is sometimes seen as advantageous and yet, central bankers can and do run for elected office (Baerg et al. 2021). Third, central banks enjoy a level of autonomy and independence from other arms of government when making policy. Independence is granted as protection against political interference (de Haan et al. 2008; Cukierman 2008) though again whether this works or not is an active area of research (Clark and Arel-Bundock 2013, Giesenow and de Haan 2019). Many citizens have come to see central bankers as distant bureaucrats whose decisions are highly technical in nature and difficult for non-experts to understand. Central bankers are often thought of as out of touch elites who ignore the wishes of ordinary citizens or as agents whose actions benefit only a small group of insiders. To explore these issues in more detail, we divide the special issue contributions into two parts.

Part 1 deals with potential sources of input legitimacy. In a policy context where direct electoral accountability is lacking by design, understanding who and what views are represented when policies are decided upon and accounted for is imperative. In this section, the authors explore how institutional contexts, especially the composition of the Monetary Policy Committee (MPC), channels of political oversight, and institutional norms shape available actions. The essential findings are that the quality of accountability is predicated on who central bankers are, the institutions where they work and deliberate, and the arena where they justify their actions.

MPC Composition:

Bodea and Kerner examine the determinants of the gender composition of central bank boards. They argue that ‘hawkishness’ is generally perceived as a male characteristic and demonstrate that when there is a perceived need to signal a commitment to price stability through hawkish policy, the gender composition of central bank board matters. The authors first find that in countries where inflation is a concern for government, male board members tend to be appointed more often than female board members. Second, focusing in on the subset of central banks who make up the Euro area, the authors also explore the link between women’s representation in politics and their reputation on central bank boards. The authors find a positive relationship between female representation in the two contexts. That the gender composition of central bank boards is found to be associated with inflation expectations is especially relevant as it implies that countries with more women on a central bank MPC might have a harder time controlling inflation and that this is due to biases rather than the effectiveness of female central bankers and their policy decisions. It therefore suggests that gender stereotyping has real economic effects and that the gender composition of MPCs matter for economic outcomes.

Baerg and Krainin explore some of the reasons why having diverse MPC membership matters for transparency, which they argue, also has implications for accountability. Using a formal game theoretic model, the authors find that the committees composed of members with opposing biases or preferences on interest rates communicate with less uncertainty language than when members have aligned biases/preferences on interest rates. The key mechanism for why this occurs, they show, is that more diverse MPCs are more likely to hold one another to account in a form of peer-accountability. The authors then test their theory using measures of preferences derived from meeting transcripts of the Federal Open Market Committee (FOMC) during the Governorship of Arthur Burns in the 1970s and FOMC meeting minutes. The authors find support for the argument that more diverse MPCs are more transparent (use less uncertainty language) and that this reduction in uncertainty language is independent from changes in the level of uncertainty in the economy. The authors’ key contribution is providing a micro-founded model that explains why central bank communications vary in their level of uncertainty and how this variation is related to the composition of central bank MPCs.

Political Oversight:

Ferrara et al. consider the interactions between the ECB President and the Economic and Monetary Affairs Committee (ECON) of the European Parliament (EP) in the quarterly Monetary Dialogues. These authors show that the questions that central bankers face in Monetary Dialogues relate to a broad set of substantive concerns that are connected to, but distinct from, the ECB's primary mandated goal of price stability. The authors find that one of the secondary mandated goals of the ECB, full employment, gets significant attention. The authors also find that national representation matters. Here they show that Members of the European parliament (MEPs) from countries with higher rates of domestic unemployment devote less time to issues related to the ECB's primary mission of inflation. The authors therefore reveal the existence of a ‘‘political’’ Phillips curve. The paper enriches our understanding of the principal–agent accountability relationship between politicians and central bankers especially in the context of a supranational government.

Moving to political ideology, Fraccaroli et al. analyse the role of ideology in driving the sentiment of questions asked by MEPs to the ECB President. These authors find evidence that sentiment is predominantly correlated with an MEPs ideological stance on a pro-/anti-European dimension rather than on a left–right dimension of ideological conflict. Their finding is important as is relates to a wealth of literature on the contested nature of European integration and the ECBs position as an independent supranational policy-making body within the institutional structures of the European Union (EU). Contestation over the appropriate amount of EU integration is a feature of EU politics more generally (Hix et al. 2006; 2007; 2018). The fact that the authors demonstrate that such contestation manifests itself in the Monetary Dialogues between the ECB and the European Parliament suggests that ECB policy-makers are subjected to the same types scrutiny that other EU policy-making institutions face when justifying their policy choices. Such a finding also bolsters claims that outside political actors hold central banks to account through channels that we observe in parliamentary politics, such as question time.

Oversight Quality:

Schonhardt-Bailey et al. examine how political institutions can also affect the quality of the interactions between parliamentarians and central bankers. The authors tackle this using the cases of US Congress and the UK Parliament. Deliberative quality is a concept that has emerged from a broader literature on deliberative democracy (Barabas, 2004; Mutz, 2008; Bächtiger et al., 2018; Bächtiger and Parkinson, 2019). It draws attention to the processes through which a diversity of political views can be reconciled and perhaps even integrated through deliberative processes. In policy discussions, deliberative quality is thought to be higher when 1) less partisan rhetoric is used, 2) when discussions revolve around the mandated policies for which central bankers should be held accountable for, 3) when less personalised narratives are used, and 4) where interlocutors provide high-quality responses to one another that integrate the reasoning expressed by other participants in the discourse. Schonhardt-Bailey et al. demonstrate that the deliberative quality of hearings is higher in the UK than the US. British Members of Parliament (MPs) invoke almost no partisan rhetoric and much less narrative when questioning central bankers compared to their American counterparts. British MPs also tend to focus on the policy for which central bankers are meant to be held to account (monetary policy), rather than veering off in other directions. Central bankers in both the US and UK context were found to be able to provide high-quality responses to the questions they were asked. Much of this is put down to the institutional setting in which hearings take place and the rules around who can participate in such hearings and how. These findings suggest careful thought around the institutional rules that structure such hearings can improve the deliberative quality of the discussions that take place, which in turn can increase the potential for input legitimacy.

Part 2 of this special issue considers potential sources of output legitimacy. The most direct source of output legitimacy for central banks is the degree to which they fulfil their respective mandates. The set of policy tools available to achieve their mandated goals has grown in recent years with policy communications and forward guidance becoming an essential part of the policy toolbox alongside more conventional tools such as changes in interest rates. This is shown to be especially important for financial markets. In addition, policy communications are also increasingly targeted towards the public. Consequently, they can thus serve as a more direct source of output legitimacy when executed well, though their policy communications going well is by no means assured. Three studies provide insights into these issues.

Financial Markets:

Parle delves into the effects of central bank communications policy by investigating the influence of the ECB's monetary policy press conferences on financial markets. He first presents two alternative approaches to measuring the economic sentiment (monetary policy tilt) expressed by ECB representatives at press conferences. The author then uses these measures to unveil how the sentiment conveyed in press conferences can have an impact on financial markets. His findings demonstrate the existence of an "information channel" in the implementation of monetary policy. He argues that central banks can leverage the information channel to communicate private information about the state of the economy and their outlook on economic performance to outside audiences, and thus shape market expectations and behaviour.

Mass Public and the Media:

Next, Ferrara and Angino cast a wider net and consider the clarity of different forms of ECB communications including speeches, press releases, and tweets. Clarity is an important consideration in central bank communication as it has a direct effect on the ability of the audience to comprehend the message being sent, which in turn has implications for accountability and the potential for output legitimacy. Relying on readability metrics, they demonstrate how the clarity of communications has evolved over time. Then the authors show that message clarity is linked to the likelihood that both traditional media and social media channels engage with central bank communications, with clearer messages having more engagement than those lacking clarity. This implies that for central banks to reach as broad an audience as possible, they need to ensure their communications are expressed with as much clarity as possible.

Building Central Bank Trust:

Finally, Brouwer & de Haan examine the determinants of Dutch citizens' trust in the ECB. The concept of trust is intimately linked to output legitimacy as those who trust an institution are likely to see the decisions made by that institution as legitimate. Indeed, this link between trust and legitimacy was explicitly recognised by the ECB in their Economic Bulletin (Issue 4/2020, Bergbauer et al.). Brouwer & de Haan demonstrate that at least in the Dutch context, public trust in the ECB is related to an individuals' self-professed ideology, their knowledge about how the ECB functions, and their trust in other EU institutions beyond the bank. They also demonstrate that members of the public who were directly affected by the financial crisis as customers of banks that either went bankrupt or were bailed out have less trust in the ECB than those with less direct experience of the crisis. These findings suggest that a central bank interested in increasing their legitimacy in the eyes of the public needs to clearly communicate and delineate the powers that they have, to increase public knowledge about their roles in economic governance, and to not to be blamed for policy failures that lie beyond their control, i.e. the Dutch central bank was tasked with banking oversight in the Dutch context, not the ECB.

Implications for Research and Policy

By paying attention to sources of accountability and legitimacy, the volume depicts the variety of ways that central bankers face constraints on their power. Thus, despite being unelected, central bankers can and do behave in ways we can recognize as democratically legitimate, despite being unelected (Montanaro 2017). Taken together, the articles show several important channels that shape central bank accountability. These include: the composition of the monetary policy committee, the nature of representation in a supranational context, and the importation of parliamentary features to manage principal-agent relationships such as question-time and oversight hearings. However, not all institutional arrangements generate the same level of oversight quality, and this has implications for the potential for input and output legitimacy. The authors point to factors such as preference diversity, economic conditions, and institutional norms as influencing the quality of oversight that is produced.

In thinking about the different types of audiences that central banks engage with beyond other central bankers and elected officials, the authors find many strategies that central banks employ when engaging with markets, the media, and the mass public. Informativeness and clarity stand out as two key principles in both shaping market behaviors and getting noticed by a broader audience in the first place. Furthermore, clear communication about what the central bank can and cannot control (and therefore be held responsible for) is also shown to be important. We think this latter point is especially relevant in today's higher inflation context and represents an innovation to the central bank communications literature which has focused on the clarity of messages rather than the clarity of responsibility thus far.

Looking ahead, what are some of the future questions that researchers may want to tackle? Further exploring committee composition on policy decisions and macro-economic outcomes and central bank communications is needed. Much of the current literature also presumes a public that is knowledgeable, financialized, and selecting into central bank information. How does monetary policy work for those who are financially vulnerable? What does a high choice media environment mean for central bank communication and central bank legitimacy? Will higher inflation (and higher interest rates) make people more or less engaged with the central bank and its communications?

In summary, the assembled papers present new theories, data, and methodological approaches to analyse central bankers' backgrounds, mandates, speeches, and deliberations. The findings presented provide novel insights into the workings of modern central banking and the manner in which accountability and legitimacy concerns are addressed by these institutions despite their technocratic reputation and independence from other arms of government.

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