

**Answers provided by Lucas Papademos
to the questionnaire drawn up by
the Committee on Economic and Monetary Affairs
of the European Parliament**

A. Personal and professional background

1. Please highlight the three most important aspects of your professional experience in monetary, financial and business matters.

My professional experience in monetary and financial matters relates to my career as a central banker and a professor of economics. The three most important aspects of my experience in these matters can be grouped as follows:

- Teaching and research. From 1975 to 1985, I taught economics at Columbia University in New York, mainly courses on macroeconomics, monetary theory and policy, and banking. At the University of Athens, where I have been a professor since 1988, I have taught courses on money and banking, economic and monetary policy as well as a course on European economic integration. My research and publications have focused on issues directly related to monetary policy, the structure of financial markets and the dynamics of inflation and employment.
- From 1985 to 1993, I held the position of Economic Counsellor (Chief Economist) at the Bank of Greece, where I was involved in all aspects of economic analysis and monetary policy formulation. I was also Head of the Economic Research Department (1988-1993) and represented the Bank of Greece in various European and international committees on monetary and financial matters (please see my answer to the next question).
- Since October 1994, I have been Governor of the Bank of Greece, after having served as Deputy Governor since December 1993. In my capacity as Governor, I have been President of the Monetary Policy Council of the Bank and Chairman of the Committee on Banking and Credit. I have been directly involved in all monetary policy decisions aimed at attaining price stability in Greece and fulfilling other convergence criteria for joining Economic and Monetary Union. I have also overseen the process of financial deregulation and capital liberalisation as well as the changes in the banking supervision framework and practices in Greece over the past seven years and, more recently, the changeover to the euro.

2. Please highlight the three most important aspects of your European and international experience.

My European experience stems from my membership in a number of committees of the European Community and of the European Union central banks. Specifically:

- From 1985 to 1988, I was a member of the Monetary Committee of the European Communities. From 1985 to 1993, I was also a member of the Committee of Alternates of the Governors of the EC Central Banks and served as Chairman of the Committee in 1989. The work of these committees focused on many aspects of European monetary and financial integration, including preparatory work for the Maastricht Treaty.
- From 1992 to 1994, I was Chairman of the Monetary Policy Sub-Committee of the Committee of Governors and, subsequently, of the Monetary Policy Sub-Committee of the Council of the European Monetary Institute. During that period, the work of this Sub-Committee included the analysis of issues connected with the monetary policy strategy and operational framework of the future European Central Bank.
- From 1994 to 1998, I was a member of the Council of the European Monetary Institute. Also, I have been a member of the General Council of the ECB since January 1999 and of its Governing Council since January 2001.

My international professional experience includes: my work as a senior economist at the Federal Reserve Bank of Boston (while on leave from Columbia University in 1980); my position as Governor for Greece of the International Monetary Fund since 1994 and membership in the Economic Policy Committee of the OECD; and, since January 2001, the chairmanship of the Central Bank Governors' Club, a forum comprising the governors of the central banks of sixteen southeast European and Asian countries.

3. What are the two most important decisions to which you have been party in your professional life? Could you explain your choice?

As a central banker, I have taken or have been party to a number of important policy decisions. I have chosen two such decisions which have had a broad and fundamental impact on the economy and on the effectiveness of monetary policy.

- As Deputy Governor, I was party to the decision to fully liberalize capital movements in Greece in 1994 without allowing the drachma to devalue, as was widely expected at the time; then I helped, by means of a stability-oriented monetary policy, to defend the currency successfully against a speculative attack. The significance of this decision is reflected in its many positive effects: first, the lifting of all capital controls was completed without undermining monetary stability; second, the credibility of central

bank policy increased, thereby favourably influencing expectations and facilitating the adoption of the exchange rate as a nominal anchor; third, the whole episode contributed to a change in the stance of budgetary policy towards faster fiscal consolidation.

- As Governor, I played a key role in the decision for the entry of the drachma into the Exchange Rate Mechanism of the European Monetary System in March 1998, which was accompanied by a devaluation of the currency. That decision, combined with other policy actions which ensured a smooth entry and participation of the drachma in the ERM, had various important consequences: it provided a timely exit from the strategy pursued for three years of unilaterally pegging the exchange rate, when that peg could no longer be sustained, and it placed the Bank's disinflation strategy within a new institutional framework, which provided additional discipline and enhanced policy credibility. More generally, it marked the beginning of the last phase of Greece's nominal convergence efforts to achieve price stability and was crucial for the fulfilment of the exchange rate and inflation criteria for the adoption of the single currency.

4. Do you have any business or financial holdings or other commitments that might be in conflict with your prospective duties, and are there any other relevant personal or other factors that need to be taken account of by the Parliament in considering your nomination?

I do not have any business or financial holdings or commitments that might be in conflict with my prospective duties. I am not aware of any personal or other factors which should be taken into account by the European Parliament in considering my nomination. I am currently on leave from the University of Athens. I intend to perform my duties at the ECB on a full-time basis as specified by its Statute.

5. On the basis of your own experience and philosophy, and in view of the uniquely independent position of the ECB, what do you believe should be the guiding principles for a European Central Banker?

A first, general guiding principle for a European Central Banker is to be totally committed to the achievement of the objectives and to the effective performance of the tasks of the ECB and the ESCB, as specified in the Statute. To this end, a second important principle is to act independently from political or other bodies when carrying out his/her tasks. A third principle is accountability to the European public for policy decisions and the performance of duties. A fourth principle, which is related to the previous one, is transparency. Monetary policy decisions must be explained to the public so that they are understood as contributing to the attainment of the policy objectives, given the available information. In particular, transparency enhances the effectiveness of monetary policy in achieving its primary objective to maintain price stability in the euro area. A fifth principle is to act in the general interest of

the euro area as a whole. A European Central Banker's decisions must be based on a European perspective and not a national one. Sixth, collegiality in the functioning of the decision making bodies of the ECB. Without limiting freedom of expression on policy matters, collegiality strengthens decision making and the effectiveness of central bank policies. Finally, observing the highest standard of ethical conduct, acting honestly and impartially, and avoiding situations which could give rise to a conflict of interests are also important principles. Abiding by the above guiding principles is necessary for the effective performance of the duties of a European Central Banker and for maintaining and promoting public trust in the European Central Bank.

B. Monetary and economic policy

6. Which is your position as to the current definition of price stability used by the ECB? Do you believe that this is the right approach and why?

I believe the ECB's definition of price stability provides an appropriate quantification of the primary objective of monetary policy in the euro area. In this sense I fully support the decision on this definition which was taken by the Governing Council of the ECB in October 1998. The basic rationale behind the ECB's choice was also clearly explained in a letter by the President, Mr. Duisenberg, to the Chairperson of the Economic and Monetary Affairs Committee, Ms Randzio-Plath, dated 16 October 2001.

I would in particular like to stress the following points:

First, the ECB's definition matches the clear demand of European citizens for low inflation and it is consistent with the objectives of many central banks in the euro area before Stage Three of EMU.

Second, the definition of price stability in terms of a range recognises the uncertainty inherent in monetary policy-making and thereby avoids giving the impression of spurious accuracy in the ECB's ability to fine-tune price developments.

Third, the definition serves well the function of steering long-term inflation expectations.

Fourth, neither prolonged inflation nor prolonged deflation are consistent with the ECB's definition of price stability. Moreover, the definition provides for a safety margin against the specific risks associated with deflation. It also acknowledges the possible existence of a small positive bias in measuring inflation by the HICP and the uncertainty regarding its magnitude.

Finally, the notion that "price stability is to be maintained over the medium term" provides an appropriate framework for the ECB's accountability as it acknowledges the lags in the

transmission of the effects of monetary policy and the existence of shocks to inflation which monetary policy cannot offset in the short run. Conversely, the medium-term orientation gives the ECB the flexibility to respond appropriately to economic shocks, thereby avoiding the introduction of unnecessarily high volatility in real activity and interest rates.

7. Would you support the ECB basing the second pillar of its monetary strategy on an explicit inflation forecast, and if so, over what time period, rather than just using staff projections? To what extent could a mixed targeting strategy (inflation target + money supply target) be defined and evaluated?

Macroeconomic projections are an important piece of information that the Governing Council analyses under the second pillar of the ECB's monetary policy strategy. They represent a useful tool for consistently organising a large body of economic data and help to build an overall picture of possible future developments. As such, I fully support their use and regard their publication as important in order to enhance the transparency of the monetary policy process.

However, I do not favour making macroeconomic projections and the adoption of an explicit inflation forecast the unique or all-encompassing tool for the conduct of monetary policy. There are a number of drawbacks associated with projections that one should always bear in mind. In particular, projections are generally model specific, i.e. their outcome is very much based on a model that, by its very nature, cannot offer a complete representation of economic reality, are surrounded by considerable uncertainty and can hardly take into account all available information in a timely manner. A diversified and comprehensive analysis of all available information, underlying the ECB's approach, is more appropriate. For this reason, I subscribe to the views of the ECB on this matter.

Moreover, I deem it important that, within the ECB's framework, there exists a clear separation of the preparation of projections, as carried out under the responsibility of the staff, from the monetary policy decisions taken by the Governing Council. I believe this separation enhances the usefulness of staff forecasts as an input in the decision-making process and the transparency of the overall monetary policy framework. There is no reason, in my view, for the Governing Council to take responsibility for the projections. In addition, the Governing Council must feel free to use the projections of others rather than the staff projections as input for taking policy decisions.

Finally, I would not support the adoption of a mixed strategy combining an inflation target and a money supply target. Indeed, such a strategy is not feasible in an uncertain economic environment. Adoption of such a strategy would merely cause confusion and would hardly provide a transparent framework. Rather, I believe that the ECB in pursuing its primary objective should look at all available information, in a forward-looking manner, in order to

derive the best assessment of the outlook for inflation. Under this set-up, the analysis of monetary developments is one useful ingredient, as is the setting of a reference value for M3 (and not a target for M3) indicating the rate of M3 growth which would be compatible with price stability over the medium term. Given that variables other than M3 also have information content regarding future price developments, a diversified approach, which looks at a variety of indicators and also takes into account possible alternative interpretations of the available information, is more conducive to robust monetary policy decisions than the mere focus on M3.

8. Assuming price stability has been achieved and can be maintained, what would you consider to be the appropriate interest rate policy, and in which way and to what extent would this take into account the need (pursuant to Article 105 of the Maastricht Treaty) to achieve the goals of Article 2 and 3a concerning growth and a high level of employment?

Before answering the first part of your question, I should like to address the issues outlined in the second part. The Treaty has assigned the ECB the primary objective of maintaining price stability and, without prejudice to this objective, the support of the "general economic policies in the Community". The ECB's monetary policy closely reflects this mandate. The best contribution of monetary policy to sustainable and high levels of growth and employment is to maintain price stability over the medium term.

Furthermore, a monetary policy focused on price stability can contribute to stabilising output and employment for a wide range of shocks (mainly on the demand side). Moreover, a medium-term orientation in the conduct of monetary policy can avoid introducing unnecessary volatility in output and employment by allowing for a measured and gradual response to some type of economic shocks (e.g. supply shocks of a cost-push nature).

Beyond its contribution to growth via the maintenance of price stability in the medium-term, monetary policy cannot do very much, if anything, to increase economic growth and employment in a sustained and systematic way. I am convinced that further improvements of growth and employment prospects must rely on policy measures and reforms which will enhance productivity and the functioning of markets. Particularly important are structural reforms which improve the flexibility and efficiency of labour and goods markets.

As regards the first part of your question, you ask me how interest rates would be set "assuming price stability ... can be maintained". However, the task of the Governing Council of the ECB, is to set the key ECB interest rates in a way that price stability can best be maintained in the future. This would serve other policy objectives as well. It cannot be assumed that price stability is given, thus allowing other objectives to be pursued independently.

9. How would you seek to resolve the policy mix problems resulting from the combination of a centralised monetary policy and decentralised fiscal policies?

Potential “policy mix” problems in the euro area can be resolved. Responsibilities are clearly defined and policy-makers have the incentive to focus on their own specific responsibilities. Furthermore, there are many appropriate means for the exchange of information.

The Treaty assigns to the ECB and to the single monetary policy the primary objective of maintaining price stability in the euro area. The Treaty and the Stability and Growth Pact have laid down important principles and fiscal and budgetary rules to discipline national fiscal policies. The Treaty finally requires the Member States to regard all aspects of their economic policies as a matter of common concern and to co-ordinate them in the context of the BEPGs, even though the responsibility for structural policies rests to a large extent with the Member States themselves.

Within this institutional framework conflicts and overlaps in competence and responsibility in the management of the single monetary policy and in the design of fiscal and structural policies are avoided in general.

For good reasons, the Treaty rules out ex-ante co-ordination of fiscal and monetary policy, focused for example on achieving a certain policy mix. Such a co-ordination would risk creating uncertainties in the public regarding the policy objectives of the different institutions. It may distract national governments from carrying out their own responsibilities. Moreover, any real or perceived political pressures on monetary policy to facilitate or “reward” developments on the fiscal and structural side with reference to a “desirable policy mix” would raise uncertainty about the objectives of monetary policy, thereby endangering credibility and reducing the benefits associated with the maintenance of price stability.

This notwithstanding, on the basis of its mandate and in full recognition of its independence, there are good reasons for the ECB to conduct a regular exchange of views and information with the policy-making bodies of the European Union. The ECB has a natural interest in being informed about fiscal and structural policy measures taken in the euro area, as these may also influence price developments and the transmission mechanism of monetary policy. Monetary policy will, of course, take euro area-wide fiscal and structural policies into account. In the same way, fiscal policies should take into account the course of monetary policy in their efforts to achieve their objectives.

C. Functioning of the ECB

10. Which reforms should ECB undergo in view of enlargement?

Over the past few months, the ECB's decision-making bodies have discussed modifying voting modalities in the Governing Council on various occasions.

The Governing Council intends to make its recommendations on a change to its voting modalities in accordance with the "enabling clause" as and when appropriate. It is worth noting that the ECB was called upon to do so as soon as possible once the Nice Treaty is ratified (which can be expected in early autumn, assuming the second Irish referendum is successful).

In establishing a suitable change, the legal limits of the enabling clause (i.e. that it is restricted to modifying the voting modalities) must be borne in mind. In addition, the ECB considers it advisable to respect a number of fundamental principles which are stipulated in the Treaty and the Statute of the ESCB and the ECB. These principles have formed the basis for the Governing Council's successful conduct of the euro area's monetary policy thus far (ad personam participation of Governing Council members – "one member, one vote" – with regard to members with voting rights).

The respect of these principles would seem to exclude certain adjustment options, such as a constituency system, while leaving open others such as a rotation system.

Any rotation system to be designed should ideally be stable vis-à-vis future euro area enlargements. It should also be relatively easy to communicate and contain safeguards against outcomes where the group of Governing Council members exercising the voting rights could be perceived as not being sufficiently representative of the euro area as a whole.

11. Would you be in favour of a confirmation procedure by the European Parliament?

The establishment of a parliamentary confirmation procedure would require a change in the Treaty. As such, it raises a question of constitutional nature, vesting an additional power in the Parliament, that pertains to the Member States to respond. Neither the ECB nor myself have a position in this regard. The candidates for the Executive Board, under either the option of consultation or that of confirmation, need to be examined by the European Parliament, and I would expect that a negative opinion of the European Parliament (or, for that case, of the Governing Council of the ECB), even if not legally binding, would have a serious impact on the decision to be taken by the Heads of State or Government. Therefore, whether the European Parliament is consulted or is called upon to approve a candidate may not, in practice, lead to a very different outcome.

12. According to the current distribution of responsibilities among members of the ECB, the Vice-President is, in addition to his statutory duty as deputy to the President, in charge of the Administration and Personnel. What will be your personal approach of the social dialogue with the ECB Staff? How do you envisage the possibilities to promote an equal opportunities policy in the ECB, in particular at the managerial level?

I do believe that a well-functioning dialogue with the staff is essential for creating and maintaining a good working atmosphere in an organisation. Such a dialogue should be maintained at many levels within the organisation. However, any dialogue must respect the fact that the parties engaged in it have different roles. More concretely, a dialogue between management and staff cannot succeed if their different roles are not recognised and staff representatives want to assume management responsibility. It can also not succeed if the management is not prepared to genuinely engage in a dialogue but see the dialogue only as a necessary formality.

As regards equal opportunities, I have no reason to believe that the ECB recruitment policy involves gender discrimination. That being said, I would certainly not want to state that the ECB has as many female staff at managerial level as ideally would be desirable. I would therefore look to see whether this issue should be given a more prominent place on the agenda.

13. Are you of the opinion that the working conditions (and staff rules) of the ECB's employees should be negotiated with the staff committee? Which other modifications are necessary in your view to bring these working conditions (and staff rules) in line with those of other European institutions?

As I understand, the role of the Staff Committee in the ECB as a body elected by the whole staff is of a consultative nature. As such, the Staff Committee is consulted on the conditions of employment in the ECB. In my view, it is not a natural negotiating party, a role that I would associate with a trade union.

According to the Statute, the conditions of employment of ECB staff are determined by the Governing Council upon a proposal from the Executive Board and with the benefit of comments from the members of the General Council. As a member of both the Governing and General Councils, I have contributed to the decisions taken in that respect and fully support them.

As the employment and working conditions at the ECB correspond to international labour standards in all respects and the rights of staff and trade unions are respected, I do not see any reason for modification at the current juncture. It is, however, clear that working conditions at the ECB need to be monitored closely so as to ensure that, in a rapidly changing environment, the ECB remains an attractive work place, that it continues to be competitive with other

international organisations and that it secures the human resources required, both in qualitative and quantitative terms, to fulfil its statutory functions and tasks. As a prospective member of the Executive Board I will certainly attach great importance to these aspects.

D. Democratic accountability

14. How do you see the distinction between the ECB independence and its accountability and what steps do you consider should be taken to ensure democratic accountability?

Independence and accountability are two sides of the same coin.

The independence of the ECB – as enshrined in the Treaty – is crucial for the success of the single monetary policy. It enables monetary policy decisions to be separated from the political cycle and ensures that the objective of price stability is consistently pursued. As such, this principle is well established and fully recognised not only by politicians, but also by the citizens of our countries.

However, independence does not mean that the ECB, or the Eurosystem for that matter, can do whatever it wishes. Independence is complemented by the principle of accountability. The citizens, or elected representatives on their behalf, are entitled to follow and to scrutinise ex post the decisions taken by the ECB in the fulfilment of its tasks. This obligation to explain and justify monetary policy decisions is an important element in legitimising the ECB's independence. In order to enable the European Parliament in particular, but also the public at large, to assess the ECB's performance against its tasks, the ECB has implemented several steps which even go beyond the statutory reporting requirements.

Apart from the President presenting the ECB's annual reports to the plenary session of the European Parliament, the quarterly testimonies of the ECB President before the Economic and Monetary Affairs Committee are a particularly important element of the ECB's accountability. At these meetings the ECB President explains the ECB's policy decisions and thereafter answers questions posed by members of the Committee. Other members of the Executive Board of the ECB also appear before the Committee. Furthermore, the ECB answers – on a voluntary basis – questions from MEPs in writing.

In addition to the direct communication with the political decision-making bodies at the European level, the ECB pursues a transparent communication policy vis-à-vis the public at large. Immediately after the Governing Council's decision on the monetary policy stance, the President addresses the public by means of a press conference in which he explains the rationale behind the decisions taken. These explanations are supplemented in greater detail by the ECB's Monthly Bulletin. For their part, the members of the Governing Council, who are

also national central bank governors, regularly explain the decisions taken by the ECB at the national level.

Although not directly linked to the principle of accountability, it is noted that the ECB has contacts with all relevant policy institutions involved in the European political process. The ECB President and another Executive Board member regularly participate in the meetings of the Eurogroup and ECOFIN Council and, in return, the President of the ECOFIN Council and a member of the European Commission are entitled to attend the meetings of the Governing Council of the ECB. The ECB's participation in the Macro-economic Dialogue should also be mentioned in this context.

15. If the European Parliament were to recommend rejection of your nomination, would you still wish to pursue that nomination?

First, let me clarify that I have not pursued my nomination. According to the Treaty, the final decision is to be taken by the Heads of State or Government who would have to assess the Parliament's opinion addressed to them. As I noted in my answer to question 11, an unfavourable opinion of the European Parliament on my nomination by the EU Council would have a serious impact on the decision to be taken by the Heads of State or Government. I would also examine carefully the arguments put forward against my nomination and I would act with the deepest respect for the opinion of the institution that represents the political will of the citizens of the Union.