



# Bashing and supporting central banks: the Bundesbank and the European Central Bank

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## Abstract

In this paper, we analyse the influences leading to external pressure on or public support for German and European monetary policy. Based upon the findings for the Deutsche Bundesbank, lessons are drawn for the European Central Bank (ECB). We show that external pressure on the ECB stems mainly from politicians or from international organisations (such as the IMF). In contrast with evidence for the Bundesbank, interest groups (such as commercial banks) hardly attempt to influence European monetary policy. German data show that factors leading to external pressure on the central bank are rising unemployment and the threat that governments will lose their majority in the next election. Evidence for the latter is, however, weak, and we show that in any case this source of pressure is likely to be of minor importance for the ECB.

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## 1. Introduction

I hear, but I do not listen. *W.F. Duisenberg, President of the European Central Bank*<sup>1</sup>

The relationship between central banks and governments is notoriously difficult. Although central banks increasingly are made independent, governments in many

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<sup>1</sup> Stated during the press conference after the meeting of the Governing Council of the ECB on April 11, 2001.

countries attempt to influence monetary policy decisions. For instance, the former German minister of Finance, Oskar Lafontaine, called for lower European interest rates in 1998 and 1999. Although there is a vast literature investigating the impact of external (political) pressure on monetary policy,<sup>2</sup> little is known about its sources and causes.

Following the Collins English Dictionary, bashing refers to strong, public and often unfair criticism, showing disapproval. In this paper, pressure on central banks will be called *central bank bashing*. The question we are most interested in is: when, why and by whom are central banks bashed—and who supports them? Intuitively, if inflation or unemployment is high, politicians might bash a central bank. Still, for most countries a clear econometric relationship between external pressure and monetary policy does not show up. One reason for this could be that measuring pressure is complex, and simple proxies for pressure (e.g. elections) do not capture the true relationship between the central bank and the outside world.

In this paper we use the methodology of Havrilesky (1993) to study external influence on European monetary policy. Havrilesky examined newspaper evidence to construct a conflict indicator for the US; we use international newspapers to construct indicators for external pressure and for public support for the European Central Bank (ECB). Using these indicators, we examine why, by whom and when external pressure on and public support for European monetary policy arises. The paper is organised as follows. In Section 2, we explain the two main factors determining monetary policy. In Section 3, we present the Havrilesky-methodology. In Section 4, we check which groups have exerted pressure or offered public support, focusing on the ECB and the Bundesbank. Moreover, we assess the extent to which pressure and support can be related to national economic circumstances. Then, we check in Section 5 the extent to which we can relate external pressure to other economic or political variables. Section 6 summarises our main findings.

## 2. Determinants of monetary policy

The public choice and subsequent political economy literature emphasises the possibility that non-economic factors might influence monetary policy. Monetary policy is directed towards achieving an economic goal, e.g. price stability. However, this is not to say that the relevant monetary policy information is entirely determined by economic factors. For instance it has been claimed that elections (Nordhaus, 1975), the political colour of governments (Hibbs, 1977) or the party preference of central bankers (Vaubel, 1997)<sup>3</sup> might have a significant impact on the conduct of monetary policy. Waller (1991) presents a ‘theory of optimal central bank bashing’: by establishing a reputation for bashing, the government may be able to obtain its desired policy outcome in the future. Therefore, monetary policy may be

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<sup>2</sup> See Berger et al. (2001) for an overview.

<sup>3</sup> Note, however, that Vaubel’s results suffer from a number of methodological problems (Berger and Woitek, 1997). See also Vaubel’s reply (Vaubel, 1998).

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