

THE EUROSISTEM, THE FEDERAL RESERVE AND THE BANK OF JAPAN. CONTRASTED STUDY

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Abstract: The central bank is the highest monetary authority within each monetary system. This is why the concern for the responsibilities, objectives and functions of central banks is present in the general economy field, as well as in those of finance, currency or financial exchange relations. Therefore, a contrasted analysis between the Eurosystem, the Federal Reserve and the Bank of Japan is of general interest for the users. The paper presents a comparison between the three systems. The status and objective differences are presented with a reference to the historical circumstances that have generated national characteristics. In the past years, due to the fact that all the three authorities have made directional changes towards independence and transparency, and because the economies of these areas are mainly convergent, a diminution of the differences between the three monetary authorities can be observed.

Introduction

The Eurosystem, the Federal Reserve and the Bank of Japan are the most important monetary authorities in the world. The idea of comparing these systems is not unique; it has always been the concern of many economists, some of them having a direct connection to bank activity, others as external analysts. Even so, we consider the subject to be of interest as the study is a direct comparison of the three monetary authorities in what regards the organization and the monetary policy instruments used.

The Eurosystem was established in 1998, the Federal Reserve - the central bank of the United States (Fed) in 1914, while BoJ- the Bank of Japan – in 1882. It can be noticed a difference of over one hundred years between the Japanese monetary authority and the Eurosystem. But it is not time that brought the most significant differences, even if the structures and the organization of these three systems mirror different historical circumstances and specific national characteristics. While the legal status and some of their duties differ to some extent, there are, in fact, few differences regarding institutional structures, the monetary policy framework and its goal. There are many factors that played an important role in reducing the differences between these monetary institutions - the three most important in the world.

One of the factors is that central banks practices evolved in the same direction: great independence, transparency and the establishment of monetary policy committees. This lead to the decrease of distinctions between these three institutions, a tendency to be noted in other central banks as well. Nevertheless, there still remain differences in the way monetary policy committees operate.

Another factor that also contributed to the decrease of differences between Eurosystem, Fed and BoJ is the convergence of the indicators from the economic and financial environment. From 1980 to 2004 the inflation rate in the United States

remained within a narrow range, while the euro zone had a continually decreasing tendency and, before the euro currency release, it reached levels consistent with those of the United States. After 1980, Japan reached a low level of inflation. Concerning the economic development, it can be said that both Fed and BoJ operate in a harmonious economic and financial environment.

There are several differences relating to the strategies of information communication, although financial markets are influenced by both Eurosystem and Fed's statements. A major difference resides from the fact that, unlike ECB and BoJ, Fed does not quantify its price stability goal and does not communicate a constant monetary policy. Other distinctions occur in public relations: ECB, the European Central Bank, does not publish the minutes of the Governing Council meetings, but offers real-time information on interest rate modifications.

Monetary Policy Objectives

The Maastricht treaty establishes that “the first objective of ESCB shall be to maintain price stability” and “without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the [European] Community with a view to contributing to the achievement of the objectives of the [European] Community”. Thus the treaty sets a clear hierarchy of the ECB and assigns cardinal importance to price stability. Moreover, ECB openly quantified price stability.

The well defined ESBC goal is in clear contrast with the multiple objectives set to Fed. In a Fed report it is set that “The Board of Governors of the Federal Reserve System and the Federal Open Market Committee (FOMC) shall maintain long run growth of the economy so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.” (Federal Reserve Act, Section 2A.1)

Even so, many analysts consider that, although The US Congress did not explicitly commission the Fed to pursue low inflation, it still tries to inform the public about the advantages of low inflation and the need to give priority to this objective. It must be said that in the past years, although the Fed had many objectives to reach, the accent was set on price stability maintenance.

Concerning BoJ, its main monetary policy goal is price stability maintenance and the second is that of providing an accessible and stable payment and settlement system. Both objectives are oriented towards financial system stability, setting the basis for economic development. On March 9th, 2006, BoJ introduced a new monetary policy framework, reviewing its opinion on price stability with a view to providing an adequate environment for economic development.

The independence of the central banks

In many countries, the gradual process of responsibility delegation from a single central bank to a monetary committee coincided with central bank's independence acknowledgement (Blinder, 2004). Central bank independence is a stratified concept, having several components:

- *personal independence*: refers to the role, status and composition of the highest management bodies of the central bank, including position assignment procedures for the members of the respective bodies, revocation rules, mandate period and renewal possibility, professional competency requirements, incongruity clause and interest conflicts.

- *financial independence*: takes into account the separation of government funds from those of the central bank.
- *functional independence*, also known as political independence, refers to decision making and monetary policy implementation autonomy.

Article 108 of the European treaty establishes that the Eurosystem is politically independent. First of all, the financial interests of the ECB are separated from those of the European Community. ECB has its own funds and its capital is subscribed and paid by national central banks in the euro zone. Secondly, a potential political influence on the ECB's individual members is minimal: the Governing Council have relatively long term mandates, while a rule reads that the members of the Executive Committee cannot be reelected. Thirdly, the independence of the Eurosystem is strengthened by the interdiction to give credits to the public sector. Finally, the Eurosystem has a functional independence, as well, as ECB has all the instruments and competences to manage the monetary policy and is authorized to independently decide how and when to use them.

Although the Fed has greater independence, it was discussed that it is somehow lesser than that of the Eurosystem. The Constitution of the United States gives the Congress the right "to coin money and regulate the value thereof". The Congress delegated this responsibility to the Fed, but in theory, it could abrogate it at any time. Still, the enactment by the Congress of a special resolution in favour of the Fed (Federal Reserve Act) proves the clear intention of separating state and monetary policies. There are a number of provisions conceived to protect the independence of the Fed. For instance, Fed is independent from other Government agencies and branches, it is financed from its own funds, and therefore there is no relation to the budgetary process. The terms of the seven Board of Governors members last for 14 years, at the most, so they cover several presidential and Congress mandates. There is a connection between the two authorities: the members of the management body of the Fed are appointed and approved by the Congress. The president and vice-president of the Board are elected by the President of the United States among the existing governors and the election must be approved by the Senate. They have four-years terms and can be reelected before the end of their term.

Regarding BoJ, its functioning law was reviewed in 1997 with the purpose of insuring the independence of the central bank. The law reads that "The Bank of Japan's autonomy regarding currency and monetary control shall be respected" To ensure the independence of the Bank, members of the Policy Board cannot be dismissed for holding opinions at difference with the government, and the government cannot order the Bank to undertake any particular policy action or to conduct any particular business operation. At the same time, it is important that the Bank's monetary policy is consistent with the government's basic economic policy framework. As a result, BoJ must "always maintain close contact with the government and exchange views sufficiently" The Bank of Japan Law also allows representatives of the government to attend Monetary Policy Meetings of the Policy Board (MPMs), to give their views and submit proposals, or request that the Board postpone a vote on monetary policy measures until the next meeting, but the government representatives have no votes in the monetary policy decisions.

Between the three central banks there are several other differences in what concerns exchange policy. In the United States, the exchange policy is the responsibility of the Department of the Treasury, unlike Japan where the currency interventions are legally the privilege of the Finance Ministry. In reality, BoJ undertakes this activity as

government agent, but using government funds. In the Euro zone, article 111 of the Treaty offers the Governing Council the right to formulate “general orientations for the exchange rate”. At the same time, the Treaty stipulates that the purpose of price stability maintenance is respected in adopting the fixed exchange rate.

Responsibility, transparency and communication

In the early 80’s, the Fed leadership realized that inflation reduction and stability would be easier to achieve if the monetary authority had public credibility, moreover, the Fed officials considered good public communication as a useful instrument in credibility building. In the same direction, Woodward (2003) underlines the fact that transparency could help increase monetary policy efficiency. Still, it could create a potential conflict for the central banks: a maximum level of transparency could generate confusion.

In order to consolidate its legitimacy, an independent central bank should answer before democratic institutions and the public for its actions, in order to accomplish its goals. The Union Treaty stipulates the elaboration of reports (for instance, ECB must draw up the Annual Report and present it before the European Parliament, the Union Commission and Council) and sets the obligation of periodic presentations to the European Parliament.

Similar reporting procedures were set in the United States and Japan. Fed answers before the Congress, and the latter can modify the Federal Reserve Act at any time. Fed must report once a year to the spokesman of the House of Representatives and to announce twice a year the banking commission of the Congress about monetary policy. Also, Fed officials answer Congress questions at its request.

BoJ has different obligations regarding compulsory public reports, as well as concerning its actions. Similar to Fed’s semi-annual report to the Congress, BoJ submits a report on currency and monetary control to the Diet twice a year, and the Governor or a designated representative appears before Diet committees, on request, to explain the Bank’s policies, business operations, and balance sheet conditions. Moreover, the BoJ Governor has periodic press conferences after monetary policy sessions in order to explain the monetary policy decisions adopted.

Since the introduction of the new monetary policy framework, BoJ examines economic activity and prices from two perspectives: the first focuses on the economic forecasts and price expectations for one or two years ahead. The second perspective is more long-term oriented and takes into account those risks that are most relevant in monetary policy implementation.

Transparency is a concept that is related to and still distinct from, responsibility. The transparency of monetary policy can be defined as the extent to which central banks offer information related to the monetary policy process. As Blinder (2004) points out, such information should be clear, have a backed content and be open to the public. According to the specialists, the limits of transparency vis-à-vis responsibility and communication are variable. Eijffinger and Geraats (2002) distinguish between five types of transparency, namely:

- *political transparency* - refers to an open and clear presentation of monetary policy objectives
- *economic transparency* - focuses on the economic information used in monetary policy
- *procedural transparency* - reflects the way monetary policy decisions are

taken and involves an explicit monetary policy rule or strategy that describes the monetary policy framework

➤ *policy transparency* - means that policy decisions should be promptly announced. Moreover, it includes an explanation of the decision, as well as a policy definition or indication of possible future actions

➤ *operational transparency* - concerns the implementation of the central bank's policy actions.

Concerning the Eurosystem, Winkler (2002) remarks different aspects of transparency that have been receiving special attention, including open communication, clarity and information efficiency. However, an effective communication must find the balance between: the open and complete presentation of the policy-making process, and simplifying the presentation of this process in the search of greater clarity. Blinder (2004) also observes that monetary policy decision-making cannot be carried out in a completely open manner.

Following the above remarks, it can be said that, both the Eurosystem and the Fed place strong emphasis on ensuring the transparency of the decision-making process and the transparency of the analyses made by the responsible decision factors.

In the case of ECB, the press conferences take place shortly after the monthly Governing Council meetings and the monetary policy decisions are publicly announced. Similarly, in the American practice, the FOMC announces monetary policy changes as soon as they are made. Also, in the case of Fed, the minutes of each meeting is published in maximum three weeks.

The Bank of Japan Law requires the Bank to make clear to the public the meaning of its decisions, as well as its decision-making process. Following this stipulation, after each monetary policy meeting, the Policy Board makes public any decisions taken and explains money market operations. Like the Fed, BoJ publishes the minutes of the monetary policy meetings after approximately one month. Other matters discussed at the Policy Board meetings are presented in the Monthly Report of the BoJ's Policy Board.

It was discussed that the publication of minutes makes the Fed and the BoJ more transparent than ECB. Still, there are two main reasons determining ECB not to publish its minutes. Firstly, ECB intends to induce the public the idea that the entity which decides is not a person, or a group of people, but rather a college (a united team which benefits from its collegial spirit). Secondly, ECB does not want to give the false impression that it would represent the place where various national interests are sustained by national central banks governors. In fact, the Treaty clearly requires that decisions should be taken in the interest of the euro area as a whole, and thus any interpretation on the basis of a national vision is excluded. This makes the situation in the euro area somehow different from those of the United States and Japan. Nevertheless, ECB publishes its diagnosis-analysis in real-time, so that all the arguments that led to the decision should be completely presented to the public. Several recent studies have shown that ECB proves to be highly predictable in its decisions, a fact that represents one of the cardinal goals of transparency.

Conclusions

While the legal status and some of the presented systems duties may differ to some extent, there are still few distinctions regarding institutional structures, monetary policy framework, but also the objectives of monetary policy instruments.

Table 1

Eurosystem, Fed and BoJ comparison: leadership, monetary policy, independence

	Eurosystem	Federal Reserve	Bank of Japan
Decision-making body	The Governing Council, (19 members): the ECB Executive Board (6 members) and the governors of the 13 central banks of the Eurosystem	Federal “Open Market” Committee (FOMC), has 12 members: the Board of Governors (members), the President of the New York Fed and 4 other Fed banks presidents (on a rotating basis)	Policy Board (9 members)
Monetary policy objectives	Price stability is the primary objective. This is defined in exact quantitative terms.	Multiple objectives: to promote maximum employment, stable prices and moderate long-term interest rates.	Multiple objectives: price stability (now defined within a range) and the stability of the financial system.
Independence	Yes	Yes	Yes

In the past years, central banks practices all over the world mainly evolved to a greater independence, transparency and monetary policy commission decision-making. These approaches contributed to the decrease of differences between the Eurosystem, the Federal Reserve System and the Bank of Japan and it corresponds to a tendency that can be noticed at other central banks’ level.

There are, however, some differences in the way monetary policy committees operate. For instance, when taking monetary policy decisions, both the Governing Council of ECB and the Board of Governors of Fed officially act by simple majority voting. In practice, both the Governing Council and the FOMC operate as collegial committees. In contrast, the Policy Board of BoJ operates in a much more individualistic manner than the other two committees.

As emphasized in Table 2, there are some differences between the communication strategies, although financial markets’ receptiveness appears to be high for both the Eurosystem (regarding monetary policy tendencies) and Fed (concerning monetary policy tendencies and economic perspectives opinions). Unlike ECB and BoJ, Fed does not quantify its price stability goal and does not communicate a constant monetary policy. ECB does not publish the minutes of the Governing Council meetings, like Fed and BoJ do, but offers real-time information on interest rate decisions. The decision not to publish meetings’ minutes must be seen as a measure of prevention for possible public pressure that the Governing Council may face in member countries.

Table 2

The Eurosystem, Fed and BoJ comparison: Responsibility, Strategies

	Eurosystem	Federal Reserve System	Bank of Japan
Responsibility and transparency	<ul style="list-style-type: none"> ▪ Immediate press conference with introductory statements following Governing Council meetings; ▪ Annual report to EU institutions and to the European Parliament ▪ Monthly Bulletin publishing. ▪ Consolidated financial statement 	<ul style="list-style-type: none"> ▪ Immediate announcement and minutes following the FOMC meetings ▪ Semi-annual reports before the Banking Commission of the Congress ▪ Hearings before the Congress ▪ Monthly Bulletin/ Report of the regional federal reserve banks. 	<ul style="list-style-type: none"> ▪ Immediate announcement after monetary policy meetings ▪ Governor's press conference ▪ subsequent publication of minutes ▪ Monthly Report of the Policy Board publishing; ▪ Semi-annual report to the Diet.
Monetary policy strategy	Pre-announced strategy	Risk management approach	Approach focused on the information content of a choice of economic indicators
Monetary policy implementation	Decentralized (operations conducted by the Eurosystem).	Centralized (operations conducted by the New York Federal Reserve Bank).	Centralized

Regarding economic and financial of the past two decades, all three central banks have faced different problems, some of them with national characteristics (as is the case of Japan), others more global in nature. The general activity framework of the three banks differs from one system to the other, the euro zone being a heterogeneous area, but we can state that these differences have reduced in the past years. To conclude, we can affirm that the monetary policy of the Eurosystem, Fed and BoJ is oriented towards the same result - that is monetary stability, regardless of the instruments used or the public interaction manner.

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