

The European Central Bank & Crises Measures.
The Role of the ECB during the euro-crisis and COVID-19
pandemic: investigating the independence and
accountability.

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List of Abbreviations:

AG	Advocate General
APP	Asset Purchasing Plan
BoE	Bank of England
BVerfG	Bundes Verfassungsgericht
CBI	Central Bank Independence
CJEU	Court of Justice of the European Union
ECB	European Central Bank
ESM	European Stability Mechanism
FED	Federal Reserve Bank of the United States
IMF	International Monetary Fund
LOLR	Lender of Last Resort
MRO	Main Refinancing Operations
OMT	Outright Monetary Transactions
PELTRO	Pandemic Emergency Longer-term Refinancing Operations
PSPP	Public Sector Purchasing Plan
SMP	Securities Markets Programme
SSM	Single Supervisory Mechanism
TARGET2	Trans-European Automated Real-time Gross settlement Express Transfer system
TLTRO	Targeted Longer-term refinancing operations
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
QE	Quantitative Easing

There are limits to monetary policy.
Ben Bernanke

Abstract

(Annelieke) Anne Marieke Mooij

The European Central Bank & Crises Measures.

The Role of the ECB during the euro-crisis and COVID-19 pandemic: investigating the independence and accountability.

This thesis investigates the role of the European Central Bank (ECB) during the euro-crisis and the COVID19 pandemic. It asks the question of whether the role of the ECB has affected the balance between independence and accountability. It does so by using a combination of economic and political theories to analyse the legal framework and actions of the ECB. This thesis furthermore places the actions in perspective by comparing with the US Federal Reserve (FED). This thesis starts in chapter 2 by examining the origins of central bank independence (CBI). Chapter 3 continues by defining the concept of accountability. This thesis uses the work of Amttenbrink (1999) to generate criteria for accountability. This chapter further examines the independence and accountability of the ECB and FED before the euro-crisis. Chapter 4 continues by examining the actions of the ECB through conventional policies. The role of the ECB during the euro crisis through its conventional policies was larger than expected. Chapter 5 of this research continues by evaluating the role of the ECB through its unconventional policies. Its role increased and changed from a cautious and conservative central bank to a more active bank. Chapter 6 of this thesis continues by examining the role of the ECB during the COVID19 crisis. Chapter 7 continues by discussing the judicial review. The level of judicial review both indicates the level of independence and the first step towards accountability. Chapter 8 continues by discussing the various methods of accountability. This chapter concludes that transparency has improved but that the main method of accountability has failed. Chapter 9 concludes that the new role of the ECB required higher levels of accountability. The accountability however did not develop to the level required, thus upsetting the balance between independence and accountability.

1. Introduction & Research Design

1.1. Introduction

Central Banks are the institutions responsible for the conduct of monetary policy. Since the late 1980s, a strong trend has been to create independent central banks. This trend was led on by the work of Nobel Prize-winners Neyaptu, Cukierman and Webb who state that a more independent central bank will better control inflation. This theory (more in chapter 2) is referred to as Central Bank Independence. Both the European Central Bank (ECB) in the European Union (EU) and the Federal Reserve Bank (FED) in the United States (US) are considered independent banks. Both the ECB and the Fed however are currently under pressure.

In the US the Federal Reserve Bank has been under criticism by President Trump. The main cause for disagreement seems to be the interest rates of the FED, which is untypical for a president to comment upon. The other central bank under pressure is the ECB who faced two major court cases on its policy. When the Eurozone crisis hit Europe in 2009 the ECB conducted various non-conventional monetary policy measures. In the words of its governor Mario Draghi: *“within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.”*¹ The ECB undertook many unprecedented actions. These actions lead to criticism that the ECB had overstepped its mandate.² Two of the ECB's unconventional programmes were challenged in court. These cases were both referred to the CJEU via the German Federal Constitutional Court (BVerfG) in its first and second reference. In the *Gauweiler* case, the German Federal Court asked preliminary questions concerning the Outright Monetary Programme.³ The second case the *Weiss* case concerns the Public Sector Asset Purchasing Programme.⁴ It is a new phenomenon for the ECB to be under such high scrutiny. The last case the *Weiss* case led to a serious clash between the CJEU and the BVerfG, whereby the BVerfG had declared the CJEU to have gone beyond its mandate. The question, therefore, is why have such tensions risen?

The answer may lie in the type of policies that were called into question. The policies under examination were unconventional. The ECB was known to be very independent but with a strict and narrow mandate. The only aim the Bank has is to maintain price stability which it has defined as an inflation target of under but near 2%. During the euro crisis and later in response to COVID-19 the role of the ECB has changed. This new role may have upset the balance between accountability and the independence of central banks. If this balance has

¹ Dan McCrum, 'Mario Draghi's 'whatever it takes' outcome in 3 charts' *Financial Times* (25 July 2017).

² Mehreen Khan, 'ECB criticized for overstepping mandate in eurozone crisis' *Financial Times* (London, 28 March 2017).

³ Case C-62/14 *Gauweiler and others v Deutscher Bundestag* [2015] ECLI:EU:C:2015:400

⁴ Case C-439/17, *Weiss and others v Bundesregierung* [2018] ECLI:EU:C:2018:1000

changed in favour of independence it may explain the pressure on the two banks. This topic will be further explored in this thesis.

1.2. Research Objective

The objective of this thesis is to investigate the balance between independence and accountability of the ECB. The research question is, therefore *“has the response of the ECB to the financial crisis and the COVID-19 crisis upset the balance between accountability and independence?”*

The accountability regime of a Central bank regarding its monetary objectives is special. According to Goodhart and Lastra central banks should be considered both an agency and a bank.⁵ Because of the special nature of their decisions, their accountability is limited but neither should they be fully independent. The authors rightly refer to independence and accountability as a balancing act.⁶ The exact balance is difficult to achieve but the increasing court challenges against the ECB indicates that the system may be out of balance. The next chapters will go into more depth for now it should be stated that the CJEU should be considered a last resort concerning monetary issues. It is potentially damaging for the banks' credibility furthermore it takes a lot of time and funds to generate a decision thereby limiting the impact of the decision. In addition, the CJEU is not, and cannot be expected to be, a monetary expert and therefore relies on the arguments put forward by the ECB (more in chapter 4). For the CJEU to be so heavily relied upon, other methods of accountability are either not available or ineffective. Unlike the ECB the United States Fed has not seen such a level of judicial review. The lack of judicial review indicates that other mechanisms of accountability may be functioning well.

Many factors are influencing central banks. To avoid omitted variables this research has opted to look at the ECB in detail and compare, where necessary, to the US FED. The ECB and FED share many commonalities but also some differences. They are both sizeable central banks dealing with large economies. Both face decentralization issues and various economic differences within their larger economy. They both had to deal with an economic crisis and took similar actions to combat Covid-19. The ECB faced a serious challenge to its independence during and after these actions. This is different from the Fed who did not face such challenges in its actions during the financial crash. The question is why monetary policy in Europe was placed under such scrutiny. The ECB will remain the focus of this research with the use of the FED to provide context. This will provide an answer to questions such as how unconventional the policies were and what impact were do these have on the role of the ECB.

⁵ Charles Goodhart and Rosa Lastra, 'Central Bank Accountability And Judicial Review' [2018] SUERF <<https://www.suerf.org/policynotes/2585/central-bank-accountability-and-judicial-review/html>> accessed 6 November 2019, p. 2.

⁶ Ibid.

1.3. Methodology

To analyse the actions of the ECB this research focuses on two specific cases. The response to the euro crisis and the COVID-19 pandemic will be examined. This research has opted to look at two cases in detail because it allows a fuller examination of the cases. As argued by Linos and Carlson, case studies allow focussing on the law in context.⁷ They argue that because the law is a product of social, economic and political debate it is best studied using a case study approach.⁸ This is particularly true when studying the ECB. The ECB's constitution was based upon economic theory and political compromise. To exclude economic and political theory from a study on the ECB provides a distorted result.

This research, therefore, examines the political and economic arguments behind the ECB and the role of central banks more generally. From an economic perspective particularly relevant are the theories underlying independence concerning output. Concretely this means that economists argue that an independent central bank can better control inflation. The discussion covers the degree of independence necessary. This research will therefore incorporate more classic economic research from Neyapti, Cukiermann and Webb and Philips, in addition, more modern economic research will be included such as that of Bodea and Hicks and De Haan and Eijffinger.

In addition to economic theory, this research will make use of the observations from political studies. The political theory will be primarily used to assess the effectiveness of the accountability framework. The framework under which the ECB is held accountable is the law. Its effectiveness, however, can be best judged using work from the political sciences. By incorporating research from the economic and political sciences this research provides a well-rounded discussion of the ECB.

In addition to a multidisciplinary approach, this research uses the comparative method.⁹ This method is defined as taking law as its object and comparison as its process.¹⁰ By comparing to the US FED this research will generate more context. This context is needed to provide an accurate picture of the ECB policies in context. Due to the previously mentioned economic and political complexity, this research has opted to look at only one other central bank: the FED.

According to Hirschl, there are four different types of comparative research in law. The fourth type of research aims to build a theory through causal interference. This type of research has

⁷ Katerina Linos and Melissa Carlson, 'Qualitative Methods for Law Review Writing' (2017) 84 U Chi L Rev 213, pp. 213-214.

⁸ Ibid.

⁹ Federico Fabbrini, *Economic Governance in Europe*. (Oxford University Press 2016)

¹⁰ Konrad Zweigert and Hein Kötz, *Introduction to comparative law. Vol. 1*. (Oxford: Clarendon Press 1987)

an aspiration to explain rather than describe.¹¹ This is the type of research that this thesis will conduct. Comparing to another central bank provides the context that allows evaluating whether the response of the ECB has upset its balance between independence and accountability. The comparison will be particularly relevant to examine whether and if so how unconventional some of the ECB's crisis measures are. It furthermore allows a more in-depth discussion of the accountability framework in practice. By comparing to the FED a more accurate analysis can be made as to the effectiveness of the accountability.

There is no, one set of how to compare legal systems but there are common aspects. This research has chosen to abide by the method laid out by Mark Van Hoecke.¹² Whereby this research opted to look at a central bank based upon similarities. The FED is similar in size to the ECB and has faced both the financial crisis and it has responded to the COVID-19 pandemic. The FED and ECB furthermore are both considered respectable institutions. Whilst the ECB is not located in a federal state it does face similar issues of decentralisation and different economies. The response of the court to the actions of the FED, however, is limited. Thus raising the question of whether the accountability of the FED is better established than that of the ECB. The main difference to consider between both institutions is their mandate. The FED has a broader mandate as it conducts monetary policy, banking supervision and promotes consumer protection and community development.¹³ This mandate is often summarized as a dual mandate with both monetary policy and full employment as objectives.¹⁴ Which is laid down in The Full Employment and Balanced Growth Act of 1978.¹⁵ Thus when comparing it will be reflected upon that the FED has a wider mandate.

1.4. Structure

To test whether the current pressure on the ECB has risen from an upset in the balance of accountability and independence it is necessary to first evaluate the concepts of accountability and independence. Chapter 2 will therefore give a brief introduction into how central banks have developed and why central banks are independent. Chapter 3 will discuss the relationship between accountability and independence. In addition, this chapter will describe the independence and accountability of the ECB and FED before the crises in more detail. This

¹¹ Ran Hirschl, The Question of Case Selection in Comparative Constitutional Law. *American Journal of Comparative Law*, (2005) 53(1), Available at SSRN: <https://ssrn.com/abstract=901700>, p.131.

¹² Mark Van Hoecke, Methodology of Comparative Legal Research. *LaM* (2005), p. 1-35.

¹³ Federal Reserve System, 'About the FED', (last updated 06 December 2018), <www.federalreserve.gov/aboutthefed/pf.htm> accessed 01 March 2019.

¹⁴ Daniel L. Thornton, 'The Dual Mandate: Has the FED changed its objective?', *Federal Reserve Bank of St. Louis Review*, March/April 2012, 94(2), pp. 117-33
<https://files.stlouisfed.org/files/htdocs/publications/review/12/03/117-134Thornton.pdf?utm_campaign=Twitter&utm_medium=SM&utm_source=Twitter>.

¹⁵ The Full Employment and Balance Growth Act 1978.

chapter will close with a conclusion on the balance between independence and accountability of both banks before the financial crisis.

Chapter 4 will examine the role of the ECB in response to the euro crisis and pandemic through its conventional policies. Chapter 5 will analyse the role of the ECB in response to the euro crisis through its unconventional policies. Chapter 6 will then focus on the response of the ECB to the economic fallout of COVID-19 and compare these to the actions taken by the ECB during the euro crisis. Chapter 7 will continue by evaluating the crisis case law first the independence and then the accountability perspective through judicial review. The thesis will then continue by examining the other forms of accountability and their effectiveness in chapter 8. The dissertation will conclude in chapter 9 with final remarks and answer the question of whether the balance between accountability and independence is upset.

2. Central Bank Development and Independence.

2.1. Introduction

The main research question of this thesis is to examine whether the balance between independence and accountability of the ECB has changed and if this led to the intense judicial review. To answer that question, it first needs to be examined why central banks are independent. Second, it is necessary to establish what forms of accountability central banks do experience. This chapter will therefore first analyse how central banks were given shape and what central bank independence is. This will aid in the understanding of the design of central banks. As such, this chapter will be structured as follows. Section 2.2. will examine in historical perspective the developments of central banks. Section 2.3. will focus on the development of Central Bank Independence. Section 2.4 will continue by discussing inflation goals, why do central banks have inflation mandates? Section 2.5 will discuss some examples of different types of central banks. Together these sections will join in a conclusion on the development of central banks and their independence.

2.2. The development of Central Banks

This chapter gives a brief introduction to the development of central banks and how they developed into their current institutional design. To achieve these goals this chapter will first provide a brief analysis of the development of central banks. Additionally, some general theories surrounding central bank development will be discussed too. Three examples will be discussed in more detail: the Bank of England (BoE), De Nederlandsche Bank (The Netherlands) and the Bundesbank (Germany). These three examples complement each other as two developed on the continent and the other in England. Additionally, they provide examples of two different types of development. The BoE was created by the government to serve the needs of the then king and queen. The Dutch Central Bank on the other hand has its origins in a commercial bank and grew into the central bank through economic circumstances. The German Bank has been added since it has known a rather special development. Furthermore, the German Central Bank has served as the foundation for the creation of the ECB. It is therefore especially interesting to look at the why and how the German Central Bank has been developed. Following the general discussion on the development of central banks will be a brief introduction to Central Bank Independence.

Central Bank Independence(CBI) is the term used for the rationale behind independent central banks. This theory is the main reason for the current independence of central

banks. This theory will be discussed in two parts. First, the original theory as developed in the 1970s and 80s will be discussed. The question that will be answered is what economic insights led to the creation of independent central banks. When this question is answered the next aim is to sketch an overview of the current state of the theories surrounding CBI. Economic insights develop, as with many other topics the ideas surrounding CBI have been criticized. These criticisms will be discussed to provide a good overview of the current state of affairs.

When an overview of the current state of affairs is provided, this chapter will conclude by looking into some central banks. This chapter will not embark on a detailed comparative analysis but merely aims to demonstrate how CBI is given shape in practice and over time. The examination of the different central banks will therefore remain superficial and brief, in this chapter.

Central Banks are an institution created by mankind. The history of central banks and Central Bank Independence is best to split into two categories: pre and post-1914. With the proclamation in 1914 of the so-called fiat regime and shift towards currency holding systems, central banks entered the modern phase.¹ The following paragraphs will briefly describe the early history and origins of central banking. After describing the early history of banking these paragraphs will give a more in-depth overview of the modern models of central banks and their development. Before starting with the history of central banking, however, this thesis will cover another important discussion. The debate that will be briefly discussed is that of why central banks developed? What motivated central banks to be developed or generated? The following paragraph will start with a brief discussion of these questions. These theories aim to place perspective upon different political and economic biases that are held.

2.2.1. The theories of central bank development:

The important question to ask before discussing central banks in more depth is why these institutions were developed. Central banks are not found in nature and are thus a human invention. These inventions developed into full institutions under the influence of monetary/economic and political circumstances.² To better understand this invention and the motives driving the development of these institutions, this thesis will examine several theories. These theories aim to explain why central banks were created.

The first important school of thought that concerns central banks is the Modern Free Banking School or MFB. This theory states that central banks are a political invention

¹ Bertrand Blancheton, 'Central Bank Independence In A Historical Perspective. Myth, Lessons And A New Model' (2016) 52 Economic Modelling, p. 102.

² Ronald Uittenbogaard, *Evolution of central banking? De Nederlandsche Bank 1814-1852* (Ph.D. Utrecht University 2014), p. 11.

and that because of their function as lender of last resort create the financial instability of banks. These scholars tend to focus on the choices made between competition and monopoly.³ Smith examined the Scottish, French, German, English and US history of central banking. Smith's study concludes that the creation of central banks is more a historical series of accidents and political motives than based upon a real economic foundation.⁴ These scholars tend to be critical of the concept of a central bank. Key in the argument is the currency monopoly held by governments via their central bank and lender of last resort function. Argued by MFB is that the monopoly on currency tends to create inflation. This inflation is promoted by the government as it is taxation without legislation.⁵ Concerning the lender of last resort function; this school argues that a lender of last resort function destabilises the sector and therefore banking crises are more likely to occur under a central bank system than under competitive banking systems.⁶ The reason for this destabilizing effect is subscribed to the moral hazard of bailing out. Moral hazard states that banks are taking the extra risk because the shareholders take the profit, whilst the possible losses will be partially carried by society.⁷ Society carries these costs when the central bank or government bails out the bank at risk of bankruptcy.

The Free Banking School was strong in the nineteenth century and made a comeback in the 1980s.⁸ At present many economists at the Austrian school of economics still plead the case against central banks.⁹ The main suggestion in this school is that central banks were created by governments to generate income. Uittenbogaard names this principle the 'fiscal theory'.¹⁰ This theory has not gone without criticism. Goodhart agrees with most of the MFBS but argues that it is economic to have a large scale bank. It is however the fractional banking system that leads to instability.¹¹ The main historic evidence for this theory is that of the Bank of England, which shall be discussed later.¹² The Free Banking School was not the only school of thought that developed. The second large school of thought is that based on the free-rider argument.

³ Vera C. Smith, *The Rationale of Central Banking and the Free Banking Alternative*, Foreword by Leland Yeager (Indianapolis: Liberty Fund, 1990). 4/11/2018.

http://oll.libertyfund.org/titles/1413#Smith_0100_83, chapter 1.

⁴ Ibid.

⁵ Uittenbogaard 2014, p. 12.

⁶ Shirley Gedeon, 'The Modern Free Banking School: A Review.' (1997) 31(1) *Journal of Economic Issues*, pp.209-222, p. 209.

⁷ Gregory Moore, 'Solutions To The Moral Hazard Problem Arising From The Lender-Of-Last-Resort Facility' (1999) 13 *Journal of Economic Surveys*, p. 444.

⁸ Uittenbogaard 2014, p. 11.

⁹ Thomas DiLorenzo, 'The Corrupt Origins of Central Banking.' *MISES DAILY ARTICLES* (2017). [online] Available at: <https://mises.org/library/corrupt-origins-central-banking> [Accessed 18 Apr. 2018].

¹⁰ Uittenbogaard 2014, p. 15.

¹¹ Goodhart 1988, 85-102.

¹² Uittenboogaard 2014, p. 19.

In his paper, Broz argues that central banks were developed to stop free-riding.¹³ In his paper, the argument is put forward that the benefit of central banking is that of state finance and investor confidence. This benefit is non-excludable and people will therefore prefer free-riding over actively participating. The creation of central banks according to Broz was by combining the non-excludable public benefit with the excludable private benefit of monopolies on rent. This combination led to the rising of central banking, according to Broz.¹⁴ His research shows that indeed many of the initial central banks were created to fund wars for the state and were given privileges in return.¹⁵ Another observation worth mentioning is that of Adam Smith.¹⁶

In his work Smith observes that there is a trade inconvenience of exchange rates.¹⁷ He notes that the bank of Amsterdam¹⁸ has generated a system guaranteed by the city to solve this problem. This system takes away uncertainty and thereby improves trade.¹⁹ These observations seem to suggest that central banks were born from the banks focussing on trade facilitation.

In conclusion, there is not one clear theory on how central banks rose or why they were created. The FBS argues against the creation of central banks and emphasizes the profits being made by governments. Other theories argue that they are a product to improve fiscal stability and/or trade. Therefore the combined important aspects to consider when looking at the history of central banks are the involvement of the government, privileges given to the banks and the role of trade. These aspects will be focussed upon in the next paragraphs describing the history of three central banks.

2.2.2. The early history of Central Banking:

The origins of central banking lie with the private banking industry. These private banks developed by law and circumstance into the modern central banks. Whilst private banks, however, have been around in Europe since the 13th century,²⁰ centralized central banks were not established until the 18th century. Before the 18th century, the functions of central banks were taken on board by private banks. These private banks would perform

¹³ J. Lawrence Broz, 'The origins of central banking: solutions to the free-rider problem' (1998) 52(2) The MIT Press, 231-268.

¹⁴ Ibid, p. 235.

¹⁵ Ibid, p. 240-241.

¹⁶ Adam Smith, 'An Inquiry into the Nature and Causes of the Wealth of Nations' (5th edn, Methuen & Co 1776).

¹⁷ Ibid, p. 3.13.

¹⁸ In this day and age the: *Amsterdamsche Wisselbank*.

¹⁹ Smith 1776, p. 3.14-3.16.

²⁰ Jack Rasmus, 'Central bankers at the end of their rope? monetary policy and the coming depression.', (Atlanta: Clarity Press 2017), p. 30.

central bank functions such as bailing out other banks, but only in limited amounts and driven by profit.²¹ A good example of this type of development is the Bank of England.

The Bank of England was established in 1694 as a private bank. Originally it was created by King William and Queen Mary to fund the war against France.²² Though the original deed of establishment states the bank to be founded to '[...]promote the publick Good and Benefit our People [...]'.²³ The Bank did however assume the function of government bank upon creation, a function normally associated with modern central banks. Though created for the public good, it could not yet be considered a central bank and it would take another 150 years to become a proper central bank.²⁴ This development was very gradual. It would assume the role of "lender of last resort" during the South Sea Bubble in 1720 for the smaller banks.²⁵ This role of lender of last resort (LOLR) developed further during the Overend Gurney-panic in 1866.

When Overend Gurney, a London wholesale bank, went bankrupt the Bank of England refused to lend money to the company, claiming '*the firm was so rotten*'. After this refusal a panic erupted on the streets of London, the day would later be dubbed as 'Black Friday'. The Bank of England requested and was granted suspension by Parliament; allowing the Bank to issue banknotes uncovered by gold.²⁶ This episode confirmed the Bank of England's role as lender of last resort. Furthermore, these events caused the discussion about bail-outs and moral hazards. This discussion gave birth to Bagehot's principles for central bank lending.²⁷ Bagehot argued that in a time of crisis a central bank should lend quickly, freely and readily against sound collateral and with such interest rates as to scare those not in need. When Bagehot introduced his principles, they were criticized by Thomas Haney, a former governor of the BoE, as "*the most mischievous doctrine ever breathed in the monetary or banking world*".²⁸ Bagehot's doctrine is, however, still applied by central bankers today.²⁹

Other noteworthy dates in the Bank of England's development include the Bank Charter Act of 1844 during which the Bank was given the monopoly to generate banknotes and coins.³⁰ The Bank was nationalized under the Attlee government in 1946 thereby making

²¹ Rasmus 2017, p. 31.

²² Bank of England <www.bankofengland.co.uk>

²³ THE CHARTER OF THE CORPORATION OF THE GOVERNOR AND COMPANY OF THE BANK OF ENGLAND(1) [27 July 1694]

²⁴ Rasmus 2017, p. 31.

²⁵ Jason Rodrigues, 'The Bank of England: a brief history Key moments in the development of the second oldest central bank in the world.' *The Guardian* (8 January 2009).

²⁶ Rhiannon Sowerbutts, The demise of Overend Gurney (2016)2 Bank of England Quarterly Bulletin, p. 99.

²⁷ *ibid*, p. 102.

²⁸ Charles P. Kindleberger, *A Financial History of Western Europe* (Oxon: Routledge 2006), p. 92.

²⁹ The Economist, 'What Would Bagehot Do? Should Central Banks Act As Buyers Of Last Resort?' (2007) <<https://www.economist.com/finance-and-economics/2007/08/16/what-would-bagehot-do>> accessed 8 November 2019.

³⁰ Bank Charter Act 1844.

it an instrument of the government and it was not given operational independence until 1997.³¹ Thereby creating the Bank of England as the central bank as it is currently known. The Bank of England is not the only central bank that underwent this type of evolution.

De Nederlandsche Bank ((DNB)(The Dutch Bank)) was established in 1814 and is thereby one of the five oldest central banks. It was established by King William I to promote trade.³² It was created as a private bank under what would currently be considered a public limited firm.³³ When the Netherlands was liberated after the Napoleonic wars the national debt was high. In a process to restructure these debts and invest in the country the DNB was forced to lend to the state, thereby becoming a lender to the government.³⁴ During the later years, the DNB gradually developed from a lender to industries to a lender to banks. This change was partially due to the mandated geographical spread of the bank and partially due to commercial changes. The DNB had more precious metals in its vaults and was thereby able to lend more money. The other commercial banks, however, offered a more varied amount of services. Therefore the firms preferred using the services of the other smaller banks; in turn, these banks covered this amount of money by lending from the DNB.³⁵ This gradual change led to the DNB increasingly requesting access to the books of other private banks and thereby becoming the banking sector supervisor. The bank remained the largest private bank in the country until 1860. Though the tasks it assumed are what would currently be part of tasks of central banks, other tasks were virtually absent at the time.³⁶ According to Mooij and Prast, the increase of its 'normal' credit facility task was due to the increased economic output in the Netherlands during the latter half of the 19th century.³⁷

This supervisory role was increased during the First World War and the recession of 1929. The recession also caused the DNB to act as a lender of last resort.³⁸ A state committee was brought into existence to investigate whether it was necessary to nationalize banking supervision. This committee was cut short due to the Second World War.³⁹ After the War, this task was bestowed upon the DNB in 1948. This law nationalized the DNB and formally transformed it into a modern central bank. Despite its modernity, it was not as independent. The minister of Finance was allowed to give directions to the Bank to coordinate the monetary and financial policy.⁴⁰ The DNB

³¹ Rodrigues 2009.

³² Uittenbogaard 2014, p.34-35.

³³ De Nederlandsche Bank 2016, p. 3

³⁴ Uittenbogaard 2014, p. 36.

³⁵ De Nederlandsche Bank 2016, p.4

³⁶ Joke Mooij and Henriette Prast, 'A Brief History of the Institutional Design of Banking Supervision in the Netherlands.' (2002) 73(48) Research Series Supervision, p. 4

³⁷ Ibid, p. 4.

³⁸ Uittenbogaard 2014, p. 41.

³⁹ De Nederlandsche Bank 2016, p. 5

⁴⁰ Ibid, p. 6

became truly independent in 1998 under the influence of joining the European Monetary Union. Thereby becoming the fully independent bank it is today.

The development of the Bank of England and De Nederlandsche Bank show how private banks turned into modern-day central banks. As the story of the BoE and DNB shows central banks were not created overnight, rather it was an evolution shaped by economic and political circumstances. It also indicates that while both banks were created as a lender to the government; the BoE developed into its role via its function as LOLR whilst the DNB developed via supervisory tasks and trade influences.

The rapid development of central banks in the mid-19th century coincided with the Industrial Revolution. The central banks were needed as capital and production expanded.⁴¹ Though the Industrial Revolution demanded the increase of central banks by 1900 there were only 18 central banks, in 1920 this number had increased to 23. It was not until after 1920 that the rapid introduction of central banks arose, and by the year 2000, a near 200 central banks had been created.⁴² Important in this respect is that central banks have been created roughly 200-years ago. Different banks developed at different paces and with different circumstances. An interesting case to note is that of the German Central Bank, this bank has developed in a different process.

2.2.2.1. The German Central Bank

The German Central Bank is often credited as the most independent of the different central banks. It can also be named a bit of a phoenix bank as it has been destroyed and recreated several times. Since World War II the Bank has seen four major transitions. It started in 1948 as the Bank deutscher Lander as a two-tier system, whereby the regional offices in the Lander were independent. The central coordination was conducted by the Zentralbankrat. This system was changed into a one-tier system in 1957. In 1990 after the fall of the Berlin Wall the Bundesbank was created as the bank for unified Germany, introducing a new currency. Then in 1993, the Maastricht Treaty entered into force and the Bank joined the European System of Central Banks (ESCB).

Its independence did not arise voluntarily but was forced upon the Reichsbank by the allies in 1922. The Reichsbank had been buying too many government bonds to help pay for the reparations. This process had severely damaged the value of the Reichsmark. In response, the allies forced independence upon the Bank, without effect.⁴³ Howells & Bain argue that this and the later conversion of Reichsmark into Deutschmarks was what caused the German aversion against inflation. During the conversion, the German

⁴¹ Rasmus 2017, p. 31.

⁴² Ibid, p. 36.

⁴³ Peter Howells and Keith Bain, *The Economics Of Money, Banking And Finance* (Prentice Hall/Financial Times, an imprint of Pearson Education 1998), p.337-338.

savings were drastically reduced hence the shared aversion amongst institutions and thereby explaining the high independence of the central bank.⁴⁴ Additionally, the currency had been used and abused during several German eras, including the Nazi.⁴⁵ Lohman states that independence is a way for politicians to isolate monetary policy from political influence.⁴⁶ This theory seems valid, though the question of why this system was chosen is still not definitively answered. Both the theory surrounding political cycles and central bank independence were generated after the establishment of the Bundesbank. To fully understand the independence of the German Bank the founding documents must be examined.

The independence of the Bank was one of the main discussion points during its creation.⁴⁷ Interesting is the standpoint the Bank deutscher Lander took in achieving its independence. During the negotiation about its independence, the Bank deutscher Lander(BDL) strove for its independence from the government. Its council stated that *"The Central Bank Council, with complete seriousness and gravity, finds that the independence of the central bank system (...) is an absolutely decisive element of securing the currency's stability and maintaining confidence in the currency. [...]The validity of this belief becomes particularly apparent in today's Germany, whose population saw its currency collapse twice in the space of a human lifetime owing to actions by the government; the population is therefore understandably particularly suspicious of government influence on senior central bank officials."*⁴⁸ This statement clearly shows that the BDL was afraid of more political abuse of the currency. This fear seemed to have been the driving factor behind their quest for independence. This is also reflected by the discussion's referral to the submission of the Bank to the different political interests.

The documents refer to the several different periods and the different forces the Bank was submitted to. The question is even asked whether an independent central bank could be the next government.⁴⁹ This question is understandable as this discussion took place in a period when Germany was ruled by a combination of the allies and the Soviet Union. This is not to say that there was no criticism towards an independent bank, nor that questions weren't raised on how exactly the independence should be given shape.⁵⁰ Vocke president of BDL from 1948-1957 argues in his speech in 1955 that the bank should be independent of interest groups, including the economic council and politics. Without an independent central bank, there would not be a stable currency, which is in

⁴⁴ Ibid.

⁴⁵ Otto Nathan, 'Nazi War Finance and Banking.' (1945) 12(48) *Economica*, p.264.

⁴⁶ Susanne Lohmann 'Federalism and Central Bank Independence: The Politics of German Monetary Policy, 1957-92'. (1998) 50(3) *World Politics*, pp.401-446, p. 402.

⁴⁷ 30 Jahre Deutsche Bundesbank, p. 113.

⁴⁸ www.bundesbank.de >> Redaktion >> topics >> bank independence

⁴⁹ 30 Jahre Deutsche Bundesbank, P. 113.

⁵⁰ Ibid, p. 114.

the interest of the greater good.⁵¹ In his speech, he refers mostly to the interest groups of different parties, rather than other economic benefits. It, therefore, seems that the ideas of Howels and Bain and Lohmann are correct in assuming it was the German history of inflation and currency corruption that motivated such an independent bank.

At the time this independence was fairly unique as the (economic) benefits of independent banks would not be discovered till later. Despite its high independence, the Bundesbank was not a cautious bank. It was heavily involved in the development of a German economic policy.⁵² On the contrary, some have argued that the Bank was never a single player in these developments.⁵³ At this point, it should be noted that though the Bundesbank is considered one of the most independent central banks, this statement is slightly controversial. The Bundesbank Act of 1957 was an ordinary statute that could have been changed via the ordinary procedure. Lohmann, therefore, argues that the independence was only independent due to its embeddedness within the federal structure of the institutions.⁵⁴ This embeddedness and respect were partially gained by accident. In 1956 the chancellor of Germany, Adenauer, launched an attack upon the Central Bank after it had raised interest rates. The press, however, took the opposite stance and praised the Bank and its director Vocke. Thereby isolating Adenauer and socially embedding the independence of the central bank.⁵⁵

In conclusion, the German Central Bank was the odd bank out regarding its independence and development. The case also clearly shows that regardless of economic theory some decisions are made upon political sentiment. Before discussing the general theories of the advantages of independent central banks, this chapter will briefly discuss the theory of modern central bank development. The next paragraphs will aim to answer what general stages can be distilled from the 20th-century development of modern central banks. This question will be answered using the work from Blancheton.

2.2.3. The modern central banks:

As can be deduced from the previous paragraphs the history of central banks is ever moving. Though different central banks have known different stadia and different paces of development, most of this development has taken place in the 20th century. The US FED itself was created in 1913 by the Federal Reserve Act. Additionally, the developments that took place during the previous century have transformed central

⁵¹ Ibid, p. 132.

⁵² William Paterson, David Southern and G. Peele, *'Governing Germany'* (Oxford: Blackwell 1994), p. 230.

⁵³ Peter. Pulzer, *'German Politics 1945-1995.'* (Oxford: Oxford University Press 1995), p. 131.

⁵⁴ Lohmann 1998, p. 401.

⁵⁵ Simon Mee, 'Central banking independence, historical narratives and the Bank deutscher Länder, 1948-1957', p. 4-5 < http://bankinghistory.org/wp-content/uploads/Mee_paper.pdf>.

banks into modern institutions. The following paragraphs will look at the development of modern central banks using the three stages developed by Blancheton.⁵⁶

The first recognized model is the 'Bank of issue model'.⁵⁷ This model is based on the gold standard regime. According to Blancheton, there were still many different models around but dominant was the bank of issue model. Under this model, the banks generally had a monopoly of issuance and assumed the task of lender of last resort. This model slowly changed with the introduction of the fiat currency system in 1914. A greater emphasis was placed upon the possible independence of central banks. This independence was, however, incompatible with the budgetary policy. The accommodating nature of central banks led to either great inflation or devaluations.⁵⁸

The instabilities led to new thinking about central banks. Many central banks were nationalized in the 1930s thereby giving the government a certain level of control over the bank. This new model is defined by Blancheton as the 'public central bank model'.⁵⁹ This process of nationalization rapidly expanded during the 1940s in both Europe and on an international scale.⁶⁰ The main exception to the rule was the development of the German central bank. This bank remained under Nazi control during the prelude to and the war.⁶¹ After the war, public debate about the independence of a central bank had started in 1951.⁶² In 1957 the Bundesbank was created and arguably one of the most independent central banks.⁶³ The independence of central banks became more present during the end of the 1970s.

In the late 1970s more research surfaces that argue that an independent central bank reduces inflation. These studies influenced the political debate surrounding the future of central banks. A wave of independent central banks followed. This new model is defined as the independence model for central banks.⁶⁴ This model is currently still the most well-known and is abided by, even by the ECB.

In conclusion, it is important to note that the modern development of central banks has not been straightforward. The last two phases of modern development are in contrast with each other. As Blancheton notes the development of central banks has never been completed. Current questioning of the Central Bank Independence theory could lead to a completely new banking model.⁶⁵ The questioning of central bank models often coincides with crises. The role of central banks was questioned during the era of the

⁵⁶ Blancheton 2016.

⁵⁷ Ibid, p. 102.

⁵⁸ Ibid.

⁵⁹ Blancheton 2016, p. 102.

⁶⁰ Ibid, p. 103.

⁶¹ Nathan 1945, p. 5.

⁶² John Goodman, 'The Politics of Central Bank Independence.' (1991) 23(3) Comparative Politics, p. 337.

⁶³ Ibid, p. 338.

⁶⁴ Blancheton 2016, p. 103-104.

⁶⁵ Ibid, p. 104.

Great Depression, the inflationary era of the 1960s and 1970s and again during the credit bubble of the 2000s.⁶⁶ Recently central banks have been criticised for their lack of predicting future scenarios accurately. This makes it harder to justify granting such powers to unelected technocrats.⁶⁷ Though not all times the central banks have been criticised it has led to great changes, the history of central banks shows that their institutional design is not carved in stone. Improvements have been made in the past and can be made in the future. As will be shown the current ideas surrounding Central Bank Independence are being questioned. When examining the works of De Haan, Eijfinger and other scholars a question for balance between independence and accountability seems to prevail. Before however, questioning these balances the concept of Central Bank Independence deserves a bit more attention.

2.3. Central Bank Independence

Central banks take important decisions but their design protects them from various levels of oversight. The question is why they are designed to contain such levels of independence. This has to do with the theory of Central Bank Independence.

The general concept of independence is very simple. It is argued that politicians have both inflationary and employment objectives. These objectives would be to have low inflation and a high level of employment. When politicians face elections it is easy to imagine that they will place employment objectives above inflation objectives.⁶⁸ This means that they will print money to pay for public works and thereby, temporarily, lower unemployment levels. Problematically, when this process has started it is very difficult to reverse. Politicians attempting to reduce or cut the printing of extra money will be faced with a rise in unemployment. Thus creating the incentive to continue printing money, which leads to long-term inflation and creates the risk of hyperinflation. This conundrum of electoral cycles has also been referred to as the electoral politics hypothesis.⁶⁹ These risks led to the notion of separating governments from monetary policy.

The origin of the central bank independence theory is the work conducted by Kydland and Prescott in 1977.⁷⁰ In their research, they describe that decision making involves policies at both time T and all policies in the past. In addition, not only the policy choices but also the decisions taken in the past are taken into account when making the current

⁶⁶ The history of central banks. The battle of three centuries. 2017.

⁶⁷ Ibid.

⁶⁸ Marta Castello-Branco and Mark Swinburne, 'Central Bank Independence. Can it contribute to better inflation performance? Issues in theory and practice.' (1992) 29 Finance & Development, 19-21, p. 19.

⁶⁹ William Nordhaus, 'The Political Business Cycle.' (1975) 42(2) The Review of Economic Studies.

⁷⁰ Finn Kydland, and Edward C. Prescott, 'Rules Rather than Discretion: The Inconsistency of Optimal Plans.' (1997) 85(3) Journal of Political Economy, pp.473-491.

decision. This is what they describe as the 'consistent policy'.⁷¹ This consistent policy is however sub-optimal. The policy that is best under the given circumstances leads to excessive inflation without lowering unemployment. They, therefore, conclude that the policy of price stability is preferable.⁷² Crucial in their theory are the assumptions on how price expectations are determined. The authors indicate that a change in administration equals a change in the relative costs of inflation and unemployment. This change in the allocation costs is reflected by an equal change in expectations.⁷³ The cause for this suboptimal result is that there is no enforcement on future policymakers to take into account the decisions taken in the present.⁷⁴ In their article, Kydland & Prescott do not explicitly suggest the independence of central banks. They suggest looking at institutional options to increase the difficulty of changing policy measures.⁷⁵ Additionally, their ideas concerning future policy implementation and market expectations are currently embodied in the term credibility. The term credibility asks the question to what extent are policymakers convincing when they speak of future policies? Their research however does not suggest a central banker more conservative than society in order to maintain low inflation.

The first to argue the economic benefits of conservative central bankers was Rogoff.⁷⁶ In his research, he examines the benefits of appointing 'conservative' central bankers as a way to counteract inflationary biases. Conservative according to Rogoff is that the banker is more inflation averse than the government. The other option would be the model whereby the central bank is both responsible for the level of inflation and the level of unemployment.⁷⁷ However, neither does Rogoff recommend a central banker who cares too little about unemployment.⁷⁸ In this model, the bank would be given a certain degree of flexibility to be able to cope with shocks in the supply chain. He did not argue that the bank should be completely discretionary, rather in-between rigid and discretionary.⁷⁹

A central bank would gain credibility when the monetary policy would be determined by apolitical officials.⁸⁰ Arguably these technocrats can take into account long-term views because they do not have democratic accountability. During the creation of this concept, the issue was raised that such independence might be contrary to democratic principles. However, it was argued that no central bank was ever fully independent of

⁷¹ Kydland & Prescott 1977, p. 475-477.

⁷² Kydland & Prescott 1977, p. 447.

⁷³ Kydland & Prescott 1977, p. 448.

⁷⁴ Kydland & Prescott 1977, p. 481.

⁷⁵ Kydland & Prescott 1977, p. 487.

⁷⁶ Kenneth Rogoff, 'The optimal degree of commitment to an intermediate monetary target.' 1985 *The Quarterly Journal of Economics*, pp.1169-1189.

⁷⁷ Rogoff 1985, p. 1169.

⁷⁸ Rogoff 1985, p. 1176.

⁷⁹ Rogoff 1985, p. 1170.

⁸⁰ Castello-Branco & Swinburne 1992, p. 19.

the government. As the ultimate cure, the government could always change the central bank statutes.⁸¹ Furthermore, the bank has an interest in avoiding conflict with the government, since this organ can change its status. As a result, the bank would not conduct too extreme a monetary policy.

The two main important concepts flowing forth from this general idea is; independence and monetary aim. The first was best described by an article from Neyapti, Cukierman and Webb. The latter is defined by inflation bias, both will be discussed briefly.

The idea of an independent central bank assumes a clear standard for the definition of 'independence'. This definition, though imperfect, is best described in the research of Neyapti, Cukierman and Webb.⁸² In their research, they generate two main groups of criteria of independence: legal independence indicators and informal indicators of independence.⁸³

Legal independence looks at how independent a central bank is by law. This category is split up into four different sub-criteria. The first criterion is that of the CEO's appointment, dismissal and term. The second looks at how the mandate is formulated. The third criterion looks at the objectives and the last assess the goals of the bank.⁸⁴ Additionally, Cukierman et. al. provide evidence that actual and legal independence might differ. In their research, they discuss the criterion of actual turnover rates of central banks' governors. In doing so it is shown that legal and factual independence may vary.⁸⁵ Other than using the governor's turnover rate this criterion is supplemented by using a questionnaire. This questionnaire was sent to a non-random sample of professionals. The response was used as another indicator of actual independence.⁸⁶ Unfortunately, their research does not specify who was included in the sample selection, who responded and what their or the responses were. This makes the latter criterion difficult to assess. Table 6 in their research shows that the only significant correlation between factors is between legal and questionnaire-based independence.⁸⁷ The latter is unfortunate as their research results indicate that this is one of the more important aspects. Running a regression showed a minor relationship between the legal independence of the bank and inflation levels. In table 7 a regression table shows that the r^2 -value is only 0.26.⁸⁸ Thereby indicating that independence only explains 26% of the results; in this case inflation levels. Though this result is a little higher for industrialized countries it does not make for a very convincing substantive significance.

⁸¹ Castello-Branco & Swinburne 1992, p. 20.

⁸² Alex Cukierman, Steven B. Webb and Bilin Neyapti, 'Measuring The Independence Of Central Banks And Its Effect On Policy Outcomes' (1992) 6 The World Bank Economic Review.

⁸³ Cukierman, Webb & Neyapti 1992, pp. 361-369.

⁸⁴ Cukierman, Webb & Neyapti 1992, p. 358.

⁸⁵ Cukierman, Webb & Neyapti 1992, p. 363.

⁸⁶ Cukierman, Webb & Neyapti 1992, pp. 367-368.

⁸⁷ Ibid, p. 369.

⁸⁸ Ibid, p. 372.

The results indicate a 34% explanation of independence on inflation levels. That is a big influence for a single factor, yet it also indicates that the majority of the level of inflation is not explained by independence.

After the recent introduction of the concept of CBI, Temple's research shows that the connection between CBI and inflation is present in most high-income countries but not all. In his research, Iceland and Switzerland show high inflation despite the relative independence of their central banks.⁸⁹ He argues that these are observational biases and concludes that his research does confirm the relationship between inflation and independence.⁹⁰ Though this seems a valid statement, arguably it must be concluded that the mere fact of having an independent central bank does not guarantee low inflation. The latter statement has been put forth in the research done by Campillo and Miron. In their research, they show that institutional arrangements are not effective without underlying conditions. The conditions needed to generate low inflation are openness, political stability and tax policy. These fundamentals play a large role. Institutional arrangements are no guarantee of either low inflation or a quick fix.⁹¹ Later research done by Klomp and De Haan suggests that only in 20% of the countries CBI has a significant effect.⁹² The major difference in the research of Temple and that of Klomp and De Haan is that of the standards used. Whilst Temple examines a rather general relationship, the paper of Klomp and De Haan uses more dummy variables. The latter research, therefore, corrects for more variables than that of Temple. The relationship between CBI and inflation is however far from certain. Though Klomp and De Haan conclude there is no significant effect of CBI on inflation the research of Posso and Tawadros concludes the opposite. Their research indicates a strong negative relationship between CBI and inflation.⁹³

The general theory and concept of politicians increasing output via surprise inflation are still valid. Bodea and Hicks however argue that this theory is incomplete. Their research shows that CBI is more effective when complemented by increased factors of credibility.⁹⁴ They approach the concept from a credibility perspective. Arguing that the credibility of an independent central bank is what makes it effective. Thereby exploring how much the monetary outcome is dependent on the specific political institutions of a country.⁹⁵ They claim to have generated the ultimate unifying approach to political

⁸⁹ Jonathan Temple, 'Central Bank Independence And Inflation: Good News And Bad News' (1998) 61 *Economics Letters*.

⁹⁰ Temple 1998, p. 218-219.

⁹¹ Marta Campillo and Jeffrey Miron, 'Why Does Inflation Differ Across Countries?' in Christina D Romer and David H Romer, *Reducing Inflation* (University of Chicago Press 1997), p. 355-356.

⁹² Jeroen Klomp and Jakob De Haan, 'INFLATION AND CENTRAL BANK INDEPENDENCE: A META-REGRESSION ANALYSIS' (2010) 24 *Journal of Economic Surveys*, p. 452-453.

⁹³ Alberto Posso, and George Tawadros, 'Does greater central bank independence really lead to lower inflation? Evidence from panel data.' (2013)33, *Elsevier*, pp. 244-247.

⁹⁴ Cristina Bodea, and Raymond Hicks, 'Price Stability and Central Bank Independence: Discipline, Credibility, and Democratic Institutions.' (2015) 69(01) *International Organization*, pp.35-61.

⁹⁵ *Ibid*, p. 36.

economy research.⁹⁶ It is unlikely that there is an ultimate unifying approach; however, there is merit in the factors they have added. In their article, it is put forth that the law implementing process has a beneficial factor. In governments with a clear and transparent law implementing process, public expectations are more confident of non-inflationary policies. Additionally, the so-called veto players such as opposition and free press enhance this confidence.⁹⁷ The research theorizes that CBI in developed and democratic countries has a stronger impact than in dictatorships.⁹⁸ This makes sense as developed and democratic countries tend to have higher levels of press freedom and opposition. The results of the research show a trend indicating that these additional factors do affect the effectiveness of CBI. The idea that more factors are related to credibility is heard more often. Caravelis argues that an additional element that is needed is the benefits of organized interest groups. Arguing that organized interest groups would resist inflation. Therefore the financial sector plays an important role.⁹⁹ These results indicate that the generated theory concerning the benefit of these extra factors is indeed correct. The thesis is explained by the researchers that these extra factors enhance the credibility of the bank is, which controls price stability beyond the mere printing of money.¹⁰⁰

This idea of bank credibility being in a direct relationship with low levels of inflation did not go without criticism. Posen argues that rather than the independence of the central bank enhancing the credibility and thereby causing low inflation, the answer could be found in other areas. In his paper, he suggests that low inflation is caused by markets expecting the bank to strongly react to inflationary shocks.¹⁰¹ Therefore Posen's research is factoring the market's expectations into the theory of CBI.

Recently more criticism has arisen when it concerns the independence of institutional governors. The research of Cukierman et. al. considered independence to be the election and the functioning of the governors. Governors were independent when they could not be dismissed and their period was fixed. This fixed-term would make them independent; as governors could neither be dismissed nor re-elected this would allow them to operate independently of the government and its institutions. This view has been considered too limited in recent times. The question should be asked what happens after the bank governor is done? What job will they be given in return and for what favours? Independence has always been related to independence from governmental institutions. This type of independence is economically relevant when considering the government long-term credibility problem. The government credibility

⁹⁶ Ibid, p. 37.

⁹⁷ Ibid, p. 37.

⁹⁸ Ibid, p. 41.

⁹⁹ Georges Caravelis, *European Monetary Union*. (Aldershot: Avebury. 1995), p. 57.

¹⁰⁰ Bodea & Hicks 2015, p. 54.

¹⁰¹ Alberto Posen, 'Central Bank Independence and Disinflationary Credibility: A Missing Link?' (1995) SSRN Electronic Journal, p. 29.

problem takes the perspective of the market; does the market believe that the central bank operates independently of the government? The independence from the private sector is also an important question to take into consideration. If the private sector has a say in the determination of the monetary policy, it indicates a lack of public accountability. This type of independence has been questioned concerning politicians but should also be asked concerning bank governors.¹⁰² This question has been raised in a report from the Dutch Central Bank. In the report, it was considered that governors might be open to please future employers.¹⁰³ When looking at the FED it has been argued that Greenspan was reappointed as governor due to market pressures.¹⁰⁴ These types of market sentiments compromise the independence of the governor. Though independence from the government has its merits, it also allows governors to be more open to influences from the banking sector.¹⁰⁵ This is mostly the case when democratic representatives are unable to force transparency.

Additionally, independence in theory and independence in practice are two different things. As shown by Cukierman et al. the actual turnover rate of central bank governors may be higher in practice than in theory. Similarly one must take into account the independence that central bankers chose to take. In the U.S. Greenspan visited the White House quite often during Bush's presidency. The conversations with different members of staff have been kept secret but it allows one to question the independence of the FED. In the case of the ECB, the agenda of the president was kept secret and no such information existed.¹⁰⁶ As of November 2015, the diaries of all board members have been made public after external pressure.

The transparency report¹⁰⁷ points out that the ECB has not registered the practice of publishing its diaries to the Joint Transparency Register.¹⁰⁸ The Transparency Register was set up to improve transparency at EU-level decision making. Most importantly when registered private representatives have to register the interests they represent.¹⁰⁹ According to research done by the transparency report, the majority of entities supervised by the ECB have not registered. It is unlikely that the banking industry is not lobbying the ECB, this creates a lack of transparency.¹¹⁰ This idea is strengthened by the

¹⁰² Joris Luyendijk, *'Kunnen we praten?'* (Amsterdam: Uitgeverij Atlas 2017), p. 33-34.

¹⁰³ DNB Working paper 2016, p. 3.

¹⁰⁴ E. Ray Canterbury, *Alan Greenspan: The Oracle Behind the Curtain* (Wolf Scientific Publishing 2006), p.x.

¹⁰⁵ Gustavo Piga, 'Dependent and Accountable: Evidence from the modern theory of central banking.' (2000) 14(5) *Journal of Economic Surveys*, p. 587.

¹⁰⁶ Edin Mujagic, *Geldmoord. Hoe De Centrale Banken Ons Geld Vernietigen* (4th edn, Balans 2013), p. 139-140.

¹⁰⁷ Transparency International EU (2017). *TWO SIDES OF THE SAME COIN? INDEPENDENCE AND ACCOUNTABILITY OF THE EUROPEAN CENTRAL BANK*. [online] Available at: http://transparency.eu/wp-content/uploads/2017/03/TI-EU_ECB_Report_DIGITAL.pdf [Accessed 20 Apr. 2018].

¹⁰⁸ *Ibid*, p. 35.

¹⁰⁹ [ec.europa.eu >> transparency register](http://ec.europa.eu/transparency/register).

¹¹⁰ Transparency International EU, 2017, p. 36.

fact that the European Banking Federation has set up its lobbying offices in Frankfurt.¹¹¹ Furthermore, a quick examination of the diaries of the different board members shows many meetings with the private sector.¹¹² Therefore when considering accountability the relationship between governors and parliament rather than market forces will be given extra consideration.

Before ending the discussion on independence attention must be given to some of the criteria used by Cukierman, Neyapti and Webb. The main criterion that needs attention is that of the objectives. Cukierman, Neyapti and Webb code the objectives as the more focussed on price stability the more independent the central bank.¹¹³ The most independent are banks with a single mandate for price stability. The least independent are banks whose mandate includes terms like full employment. In between, there are the banks charged with price stability and objectives such as a stable banking sector.¹¹⁴ Considering that their research focuses on the relationship between independence and inflation the motivation is logical. If a bank can focus solely and independently on price stability one expects less inflation. The relationship in this research is however not focussed on inflationary goals but accountability mechanisms. The latter is a legal rather than economic concept. In law, one should examine the rules of delegation and institutional balance.

The place of a central bank is difficult to precisely define. Goodhart and Lastra state the bank is both an agency and a bank.¹¹⁵ The ECB on the other hand is one of the largest European Supranational Institutions.¹¹⁶ Central banks are different from most independent agencies as they are usually more independent. Whilst independent agencies often find themselves subordinate to an institution, central banks are more in a horizontal line with the legislative and executive institutions. Though their position is different from independent agencies the principles of the Meroni-doctrine and institutional balance seem appropriate. It would therefore be incorrect to state that the narrower the mandate the more independent the bank and then to equate this to accountability. The more independent the bank the more accountability is needed. However, the more narrow the mandate it seems the less accountability is needed.

In conclusion, independence is a difficult concept with many facets it is however important to realize that central bank independence contributes to price stability. This leads to the next important aspect of CBI; that of monetary aim.

¹¹¹ Ibid.

¹¹² Ibid p. 35 → table 8.

¹¹³ Neyapti, Cukierman & Webb 1992, p. 357.

¹¹⁴ Ibid.

¹¹⁵ Goodhart & Lastra, p. 2.

¹¹⁶ Dorothee Heisenberg and Amy Richmond, 'Supranational Institution-Building In The European Union: A Comparison Of The European Court Of Justice And The European Central Bank' (2002) 9 Journal of European Public Policy, p. 201.

2.4. Inflation goals

Hyperinflation is defined as prices rising by more than 50% per month.¹¹⁷ Though hyperinflation is not common, the results are shocking. These tragic results are the consequence of the discrepancy between the availability of currency and commodities. Hyperinflation can only occur when a fiat currency can no longer be transferred into a commodity. This is the result of a currency being printed without natural constraints.¹¹⁸

The most recent hyperinflation in history was in Venezuela and Zimbabwe. The Zimbabwean period started from the early months of 2007 until it introduced the US dollar in 2009.¹¹⁹ The inflation in Zimbabwe has been estimated to have reached 89.7 sextillion per cent.¹²⁰ The human implication of such inflation is the lack of conversion opportunities. A day's wages cannot afford the groceries when purchased the next day or the next hour, resulting in the infamous 'billionaire starving' protest signs. The resulting circumstances of hunger and disparity are not country-specific. The most recent example of a country close to hyperinflation is Venezuela. The prices are rising at a rate of 400% per year; though not enough to qualify as hyperinflation it already led to the scarcity of food and medicine.¹²¹ Hyperinflation is not something a country would strive for. Thereby explaining the need to control price levels, however not explaining why most central banks are charged with aiming for a low, but, inflation nevertheless.

The aim for inflation is explained by the fear of deflation and the need to correct the market. Deflation is considered bad for the economy because it reduces demand. Consumers expect prices to fall and wait with their purchases until a later time when prices have dropped even more. Though this theory is over-simplistic and the opposite can also be proven, deflation is nevertheless considered bad for the economy. The danger of deflation is that of the deflation trap. This is the scenario in which deflation becomes so severe that saving becomes relatively more attractive due to the rise in real interest rates. Spending will be cut and business will face a relative increase in wages and debt burdens will increase.¹²² Due to the relative increase in wages and the loss in demand businesses will be reluctant to hire new employees. This reluctance will push up unemployment causing a bigger drop in demand and thereby forming a trap in the

¹¹⁷ Kimberley Amadeo, 'What Is Hyperinflation? Its Causes, Effects and Examples.' *The Balance* 2018. [online] Available at: <https://www.thebalance.com/what-is-hyperinflation-definition-causes-and-examples-3306097> [Accessed 23 Feb. 2018].

¹¹⁸ S. Hanke and A. Kwok, On the Measurement of Zimbabwe's Hyperinflation. *Cato Journal* [online] (2009) 29(2), pp.353-364. Available at: <https://object.cato.org/sites/cato.org/files/serials/files/cato-journal/2009/5/cj29n2-8.pdf> [Accessed 14 Feb. 2018].

¹¹⁹ Hanke 2018.

¹²⁰ Hanke 2018b.

¹²¹ Aljazeera 2017.

¹²² Economist.com, 2015

negative spiral of deflation, unemployment and recession. A similar scenario has occurred in Japan since the 1990s. In Japan, a recession led to deflation which further decreased economic output.¹²³ This fear explains why deflation was to be avoided. The general aim for inflation depends on the economic theory that one supports. There are two main branches of economist that argue inflation benefits the economy (to an extent), these are Keynesians and Monetarists.

Monetarist Irving Fisher generated the Quantity Theory of Money. This theory entails that nominal GDP can be expressed as the price of goods multiplied by the number of goods bought ($p \cdot q$). This is equal to the amount of money multiplied by the velocity ($m \cdot v$). The resulting equation is $MV = PQ$.¹²⁴ By increasing the amount of money either prices or the total output must go up. In the short run, it is expected that the number of goods and services produced go up. This is especially so when the increase in money is unexpected.¹²⁵

Keynesian economists believe that inflation increases employment, their main model is that of the Philips curve. The research conducted by Phillips investigated the relationship between unemployment rates and rate of change of money wage rates.¹²⁶ The paper investigates data on the thesis that as wages rise, more labourers will consider taking a job. This then reduces unemployment which will increase the demand for employees and thereby increase the wage rates. The increased wage rates will lead to higher prices in production and increase the level of spending power of the workers and thus it leads to inflation. This concept creates a relationship between the level of employment and inflation.¹²⁷ The research looked at data in the UK from 1861-1957 and discovers a relationship between unemployment and the change in wage rates. The paper, therefore, concludes that there is a relationship between inflation and the level of unemployment. This relationship was interpreted in such a way that if inflation increases, the level of unemployment decreases.¹²⁸ This relation provides a good incentive for an inflation bias. Additionally, Keynesian economists believe that Aggregate Demand is equal to the amount of labour that is required in any given period. Aggregate Demand consists of net exports, investment, consumption and government spending. If there is inflation the government can spend more and therefore the AD will increase, leading to less unemployment.¹²⁹ All the arguments mentioned have, however, been criticised.

¹²³ See for more discussion Takatoshi Ito and Frederic Mishkin, 'TWO DECADES OF JAPANESE MONETARY POLICY AND THE DEFLATION PROBLEM.' [2004] NBER..

¹²⁴ Irving Fisher and Harry G Brown, *The Purchasing Power Of Money* (The Macmillan Co 1922), p. 25-26.

¹²⁵ Cowen, T. (2017) *Principles of Macroeconomics: Game of theories: Keynesians*. [Lecture] Marginal Revolution University, p. 662.

¹²⁶ A. W. Phillips, 'The Relation Between Unemployment And The Rate Of Change Of Money Wage Rates In The United Kingdom, 1861-1957' (1958) 25 *Economica*.

¹²⁷ Phillips 1958, p. 283-284.

¹²⁸ Phillips 1958, p. 299.

¹²⁹ Cowen 2017.

The need for inflation has been established in earlier paragraphs but did not go without receiving criticism. The four reasons for price control established are fear of hyperinflation, fear of deflation, Quantity Theory of Money and the Philips curve. Neither of these concepts has gone without criticism.

When concerning the fear of hyperinflation, it is highly related to earlier arguments related to independence. Additionally, statistics show inflation in the U.S. and the Netherlands to be extremely low before the creation of central banks.¹³⁰ These statistics unnerve the argument that central banks are needed to ensure the prevention of hyperinflation. Additionally, the fear of deflation is considered to be exaggerated by some.

Mujagic argues that the qualification of deflation as bad or good depends on the cause of the price drop. The example he provides is that of a computer. Prices of computers dropped enormously due to the increase in trade, drop in production costs and technological improvements. This form of deflation is called the positive shock.¹³¹ His example shows that deflation should only be feared when it occurs for the wrong reasons. This idea is supported by the general idea of deflation and recessions being caused by supply shocks, rather than demand. This theory is named the real business cyclists, the third of the four mainstream economists.¹³² As both fears have been criticized the question remains whether the considered benefit theories are still valid.

The first economic reasoning is that of the Quantity of Money Theory. Argued is that if $M*V = P*Q$ an increase in money can increase output. In the long run, money is considered neutral therefore the mere increase of the money supply will lead to an increase in prices without an extra increase in output.¹³³ The exact opposite also being true, that the decrease of money will decrease the prices in the long run. In the short run, the decrease of money supplied will cause output to fall. This short-run effect is painful to the government experiencing it and therefore considered less desirable than steady inflation. This contrast between short and long-run effects is also the general criticism towards the Philips curve.

After the stagflation in the US during the Great Depression more criticism arose concerning the trade-off between inflation and unemployment that is perceived in the Philips curve. In the long run, it is argued that workers cannot be fooled permanently and will perceive inflation correctly. They will demand higher wages and thereby restoring their nominal wage level to the real wage level. This effect entails that in the long run there is no trade-off between inflation and unemployment. When a steady rate

¹³⁰ Mujagic 2013, p. 6-7.

¹³¹ Mujagic 2013, p. 112-113.

¹³² Cowen 2017b.

¹³³ Cowen & Tabarrok 2015, p. 635.

of inflation is kept unemployment will return to its natural level.¹³⁴ In the long-run inflation does not decrease the natural rate of unemployment, it will merely mask it for a short period of time. Additionally, the Philips curve and the Barro Gordon model presume that labour agents do not have rational expectations of inflation. If inflation is predicted correctly the short-run growth effects are lost.¹³⁵ With the current aim of the ECB to keep inflation near 2%, one can argue inflation will be predicted quite rationally.

Considering all the above it seems fair to conclude that the inflationary policy once did, temporarily, push unemployment down. At current the inflationary policy however seems to be built on the fear of deflation (or perhaps habit?). This fear is reflected in the structural report on the ECB whereby the need for buffers against the “*risks of deflation*”, is considered necessary.¹³⁶ Deflation in the short run may have negative economic consequences. The negative short-run effects of deflation explain why there are safeguards against deflation, it, however, does not justify forced inflation. Inflation still places a tax upon savings and thus promotes investment and spending. It decreases the real interest rates and therefore decreases the real burden of the government debt.¹³⁷ Furthermore, inflation allows firms to provide real wage cuts to workers, whilst giving them a raise. Workers are generally reluctant to accept a cut in their wage. When inflation increases more than the raise given, in real terms labourers receive a wage cut. In nominal terms, they receive a raise and are thus happy.¹³⁸

In conclusion, it is accurate to observe that all of the aspects of CBI underwent criticism. This criticism has not led to a complete rejection of the theory. It did, however, give cause to doubt the economic fundamentals underpinning the independence of central banks. Meaning that the concept of independence must be considered flexible and as of yet there is no perfect design created. In practice, there are different forms of CBI to be recognized.

2.5. Central Bank Independence in Practice:

There are different ways in which CBI is given shape in practice. The previous paragraphs have looked at the development of central banks in the past. Without commenting on the quality of the design, these paragraphs will show two different models in which CBI has been implemented at present. These examples serve to show two different options of how central banks can be designed. The first example will be that of New Zealand where independence is low. The second example will be one of rather high

¹³⁴ Gergo Motyovski, 'The Evolution Of Phillips Curve Concepts And Their Implications For Economic Policy' (2013) *History of Economic Thought*, p. 5-6.

¹³⁵ Allan Drazen, *Political Economy In Macroeconomics* (Princeton University Press 2000), p. 114.

¹³⁶ The European Central Bank 2008, p. 20-21; www.ecb.europa.eu >> strategy >> price stability

¹³⁷ Nicholas Mankiw, *Macroeconomics*. 8th ed. International, (Worth 2012), p. 107.

¹³⁸ Mankiw 2012, p. 119.

independence, namely South Africa. These two banks have been chosen for different reasons. New Zealand has a rather unique system with coordination between the minister of finance and the governor of the Central Bank. The independence of the New Zealand Central Bank is thus considered low. South Africa, however, has a more common entrenchment of central bank independence via constitutional law. This bank also has seen a true test on its independence. Because they are two forms of high and low independence these two banks will be reflected upon in the conclusion. They will serve as examples for potential changes to the ECB structure.

New Zealand has a system whereby there is a close interaction between the minister of finance and the governor of the Bank. Section 9 of the Bank Act determines that the inflationary target is set in agreement between the governor and the minister of finance.¹³⁹ This document is called the Policy Target Agreement (PTA). According to section 12, this objective can be overturned from time to time by the council on the advice of the minister. These sections generate closer cooperation between the minister of finance and the governor. The governor can be dismissed for inadequate performance related to the PTA.¹⁴⁰ These rules have been laid down into statutory acts as New Zealand does not have a written constitution. What should however be noted is that the title of section 5 is the 'Constitution of the Reserve Bank of New Zealand'. The naming of the 'constitution of the bank' does not have any legal effects; however, arguably, it adds gravity to the bill. The Act can be changed via the normal legislative process and requires a simple majority.¹⁴¹ This system, therefore, has relative close target cooperation between government and Bank. The Bank is free to pursue this goal in whatever way it sees fit and the governors can only be fired when they do not achieve the pre-set goal. Though the Bank has complete operational independence its independence is considered low. This form of cooperation contrasts with banks whose independence is constitutionally embedded.

The South African Central Bank has its independence entrenched within the constitution. Section 224 of the South African constitution states that "*The South African Reserve Bank, in pursuit of its primary object, must perform its functions independently [...]*". The process of the constitution is much harder to change than that of an ordinary bill. Thereby at first sight the South African Reserve Bank's independence is of a higher standard than that of the New Zealand Bank. The constitution remains very general and refers details to an Act of Parliament. When examining the Act in more detail independence seems to be different. The South African Reserve Bank is owned by private shareholders rather than the state.¹⁴² According to section 4(3) of the Bank Act, these shareholders elect the board members. The exception being the: "*Governor, three*

¹³⁹ Reserve Bank of New Zealand Act 1989.

¹⁴⁰ David Archer, *Inflation Targeting in New Zealand*. [online] (2000) International Monetary Fund.

¹⁴¹ www.parliament.nz >> how a bill becomes law.

¹⁴² www.resbank.co.za >> about >> history >> ownership

*Deputy Governors (of whom one shall be designated by the President of the Republic as Senior Deputy Governor) and three other directors, which Governor, Deputy Governors and other directors shall be appointed by the President of the Republic after consultation with the Minister and the Board”.*¹⁴³ These governors are appointed for 5 or 3 years each.¹⁴⁴ To get rid of the governor it is possible for Parliament, or other parties, to take legal action to have the governor declared unfit. Additionally, despite the constitutional assurance of independence, it would only take a simple act of Parliament to alter these rules.¹⁴⁵ Though the bank is guaranteed independence if the minister feels the bank is neglecting its duties he or she can ask the Supreme Court to force the bank to comply.¹⁴⁶

Interesting to note at this stage is the legal differences and practical applications. This research has discussed the paper written by Neyapti a.o. in which it is argued that both legal and factual independence matters. When looking at the legal design of the New Zealand Central Bank the Bank is rather dependent. The goals are set in agreement with the governor and the minister but can be overturned by the minister and council. Plus its independence is only laid down in a simple Act of Parliament. The opposite is true for the central bank of South Africa whose independence is laid down in the constitution. It is responsible for the currency value but is allowed to self-define what that means. In theory, the South African Bank is much more independent. This is much reflected in the turnover rate of the central bank governors. The research done by Vuletin & Zu shows that the turnover rate in South Africa is 0.086 and a governor is replaced roughly every 11 years and 7 months; the New Zealand figures are 0.143 and a governor is replaced every 7 years.¹⁴⁷ Regardless of the threats to its independence¹⁴⁸ the South African Reserve Bank seems to be the more independent.

The previous examples show two forms of central bank independence. One structure whereby the bank has to cooperate on setting the goals and its independence is only guaranteed via a normal statute. The other has very high independence whereby the independence of the Bank is constitutionally entrenched. These examples are not complete and many more forms of central bank organization exist.

¹⁴³ Section 4(1) South African Reserve Bank Act 90 of 1989.

¹⁴⁴ Section 5.

¹⁴⁵ Jannie Rossouw, It's hard to get rid of the governor of a central bank. Here's why. *The conversation* 2016.

¹⁴⁶ Section 37.

¹⁴⁷ GUILLERMO VULETIN and LING ZHU, 'Replacing A "Disobedient" Central Bank Governor With A "Docile" One: A Novel Measure Of Central Bank Independence And Its Effect On Inflation' (2011) 43 *Journal of Money, Credit and Banking*.

¹⁴⁸ CNBCAfrica 2017.

2.6. Conclusion

This chapter has shown that central banks developed in various stages. The early central banks were often created as part of the government and their financial needs. The more modern central banks have seen increased, but not sole, focus on monetary stability and the need for independence.

It should be considered that the original Central Bank Independence theory included a fairly independent central bank. It focussed on legal and actual independence from the democratic legislator to generate higher credibility and prevent high and hyperinflation. The main foundation for this concept was that of the political cycle and its impact upon credibility.

The economic theory behind this idea is still considered valid; however, the initial idea has been updated and challenged. Over the years the theory has developed to include other factors such as; free press and opposition. It has also been suggested that other factors carry a higher weight than the independence of Central Banks in stabilizing inflation. Recently the inflation concept has been criticized to the point where it is considered to be economically inefficient. However, a low level of inflation is still, by many, considered preferential to no inflation.

This chapter answered the question as to why central banks have developed and why they are independent and has shown examples of how to give shape to such independence. As stated before this research is interested in the balance (and potential distortion) between independence and accountability. Though independence is important, central banks are not without accountability mechanisms. The following chapter will examine what types of accountability there are and more specifically the independence and accountability of the ECB and US FED.

3. Central Bank Accountability of the ECB & FED

3.1. Introduction

Accountability can take many shapes and forms and there is no one clear definition or set of criteria. The following paragraphs will discuss various criteria that have emerged. Section 3.2. will start by exploring the concept of accountability from a legal perspective. Section 3.3. will continue by further examining the independence and accountability framework of the ECB. Section 3.4. will continue by exploring the framework for the FED. Section 3.5 will examine the balance between accountability and independence pre-crisis for both the ECB and the FED.

3.2. Conceptualizing accountability

It may seem contradictory to Central Bank Independence that there should be such a thing as central bank accountability. The previous paragraphs covered Central Bank Independence which is based upon the concept of separating monetary experts from the political cycle. Since this theory is still considered to have value today – why accountability? The first reason for accountability is simple, experts can be wrong too. The second reason as argued by Goodhart & Lastra is that too much independence leads to “a state within a state”.¹ Accountability should enable the bank to be judged for the reasonableness of its actions without politicizing the bank.² Therefore to ensure central banks are accountable for their actions does not necessarily lead to a reduction of their political independence. Accountability can be achieved without politicizing the bank, which leaves the question of how to hold central banks accountable.

In his work Amtenbrink states that democratic accountability of central banks includes the participation of all three branches of government.³ In his work, he however chose not to include an examination of judicial review. There are many arguments to consider the judicial review as an accountability mechanism ineffective. One argument would be that the road to judicial revision is timely and costly. An individual may find that the central bank exceeds its mandate but would be hesitant to start a procedure due to the incurred legal fees. A government might find the road to court more financially

¹ Charles Goodhart & Rosa Lastra, 'Central Bank Accountability And Judicial Review' [2018] SUERF <<https://www.suerf.org/policynotes/2585/central-bank-accountability-and-judicial-review/html>> accessed 6 November 2019, p. 2.

² Ibid, p. 2-3.

³ Fabian Amtenbrink, *The Democratic Accountability of Central Banks. A Comparative Study of the European Central Bank*. (Hart Publishing 1999), p. 4.

accessible. The government will still be hampered by the time it will take to obtain a judgement. Central bank decisions often have a direct effect on the economy and reversing the decision might prove impossible. This might explain why Amtenbrink at the time of writing his work found there to be too little judicial review to take into consideration.⁴ With the crisis, judicial review gained popularity leaving the question of whether the judicial review should be considered part of accountability. As Goodhart and Lastra argue it is without a doubt that the CJEU should be the final judge of whether the ECB has remained within the limits given by the law.⁵ The CJEU is however not an expert in monetary economics and therefore should not intervene with the discretionary position of the Bank. This position seems most easy to defend when there is a (strong) accountability mechanism in place.⁶ Goodhart and Lastra recommend a specialized chamber at the CJEU to deal with monetary matters.⁷ This would be a possible solution, for the purpose of this research and the above-mentioned arguments this thesis will investigate accountability in and outside courts.

The CJEU for many reasons as stated above is not a primary form of accountability. The CJEU has, however, during the euro crisis played an important role in determining the limits of the ECB mandate. Perhaps because the primary accountability mechanism of the ECB is little, the CJEU has received an important role in the accountability. The main question that this research will focus on is what level of judicial review the CJEU has taken. This is an important question, if the CJEU decided to take a high level of judicial review this increases the accountability of the ECB. Vice versa, if the CJEU decided to take a limited level of judicial review this decreases the accountability of the ECB vis-à-vis the CJEU. The level of judicial review, however, does not impact the other forms of possible accountability and is, therefore, an independent criterion.

In an article written by Amtenbrink, Eijffinger and De Haan they consider that central bank accountability has three major facets.⁸ The first is the definition and ranking of monetary objectives. The second is the transparency of the monetary policy and last but not least the question of final responsibility.⁹ These are three highly interesting relationships that seem to be reoccurring in more papers. Some authors such as Issing, however, chose to separate transparency from accountability. This separation is done on the basis that accountability refers to deeds whilst transparency refers to words.¹⁰ Issing makes a good argument that accountability refers to actions being monitored and

⁴ Ibid.

⁵ Goodhart and Lastra 2018 n.1, p. 4.

⁶ Ibid.

⁷ Ibid.

⁸ Jakob de Haan, Fabian Amtenbrink and Sylvester C. W. Eijffinger, 'Accountability Of Central Banks: Aspects And Quantifications' (1998) 52 PSL Quarterly Review.

⁹ Ibid, p. 172.

¹⁰ Otmar Issing, 'The Eurosystem: Transparent Andaccountable Or 'Willem In Euroland' (1999) 37 JCMS: Journal of Common Market Studies, p. 506.

transparency is the attempt to explain these actions.¹¹ This research on the other hand takes the view as described by Eijffinger and De Haan that accountability largely rests upon transparency. Without transparency in central bank policy, it is difficult if not near impossible to hold the institution accountable.¹² Or as Naurin states “[t]ransparency literally means that it is possible to look into something”.¹³ As will be discussed more, in a later stage of this research the CJEU largely judges the European Central Bank on its statements. In the OMT case, these were statements of intention as the programme was not yet implemented. Its actions in the OMT case had not yet occurred, and so far have not, the CJEU, therefore, relied on the Bank’s intentions provided in press statements and others. Additionally, if we were to separate transparency and accountability, it would lead to a very undesirable situation. If a central bank is not transparent and only its actions could be judged, accountability can only take place ex-post. In the case of central bank accountability having to wait for actions would decrease possible accountability. As will be examined in chapter 5 with the letters sent to various governments, not all actions are directly visible. Thus without transparency, final accountability is limited. Additionally, it is in the central bank’s interest to have a high level of credibility. If ex-post accountability is the sole possibility, this may damage the central bank’s credibility as its actions can be overturned. Even with high levels of transparency actions can be overturned, it is however less likely to occur when ex-ante checks are in place. Hence this research will consider transparency as a crucial part of accountability rather than a separate topic. This still leaves the question of how to define accountability.

To analyse the effectiveness of accountability clear criteria are needed. The three relationships defined by Amtenbrink, Eijffinger and De Haan make for a good start. Their research has quantified these criteria. This quantification is very useful when comparing de jure mechanisms. This thesis on the other hand wishes to compare the effectiveness of the mechanisms in detail. The framework will therefore not be aimed at giving numbers for criteria, rather it will generate a framework of questions to effectively analyse accountability.

The first of the relationships that need defining is that of monetary objectives. According to Amtenbrink’s earlier work, monetary objectives are “[...]the ultimate purpose at which a central bank aims with its monetary policies and its day-to-day performance.”¹⁴ In their article, the authors argue that when a central bank has a single objective it is easier to hold the bank accountable.¹⁵ “It is easier to control a narrowly defined target

¹¹ Ibid.

¹² Jakob De Haan and Sylvester C.W. Eijffinger, 'The Democratic Accountability Of The European Central Bank: A Comment On Two Fairy-Tales' (2000) 38 JCMS: Journal of Common Market Studies, pg. 399.

¹³ Daniel Naurin, 'Transparency, Publicity, Accountability – The missing links' (2007) CONNEX-RG 2, p. 2.

¹⁴ Amtenbrink 1999 n.3, p. 43.

¹⁵ De Haan et. al. PSL Quarterly Review 1998 n.8., pg. 172-173.

than a broadly defined objective."¹⁶ This statement is very logical as it is easier to check whether the central bank has achieved near 2% inflation than whether its policies have increased employment whilst safeguarding price stability. The first question related to monetary objectives is therefore what objectives are set and how well are they defined? The second question that Amtenbrink rightly raises is whether these objectives are set in statutory and by whom they are set.¹⁷ Adding to this question this thesis is interested in the flexibility of these objectives. This means that it will be examined whether the objectives are interpreted strictly or if they are slightly flexible in times of crisis. These two questions closely resemble the four questions raised by Amtenbrink, De Haan & Eijfinger.¹⁸ They have four questions to precisely quantify the outcomes. As this research does not need to quantify the extra questions will be considered as part of the larger two questions. The next question is then the question of Transparency.

Transparency according to their article is measured using three criteria. The first is the question of whether a bank must produce monetary policy reports. This report is further defined as a report that explains the intentions, actions and objectives of the Central Bank.¹⁹ The explanation of the Central Bank's actions is an important aspect of transparency. The word report however indicates a long explanation of the Bank's actions. This thesis will not limit the explanation to the dictionary definition of reports but will instead focus on all ex-ante aspects of clarification. These would include press statements and other documents. In addition to ex-ante transparency the criteria of Amtenbrink a.o. focus on the ex-post transparency.²⁰ This criterion will be included in this framework too. In their research, the authors also focus on the publication of minutes. Arguing that minutes, published within an adequate amount of time, improve transparency.²¹ The publication of minutes is, however, slightly controversial. Revealing the minutes would show which standpoints were taken by the various national governors. Thereby opening them up for scrutiny on their behaviour rather than ECB decision making. Since the publication of the minutes would not add much to the transparency process²² (assuming decisions are supported by other statements). This research has decided not to include the publication of minutes as part of the transparency process. Rather than the minutes, this research will focus on whether the individual governors have the option of dissent.

Dissent may undermine the credibility of the decision. Concerning judicial dissenting opinions, it has been argued that it undermines the credibility of the court and its unity.²³ Similar arguments can be made about the ECB, when a governor publicly

¹⁶ Ibid, p. 173.

¹⁷ Amtenbrink 1999 n.3, pg. 43.

¹⁸ De Haan et. al. PSL Quarterly Review 1998 n.8., p. 177.

¹⁹ Ibid, p. 178-179.

²⁰ Ibid.

²¹ Ibid, p. 179.

²² Ibid, p. 179.

²³ Julia Laffranque, 'Dissenting Opinion and Judicial Independence' (2003) 8(162) *Juridica*

dissents from the majority conclusion it undermines the unity of the Central Bank. Dissent may therefore be regarded as highly undesirable as it may undermine not only the unity but also the credibility of the decision. This research however finds that there is more reason to look at dissent in terms of accountability. There are several reasons for this. Dissent indicates increases accountability at the national level. As national parliaments may have questions as to why certain choices were made, possibly against their direct interests. Some argue that a dissenting opinion in court makes a judgement stronger because it shows that there is no consensus.²⁴ This argument does not seem valid for Central Banks per se. The lack of consensus amongst the executive board however may show that a decision was not technocratic but contained an element of choice. The idea behind Central Bank Independence is that choices are technocratic and based upon monetary expertise. A dissenting opinion may indicate that there was an element of choice involved thus showing a potential political aspect to the decision. Dissent, therefore, increases transparency. The three transparency topics that will therefore be examined in this research is the ex-ante statements the Central Banks give, the ex-post clarification on whether the central bank reached its goals and dissenting statements of governors. This leaves the question of final responsibility.

The criteria for final responsibility as described by Amtenbrink et. al. will be used by this research. This asks the question of the relationship between the executive branch and Parliament. The first relationship has an interesting aspect to it that needs consideration. As Amtenbrink states in his earlier work there can be a formal and de facto relationship between the bank and executive. A de facto relationship between the executive can open the bank to political instruction.²⁵ It is thus important in the relationship with the government to examine whether these relations are public. Concerning the relationship with Parliament, these include examining the monitoring by Parliament and the right to give instructions. Additionally, the overriding mechanisms will be examined and the procedure for appeal. The other criteria that will be taken on board is that of legislative review. Who can change the laws surrounding central bank independence and the dismissal procedure of governors?²⁶ The fourth relationship that is not mentioned by the research of De Haan et. al. is that of their relationship with the CJEU. In their research, they focus on government and Parliament.²⁷ Since the euro-crisis ECB policy has seen the deliberation of the CJEU. This research will therefore consider the CJEU as a potential override mechanism. It should, however, be noted that the CJEU can only judge the lawfulness of the decisions, not the content of the decision.²⁸ The CJEU should therefore be considered as a final institution that safeguards the limits of

Int'l, p. 170.

²⁴ Ibid, p. 170.

²⁵ Amtenbrink 1999 n.3, p. 48.

²⁶ De Haan et. al. PSL Quarterly Review 1998 n.8, p. 180.

²⁷ Ibid.

²⁸ Goodhart and Lastra 2018 n.1, p. 4.

the mandate. It is however not an institution that can override the content of the decision in case of political differences.

The three themes mentioned above will be the guiding thread to analysing accountability for the ECB and FED.

3.3. ECB Independence and Accountability

The following paragraphs will discuss the structure, independence, and accountability of the European Central Bank pre-crisis. This discussion will form the basis for analysing the change in the mandate and the effectiveness of accountability. Similarly, the next part of this chapter will discuss the basic structure, independence and accountability of the United States Federal Reserve Bank.

3.3.1. Background to the ECB

When designing the ECB two institutional Central Bank models had developed, the Anglo-French model and the German model. The first model includes, in addition to price stability, tasks such as maintenance of high employment, stabilization of the business cycles etc. The Anglo-French model is very politically dependant and its policies generally require political approval.²⁹ The German model on the other hand favours the opposite layout. At the time of the signing of the Maastricht Treaty in 1992, the latter had not yet been proven as a well-functioning model. The empirical evidence supporting the concept of central bank independence was lacking.³⁰ It, therefore, seems counterintuitive that this model was chosen as the foundation for the European Central Bank. In economic terms, this choice can, however, be well-defended.

Taking Germany and Italy as an example De Grauwe argues that by looking at the Barro-Gordon model Germany suffers losses by joining a monetary union with Italy. It is therefore understandable that Germany would not wish to join a monetary union with Italy unless it can impose its own rules.³¹ If Italy gains more than it loses by accepting the German terms, it will agree. The gains, however, might not always be economic.

When the ECB was created there was no European constitutional history of independent Central Banks. The idea of a central bank originates from the U.S. tradition and

²⁹ Paul De Grauwe, 'The European Central Bank As Lender Of Last Resort In The Government Bond Markets' (2013) 59 CESifo Economic Studies, p. 164.

³⁰ Marta Castello-Branco and Mark Swinburne, 'Central Bank Independence. Can it contribute to better inflation performance? Issues in theory and practice.' (1992) 29 Finance & Development, p. 21.

³¹ De Grauwe 2005 n.29, pp. 144-145.

constitutional view of checks and balances, rather than the European view of Montesquieu's trias politica. It was considered that the influence of a central bank is widespread and therefore a few rule the majority.³²

When the ECB was created it was under strong debate about what the relationship should be between the bankers and the politicians. The Germans stressed the independence of the Central Bank. It was a commonly held belief that high CBI leads to low inflation. Strong evidence of this was the German Bundesbank, despite the argument that this bank had only known 'easy' times.³³ The argument of easy times refers to the creation of the German bank in 1957 in West Germany. It became the central bank of the whole of Germany after 1990 until the Maastricht treaty came into force in 1993. In the Maastricht Treaty, it was agreed that bankers should be independent for the day-to-day running of the bank. At a general level, they should, however, be subject to some political direction and accountability.³⁴ The ECB's independence was statutorily guaranteed and the political independence of the leaders was guaranteed.³⁵ The argument of political direction was thereby not reflected in the statutes of the ECB.

3.3.2. Independence & Legal framework

The following paragraphs will discuss one of the more famous aspects of the ECB, its independence. It is not the intention of these paragraphs to discuss the validity or reasons behind independence. The function of these paragraphs is merely to describe independence. No comments will be given in this stage on its transparency, accountability, effectiveness, or other aspects.

The ECB is politically independent of the EU institutions and the Member States. This independence is entrenched in article 103 TFEU; which states that the ECB shall not '[...] seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body.' As a measure of accountability, it publishes an annual report and the president of the Bank participates in quarterly hearings conducted by the Committee of Economic and Monetary Affairs of the European Parliament.³⁶ To change the treaty provisions all Member States must agree.³⁷ Additionally, in the case of changes to the monetary structure, the ECB has to be

³² Randzio-Plath, C. (1998). *Report on democratic accountability of 3rd phase of EMU*. [online] Committee on Economic and Monetary Affairs and Industrial Policy.

³³ Mark Levitt and Christopher Lord, *The political economy of monetary union*. (Palgrave MacMillan 2000), pp. 120-121.

³⁴ Neill Nugent, *The government and politics of the European Union* (Palgrave Macmillan 2006), p. 324.

³⁵ Levitt and Lord 2000, pp. 120-121.

³⁶ www.ecb.europa.eu >> about >> accountability

³⁷ Article 48 Treaty on the European Union

consulted. It is therefore unlikely that fundamental changes to the treaty will be made. Even more unlikely is that the threat of such changes could be used as a means to hold the ECB accountable.

To guarantee individual independence, the members of the Executive board have a non-renewable period of 8-years and enjoy the status of tenure. They are appointed by the European Council by a qualified majority. Additionally, the Bank is not allowed to make loans to EU bodies or the Member States, thereby shielding it from undue influence.³⁸ These factors combined, create a highly independent central bank. Though the Bank must be considered independent on paper, practice might be different. It is argued that even independent central banks will give ground to political needs to preserve their independence.³⁹ This argument is considered valid for the ECB also, therefore it should be concluded that the ECB is independent but not operating in a political vacuum.⁴⁰ The next few paragraphs will look at the scope of the mandate. First will be the no-bail-out clause and the prohibition on monetary financing.

3.3.2.1. Prohibition on direct financing art. 123 & No bail-out clause art. 125:

Both article 123 and article 125 TFEU are important features of the ECB and were at the centre of litigation. The articles also provide clear limits to the ECB mandate. These articles could be interpreted in three different ways: literal, purposive and ultima ratio.⁴¹ The literal explanation focuses on the wording of the texts. The purposive includes the purpose of the articles which is the market reasoning. States with a risky fiscal policy would have to borrow under higher premiums than states with a more prudent fiscal policy. Within this reasoning, any form of Member State assistance would distort the functioning of market premiums. The third explanation places the purpose of the no-bailout clause within the broader perspective of price stability.⁴² These two articles will be briefly discussed in shape and aim.

Article 123 TFEU contains the prohibition on direct financing and lending from the ECB or any national central bank to the Member States, government bodies or Union bodies. It gives shape to a monetary policy, independent of the Member States. It prevents that public debt is financed by printing money.⁴³ This is by the ECB referred to as a form of

³⁸ www.ecb.europa.eu >> about >> independence

³⁹ John B. Goodman, 'The Politics Of Central Bank Independence' (1991) 23 Comparative Politics, p. 335.

⁴⁰ José Fernández-Albertos, 'The Politics Of Central Bank Independence' (2015) 18 Annual Review of Political Science, p. 227.

⁴¹ Vestert Borger, 'The ESM and the European Court's Predicament in Pringle', *German L.J.* (2013) 14(01), p. 129.

⁴² *Ibid*, p. 130-131.

⁴³ Hanno Beck and Aloys Prinz, 'The Trilemma Of A Monetary Union: Another Impossible Trinity' (2012)

47 Intereconomics, p. 40.

functional independence. If the Bank would be obliged to fund member state deficit it would reduce the ability to influence price stability.⁴⁴ Hence this provision reinforces the functional independence of the ECB. To give shape to this prohibition the ECB has put ceilings on the number of overnight deposits and fixed-term deposits.⁴⁵ Thereby giving grip to this article, however, the maxima are to be determined per individual case.

The second important article is that of the no bail-out clause. Article 125 TFEU states that “*The Union shall not be liable for or assume the commitments of central governments [...]*”. The rationale behind a no bail-out clause is to prevent too much deficit spending. In a monetary union, there is no exchange rate risk upon deficit spending. The risk of one member generating too large a public debt is, therefore, more likely. Via a no bail-out clause each member is made liable for its debts, in theory.⁴⁶ Before the euro crisis, this was interpreted by some as to prevent any form of assistance including loans.⁴⁷ The opposing argument would be to refer to the link between budgetary discipline and article 125.⁴⁸ An argument can be made that loans do not necessarily endanger the budgetary discipline sought to achieve by article 125. This would later be clarified further in the *Gauweiler* case, which will be discussed in later chapters. To discuss the full scope of the mandate the question of last resort must be discussed.

3.3.2.2. *Lender of Last Resort:*

The role of lender of last resort (LOLR) is an important function for central banks. As stated in the previous chapter the LOLR is the bank lending to the government or the banks in need. These two functions are difficult to recognize within the ECB due to the previously mentioned articles. The ECB cannot directly lend to the various Member States. This leaves the possibility of lending or bailing out national banks in need. Lending to the national banks in need is more expensive than to the Member States.⁴⁹ Hence arguably the ECB must be prevented from having to lend to national banks. The risk of moral hazard makes it, however, difficult to assist the Member States. De Grauwe, however, argues that the ECB should not concern itself with moral hazard problems. In

⁴⁴ Lorenzo Bini Smaghi, 'Central bank independence: from theory to practice' (Speech by Lorenzo Bini Smaghi at the Good Governance and Effective Partnership in Budapest 19 April 2007).

⁴⁵ European Central Bank Decision (EU) no. 8/2014 of 20 February 2014 on the prohibition of monetary financing and the remuneration of government deposits by national central banks.

⁴⁶ Demosthenes Ioannou, Patrick Leblond and Arne Niemann, *European Integration In Times Of Crisis: Theoretical Perspectives*. (Routledge 2017), p. 107-108

⁴⁷ Alicia Hinarejos, 'THE COURT OF JUSTICE OF THE EU AND THE LEGALITY OF THE EUROPEAN STABILITY MECHANISM' (2013) 72 *The Cambridge Law Journal*., p. 237.

⁴⁸ Antonis Antoniadis, Robert Schütze and Eleanor Spaventa, *The European Union And Global Emergencies* (Hart 2011), p. 14-15.

⁴⁹ De Grauwe 2013, p. 522.

his research, he argues that ECB should not be prevented to be the LOLR by the moral hazard. It should be a different set of instruments that will aim to prevent moral hazard.⁵⁰ This argument of splitting the risk of preventing moral hazard from the LOLR is not uncontested. In their paper, Goodhart and Huang argue that a good LOLR does prevent moral hazard at the macro-level.⁵¹ Similarly, the Bagehot principles consider that NCBs should be a lender of last resort to solvent institutions at higher than market rates. The exact nature of a good LOLR is therefore contested.

The exact role of the ECB as lender of last resort remains unclear. When the ECB was created, Goodhart predicted that the role of the ECB would be unclear. In the case of major rescue operations, the ECB would have to approach the Parliament and the EU Budget. A process well described as politically difficult. Goodhart also described that by lack of further integration, the position of LOLR would be best served by the NCBs – though these might not wish to pay for issues caused by other countries.⁵² Before the euro crisis erupted the ECB as LOLR was unclear and predicted as problematic. It is therefore uncertain whether it would be part of its mandate. Clear is that it is not explicitly mentioned in the Treaties. The next paragraphs will discuss the accountability of the ECB.

3.3.3. Accountability

To analyse the effectiveness of the accountability of the ECB and its comparison to the independence the general outline of its accountability must be examined. The following paragraphs will briefly examine the ECB accountability according to the questions and themes discussed earlier. This discussion will be brief as work on pre-crisis accountability has been done.⁵³

The first theme to consider is that of the mandate of the ECB. The mandate of the ECB is narrow as article 127 TFEU the primary objective of the ECB is price stability. Additionally, the article gives the ECB the objective to support the general economic policy. This objective however may not interfere and is second to the price stability objective of the Bank. According to the accountability standard developed earlier a clear primary objective aids with accountability. The Treaty remains vague about what price stability exactly means. The ESCB has further defined price stability to be interpreted as inflation close to but under 2% measured according to the Harmonized Index of

⁵⁰ Ibid, p. 527.

⁵¹ Charles Goodhart and Haizhou Huang, 'The Lender Of Last Resort' (2005) 29 Elsevier, p. 1062.

⁵² Charles Goodhart, 'Myths about the Lender of Last Resort' (1999) 2(3) International Finance, p. 352.

⁵³ For further information please consult the work of Amttenbrink, De Haan and Eijfinger.

Consumer Prices.⁵⁴ Thereby the mandate of the ECB has become tangible and easy to measure, though the definition of “close to” will be open to interpretation. In general, however, it seems the performance of the Bank is easy to measure. This leads to the next question which is that of transparency.

The statute of the ESCB and ECB provides the mainframe of ECB transparency. Article 15 of the statutes give the ECB obligation to quarterly publish a report on its activities. In addition, a weekly consolidated financial statement has to be given. Additionally, the ECB has to address an annual report on its activities to the European Parliament, Commission, Council and European Council. Amtenbrink states that in general, these reports will ensure transparency but that more detailed instructions on these reports would have been desirable.⁵⁵ Furthermore, the law is unclear whether these include the publications of forecasts.⁵⁶ The publication of monetary forecasts improves transparency and accountability as they can be used to explain why adjustments are necessary.⁵⁷

In addition to its legal requirements, the ECB has adopted a few more channels of communication. These channels are webcasts where the hearings at the European Parliament are published and the publication of written questions by Members of the European Parliament.⁵⁸ Furthermore, the ECB participates in press conferences, publishes the economic bulletin, accounts of meetings and interviews, speeches and articles.⁵⁹ On the surface, there seem to be plenty of statements and information provided by the ECB to create transparency. According to Bini-Smaghi and Gros, the legal requirements for the ECB should make it one of the most transparent central banks. It should, however, be noted that the market still perceives the ECB as not very transparent.⁶⁰ This leaves the question of final accountability.

Concerning final accountability, the first question that needs to be raised is: is there the possibility for other institutions to influence or hold the central bank accountable for its actions? The law is very clear that no other organs or the Member States may instruct the Central Bank or even seek to do so. According to Amtenbrink, this should not be

⁵⁴ European Bank, 'Definition Of Price Stability' (*European Central Bank*, 2019) <<https://www.ecb.europa.eu/mopo/strategy/pricestab/html/index.en.html>> accessed 11 November 2019.

⁵⁵ Amtenbrink 1999 n.3, p. 320.

⁵⁶ Ibid, p. 319.

⁵⁷ Petra M. Geraats, 'Transparency And Reputation: Should The ECB Publish Its Inflation Forecasts?' [1999] "Monetary Policy-Making under Uncertainty", p. 22.

⁵⁸ European Bank, 'Accountability' (*European Central Bank*, 2019) <<https://www.ecb.europa.eu/ecb/orga/accountability/html/index.en.html>> accessed 11 November 2019.

⁵⁹ Nicolò Fraccaroli, Alessandro Giovannini and Jean-François Jamet, 'The Evolution Of The ECB'S Accountability Practices During The Crisis' (2018) 5 ECB Economic Bulletin.

⁶⁰ Lorenzo Bini-Smaghi and Daniel Gros, 'Is The ECB Sufficiently Accountable And Transparent?' (2001) 169 CEPS <<https://www.ceps.eu/wp-content/uploads/2009/08/79.pdf>> accessed 8 November 2019, p. 18.

interpreted that the institutions may not state their opinion or try to convince the Bank of their opinion. This would be contradictory to the participatory rights of these institutions.⁶¹ Regardless of their participatory right there is no voting right nor are there any overriding mechanisms in place for other EU Institutions.⁶² There was a suggestion to implement such a mechanism but this was rejected.⁶³ The only way to change Central Bank policy by force is to change the Treaties which would require consent from the participating Member States. A task that seems difficult to achieve. Furthermore, NCB governors cannot be dismissed unless they no longer fulfil the requirements or when he/she has been guilty of serious misconduct.⁶⁴ Similar rules apply to the ECB governing board who sit for a term of eight years and their dismissal is pronounced by the ECJ. Thereby guaranteeing personal independence but limiting accountability. Though there is little knowledge of what serious misconduct can entail as no proceedings have been brought against members of the executive board.⁶⁵

In conclusion, the possibility for accountability concerning the ECB is varied. The mandate is quite narrowly defined as price stability. Though the secondary objective of the ECB is open to interpretation this may not conflict with the primary objective. In this regard, accountability is moderately high. The transparency seems *prima facie* to be high as well as there are many methods for the ECB to explain its actions. The accountability in terms of policy or governors is on the other hand very low. There is no override mechanism, other than the court, nor can governors be dismissed. Furthermore, the potential for the European Parliament to change this is limited as it would require a Treaty change. Such limited accountability may be the reason for increased judicial pressure upon the ECB mandate. The next few paragraphs will discuss and briefly compare the accountability system of the ECB with that of the US FED.

3.4. US FED Independence and Accountability

The following paragraphs will briefly discuss the independence and accountability of the US FED. The main concern of this thesis is the ECB accountability framework. Since the FED only serves as a comparison less attention will be paid to the background and ideas.

⁶¹ Amtenbrink 1999 n.3, p. 230.

⁶² Ibid, p. 275-276.

⁶³ Jakob de Haan, Sylvester C. W Eijffinger and Sandra Waller, *The European Central Bank: Credibility, Transparency, And Centralization* (The MIT Press 2005), p. 111.

⁶⁴ ESCB Statutes article 14.2.

⁶⁵ Yves Mersch, 'Central Bank Independence Revisited' [2017] Keynote address by Yves Mersch, Member of the Executive Board of the ECB, at the "Symposium on Building the Financial System of the 21st Century: An Agenda for Europe and the United States", Frankfurt am Main, 30 March 2017.

3.4.1. Background and development

The US Fed was not created overnight and has seen many changes that led to the bank that is in existence today. Its initial purpose was drafted very broad with oversight and discount rate to “accommodate commerce and businesses”. This initial mandate came about as a compromise between various groups.⁶⁶ There was a mixed political oversight in Washington and independent regional banks.⁶⁷ The FED continued to grow in importance in 1923-1929 due to more centralization and active behaviour. This development was partially unexpected and more active than envisioned.⁶⁸ A good example is the developments in the Open Market Programmes.

The FED had allowed open market policies since 1914 but these policies became more active during the 1920s.⁶⁹ Conflict arose between the various regional banks over the exact nature of these transactions. In the 1920s the regional banks, therefore, decided to appoint a committee.⁷⁰ This committee laid the fundamentals for further coordination. Increased purchases of government securities led to conflict among the regional reserve banks and with the Treasury. The result of these conflicts was further coordination among regional reserve banks.⁷¹ Due to further growth of federal power and the war effort the FED underwent some drastic changes leading up to the 1950s. Whereby it grew into a centralized central bank with headquarters in Washington.⁷² It is therefore interesting to note that the Federal Reserve has developed into the current version through conflict and criticism.

3.4.2. Independence and Mandate

The first important topic to discuss is that of the structure of the FED and its independence. Both the FED and the ESCB have various branches. The ESCB is composed of the ECB and its national banks whereas the FED is composed of 12 regional Federal Reserve Banks and one Federal Reserve Board in Washington. Not unlike the ECB the board members are nominated by the President and confirmed by the senate. The term of office for board members is 14 years. An interesting difference however is that the chair and vice-chair of the board serve 4-year terms. They can be reappointed by the president to serve another term as chair as long as their 14-year mandate does not run

⁶⁶ Allan H Meltzer and Allan Greenspan, *A History Of The Federal Reserve* (University of Chicago Press 2003), pp. 65-66.

⁶⁷ Ibid, p. 67.

⁶⁸ Ibid, p. 137.

⁶⁹ Ibid, p. 142.

⁷⁰ Ibid.

⁷¹ Ibid, p. 143.

⁷² Ibid, p. 726.

out.⁷³ This decreases their independence as their renewal as chair or vice-chair depends on the president's approval. The independence of the FED seems to be consistently less than that of the ECB.

When the FED was created in 1913 two of its board members were part of the government. Namely the Secretary of the Treasury and the Comptroller of the Currency.⁷⁴ Over time the FED grew more independent. The term of office was lengthened and the governmental positions in the board were abolished.⁷⁵ The FED however is less independent from the government than the ECB as its statutes can be changed with a simple majority.

Perhaps the most interesting difference between the FED and the ECB is that of the objectives. Whilst the objective of the ECB was directly defined in the Treaties and further defined in the Statute, the objectives of the FED have known amendments and developments. The most interesting difference is that the FED resulted with a dual mandate, meaning that its objectives consist of both price stability and full employment. Whilst the ECB's main focus is that of price stability the FED also aims to generate full employment and moderate long-term interest rates.⁷⁶ The compatibility of these three goals is somewhat debatable in the short run. In the long-term, they seem very compatible but they have not been exactly defined. The Humphrey-Hawkins Act did define price stability as 3% inflation and 4% unemployment rate to be achieved by 1983. Clearer than the ECB was the mandate for the FED to act as a lender of last resort.⁷⁷ The FED furthermore acts as a fiscal agent for the government providing multiple services for the government.⁷⁸

The impact of accountability, in this case, is two-fold. It seems more difficult to keep a Bank accountable for such a vague and broad mandate. On the other hand with such a broad mandate, accountability becomes more important. The next question, therefore, is how the FED's accountability is designed.

3.4.3. Accountability

The following paragraphs will briefly examine the accountability of the FED before moving on to the next section of this chapter. As with the ECB the accountability of the

⁷³ Patricia S. Pollard, 'A Look Inside Two Central Banks: The European Central Bank And The Federal Reserve' (2003) 85 Review, p. 16.

⁷⁴ Ibid, p. 24.

⁷⁵ Ibid.

⁷⁶ Ibid.

⁷⁷ Amtenbrink 1999 n.3, p. 153.

⁷⁸ Ibid.

FED will be examined in three different stages; objectives, transparency and final accountability.

As stated in the previous paragraph the FED is less independent from the government than the ECB as its institutional design can be changed via the normal legislative procedure. The normal legislative procedure for the US means both Congress and the Senate will have to approve the changes. If a change is accepted in both houses the President can either veto the bill or sign it into law.⁷⁹ A potential veto can be overridden with a 2/3 majority in both Congress and the Senate.⁸⁰ Changing the structure of the central bank would therefore not be an easy task. It is, however, easier to change the structure of the FED than that of the ECB. The possibility of changing the legislation means that the FED has larger accountability to the legislator. The final accountability of the FED is, therefore, higher than that of the ECB.

This accountability is also reflected in the reporting obligations to the government that were introduced in 1978.⁸¹ Yet reporting is hindered by the broadness of the mandate of the FED. Though reporting was increased to include goals the FED aims to achieve, these goals are not binding in any way to the FED.⁸² The increases in transparency however have led to the FED being part of the most transparent central banks.⁸³ The mandate of the FED however remains vague which limits accountability. The accountability was increased in 2000, by introducing semi-annual hearings. Furthermore, the FED is to submit a written report.⁸⁴

Accountability is however reflected in the process of selecting the new Board of Governors. The Senate takes a deep interest and thoroughly question the potential candidates.⁸⁵ Thereby appointment takes a larger aspect of accountability. On the other hand, the term of the board members is 14-years, a very long term compared to that of other officials.⁸⁶

The accountability of the FED is wider than that of the ECB, Waller, therefore, speaks not of accountability but rather of a series of checks and balances. He considers that by creating the system of regional banks there would be a check upon the government

⁷⁹ 'The Legislative Process' (*Congressman Bill Keating*, 2019) <<https://keating.house.gov/policy-work/legislative-process>> accessed 11 November 2019.

⁸⁰ 'U.S. Senate: Vetoes' (*Senate.gov*, 2019) <https://www.senate.gov/reference/reference_index_subjects/Vetoes_vrd.htm> accessed 11 November 2019.

⁸¹ Amtenbrink 1999 n.3, p. 190.

⁸² Ibid, p. 191.

⁸³ Sylvester C.W. Eijffinger and Petra M. Geraats, 'How Transparent Are Central Banks?' (2006) 22 *European Journal of Political Economy*, p. 2.

⁸⁴ Pollard 2003 n.73, p.25.

⁸⁵ Ibid, p. 243.

⁸⁶ Ibid, p. 244.

control.⁸⁷ He furthermore comments that the selection of political appointees and non-political appointments is a check upon governmental influence. The regional board directors are appointed by the citizenry rather than the federal government.⁸⁸ The federal government on the other hand would appoint 7 of the 19 board members. Thus creating a balance between its independence and accountability. Similarly, the FED has been given autonomy when it comes to its budget, yet must be inspected by an independent auditor.⁸⁹

Though the checks and balances of the FED are larger than those of the ECB, the FED has been criticized. After the response to the financial crisis arguments for a closer political oversight rose.⁹⁰ There are clear arguments against more government control but it is interesting to note that the financial crisis increased discussion on central bank independence, not only in Europe. More discussion on the independence and accountability of the FED post-crisis in chapter four. The next few paragraphs will compare the independence and accountability ratios of the ECB and the FED. The comparison will gain an overview of the gap or surplus of accountability.

3.5. Accountability v Independence two banks compared

This research aims to test whether the balance between independence and accountability is upset by the new role of the ECB during the crises. The following paragraphs will discuss the balance between the two pre-crises.

To consider a change in independence, one needs to measure independence. The main theory for measuring Central Bank Independence was developed by Neyapti, Cukierman and Webb. This chapter has discussed the main changes and amendments to their theory. There is, however, one criterion that needs to be discussed: objectives. Neyapti, Cukierman and Webb state that the broader the objectives the less independent the central bank.⁹¹ Directly comparing Central Bank Independence with accountability will give a distorted image. The idea that the more narrow the objectives the more independent the bank can focus on inflation is correct. This would mean balancing a more technocratic (and hence more independent) against accountability. Whereby the more narrow the objectives the less accountability is needed. To measure independence like this against accountability counterargues the legal principles. The narrower and

⁸⁷ Christopher J. Waller, 'Independence + Accountability: Why The Fed Is A Well-Designed Central Bank' (2011) 93 *Review Federal Reserve Bank of St. Louis*, p. 298.

⁸⁸ Ibid.

⁸⁹ Ibid.

⁹⁰ Ibid, p.299.

⁹¹ Alex Cukierman, Steven B. Web and Bilin Neyapti, 'Measuring The Independence Of Central Banks And Its Effect On Policy Outcomes' (1992) 6 *The World Bank Economic Review*.

more technocratic the objectives the less accountability is necessary.⁹² This is especially the case when the objectives require technical expertise rather than political decision making. When analysing the ratio of independence and accountability this research will correct, when necessary, for the objectives factor.

One of the main bodies of research done on this topic is that of Laurens et al. In their work they describe the various trends in independence and accountability. Among which that of the ECB and FED. Their research discovers that the ECB is among the most independent central banks with a score of 0.8 or higher.⁹³ Their accountability on the other hand is also judged as quite high namely between 0.70-0.79 as is the accountability of the FED.⁹⁴ Similarly, the FED is considered to have one of the highest levels of transparency (0.8 or higher), whereas the ECB only scores a medium of 0.45-0.69.⁹⁵ The FED despite high accountability and transparency scores a little lower on the independence scale. Its independence is valued at a score between 0.7-0.79.⁹⁶ Both the ECB and the FED are further considered to have a relatively low accountability deficit.⁹⁷ This statement, however, deserves some attention. Neither in the accountability nor the independence is the legal foundation taken as a measurement. Additionally, the mandate needs adjustment. Price stability as only or major goal ranks higher on the independence scale than when multiple objectives are included.⁹⁸ Taking this into consideration the FED accountability deficit will remain roughly the same. As for the FED, the relationship with the legislator will be closer yet their mandate requires extra accountability. The ECB on this pre-crisis scale will get a similar adjustment. The ECB has a narrower mandate requiring less accountability yet their independence is higher with regard to the legislator. Changing a Treaty is more difficult than changing normal legislation. This has also been noted by De Haan et al in their work. Their research finds in 1998 that the ECB has high accountability when it comes to its mandate. The mandate is very clear on its objectives.⁹⁹ The ECB scores however very low on its transparency with only 1 out of 3.¹⁰⁰ It scores even worse on the final accountability which takes into account the relationship with parliament and the legal foundation. In this, the ECB scores 0.¹⁰¹ Their work, however, also shows that due to the limited mandate the ECB's lack of accountability is not per se a point for concern.

⁹² Meroni doctrine

⁹³ Bernard J. Laurens, Marco Arnone and Jean-Francis Segalotto, *Central Bank Independence, Accountability and Transparency. A Global Perspective*. (Basingstoke: Palgrave Macmillan 2009), p. 156.

⁹⁴ Ibid, p. 164.

⁹⁵ Ibid, p. 168.

⁹⁶ Ibid, p. 156.

⁹⁷ Ibid, p. 181.

⁹⁸ Ibid, p. 129.

⁹⁹ Jacob De Haan, Fabian Amtenbrink and Sylvester Eijffinger, 'Accountability Of Central Banks' [1998] Center Discussion Paper, p. 15.

¹⁰⁰ Ibid, p. 15.

¹⁰¹ Ibid.

The limited accountability of the ECB does not give an immediate reason for concern. As stated before accountability and independence should be in balance. De Haan et al's paper indicates that the ECB is high in independence, but this is largely compensated by their limited objectives.¹⁰² The technocratic mandate, therefore, compensates for the limited accountability. The paper further indicates that the FED has a broader set of objectives yet also has independence higher level of accountability. According to the paper, both banks are closely located to the average ratio of independence and objectives.¹⁰³ Thus indicating that there is a balance between independence and accountability. The ratio between independence and transparency seems to give cause for concern. The ECB is high in its independence (even when correcting for mandate) yet low in its transparency. This is very different for the US whose transparency ratio is much higher.¹⁰⁴ In general, this would give cause for concern when the role of the ECB increases. The accountability of the ECB especially in relation to the legislator and its transparency seems to give some rise for future concern.

The low accountability of the ECB seems to have raised issues pre-crisis. In the work of De Haan dating from pre-establishment, he describes the accountability of the ECB as problematic. He considers the independence of the ECB (mainly due to the necessity of treaty change) and the lack of counterparts cause for concern. Whilst national central banks often face strong counterparts such as a minister of finance or economic affairs the ECB has no such counterpart.¹⁰⁵ This observation will cause the balance between independence and accountability to be upset in case the role of the ECB increases.

3.6. Conclusion

This chapter has examined the concept of accountability and found that it consists of several criteria. The first is that of the objectives and instruments. Whereby clear and limited objectives and instruments provide a higher level of accountability. The second important factor is that of final accountability. This aspect of accountability looks at whether central bank policy can be overturned or governors are held responsible. This research includes accountability through the courts. This was not included in earlier research but has gained in importance since the euro-crisis case law. Thirdly there is the criterion of transparency. Transparency in this research will include communication and governor dissent.

¹⁰² Ibid, p. 18.

¹⁰³ Ibid.

¹⁰⁴ Ibid, p. 19.

¹⁰⁵ Jacob De Haan, 'The European Central Bank: Independence, Accountability And Strategy: A Review' [1996] Kluwer <<https://link.springer.com/content/pdf/10.1023%2FA%3A1004972705141.pdf>> accessed 11 November 2019, p. 417.

This chapter has further identified the legal framework for the independence and accountability of the ECB. The ECB is legally independent of other institutions but does not operate in a political vacuum. Its mandate is determined by its primary monetary objective and secondary economic objective. Its policies may furthermore not violate the prohibition on direct lending of article 123 TFEU and the no bail-out clause of article 125 TFEU. Despite these clear limitations, the role of the ECB as lender of last resort was debated. This chapter furthermore found that the limited role of the ECB was accompanied by a limited form of accountability. The next part of this chapter examined the FED. The FED has a broader mandate and more accountability. The relationship with the U.S. representatives is higher as the independence of the FED is vested in normal law. Furthermore, the governors, though independent, are scrutinized before selection by the senate. The broader mandate combined with more intense accountability is more stable than the ECB relationship.

The accountability and independence of the ECB was a difficult balancing act, to begin with. Its narrow mandate combined with low accountability has functioned under normal economic circumstances where little demand for review was necessary. The euro-crisis and COVID19 crisis, however, have changed this balance. The next chapters will analyse how the crises have impacted the role of the ECB.

4. The role of the ECB during euro-crisis and COVID19 pandemic through conventional policies

4.1. Introduction

This chapter will analyse the role of the European Central Bank in response to the financial crisis and COVID19 through its conventional policies. This chapter will start by giving a brief overview of the euro crisis in section 4.2 and the COVID19 pandemic in section 4.3. Section 4.4. will then continue with a brief description of conventional monetary policy pre-crisis. Section 4.5. will then analyse the impact of the crisis upon conventional policy. It will do so by assessing the two main forms of conventional policy: the interest rates and TARGET2. Before the conclusion section, 4.6 will compare the role of the ECB with that of the FED. This chapter will close with a conclusion in section 4.7.

4.2. The euro-crisis

The financial crisis is not one period of time with one single identifiable cause. According to Trichet, the euro crisis has known three phases. These are the financial turmoil from 09 August 2007, the full-blown financial crisis which started on the 15th of September 2008 and the phasing out of non-standard measures towards the end of 2009.¹

The financial turmoil in 2008 was caused by a combination of a credit boom and a housing bubble.² According to Acharya and Richardson, it further spread to the economy due to the high levels of securitization of large complex financial institutions. Instead of spreading the risk through securitization, they were used to bypass minimum collateral rules.³ The first signs of this turmoil were noticeable in 2007 with the rise in the Libor (interbank lending rate). This rate started to increase as banks were reluctant to lend to one another. The ECB responded to this turmoil by decreasing interest rates and providing liquidity to banks that needed it.⁴ In September 2008 the Bank furthermore increased its liquidity provision. It provided unlimited liquidity to banks at its policy rate interest with maturity rates up to six months.⁵ Secondly, the Bank increased the type of

¹ Jean-Claude Trichet, 'State of the Union: The Financial Crisis and the ECB's Response between 2007 and 2009' (2010) JCMS 48, p. 8.

² Viral V Acharya and Matthew Richardson, 'Causes Of The Financial Crisis' (2009) 21 Critical Review, p. 195.

³ Ibid, p.196-197.

⁴ Jean-Claude Trichet, 'Speech' (Ceremony conferring the honorary title of Doctor Honoris Causa at the University of National and World Economy, Sofia 12 June 2009)

<<https://www.ecb.europa.eu/press/key/date/2009/html/sp090612.en.html>>

⁵ Ibid.

collateral it would accept. It lastly increased the number of counterparties eligible for liquidity.^{6 7} It furthermore decided to ease collateral rules to increase liquidity.⁸ In mid-September 2008 the ECB started its “enhanced credit support”.⁹ The ECB was later credited for its quick response to the financial crisis.¹⁰ The financial turmoil would, however, become a domino starting another crisis in Europe: the euro crisis.

The euro crisis’ main roots lied in the borrowing and lending behaviours towards governments.¹¹ As Hall describes the fault lies with the borrowing governments and the northern countries whose financial institutions did much of the lending.¹² Another issue that lies at the root of the euro crisis is the loss for the southern nations to depreciate their currency. The loss of depreciation combined with domestic economic factors made it difficult to remain competitive.¹³ Their demand-led growth resulted in higher levels of domestic inflation which in turn led to higher labour costs and fewer exports.¹⁴ This was combined with relatively low borrowing costs as the EMU was anchored to countries that were seen as safe.¹⁵ In early 2008 the bond yields of the periphery countries seem to drastically rise.¹⁶ The crisis fully started in 2009 & 2010 when the Greek government announced its deficit was much higher than originally predicted. As of late 2008, the bond yields for the periphery start to rise significantly.¹⁷

Over the course of the euro crisis, the governments incurred heavy debt burdens. Irish debt to GDP rose from 62 to 123 per cent throughout 2009-2013.¹⁸ Portugal’s debt rose from 84 to 130 per cent over the same period.¹⁹ To aid financial recovery and provide assistance to members in severe financial distress the European Stability Mechanism (ESM) was founded in 2012, as a replacement of the European Financial Stability Fund set up earlier in 2010. During the euro crisis, five countries would require ESM assistance: Greece, Ireland, Cyprus, Portugal and Spain. The European Council was criticized for its approach towards the euro crisis. When it introduced 50% haircuts against Greek bonds it did so against the explicit warning of the ECB. The ECB argued

⁶ Ibid.

⁷ Emil Stavrev et. al., *Euro Area Monetary Policy in Uncharted Waters* (International Monetary Fund 2009), p. 3-4.

⁸ ECB Press Release, ‘Measures to further expand the collateral framework and enhance the provision of liquidity’ (15 October 2008) <<https://www.ecb.europa.eu/press/pr/date/2008/html/pr081015.en.html>>

⁹ Stavrev et. al., p. 4.

¹⁰ Wallace 2016, p.1.

¹¹ Peter A. Hall, 'The Economics And Politics Of The Euro Crisis' (2012) 21 German Politics, p. 357.

¹² Ibid.

¹³ Ibid, p. 359.

¹⁴ Ibid, p. 359-360.

¹⁵ Ibid.

¹⁶ Michael G. Arghyrou and John D. Tsoukalas, 'The Greek Debt Crisis: Likely Causes, Mechanics And Outcomes' (2011) 34 The World Economy, p. 175.

¹⁷ Ibid.

¹⁸ Wallace 2016, p. 16.

¹⁹ Ibid.

that it would undermine confidence in the market.²⁰ Though arguably very late the ECB did play an important part in the calming of the markets. The famous words of Mario Draghi in 2012 ‘whatever it takes’ seemed to calm the markets. Despite the calming effect, the ECB was still responding to the financial aftermath of the euro crisis when the second crisis hit: the COVID19 pandemic.

4.3. The COVID19 pandemic

In late 2019 the first Corona cases popped up in China, reaching Europe in early 2020. To stop the spreading of the disease many European nations took countermeasures. The responses to the novel virus varied per country from full lockdown in the southern nations such as Spain and Italy to lesser or “intelligent” lockdowns in the Netherlands.²¹ The economic impact upon the nations, however, is big. The European Commission predicted that the European economy will contract by 7.5% in 2020.²² The recession, it predicted, will not be evenly distributed as the Greek economy is predicted to contract with 9.75%.²³ These numbers indicate the difficulty of a pan-European approach as not all countries are hit equally, thus making it difficult to generate a one-size-fits-all approach.

To mitigate the economic impact the European Central Bank responded fast. The ECB had two overarching principles in this policy response. The first objective was to stabilize the volatility of the markets and the second to ensure the mitigation of the recession in all areas of the economy.²⁴ The main response program of the ECB has been the Pandemic Emergency Purchase Programme (PEPP).²⁵ The PEPP was not the only program implemented by the ECB. In addition to PEPP, the ECB introduced Pandemic Emergency Long Term Operations (PELTRO).²⁶ Furthermore, the ECB conducted Targeted Longer-Term Refinancing Operations (TLTRO).²⁷ These targeted programmes will be discussed in the next chapters. This chapter will start by analyzing the role of the ECB through its conventional policies.

²⁰ Paul J. J. Welfens, 'Stabilizing The Euro Area And Overcoming The Confidence Crisis' (2012) 9 International Economics and Economic Policy, p. 7.

²¹ Localfocus2.appspot.com. 2020. *NOS Corona Maatregelen Europa*. [online] Available at: <<https://localfocus2.appspot.com/5ea96168be999>> [Accessed 28 April 2020].

²² Press Release European Commission Spring 2020 Economic Forecast: A deep and uneven recession, an uncertain recovery.

²³ Ibid.

²⁴ Isabel Schnabel, 2020. *The ECB'S Response To The COVID-19 Pandemic*.

²⁵ European Central Bank, 2020. *ECB Announces €750 Billion Pandemic Emergency Purchase Programme (PEPP)*. [online] [Accessed 28 May 2020].

²⁶ Press Release ECB announces new pandemic emergency long-term finance operations, 30 April 2020.

²⁷ Press Release ECB recalibrates targeted lending operations to further support real economy, 30 April 2020.

4.4. Normal monetary policy:

To assess how the role of the ECB has changed it is important to first discuss what the 'normal' or non-crisis actions of the ECB comprised of. When the ECB was created, the monetary tools it was given were the marginal lending facility, standing facilities, minimum reserve requirements for credit institutions and forward guidance.²⁸ The money supply means the amount of money supplied to the market. The relationship between the money supply and inflation is near to one.²⁹ The ECB may use monetary supply as an extra boost to the economy. The bank can reduce the amount of money on the market by increasing the number of reserves to be held.³⁰

In addition, it was expected the ECB would use open market operations. These operations were expected to cover a span from ad hoc fine-tuning operations. These would be conducted with little advance notice, and longer-term operations conducted monthly based on contracts with three-month maturity and ad-hoc structural operations.³¹ Another monetary tool described by Levitt & Lord is that of reserve ratio adjustment. It was believed that by increasing the reserve ratio the ECB would not need to intervene in the money market. However, it was also argued that the ECB should not use such ratios because they could distort competition.³²

In conclusion according to Bini Smaghi “[...]in normal times the central bank is neither involved in direct lending to the private sector or the government, nor in outright purchases of government bonds, corporate debt or other types of debt instrument. By steering the level of the key interest rates, the central bank effectively manages the liquidity conditions in money markets and pursues its primary objective of maintaining price stability over the medium term. This has proved to be a reliable way of providing sufficient monetary stimulus to the economy during downturns, of containing inflationary pressures during upturns and of ensuring the sound functioning of money markets.”³³ The next paragraphs will thus discuss how the ECB responded through its conventional policy to the crises.

²⁸ Katerina Pantazatou and Ioannis G. Asimakopoulos, 'Conventional and unconventional monetary policy' in Federico Fabbrini & Marco Ventoruzzo (eds.), *Research Handbook on EU Economic Law* (Cheltenham: Edward Elgar 2019), pp. 176-177.

²⁹ Alvaro Pascual-Leone, Vincent Walsh, Carl E. Walsh, *Monetary Theory and Policy* (2nd edn, MIT Press 2003), pp. 9-10.

³⁰ Caravelis 2005, p. 54.

³¹ Levitt & Lord 2000, p. 136.

³² Levitt & Lord 2000, pp. 136-137.

³³ Lorenzo Bini Smaghi, 'Keynote lecture' (International Center for Monetary and Banking Studies (ICMB), Geneva 28 April 2009) < <https://www.ecb.europa.eu/press/key/date/2009/html/sp090428.en.html> >

4.5. ECB's Conventional Crises Policy

In 2012 Draghi, the then governor of the ECB stated that the ECB within its mandate would do whatever it takes.³⁴ Up until 2012, the ECB had not been very active in trying to combat the euro crisis.³⁵ The ECB then introduced several unconventional policies, all of which seemed to have experienced both criticism and praise. The more conventional policies that were impacted by the euro crisis were the interest rates and the payment system. It furthermore undertook several unprecedented actions. The ECB sent letters to the government of Ireland in 2010 and to the Italian government in 2011. The ECB furthermore rolled out two measures to counter-act the euro crisis. The first was the Outright Monetary Transactions in 2012 and the second measure was the Asset Purchasing Programme in 2015.³⁶

The following paragraphs will discuss the exact nature of the measures taken by the ECB and how they impact the role of the ECB. This section will also discuss the legality of the measures. Legality and impact upon role are not the same but interrelated. If a measure is (or should be) considered legal this automatically means it is within the ECB's mandate. If a measure is (or should be considered) illegal the measure is outside of the EU mandate. However, even when a measure is legal and thus within the mandate, this still impacts the role of the ECB. Discussing legality furthermore shows the interpretation of the ECB of its mandate which reflects its vision upon its role (narrow or broad).

The following paragraphs will furthermore compare these actions to those taken in the United States to judge how 'unconventional' these measures truly are. This comparison will provide context to the ECB's actions (see chapter one for more details).

4.5.1. Interest Rates

The ordinary monetary policy is via the change in interest rates. The interest rate set by the central bank influence the interest rates set by the commercial banks. To achieve the desired inflationary target, the ECB can either lower or increase the short-term interest rates. When there is a, perceived, threat of inflation the ECB will increase the interest rates to decrease borrowing and business investment and thereby the flow of money. When there is a threat of deflation the Bank may lower the interest rates to increase consumer borrowing and business investment and thereby the flow of money

³⁴ Mario Draghi, 'Verbatim Of The Remarks Made By Mario Draghi' (Speech by Mario Draghi, President of the European Central Bank at the Global Investment Conference in London 26 July 2012, 2012).

³⁵ Welfens 2012, p. 8.

³⁶ ECB Monetary Instruments, 'Asset Purchase programmes' [last accessed 03 June 2020], <<https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html>>

into the economy.³⁷ In ordinary times central banks, except for Latin America and transition countries, do not change their interest rates.³⁸

The biggest tool the central bank has to adjust monetary policy is the short-term interest rate.³⁹ It varies per system that may set these interest rates. In the Eurozone, these are set solely by the ECB. Four main factors influence the interest rates: actual and predicted levels of inflation, the output gap, the market expectations and changes abroad.⁴⁰ These short term interest rates are mostly used by central banks with an inflationary target, such as the ECB.⁴¹

The effects of monetary policy should neither be underestimated nor overestimated. Monetary policy seems to lose significant effect beyond a five-year horizon. The actions of central banks are considered persistent but not permanent.⁴² Monetary policy has a larger impact on short-term interest rates, its connection with long term interest rates are, however, smaller.⁴³ One reason interest rates are not changed very often can be found in Caravelis' description of interest rates. He describes it as *"the choice of interest rates as an instrument of monetary policy is the recognition that the earlier practice relying on 'monetary aggregate targets' and on control via reserves had failed"*.⁴⁴

Interesting to observe is how the interest rates and their behaviour changed. The pre-crisis deposit rate interest from the ECB varied between 1.00 and 3.75 with an average of 2.42. After the effects of the crisis began to hit in 2007 the average interest rate went down to 1.13. The ECB has been criticized for the current negative interest rates that hit savers and pension funds. More interesting however is the behaviour of the standard deviation to the mean. The standard deviation (0.75) is much lower pre-crisis than after the crisis (1.22), the main reason for this result is the continuous cycle of the interest rates. Before the crisis, the interest rates have been going up and down in cycles, after the crisis the rates have only been going down.⁴⁵ This observation says very little about the role of the Central Bank other than that its behaviour no longer abides by a cycle.

³⁷ ECB, 'what is monetary policy' (10 July 2015), <<https://www.ecb.europa.eu/explainers/tell-me/html/what-is-monetary-policy.en.html>> accessed 06 May 2019.

³⁸ Peter Sinclair, 'The transmission of monetary policy through interest rates' in Lavan Mahadeva & Peter J.N Sinclair (eds), *How Monetary Policy Works* (London: Routledge 2004) Available from: ProQuest Ebook Central. [2 November 2017], p. 4.

³⁹ Sinclair 2004, p. 5.

⁴⁰ Sinclair 2004, p. 6.

⁴¹ Sinclair 2004, p. 7.

⁴² Vance Roley and Gordon Sellon, 'Monetary Policy Actions and Long-Term Interest Rates', *Federal Reserve Bank of Kansas City Economic Quarterly*, (1995)80, p. 84.

⁴³ Roley & Sellon 1995, p. 85.

⁴⁴ Caravelis 2005, p. 55.

⁴⁵ ECB, 'Key ECB Interest rates' [accessed 03 June 2020] <https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html>

Similar observations can be made from the other interest rate data. Showing that indeed the interest rates have changed according to the period of financial instability.

The interest rates have played an important part in the signalling of the ECB towards the market.⁴⁶ Though the interest rates themselves are not a key component of the ECB financial crisis response they have been causing distress. The Dutch and German Central Bank Governors openly criticized the ECB policy. Both governors have been criticizing the low-interest-rate policy.⁴⁷ Knot governor of the Dutch Central Bank has been criticizing the interest rates since 2016, stating that the low-interest rates leave the ECB unable to deal with the next crisis. Additionally, he feels that despite low inflation, interest rates do not need to remain so low. Furthermore, he received various questions from the public concerning the effect of the low-interest rates on savings and pension funds.⁴⁸

The interest rates, therefore, show that the ECB is actively counteracting the financial instability. Though they have remained well within their mandate this conventional policy is currently used to counteract inflation in a perhaps unconventional way. The unconventionality of current interest rates is also confirmed as such by Mr Praet a member of the executive board ECB.⁴⁹ Though perhaps unconventional during the euro crisis the interest rates played a different role during the COVID19 pandemic.

The interest rates had been declining since 2011. With the interest rates negative at the start of the COVID19 pandemic there was little space for the ECB to manoeuvre. As was the criticism of Klaas Knot. This may explain why the ECB did not respond by lowering its interest rates to the pandemic. The low rates forced the ECB to try something new: dual interest rates. During the COVID19 response, the ECB introduced dual interest rates.⁵⁰ According to article 12.1, the ECB is responsible for setting key interest rates. Though there is no specific mention of dual interest rates, there is little reason to consider them illegal. The interest rate adjustment for savings and investments opens many economic possibilities. Lonergan and Green explain that by using different interest rates on deposits and lending the ECB can more precisely stimulate the economy.⁵¹ They furthermore state that using dual interest rates is not tried by many central banks but

⁴⁶ Philippine Cour-Thimann and Bernhard Winkler, 'The ECB'S Non-Standard Monetary Policy Measures: The Role Of Institutional Factors And Financial Structure' (2012) 28 Oxford Review of Economic Policy, p. 781.

⁴⁷ Ingrid Weel, 'DNB-baas knot is keihard over het beleid van de ECB' *Trouw* (13 September 2019).

⁴⁸ Ibid.

⁴⁹ Peter Praet, 'speech The ECB's monetary policy: past and present' (Febelfin Connect event, Brussels/Londerzeel, 16 March 2017)

<<https://www.ecb.europa.eu/press/key/date/2017/html/sp170316.en.html>>

⁵⁰ European Central Bank Press Release, 'ECB announces easing of conditions for targeted longer-term refinancing operations (TLTRO III)' (12 March 2020).

⁵¹ Eric Lonergan and Megan Greene, 'Dual interest rates gives central banks limitless firing power' (*Vox Eu*, 03 September 2020).

offers a wide range of options.⁵² These include avoiding savers being negatively hit by the low rates whilst promoting lending. Thus addressing the criticisms given earlier by the governor of the DNB. The dual interest rates fall in the more conventional sense of central banking, as central banks set interest rates. That they have not been used often is because the economic effects are not yet clear.⁵³ The ECB resorting to such a new strategy indicates the unusualness of the situation where lowering other rates was no longer possible. By resorting to a new strategy of which the effects are not crystal clear the ECB further indicates both a more active role and accountability to national concerns.

The interest rates are not the only conventional policy that has seen the impact of the economic crisis. Another conventional policy that has seen this impact is that of its payment system: TARGET2.

4.5.2. TARGET2

To clear transactions between the different national banks in the Member States, the ECB uses the so-called TARGET2 system. This system clears payments from one Member State to the other via central bank money. If a customer in Italy purchases shoes from Germany, the payment is made through the customer's bank. This bank then writes a cheque to the Italian National Central Bank. The Italian National Central Bank then deducts this amount for the bank and generates a debit towards the European Central Bank (the ECB). The ECB then incurs a debt to the German Central Bank who credits the local German bank who credits the German seller.⁵⁴ The credits and debits are vis-à-vis the European Central Bank. In case of loss, the ECB is the primary risk bearer, if recapitalization is needed the central banks are liable to the extent of their capital share.⁵⁵ Unusual is for this programme is the lack of settlement agreements.

Despite the lack of settlement procedures, this did not lead to large build-ups of debits before the euro crisis. From the data, it can be considered that in 2008 the balances were negligible, with debits no larger than 116 EUR. During the financial instability from 2007-2009, there was a large increase in the balance from mid-2008 until mid-2009. The balances normalized again until mid to late-2014 where the deficits began to drop

⁵² Ibid.

⁵³ Ibid.

⁵⁴ European Bank, TARGET2 European Central Bank (2019), <https://www.ecb.europa.eu/paym/target/target2/html/index.en.html> (last visited Sep 10, 2019).; Karl Whelan, *TARGET2 and central bank balance sheets*, 29 *Economic Policy* 79-137 (2013)., p. 7.

⁵⁵ Karl Whelan, *Professor Sinn misses the target*, VOX (2011), <https://voxeu.org/article/there-hidden-eurozone-bailout> (last visited Sep 10, 2019). European Central Bank, *The Eurosystem's asset purchase programme and TARGET balances* (2019), p. 7.

rapidly.⁵⁶ The balances per individual country differ, Ireland's balances have dropped from mid-2008 to mid-2015 and have since stabilized.⁵⁷ Germany's balance on the other hand has been steadily rising with an extreme peak in August 2012. Its surplus is currently estimated at around 934,640.60 million.⁵⁸ The two more worrisome deficits are those of Italy whose balance has been dropping steadily since mid-2011 to a balance of -486.496.06 million in May 2019.⁵⁹ The balances stabilized and the debits slowly decreased until the second economic challenge hit: the COVID19 pandemic. Since the start of the pandemic in Italy in February 2020 the debits of the Italian Central Bank have been steadily increasing.⁶⁰ The second is Greece whose balance started in 2008 at -19 257.54 million and has known drastic changes during the past years. Their balance has recently returned to a deficit of a little over 20 000 million in 2019 but has been decreasing since the start of the pandemic.⁶¹

Sinn describes the result of this system as forced capital flight from the net exporting countries to Portugal, Italy, Greece and Spain.⁶² The deficit on a TARGET2 account indicates foreign borrowing, whilst a surplus indicates foreign lending.⁶³ During the euro crisis, these accounts have been growing rapidly.⁶⁴ The account of Germany in 2008 was a sum of 115 billion euros compared to 868 in January 2019. On the other hand, Spain's debt increased from -35 billion to -400.8 billion EUR in 2019.⁶⁵ In 2008 the total sum of money that the system owed or was owed was 606.4 billion euros. The average that nations owed or were owed by the system was 40.4 billion euros. This number kept increasing throughout the euro crisis in 2011 and 2012 to respectively 1619.7 and 1934.4 billion euro. In 2019 the final amount of money owed to and by the system is 2343 billion

⁵⁶ Monthly TARGET balances for European Central Bank (ECB) - Quick View - ECB Statistical Data Warehouse, Sdw.ecb.europa.eu (2019), http://sdw.ecb.europa.eu/quickview.do;jsessionid=86CD1AED9B95D96D3AF53CC1EA977ADB?SERIES_K EY=347.TGB.M.4F.E.A094T.U2.EUR.E (last visited Sep 10, 2019).

⁵⁷ Monthly TARGET balances for Ireland - Quick View - ECB Statistical Data Warehouse, Sdw.ecb.europa.eu (2019), http://sdw.ecb.europa.eu/quickview.do;jsessionid=86CD1AED9B95D96D3AF53CC1EA977ADB?SERIES_K EY=347.TGB.M.IE.N.A094T.U2.EUR.A (last visited Sep 10, 2019).

⁵⁸ Monthly TARGET balances for European Central Bank (ECB) - Quick View - ECB Statistical Data Warehouse, Sdw.ecb.europa.eu (2019)

⁵⁹ Monthly TARGET balances for European Central Bank (ECB) - Quick View - ECB Statistical Data Warehouse, Sdw.ecb.europa.eu (2019)

⁶⁰ Monthly TARGET balances for European Central Bank (ECB) - Quick View - ECB Statistical Data Warehouse, Sdw.ecb.europa.eu (2019)

⁶¹ Monthly TARGET balances for European Central Bank (ECB) - Quick View - ECB Statistical Data Warehouse, Sdw.ecb.europa.eu (2019)

⁶² Hans-Werner Sinn, 'The ECB's Secret Bailout Strategy' (2011) 25(42) *The International economy*, at p. 43.

⁶³ David Blake, *The silent bailout system that could rip the eurozone apart*, Financial Times, 2019, <https://www.ft.com/articles/the-silent-bailout-system-that-could-rip-the-eurozone-apart-20180726> (last visited Sep 10, 2019).

⁶⁴ Ibid.

⁶⁵ ECB, TARGET Balances (2019).

euro. The average that countries owed or were owed increased from 40.4 to 156.2 billion euros.⁶⁶

The risks associated with these numbers are currently hypothetical as it depends upon a country leaving the Eurozone without honouring its debt.⁶⁷ This scenario could lead to potential recapitalization.⁶⁸ There was the wish of some Italian government parties to have some of this debt cancelled.⁶⁹ The cancellation is however hypothetical and would, if accepted, be part of a larger programme. Thus making it too hypothetical to further consider. The increases in the TARGET2 figures however make that it is no longer a matter of just accounting. There are real impacts upon the monetary policy and the nature of the EMU. These impacts are enough to doubt the legality of the programme.

For TARGET2 to be considered lawful it must be within the ECB's mandate and abide by the prohibition of direct credit and the no bail-out clause. It is difficult to exactly define the TARGET2 system. The system intends to facilitate trans-European payments. The effect of the system, however, was to fill any liquidity gaps arising after programme failures. Economists like Werner-Sinn⁷⁰ and Whelan⁷¹ have discussed at great length what the economic risks of this system are. There are a variety of opinions, whereby the debate mainly focuses on one country or all countries leaving the Eurozone and not being able to pay back its debts.

To test the legality of TARGET2 the system must be tested whether it is monetary or economic in nature, proportional and no violation of article 123 or 125 TFEU. By assessing the programme under the legal framework the role of the ECB will be clarified. Before doing so there is the question of whether it falls under European Union Law. The TARGET2 system is the payment system of the Eurozone.⁷² The eligible banks enter into a contract with their local national central banks. The system is owned and operated by the Eurosystem but non-euro EU member states also participate.⁷³ It is unclear how exactly this system should be classified and whether it should be seen as its own entity. The application of EU rules, however, should be interpreted broad rather than narrow.

⁶⁶ Calculated using the data from: ECB, TARGET Balances (2019) - not including the ECB and U4 data.

⁶⁷ Ulrich Bindseil & Philipp Johann König, TARGET2 and the European Sovereign Debt Crisis, *Kredit und Kapital* (2012) 45, p. 157-158.

⁶⁸ Oliver Hartwich, *Europe's hidden doomsday machine*, Business Spectator (2019), <https://oliverhartwich.com/2011/11/22/europes-hidden-doomsday-machine/> (last visited Sep 10, 2019); Organisatie DNB - De Nederlandsche Bank, Dnb.nl (2019), <https://www.dnb.nl/over-dnb/organisatie/index.jsp> (last visited Sep 10, 2019).

⁶⁹ David Blake, *The silent bailout system that could rip the eurozone apart*, Financial Times, 2019, <https://www.ft.com/articles/the-silent-bailout-system-that-could-rip-the-eurozone-apart-20180726> (last visited Sep 10, 2019); hypothetical as it is not yet accepted and is unlikely to be accepted without conditionality.

⁷⁰ Hans-Werner Sinn & Timo Wollmershäuser, *Target loans, current account balances and capital flows: the ECB's rescue facility*, 19 International Tax and Public Finance 468-508 (2012).

⁷¹ Karl Whelan, *TARGET2 and central bank balance sheets*, (2013) 29 Economic Policy 79-137.

⁷² European Central Bank, *The Eurosystem's asset purchase programme and TARGET balances* (2019), p. 5.

⁷³ *Ibid.*, pp. 5-6.

A similar question was asked in the *Pringle* case whereby it was questioned whether the ESM Treaty would have to abide by EU rules. The ESM Treaty had been founded by the Member States outside of the European Union platform. The argument that it should therefore be seen as outside of EU law was, however, considered invalid. The Advocate General starts by concluding that regardless of the ESM being an international organisation, Member States will have to abide by EU rules.⁷⁴ The Advocate General further argues that because the ESM funds are derived from share capital from the Member States, they have to abide by EU rules. The argument that the ESM is not the Member States is not valid according to the AG.⁷⁵ It is, in his opinion, not possible for Member States to circumvent article 125 TFEU using an independent international organisation. The Member States would have to abide by EU law even though the ESM was not strictly speaking an EU entity or agreement. Despite the uncertainty on how to exactly classify the TARGET2 system, based upon the previous argument, it will have to abide by EU laws and legislation. Though additional banks may enter, the TARGET2 system is owned and operated by the Eurosystem hence making it unlikely EU law would not apply. Therefore, the next question that needs answering is whether the TARGET2 system is within the mandate of the ECB.

4.5.2.1. Is TARGET2 part of monetary policy?

The first question to answer for a measure to be considered monetary in nature is that of the aim.⁷⁶ Under article 127 TFEU the mandate of the ECB is limited to monetary policy and general support of the economic policy. For TARGET2 to fall within the mandate of the ECB it, therefore, must classify as monetary policy. Under Article 127(2)(b) TFEU and 3.1 of the statute of the ESCB it is given the task to promote the smooth operation of payment systems. The original aim of the system, therefore, seems to fall within the tasks of the ECB. The effect of the measure, however, has more impact than the mere facilitation of the payment systems.

According to Durden the concept of Eurobonds, European Stability Mechanism (ESM) and TARGET2 are very similar.⁷⁷ All three systems are a mechanism whereby collectively guaranteed loans are provided. The ESM and Eurobonds are economic in nature. Though as Durden describes, Eurobonds and the ESM have more parliamentary oversight. In addition, the creditor countries have more control over the interest rates and conditions

⁷⁴ Case C-370/12, *Thomas Pringle v. Government of Ireland* [2012] ECLI:EU:C:2012:675, opinion AG Kokott, para. 109.

⁷⁵ *Ibid.*, para. 110.

⁷⁶ Case C-62/14, *Peter Gauweiler a.o. v. Deutscher Bundestag*, 2015, para. 46.

⁷⁷ Tyler Durden, *Is TARGET2 A Less Than Thinly Veiled Bailout For Europe's Periphery?* Zero Hedge (2012), <https://www.zerohedge.com/news/guest-post-target2-less-thinly-veiled-bailout-europes-periphery> (last visited Sep 10, 2019).

in Eurobonds and the ESM.⁷⁸ As prof. Blake puts it “*all three devices serve as bailout systems and form a “transfer union”*”.⁷⁹ Considering the close resemblance of the ESM and TARGET2 the question is whether the system should be classified as economic policy. Sinn and Wollmershäuser consider that “*If we define fiscal support as a transfer of the command over real economic resources, and monetary policy as a change in the aggregate stock of central bank money balances or its distribution over space, the ECB policies that led to the Target balances clearly constituted fiscal support rather than monetary policies. [...] as also shown, the ECB policy did make real resources available to the crisis countries that would not have been available had they been restricted to the inflow of private capital.*”⁸⁰ The system thus, according to Sinn & Wollmershäuser, provided real resources to the periphery that were not available on the private market, which constitutes fiscal policy.⁸¹ This transfer is, however, not the main aim of the system but rather an indirect effect. The question thus is whether this indirect effect is enough to classify the system as economic.

The balances before the euro crisis were certainly not high enough to generate discussion. These balances should be considered a by-product of promoting smooth payment systems. The current accounts, however, have led to some discussion. The question however remains, do the indirect effects of the TARGET2 system outweigh the direct effects?

The question of indirect effects was further explained by the CJEU in the *Weiss* case.⁸² The BVerfG had argued that these measures can only be considered indirect when they are connected to the challenged measures and when the consequences were unforeseeable. If the effects are intended or foreseeable they can still be considered indirect when they are “[...] *comparable in weight to the monetary policy objective pursued.*”⁸³ Applying that logic to the TARGET2 system it is easy to argue that the effects were foreseeable and do not compare to the monetary objective pursued. Thereby the system would classify as economic rather than monetary. However, before the euro crisis, the system worked smoothly and the balances (deficits and credits) were low. One can argue that it is predictable that without rules on repayment balances won’t be settled and deficits will rise. This argument seems to be largely based, however, on the hind-sight bias. When the European Union was created, a balance-of-payment crisis was

⁷⁸ Ibid.

⁷⁹ David P. Blake, *Target2: The Silent Bailout System that Keeps the Euro Afloat*, SSRN Electronic Journal (2018), p 32.

⁸⁰ Hans-Werner Sinn & Timo Wollmershäuser, *Target loans, current account balances and capital flows: the ECB’s rescue facility*, 19 International Tax and Public Finance 468-508 (2012), p. 487.

⁸¹ Ibid.

⁸² Case C-439/17 *Weiss and others v Bundesregierung* [2018] ECLI:EU:C:2018:1000

⁸³ BVerfG, Order of the Second Senate of 18 July 2017 – 2 BvR 859/15 – paras. (1-137), ECLI:DE:BVerfG:2017:rs20170718.2bvr085915, paraf. 119.

considered impossible.⁸⁴ Therefore for the ECB to have predicted a crisis deemed impossible, and the effect upon its payment system seems a bit far-fetched. A counter-argument can however be made that the balance increases were predictable when the APP was introduced.⁸⁵ At the least, the Asset-Purchasing plans are the explanation for the TARGET2 increases, according to the ECB the APP has led to a rise in cross-border payments by the NCBs when purchasing assets.⁸⁶ Though this explanation has also been criticized.⁸⁷ Perhaps the balances were more predictable with APP it leaves the question of whether this should be considered a fault of the design in TARGET2 or the Purchasing Plans. The argument can be made that it is the ECB's purchasing programme that introduced such high deficits and credits and should have taken this on board in its design. The opposite argument can also be made that TARGET2 as a payment system should be immune to unconventional monetary policies. Both of these arguments carry value. The CJEU in *Weiss*, however, disagreed with this method of interpretation for indirect effects.

It is considered that indirect effects can be foreseeable and accepted.⁸⁸ These effects have furthermore no consequence upon the classification of economic or monetary policy.⁸⁹ The indirect effects, however, cannot be contrary to the policy of price stability.⁹⁰ If therefore the TARGET2 system does not undermine the objective of price stability the indirect effects seem negligible. To judge whether the system undermines the objective of price stability the macro-economic effects of the system must be considered.

Abad et. al. argue that through the TARGET2 system certain creditor and debtor nations develop. The development of these two groups of nations endangers the singleness of monetary policy, specifically liquidity management.⁹¹ The creditor banks will have to offer debt instruments to their banking sector to absorb the excess liquidity. This whilst the debtor countries will have to expand open market operations to increase liquidity in their national banking sector.⁹² The divergence described by Abad et. al. may threaten the 'singleness of monetary policy'. The singleness in monetary policy is embedded in

⁸⁴ COMMISSION OF THE EUROPEAN COMMUNITIES DIRECTORATE-GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS, *One market, one money An evaluation of the potential benefits and costs of forming an economic and monetary union* (1990), https://ec.europa.eu/economy_finance/publications/pages/publication7454_en.pdf (last visited Sep 10, 2019), p. 24.

⁸⁵ Why the ECB rules on risk limitation do not obviate shared liability, OMFIF, <https://www.omfif.org/analysis/commentary/2015/february/why-the-ecb-rules-on-risk-limitation-do-not-obviate-shared-liability/> (last visited Aug 11, 2019).

⁸⁶ TARGET balances and the asset purchase programme online: https://www.ecb.europa.eu/pub/pdf/other/eb201607_box02.en.pdf, p. 1.

⁸⁷ Marcello Minenna, *The ECB's story on Target2 doesn't add up*, *Financial Times* 14 September 2017

⁸⁸ Case C-493/17, *Heinrich Weiss a.o. v. Bundesregierung a.o.*, 2018, para. 63.

⁸⁹ *Ibid.*, para. 63.

⁹⁰ Case C-62/14, *Peter Gauweiler a.o. v. Deutscher Bundestag*, 2015, para. 59.

⁹¹ Jose Abad, Axel Loeffler & Holger Zemanek, *TARGET2 Unlimited: Monetary Policy Implications of Asymmetric Liquidity Management within the Euro Area*, *SSRN Electronic Journal* (2011), Pg. 6.

⁹² *Ibid.*, p. 7.

article 119(2) TFEU as the ‘conduct of a single monetary policy’. It was emphasized by the CJEU in *Gauweiler* whereby it concluded that the ECB was within its mandate when restoring transmission mechanism if the lack of these mechanisms would undermine the singleness of monetary policy.⁹³ By dividing the monetary needs of the countries in two, the effects of the TARGET2 system indeed fall outside the monetary mandate. In their report on APP and TARGET2 the Dutch Central Bank, however, considers the balances to reflect the risk perceptions of various countries.⁹⁴ This would indicate an underlying economic problem whereby TARGET2 is the reflection rather than the cause. The TARGET2 system itself does not create the divide in the singleness of monetary policy only maps the divide. If the latter argument is accepted this makes the TARGET2 system fall within the monetary policy domain. This argument is also strongly considering the balances starting to increase under external economic duress. Though the lack of settlement procedures associated with TARGET2 is a strong argument to consider the cause within the system. The settlement procedures however seem to be more related to proportionality which will be discussed in the following paragraphs.

4.5.2.2. *Is TARGET2 proportional?*

All EU policies, including those of the ECB, have to be proportional.⁹⁵ Proportionality is defined by the CJEU as the “acts of the EU institutions be appropriate for attaining the legitimate objectives pursued by the legislation at issue and do not go beyond what is necessary in order to achieve those objectives”⁹⁶ Since the objective of the system seems to be clearly within the mandate of the ECB the question is whether the act goes beyond what is necessary. There are two steps in which to judge proportionality: suitability and necessity. The first question that of suitability is easily established. The TARGET2 system makes trans-European payments possible. It should therefore be considered suitable to the objective of promoting smooth payments within the Eurozone. The second criterion is whether the system does not go beyond what is necessary to achieve that aim.

From an economic perspective, the difficulties with the system arise with the amounts of debit and credit that are accumulated. Additionally, the TARGET2 credits have been crowding out the Emergency Liquidity Assistance (ELA), thereby surpassing the goal of the system. When ELA lending was insufficient the ECB filled the gaps through the TARGET2 debits.⁹⁷ It can thus be argued that the sizes of the credits and debits go

⁹³ Case C-62/14, Peter Gauweiler a.o. v. Deutscher Bundestag, 2015, paraf. 50.

⁹⁴ DNB Bulletin, *Target2 imbalances reflect QE and persistent fragmentation within the euro area*, 2019, <https://www.dnb.nl/en/news/news-and-archive/dnbulletin-2016/dnb342673.jsp#> (last visited Sep 10, 2019).

⁹⁵ Case C-62/14, Peter Gauweiler a.o. v. Deutscher Bundestag, 2015, paraf. 66.

⁹⁶ Ibid., paraf. 67.

⁹⁷ Markus Konrad Brunnermeier, Harold James & Jean-Pierre Landau, *The Euro and the battle of ideas* (2016), p. 302.

beyond what is proportional to facilitate payment. The large debits and credits are crowding out monetary measures and facilitate capital flight. This combination would arguably render the system to go beyond what is necessary. It is however not that simple.

Some of the TARGET2 balances are caused by the capital flight of the peripheral countries.⁹⁸ This capital flight is due to the lack of faith in the domestic banking industry. As discussed in the second section of this chapter this was especially visible during the euro crisis and the pandemic. When the European Banking Union is fully completed (especially the European Deposit Insurance Scheme) this should re-install faith in the banking sector. Such faith would motivate savers to bring their savings back into the periphery countries. Though the TARGET2 system is an indicator and facilitator of capital flight it is not the cause. The TARGET2 system may be ringing alarm bells but it is not the fire causing the alarm to go off. From a proportionality perspective, however, the extent to which these imbalances seem to grow to give cause to consider limitations. The completion of the banking industry is therefore likely to reduce the risk of capital flight and bring credits and debts down. Capital flight is, however, not the only reason for the high balances.

As Hartwich describes, TARGET2 deficits indicate an important gap in the underlying system. The deficits account for a capital flight and a trade deficit whereby countries such as Greece remained uncompetitive and ran their trade deficits on the TARGET2 system.⁹⁹ The resulting claims are made more fragile because there are no rules of collateral in place concerning the TARGET2 debts.¹⁰⁰ The TARGET2 programme thereby keeps an economic imbalance in place. From a legal perspective, some limits to stimulate economic competitiveness seem necessary.

In the *Gauweiler* case, the CJEU found that the OMT programme was within the boundaries of proportionality due to the various limits.¹⁰¹ The introduction of such measures is not straightforward. A solution proposed by Werner-Sinn in an early paper is to impose a cap upon the TARGET2 system.¹⁰² A cap would keep a balance upon the TARGET2 credits and deficits.¹⁰³ This would arguably make the system more proportional. As Whelan, however, describes such a solution is not very easy to introduce and might be highly disruptive. If a cap were to be introduced the euro would no longer be equal in every country.¹⁰⁴ When a country reaches the cap a euro in the

⁹⁸ Blake 2018, p. 34.

⁹⁹ The New Zealand Initiative, *Bigger than the GFC - Target 2 and the Euro crisis* (2018), <https://www.youtube.com/watch?v=q2QYajGgtw8> (last visited Sep 10, 2019).

¹⁰⁰ Whelan 2013, p. 9.

¹⁰¹ *Ibid.*, paraf. 88.

¹⁰² Hans-Werner Sinn, *The ECB's Secret Bailout Strategy*, *THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY* (2011), p. 43.

¹⁰³ *Ibid.*

¹⁰⁴ Whelan 2013, pg. 27.

debtor state could not leave the country, whereas a creditor state can still freely transfer their euros. According to Whelan, the cap would be highly disruptive¹⁰⁵, not to mention it would be against various principles underlying the Monetary Union, such as the promotion of smooth payment across the Eurozone. To introduce a cap to reach the proportionality requirement, therefore, seems counterproductive. Another solution proposed is that of introducing an annual settlement system. This could take place either via monetary-policy-related assets or senior bonds.¹⁰⁶ As Whelan, however, describes the possibilities to settle these debts with monetary-policy-related assets may not yield proper returns.¹⁰⁷ To settle in senior bonds may even be contrary to the interest of monetary policy. Governments in the debtor countries would have to issue more senior bonds to settle their TARGET2 debts. This increased amount of debt would raise the nation's credit risk and make it more difficult for the ECB to conduct monetary policy.¹⁰⁸ From a proportionality perspective, it seems wise to introduce some sort of mechanism to reduce the TARGET2 balances. In the United States, a similar system is in place called 'Fedwire' whereby the balances are settled periodically through marketable interest-bearing bonds via gold-covered bonds.¹⁰⁹ A periodical settlement may decrease the chances of excessive balances and thereby increase the proportionality of the system. Thereby allowing the system to promote smooth payment throughout the Eurozone without excessive balances with economic impacts. The solutions, however, are not uncontested. The perfect solution might require some more economic head breaking.

It, therefore, seems difficult to determine whether the TARGET2 system is to classify as monetary policy. Its goal is to promote the smooth functioning of payments across the Eurozone which, without doubt, falls within the mandate of the ECB. The indirect effects that were considered do not change this conclusion. From a role perspective, it is however interesting to observe how these effects came about. The divide between the two groups of nations as described by Abad et. al. is not the result of ECB behaviour but rather the result of inaction. If the ECB were to actively ensure settlement the impact would have been different. This indicates two things; that the role of the ECB is influenced by economic circumstances and that both actions and inactions can impact the ECB. The second question concerning the legal framework was proportionality.

The CJEU has however given the ECB a large margin of discretion concerning proportionality.¹¹⁰ If the ECB can justify the system as proportional it is likely the CJEU will accept their argument. This will further be discussed as part of judicial review under accountability. The programme seemed necessary to catch some of the blows of the

¹⁰⁵ Ibid., pg. 38.

¹⁰⁶ Whelan 2017, pg. 21-22.

¹⁰⁷ Ibid., pg. 21.

¹⁰⁸ Ibid., pg. 22.

¹⁰⁹ Europe's Target2 can learn from us, OMFIF, <https://www.omfif.org/analysis/commentary/2018/july/europes-target-2-can-learn-from-us/> (last visited Aug 11, 2019); <https://dokumente.unibw.de/pub/bscw.cgi/d7842948/Target2.pdf>

¹¹⁰ Gauweiler, paraf. 68

euro crisis and currently the pandemic. Though needed the programme crowded out ELA, providing a backdoor to the ECB programme via the ECB's TARGET2. To fully reflect upon the legality and role of the ECB the limits of articles 123 and 125 TFEU have to be considered.

4.5.2.3. No credit & No bail-out

The second main consideration when discussing the legality and the role of an ECB programme is that of articles 123 and 125 TFEU. These articles prohibit direct lending and bail-out systems. Before the euro crisis, these articles were interpreted in three different ways: literal, purposive and ultima ratio.¹¹¹ The financial crisis case law has shown that the CJEU uses an ultima ratio approach towards articles 123 and 125 TFEU. This means that to assess the compatibility of TARGET2 with the no bail-out clause, the literal meaning first has to be discussed. If TARGET2 does not violate the wording of the article then the purpose must be examined. The purpose should be held within the greater concept of the stability of the Eurozone. Regardless of the exact interpretation, the relationship with the government is important. Article 123 TFEU prohibits the ECB or national central banks to grant overdraft or credit facilities to government organs. In its turn article, 125 TFEU prohibits the assumption of liabilities from governments or their bodies governed by public law. To violate these articles a benefit for the governments is therefore required.

4.5.2.3.1. How are Governments involved?

The relationship of creditor and debtor nations with the ECB is most visible in the direct relationship with the NCBs (who are either the direct creditor or debtor). The impact upon the government is in their relationship with their NCB and the private financial sector.

The TARGET2 system impacts the government budgets in several ways. The first and most direct impact is that via the profit and loss distribution of NCBs. The Treaties do not mention rules on ownership of the central bank; this is left for national legislation to determine.¹¹² Under its national law, the federal government of Germany would have to refinance the national central bank in case of negative net equity.¹¹³ Meaning that if

¹¹¹ Borger 2013, p. 129.

¹¹² European Central Bank, OPINION OF THE EUROPEAN CENTRAL BANK of 6 October 2005 at the request of the Italian Ministry of Economy and Finance on an amendment to the draft law on the protection of savings concerning the Banca d'Italia (CON/2005/34) (2015)., paraf.6.

¹¹³ BVerfG, Judgement of the Second Senate of 21 June 2016 – 2 BvR 2728/13-, parafs. (1-220), p. 126.

a debtor were to default the Bundesbank will have to take its share of the loss, according to its capital share in the ECB.¹¹⁴ In the case of both the German Bundesbank and the Dutch DNB, the government is 100% shareholder. This means that these losses indirectly harms the government budget either through refinancing or less profit. This is slightly different for the Italian Central Bank. The Italian Central Bank, Banca d'Italia, is owned by various shareholders.¹¹⁵ Most of these shareholders are private banks and institutes. Two of the shareholders, however, are controlled and owned by the government. These two are the Istituto Nazionale della Previdenza Sociale and the Istituto Nazionale per l'Assicurazione contro gli Infortuni sul Lavoro. Respectively both institutes own 9.000 shares a combined total of 18.000 shares of the 300.000. The government, therefore, has a total of 6% shares. The Italian government's profit on a deduction of their TARGET2 debit is therefore limited.

The second important relation with the government is that of "the bail-out of uncompetitive economies".¹¹⁶ Blake describes that due to the TARGET2 system the government of debtor nations do not have to change the uncompetitive nature of their economies.¹¹⁷ Blake also describes the situation of governments who are unable to raise long-term funding on the private markets, can finance the deficit through commercial bank borrowing via short-term treasury bills. The commercial banks in their place borrow from the national central bank who borrows from the ECB through TARGET2. This situation occurred with Greece who could finance as long as it was in the Eurozone.¹¹⁸ The question is whether this is compatible with the prohibitions laid down in the Treaties. This question will be discussed in the following paragraphs.

4.5.2.3.2. Article 123 TFEU

The wording of article 123 prohibits monetary finance and any form of credit facilities by the ECB to Member State governments. There is no direct relationship between the ECB or the NCBs and the national governments as claims are against private and central banks. Thus making it unlikely there is a direct violation of article 123 TFEU. Thus leaving the question of whether there is a de facto breach of this prohibition. According to economists, the TARGET2 system does provide finance to the Member States.

¹¹⁴ Hans-Werner Sinn & Timo Wollmershäuser, *Target loans, current account balances and capital flows: the ECB's rescue facility*, 19 International Tax and Public Finance 468-508 (2012), p. 473.

¹¹⁵ Bancaditalia.it (2019), https://www.bancaditalia.it/chi-siamo/funzioni-governance/partecipanti-capitale/Shareholders.pdf?language_id=1 (last visited Sep 10, 2019).

¹¹⁶ Blake 2018, pg. 36.

¹¹⁷ Ibid.

¹¹⁸ Blake 2018, pg. 31.

Sinn describes the TARGET2 system as effectively providing Eurobond loans to the debit countries.¹¹⁹ Whereby the Euro-countries respective to their capital share provided loans to the NCBs of the GIIPS. Furthermore, he considers that economically it is irrelevant that the credit flows from the central bank to the commercial bank who then either transfer it to the real economy or the state.¹²⁰ This statement is similar to the Greek situation described by Blake as mentioned earlier. Indirectly it seems that the ESCB is thereby providing liquidity to the state. The question is whether this is enough to consider it a de facto violation of article 123TFEU.

There are several conditions to prevent a violation of the spirit of articles 123TFEU that can be distinguished from the case law. In *Gauweiler* the CJEU first considers a hypothetical situation whereby of a de facto breach.¹²¹ It then further assesses whether there are enough safeguards to prevent such a hypothetical situation. When applying the same approach to TARGET2 the first question is what would be the hypothetical and unlawful situation. The next question is whether the system knows enough safeguards to prevent the hypothetical from taking place. In the TARGET2 situation, the hypothetical would be that of the government being able to withdraw credit from the NCB/ECB through the commercial banks. In this situation, the commercial banks would act as intermediaries for the government in granting them credit with the ECB. Such a situation would seem to violate the spirit of article 123TFEU. The question is whether, like the OMT programme, the TARGET2 system has enough safeguards to prevent such a situation. There are enough safeguards when the ESCB intervention cannot be used by Governments when determining their budget. Second, the intervention cannot harmonize interest rates upon Governmental loans without respect for fiscal discipline.¹²² The programme must therefore entail enough safeguards to ensure budgetary discipline.

To determine whether the spirit of either of these articles is broken the most important criterion is that of budgetary incentive. The Treaties aim to incentivise the Member States to keep a sound budgetary policy. It is, therefore, necessary to assess the impact of the TARGET2 system on the Member States' budgetary policy. Referring back to the example of Blake; with the Greek government obtaining liquidity indirectly through TARGET2. This situation is arguably in violation of the spirit of article 123TFEU. As Blake describes this situation occurred when the Greek government could not obtain liquidity through the financial markets. This should be a clear warning sign to improve the state's financial situation. The CJEU considered the OMT programme lawful because it was limited in its application.¹²³ The TARGET2 system does not entail such limitations within its system. However by placing a cap in 2015 on the number of short-term T-bills that

¹¹⁹ Hans-Werner Sinn & Timo Wollmershäuser 2012, p. 4487.

¹²⁰ Ibid.

¹²¹ Case C-62/14, Peter Gauweiler a.o. v. Deutscher Bundestag, 2015, paraf. 104.

¹²² Ibid, paraf. 113.

¹²³ Case C-62/14, Peter Gauweiler a.o. v. Deutscher Bundestag, 2015, paraf. 116.

could be issued by the government the ECB factually limiting Greece's access to liquidity through TARGET2. This cap was placed upon the government as part of the rescue programme.¹²⁴ It, therefore, seems that the access for the government to liquidity through the TARGET2 system was limited. The cap introduced for Greece is not universal, governments are however bound by the general rules of the SGP. The potential for a government to access liquidity by issuing short-term bonds is therefore not without restrictions. These restrictions may, however, be considered a loss. In addition, as Whelan stated the interest rate upon TARGET2 claims is equal to the MRO.¹²⁵ This low-interest rate may allow the government to obtain liquidity at lower rates than if it were to borrow from the commercial market without TARGET2. Considering these arguments, the question is whether TARGET2 has enough build-in safeguards to prevent governments from using it as a credit facility.

The answer to this question is difficult. The argument that governments can obtain cheap credit through their commercial banks via issuing short-term bills indicates that there are insufficient safeguards. This argument is strengthened by the universal, rather than risk-specific, the interest rate used by TARGET2 leading to easier credit conditions. This argument has led to the system being called the 'credit card for nations with more imports than exports'. The main difference being these loans do not have deadlines for repayment.¹²⁶ The situation with Greece, where this issue presented itself, however, occurred when there was little or no credit available from the markets. It can therefore also be argued that the moment governments reach for this type of credit it is in serious financial trouble. The opportunity to continue borrowing through TARGET2, therefore, gives an argument that the system does not safeguard the impetus to keep a sound budget. The resolution of this situation should not be a concern of TARGET2 but rather one of the Stability and Growth Pact. The question is therefore whether this potential design flaw should be accounted to the TARGET2 system or should be part of the concern of the Eurozone. The latter is arguable as economists and the ECB have observed a trend and relationship between the Purchasing Programme and OMT and increasing TARGET2 balances.¹²⁷ Furthermore to continue borrowing with eased conditions requires countries to issue short-term treasury bills. The requirement to issue such bills is a matter of the SGP, not the ECB. Though the eased conditions made possible

¹²⁴ Claire Jones & Stefan Wagstyl, *ECB weighs curbs on Greek banks' government debt purchases*, Financial Times, 2015.

¹²⁵ Whelan 2013, pg. 8.

¹²⁶ David Blake, *The silent bailout system that could rip the eurozone apart*, Financial Times, 2019, <https://www.ft.com/articles/the-silent-bailout-system-that-could-rip-the-eurozone-apart-20180726> (last visited Sep 10, 2019).

¹²⁷ Ecb.europa.eu (2019), https://www.ecb.europa.eu/pub/pdf/other/eb201607_box02.en.pdf (last visited Sep 10, 2019), p. 4; Others however have argued this explanation to be incomplete, Marcello Minenna, *The ECB's story on Target2 doesn't add up*, Financial Times, 2019, <https://ftalphaville.ft.com/2017/09/14/2193700/guest-post-the-ecbs-story-on-target2-doesnt-add-up/> (last visited Sep 10, 2019).

through TARGET2 remain difficult with respect to article 123 TFEU. With this in mind, the final question is that of article 125 TFEU the no bail-out clause.

4.5.2.3.3. Article 125 TFEU

This question of risk-sharing and article 125 TFEU is not entirely new. The *Weiss* case concerned the ECB's Asset Purchasing Programme.¹²⁸ The programme under discussion, in this case, was the Public Sector Asset Purchasing Programme (PSPP). The programme only allowed for the purchase of bonds that mature no less than 1 year and less than 31 years. These included marketable debt instruments of regional and local governments. The different national Banks buy these instruments according to a division key made by the ECB.¹²⁹ The referring court was concerned that this programme would violate articles 123 and 125 TFEU. This fear was based upon potential loss sharing rules among the NCBs.¹³⁰ The CJEU found that this question was too hypothetical to be considered admissible.¹³¹ This was based upon the lack of loss-sharing rules and no foreseeable rules of that nature.¹³² Since central banks were responsible for their own losses and there was no reason to expect a loss-sharing rule introduced by the ECB it was a question of a hypothetical nature.¹³³ The situation of TARGET2 is, however, different.

The main difference between the TARGET2 system and the situation in *Weiss* is who carries the risk. In the *Weiss* case, the national central banks carried the primary risk for the bonds of their government. As the CJEU rightly states there is no primary law on the losses of central banks, therefore potential losses will have to be sorted out under national laws. Under the TARGET2 system, however, the primary claim is against and by the ECB.¹³⁴ The risk of default of TARGET2 credits is carried by the ECB and thereby by all the NCBs through their capital key. This risk-sharing loss is in theory prohibited by article 125 TFEU. However, in *Weiss* these concerned government bonds rather than claims upon private banks.

¹²⁸ European Bank, Asset purchase programmes European Central Bank (2019), <https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html> (last visited Sep 10, 2019).

¹²⁹ European Bank, Capital subscription European Central Bank (2019), <https://www.ecb.europa.eu/ecb/orga/capital/html/index.en.html> (last visited Sep 10, 2019).

¹³⁰ Case C-493/17, *Heinrich Weiss a.o. v. Bundesregierung a.o.*, 2018, paraf. 16.

¹³¹ *Ibid.*, paraf. 167.

¹³² *Ibid.*, paraf. 163.

¹³³ Though a small portion of the bonds was bought by the ECB thereby introducing some potential loss-sharing. See for more discussion; Annelieke A.M. Mooij, 'The Weiss Judgment: The Court's Further Clarification Of The ECB'S Legal Framework: Case C-493/17 Weiss And Others, EU:C:2018:1000' (2019) 26 *Maastricht Journal*.

¹³⁴ European Central Bank, The Eurosystem's asset purchase programme and TARGET balances (2019), p. 7.

In the *Gauweiler* and *Weiss* cases, article 125TFEU played a less dominant role compared to article 123TFEU. It did however feature more prominently in the *Pringle* case. The reason for this might be quite simple; the Member States were directly involved in the granting of financial support. The measure under examination in the *Pringle* case was that of the ESM. The purpose of the ESM is to provide stability support for members who are in severe financial distress and when the stability of the euro area is threatened.¹³⁵ They will provide support and in return gain preferential creditor status.¹³⁶

The relationship between the governments is very clear in the case of the ESM. The members provide the funds to the ESM and the receiving party is the member in distress. The ESM, however, is of economic policy and not that of the ECB. The relationship with the government in TARGET2 is weak at best. Some governments, however, hold all or part of the shares in their central banks. Thereby creating an indirect link between the central banks and the government. This link, however, depends upon national law as it is up to each individual country to arrange ownership of the national central bank. Thus making it unlikely this would constitute a violation of article 125TFEU. The other benefit that governments enjoy through TARGET2 is that of their private sector.

Until the completion of the European Banking Union, the national governments are responsible for ensuring the saver's deposits.¹³⁷ Since the central banks of the uncompetitive industry do not have to settle, the liquidity remains in their industry. By providing liquidity to the private sector TARGET2 saves an uncompetitive economy from bankruptcy. Thereby preventing the government from having to rescue its banks or having to compensate for lost deposits. The benefit to the government is indirect and is gone upon the completion of the banking union. It is therefore highly questionable this would form a violation of the no-bailout clause. On the other hand by keeping alive an uncompetitive economy the impetus to keep a sound financial policy seems violated. The government is not incentivized to increase the competitiveness of its financial industry. The benefit for the government is indirect but the impetus to keep a sound budgetary policy is also breached. The fact remains however that through TARGET2 uncompetitive sectors are kept alive, not governments directly. Due to the weak relationship with the government, it is unlikely that TARGET2 would be considered illegal.

¹³⁵ Article 3 ESM Treaty.

¹³⁶ *Ibid.*, preamble 13.

¹³⁷ Deposit guarantee schemes, European Commission - European Commission (2019), https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/managing-risks-banks-and-financial-institutions/deposit-guarantee-schemes_en (last visited Sep 10, 2019).

4.5.3. TARGET2 & Role of the ECB

The TARGET2 system has been much debated by the economic community on its impact. It has been labelled as the 'silent-bailout system' and the Bank of International Settlements has stated that the system provided for liquidity flow to the peripheral countries.¹³⁸ Despite these strong words the system however does not seem to be illegal. The question however remained how it has impacted the role of the ECB.

According to some opinions it has created the first version of Eurobonds or transfer union. Homberg points out in an article in 2012 that the ESM was to be formally voted upon, yet was economically already in existence through TARGET2. Similarly, he argues that the TARGET2 system had introduced Eurobonds before they were created.¹³⁹ This creation stretches the role of the ECB. Though perhaps not intentionally, the ECB had created the ESM and Eurobonds Avant-la-Lettre. As the previous paragraphs indicate the system is likely to be considered legal by the CJEU. It does however show the large impact of the crises upon the role of the ECB. In this case, however, the ECB assumed this role passively. Though it can be questioned whether the ECB was passive.

The shock-absorption function that TARGET2 created might have prevented the Eurozone from collapse.¹⁴⁰ The balance excesses, however, continued for a prolonged period of time. Demonstrating the ECB's willingness to tolerate such deficits. These deficits facilitate capital flight, as was the case in Ireland and Spain.¹⁴¹ Facilitating the transfer of funds within the EU is not worrisome. However, by facilitating capital flight the TARGET2 system is aiding underlying economic issues. These issues came to light in 2011 and the system has not been changed, nor have settling attempts been undertaken.

All in all the TARGET2 system indicates that the impact of the crisis upon the role of the ECB is large. This is particularly true because the effect of the system represents that of Eurobonds and the ESM. A system that tolerates such high excesses should be under high levels of accountability.

¹³⁸ Tyler Durden, BIS Admits TARGET2 Is A Stealth Bailout Of Europe's Periphery Zero Hedge (2017), <https://www.zerohedge.com/news/2017-03-06/bis-admits-target2-stealth-bailout-europes-periphery> (last visited Sep 10, 2019).

¹³⁹ Stefan Homberg, 'Notes on the Target2 Dispute' (2012) 13(1) CESifo, p. 53.

¹⁴⁰ Sergio Cesaratto, 'The implications of TARGET2 in the European balance of payments crisis and beyond', (2013) 10(3) *European Journal of Economics and Economic Policies: Intervention*.

¹⁴¹ Homberg 2012, p. 52.

4.6. Conventional policies and the FED

In earlier paragraphs, it has been established that legally the mandate of the FED is broader than that of the ECB. The question is hence how this has or has not been reflected in the actions of the FED during the crisis. The second question that deserves attention in relation to the mandate of the FED is that of flexibility. How flexible is the mandate of the FED in crisis?

As stated by Gros et al. the first phases of the crisis were similar in both the US and the Eurozone.¹⁴² The first response of both the FED and the ECB was to cut interest rates close to zero.¹⁴³ With regard to the FED, it can be observed that the interest rates started to decrease in June / August 2007.¹⁴⁴ In December 2008 the interest rates reached their low point of 0.16 per cent.¹⁴⁵ The interest rates varied between 0.07 and 0.17 per cent until November 2016. They then slowly started to move up to 2.40 per cent in January 2019, roughly half of pre-crisis levels.¹⁴⁶ There seem to be two main differences between the interest rate policy of the ECB and the FED. The FED interest rate was low but remained positive, whilst the ECB has entered the negative numbers. Furthermore, the FED's interest rates decrease, stabilized and increased. The difference is that the rates seem less volatile. It must further be taken into consideration that the ECB's interest rates have decreased to zero and negative from 2012 onwards.¹⁴⁷ At which time the Eurozone started to face a different type of financial crisis. The behaviour of the ECB interest rates thus seems to be more out of the ordinary than those of the FED.

The second large impact the euro-crisis had on the ECB policy is that of the TARGET2 system. It is particularly interesting to compare the impact upon TARGET2 with that of the FED. To settle transactions the FED uses a system called Fedwire. Unlike the TARGET2 system, Fedwire promotes its users to collateralize debits.¹⁴⁸ Institutions using posting collateral avoid paying a fee.¹⁴⁹ During the period of financial instability, Andrews and Kroeger find that the speed of settlement at the Fedwire system increases.¹⁵⁰ The increased settlement they link to the increased liquidity made available

¹⁴² European Parliament, 'Central Banks In Times Of Crisis The FED Versus The ECB' (2012), p. 6.

¹⁴³ Ibid, p. 7.

¹⁴⁴ FED Effective Federal Funds Rate <<https://fred.stlouisfed.org/series/FEDFUNDS>>

¹⁴⁵ Ibid.

¹⁴⁶ Ibid.

¹⁴⁷ Key ECB Interest rates

<https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html>

¹⁴⁸ James McAndrews & Alexander Kroeger, 'The Payment System Benefits of High Reserve Balances', *Federal Reserve Bank of New York Staff Reports* (2016)779, p. 2.

¹⁴⁹ Ibid.

¹⁵⁰ Ibid, pp. 3-4.

by the FED. As a result of the increased settlement, they argue the exposure of the FED is reduced.¹⁵¹

It is interesting to see that when comparing the Fedwire with TARGET2 the financial instability had the opposite impact in the US versus the Eurozone. This shows that a payment system during financial instability does not have to generate an excessive impact. Thereby arguably increasing the role of the payment system and the accountability needed. It should however also be taken into consideration that the Eurozone has a span of different countries. Whilst the US has Federal Reserve banks spread in economic areas. The economic situation is thus not completely similar.

In general, the impact of the crisis upon the unconventional policies of the FED has been less dramatic than with the ECB. This gives belief to think the unconventional policies of the ECB have been overstretched during the crisis. This brings the question of what the impact of the financial instability has been upon unconventional programmes of the ECB and the FED.

4.7. Conclusion

This chapter analysed the role of the ECB during the crises through its conventional policies. Two facets were discussed the interest rates and the TARGET2 system. There is an interesting difference between the two. The ECB actively tried to use the interest rates to counteract the impact of the crises. Whereby the interest rates reached negative levels during the euro-crisis thus forcing the ECB to use dual rates during the COVID19 pandemic. The impact upon the TARGET2 system however rose due to underlying issues. Though the ECB did not use TARGET2 to actively mitigate the crises impact, the system formed a cushion. The system should be considered legal but the difficulties with proportionality indicate that the ECB considers its role to be broad rather than narrow. The impact of this system has changed the role of the ECB as it effectively introduced the first type of Eurobonds.

In comparison with the US, the ECB has been more extreme. The volatility and levels of the interest rates were larger than its American counterpart. The ECB on the other hand dealt with the aftermath of the financial crisis much longer than the FED. The ECB, however, through its conventional policies showed that it was willing to take up crisis mitigation. It adjusted its interest rates in response to the crises. The role of the ECB through its conventional policies was serious. The persistence of negative interest rates followed by unprecedented dual rates and the TARGET2 system indicates a serious response. The impact of the conventional policies on the role of the ECB is not enough to determine whether the balance of independence and accountability has changed. To

¹⁵¹ Ibid, p. 17.

further determine that the impact of the unconventional policy needs to be analysed. The next chapter will therefore discuss the unconventional policies of the ECB.

5. Unconventional Monetary Policy and the euro-crisis

5.1. Introduction

In addition to the conventional monetary policy, the ECB also conducted measures specifically designed to counteract the euro crisis. These measures will be discussed in the coming paragraphs. Section 5.2. will start with discussing the various pressure mechanisms the ECB used before introducing its first targeted programme. The following sections will continue by analysing the different programmes designed by the ECB. Section 5.3. will analyse the Securities Market Programme. Section 5.4 will continue by analysing the Outright Monetary Transaction. Section 5.5. will follow by analysing the role of the ECB within the European Stability Mechanism. Section 5.6. will cover the Asset Purchasing Programme. After having discussed the role of the ECB in its unconventional monetary policy, section 5.7 will compare to the policies of the FED. This chapter will then give a discussion in section 5.8 of the Single Supervisory Mechanism as the change to its legal framework. Section 5.9 discusses the role of the ECB during the euro crisis through its unconventional policies. And section 5.10 will end with a conclusion.

5.2. Pressure upon countries

During the euro crisis, the ECB has put the Member States under pressure through various methods. These methods ranged from threatening to cut off liquidity to redefining collateral lists. These can be best viewed when discussing the Troika negotiations with Greece and the letters sent to various governments. The following paragraphs will briefly analyse the different responses.

5.2.1. Negotiations between Greece and the ECB.

During the negotiations with the Greek government, the ECB has taken off Greek assets of the accepted collateral list. Thereby demonstrating the discretion the ECB has on collateral and how it can be used to sway government opinion.¹ An interesting example

¹ Karl Whelan(2016) : Banking union and the ECB as lender of last resort, Working Paper Series, No. 16/09, University College Dublin, UCD Centre for Economic Research, Dublin, p. 4.

can be found in the statement made by the ECB on the 28th of February 2012.² In this statement, the ECB discussed temporarily the eligibility of Greek bonds as collateral.³ It states that *“Marketable debt instruments issued or fully guaranteed by the Hellenic Republic will become in principle eligible upon activation of the collateral enhancement scheme agreed by the Heads of State or Government of the euro area on 21 July 2011, and confirmed on 26 October 2011, together with a number of other measures aimed at assisting Greece in its adjustment programme. This is expected to take place by mid-March 2012.”*⁴ This statement exemplifies the pressure used by the ECB to increase the incentive for Greece to implement the reforms agreed upon. These reforms are clearly laid out in The Second Economic Adjustment.⁵ The adjustment report also clearly indicates that the reforms agreed upon in the first economic reform were not fully implemented.⁶ The carrot and stick method of the ECB, therefore, has its reasons. Similarly, the ECB has temporarily suspended Greek bonds in July 2012.⁷ According to the ECB press statement, this suspension is in place awaiting the conclusion of the Troika review of the implementation of the second bailout agreement.⁸ In February 2015 the ECB lifted a waiver for minimum credit rating requirements for marketable instruments issued by or guaranteed by the Greek government.⁹ This waiver was lifted because *“The Governing Council decision is based on the fact that it is currently not possible to assume a successful conclusion of the programme review and is in line with existing Eurosystem rules.”*¹⁰ This lift was instigated shortly after the victory of the Syriza party victory in the 2015 elections. They are generally considered a sign of the intensifying relationships between the ECB and Greece.¹¹ The bonds were accepted as collateral a year later following a successful review of the Greek implementation of conditionality.¹² This waiver however did not cover the Asset Purchasing Programme that will be discussed

² European Central Bank Press Release, ‘Eligibility of Greek bonds used as collateral in Eurosystem monetary policy operations’ (28 February 2012)

<<https://www.ecb.europa.eu/press/pr/date/2012/html/pr120228.en.html>>

³ Ibid.

⁴ Ibid.

⁵ European Commission, Occasional Papers 94 2012.

⁶ Ibid, p. 21.

⁷ DECISION OF THE EUROPEAN CENTRAL BANK of 18 July 2012 repealing Decision ECB/2012/3 on the eligibility of marketable debt instruments issued or fully guaranteed by the Hellenic Republic in the context of the Hellenic Republic’s debt exchange offer (ECB/2012/14).

⁸ ECB Press Release, ‘Collateral eligibility of bonds issued or guaranteed by the Greek government’ (Frankfurt, 20 July 2012) <<https://www.ecb.europa.eu/press/pr/date/2012/html/pr120720.en.html>>

⁹ ECB Press Release, ‘Eligibility of Greek bonds used as collateral in Eurosystem monetary policy operations’ (Frankfurt, 4 February 2015)

<<https://www.ecb.europa.eu/press/pr/date/2015/html/pr150204.en.html>>

¹⁰ Ibid.

¹¹ Suzanne Lynch & Derek Scally, ‘ECB bans use of Greek government debt as collateral for loans’ *The Irish Times* (04 February 2015).

¹² ECB Press Release, ‘ECB reinstates waiver affecting the eligibility of Greek bonds used as collateral in Eurosystem monetary policy operations’ (Frankfurt, 22 June 2016)

<https://www.ecb.europa.eu/press/pr/date/2016/html/pr160622_1.en.html>

later.¹³ These cases show the pressure the ECB can exert over nations through its collateral eligibility list that was mentioned earlier by Whelan¹⁴ and how it has been used.

It can be argued that the ECB pressure was necessary. The argument could be made that the ECB had to safeguard its transmission channels and therefore ensure reform took place. It should however be noted that the economic merit of these reforms has been questioned.¹⁵ The reform measures are therefore arguably a matter of economic and political decision-making rather than a technocratic choice. The heavy involvement of the ECB within these choices indicates the growing role of the institution. Another example of the use of ECB influence has been through communications with the Irish, Spanish and Italian governments.

5.2.2. Irish Letters

The case of Ireland and the ECB is one worthy of examining. In 2007 the Irish property bubble burst, leading to severe financial stress. In 2008 the government gave a blanket guarantee to the domestic banks. In 2010 the emergency assistance for the Irish government had been approved.¹⁶ The necessity or effectiveness of emergency assistance for Ireland is not relevant to this research. What is relevant, however, are the circumstances and the ECB pressure under which they applied for assistance.

A few weeks before Ireland applied for emergency assistance correspondence had taken place between the ECB president Trichet and future president Draghi and the Irish Minister of Finance. This correspondence had taken place via the so-called 'Irish Letters'. The Irish Letters refer to the letter sent by ECB governor Trichet to the Irish Minister of Finance on the 15th of October 2010 and on the 19th of November 2010.¹⁷ For a few years, these letters remained unpublished. It was contested under what threat the Irish government was to apply for emergency assistance. As Thomas Beukers writes *"It must be noted first that two slightly different versions exist of what happened in the case of the Irish request for a bailout. Both versions conclude that the request was made under great pressure from the ECB, and both versions argue that the ECB could exercise this*

¹³ COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS MONETARY DIALOGUE WITH MARIO DRAGHI, PRESIDENT OF THE EUROPEAN CENTRAL BANK (pursuant to Article 284(3) TFEU) BRUSSELS, MONDAY, 9 JULY 2018. Accessible

https://www.europarl.europa.eu/cmsdata/151460/Monetary%20dialogue%2009.07.2018_EN.pdf

¹⁴ Karl Whelan(2016) : Banking union and the ECB as lender of last resort, Working Paper Series, No. 16/09, University College Dublin, UCD Centre for Economic Research, Dublin, p. 4.

¹⁵ Stieglitz 2016, pp. 231-247.

¹⁶ 'Ireland | European Stability Mechanism' (*Esm.europa.eu*, 2019)

<<https://www.esm.europa.eu/assistance/ireland>> accessed 10 December 2019.

¹⁷ ECB, 'Irish letters', (Frankfurt, 06 November 2014) <<https://www.ecb.europa.eu/press/html/irish-letters.en.html>>

pressure by threatening to cut off liquidity to the Irish banks. The difference between the two versions lies in the type of liquidity that is threatened to be cut off: emergency lending assistance (ELA) by the Irish Central Bank according to the first version, direct ECB liquidity according to the second version. It may very well be that the ECB actually threatened to cut off both."¹⁸ Before the publication of the letters, there was doubt as to what exactly the ECB has asked the Irish government to do and what threats it made. As Beukers, however, notes not under discussion was the pressure put on the Irish government by the ECB. The letters have since been published and it seems that the ECB was mainly concerned about the Emergency Liquidity Assistance.

In the first letter the Trichet writes *"Therefore, if ELA is provided in significant amounts, the Governing Council will assess whether there is a need to impose specific conditions in order to protect the integrity of our monetary policy."*¹⁹ He then continues by emphasizing the large amounts of liquidity provided to the large Irish banks. In the second letter, Trichet writes a four-point action plan he would like for the Irish government to take. First, the Irish government will have to send a request for financial support to the Eurogroup. This request has to include *"commitment to undertake decisive actions in the areas of fiscal consolidation, structural reforms and financial sector restructuring, in agreement with the European Commission, the International Monetary Fund and the ECB;"* Thirdly funds will be provided for Irish bank restructuring and fourth the Irish government has to guarantee the ELA funds provided.²⁰ The letters, therefore, indicate a concrete call for action from the Irish government if it wishes the ELA to continue. The second letter, however, closes with a different note as well. It states that *"Besides the issue of the provision of ELA, the Governing Council of the ECB is extremely concerned about the very large overall credit exposure of the Eurosystem towards the Irish banking system. [...] The assessment of the Governing Council on the appropriateness of the Eurosystem's exposure to Irish banks will essentially depend on rapid and decisive progress in the formulation of a concrete action plan [...]."* The last paragraph closes on the overall exposure of the Eurosystem besides the ELA. This paragraph hints at the ECB potentially cutting off more liquidity than the ELA thereby hinting that the ECB may have intended to cut off both ELA and general liquidity.

The interesting lesson regarding the ECB's role is that it can pressure countries into accepting emergency assistance and economic reforms. The situation in Ireland may well have been a threat to the overall price stability in Europe. The Greek sovereign debt

¹⁸ Thomas Beukers, 'THE NEW ECB AND ITS RELATIONSHIP WITH THE EUROZONE MEMBER STATES: BETWEEN CENTRAL BANK INDEPENDENCE AND CENTRAL BANK INTERVENTION' (2013) 50 Common Market Law Review, p. 1596.

¹⁹ Letter Jean-Claude Trichet to Mr. Brian Lenihan, (Frankfurt, 15 October 2010) <https://www.ecb.europa.eu/press/shared/pdf/2010-10-15_Letter_ECB_President_to_IE_FinMin.pdf?e19978a39fa112418947d2e16895009a>

²⁰ Letter Jean-Claude Trichet to Mr. Brian Lenihan, (Frankfurt 19 November 2010) <[ecb.europa.eu/press/shared/pdf/2010-11-19_Letter_ECB_President_to%20IE_FinMin.pdf?31295060a74c0ffe738a12cd9139f578](https://www.ecb.europa.eu/press/shared/pdf/2010-11-19_Letter_ECB_President_to%20IE_FinMin.pdf?31295060a74c0ffe738a12cd9139f578)>

crisis has shown that the unrest in one Member State may cause a domino effect on others. It may therefore have been well within the ECB's mandate to act upon the Irish situation. It is furthermore within the ECB's discretion to restrict ELA lending. ELA lending is primarily within the discretion of the NCB but this can be cut off through a 2/3 majority vote from the Governing Council when considered against ECB objectives.²¹ There is no explicit prohibition against sharing the intention of the Governing Council to take such a decision. The cases of the letters however show that the ECB can use this power as leverage. This leverage has a large impact on how the ECB chooses to use its mandate as they push a country toward economic reform. Economic policy, however, is not within the mandate of the ECB. The later cases that will be discussed in the following paragraphs, will indicate that the separation between the economic and monetary policy is not clear cut. It would therefore be unjust to say that a push by the ECB for national economic reform should be considered out of its mandate. What should on the other hand be noted is that the bail-out system in place is agreed upon with the IMF, European Commission, and the European Central Bank. Whereby the ECB has been given several roles in setting criteria, safeguarding the implementation and remaining a close consultant.²² It is therefore difficult to see how the ECB separates its monetary mandate from too much economic interference. Its role in the so-called "Troika" with the European Commission and the IMF has been further debated in the *Gauweiler* case. More discussion on this topic will therefore follow in the next paragraphs. Before, however, moving to the *Gauweiler* case attention should be paid to the letters sent to the Spanish and Italian governments.

5.2.3. Spanish Letters

Besides the letters sent to the Irish government, the ECB decided to send similar letters to the Spanish government. The letter written by Trichet on the 05th of August 2011 to the Spanish government concerned the Spanish sovereign bonds.²³ To restore the "*credibility of the sovereign's signature in capital markets*"²⁴ The Spanish government had to improve the functioning of the labour market. The ECB specifically commented that the wage-bargaining reform bill introduced by the government should allow for

²¹ ELA PROCEDURES (the procedures underlying the Governing Council's role pursuant to Article 14.4 of the Statute of the European System of Central Banks and of the European Central Bank with regard to the provision of ELA to individual credit institutions)

<https://www.ecb.europa.eu/pub/pdf/other/201402_elaprocedures.en.pdf>

²² IMF Press Release, 'Ireland: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding' (03 December 2010)

<<https://www.imf.org/external/np/loi/2010/irl/120310.pdf>>

²³ Letter Trichet to José Luis Rodríguez Zapatero (Frankfurt, 05 August 2011),

<https://www.ecb.europa.eu/pub/pdf/other/2011-08-05-letter-from-trichet-and-fernandez-ordonez-to-zapateroen.pdf>.

²⁴ Ibid.

industry-level agreements. It is highly unorthodox for the ECB to comment on such a bill especially when this is adopted through the democratic process. The ECB furthermore recommended that the Spanish government abolished inflation-adjustment clauses and encourage private sector wage moderation. These are arguably fiscal policies and the right fiscal policy is highly political.

The ECB furthermore commented upon the public finance regime of the Spanish government. It would have to increase transparency and reassure the markets it would keep a sustainable government budget. The comment upon the increased transparency may fit within the general European framework, commenting upon the fiscal reforms necessary seems beyond the mandate of the ECB. Thirdly the ECB comments in this letter upon product reform and the reform of the energy market. To increase the renting market for houses and the increased competition in the services industry. These are arguably not sectors the ECB is at liberty to comment upon. On the other hand, the ECB does refer to statements made earlier, by the Spanish government.

On the 21st of July, the Spanish government concluded, at the Euro Heads of State summit, it was determined to commit to structural reform to achieve fiscal sustainability. This statement as referred to by the ECB was a pre-made commitment by the Spanish government. The ECB, however, is very explicit in how this sustainability should be reached. It does so however without threat as it was seen in the letter sent to Ireland. It can thus be seen as advice from an expert body. However also one with the power to cut off the country to the money supply as was the threat in Ireland.

Torreblanca argues that this letter should be seen as the ECB overstepping its mandate with a stick and carrot at hand.²⁵ The stick he argues is the concrete measures the Spanish government should take. The carrot is the 36 billion euros Spanish and Italian bond purchase starting on August the 8th.²⁶ It is difficult to state whether the ECB overstepped its mandate as the letters were not challenged in front of the CJEU. It does however seem that the ECB is heavily involved in economic policy and played a large role in economic reform. The same day of the Spanish letter the ECB sent a letter to the Italian government.

5.2.4. Italian Letters

The letters sent from Mario Draghi to the Italian government are perhaps more telling of the ECB's mandate than those sent to the Irish or Spanish government. In this letter, the president of the ECB asks the Italian government to reach a more sustainable financial situation (as was the case in the Spanish letter). To do so the Italian government

²⁵ José Torreblanca, Letter to Zapatero, *El País* 04 December 2013.

²⁶ Ibid; part of the Securities Markets Programme.

should liberalize its markets, increase privatization, reform wage-bargaining systems and change laws on hiring and dismissing workers. The government is furthermore asked to improve its administrative efficiency and create a more business-friendly atmosphere.²⁷ As Beukers argues these letters show how the ECB used its position to pressure the Italian government to reform. The letter sets a detailed plan for financial reform. In return, the ECB will buy Italian bonds on the secondary market and thereby reduce the yield on Italian bonds.²⁸

The case of the Italian (or Irish) letters has not been put in front of the CJEU and it is therefore difficult to state if and how these fit into the ECB mandate. Three factors should be taken into consideration when examining the impact upon the role of the ECB. The first is the individuality of the Member State being addressed rather than a common policy.²⁹ The second is the great detail by which the ECB is stating the desired reforms and third the effectiveness of the pressure.³⁰ It is very difficult at this stage to argue that the ECB is not interacting with fiscal policy. It seems to be exerting its will for reform upon the individual Member States. On the other hand, the ECB's assistance cannot be considered a permanent measure and therefore conditionality is arguably within its mandate.³¹

The measures the ECB desires, though potentially within its mandate, are contested. The ECB is demanding economic reform. Reform that is not always within the best economic interest of the country they are demanded from.³² The human costs of these measures are real and often invasive.³³ The ECB is thereby entering political decision-making, an area that requires political accountability. In later chapters, the accountability will be further assessed but it looks unlikely that the independent design of the ECB has left space for political accountability. Certainly, it is questionable the accountability is of such nature as warranted by the difficult economic decisions taken. This will be further discussed in chapters 7 and 8.

²⁷ Letter Trichet & Draghi, 'un'azione pressante per ristabilire la fiducia degli investitori' (Frankfurt/Rome, 05 August 2011) <https://www.corriere.it/economia/11_settembre_29/trichet_draghi_inglese_304a5f1e-ea59-11e0-ae06-4da866778017.shtml?refresh_ce-cp>

²⁸ Beukers 2013, pp. 1599-1600.

²⁹ Ibid, p. 1602.

³⁰ Ibid.

³¹ Ibid, p. 1608.

³² Stieglitz 2016, pp. 231-247.

³³ Ibid.

5.3. Securities Markets Programme

The ECB's Securities Markets Programme (SMP) was established on the 14th of May 2010.³⁴ The programme responded to the "exceptional circumstances" that impeded the ECB's transmission channels. Article 1 of the Decision allows for NCBs to purchase government bonds on the secondary market of all countries that have the euro as their currency. The SMP Decision does not distinguish between the Member States. There are thus no conditionality clauses attached to the SMP.

In 2013 the ECB published the statistics of its SMP holdings in 2012 at the termination of the SMP. The bonds held were those of Ireland, Greece, Spain, Portugal and Italy.³⁵ Except for Portugal, these were the countries in correspondence with the ECB. Though the SMP did not contain explicit conditionality clauses – the coincidence is remarkable. According to Buiter the SMP is the first programme through which the ECB provided LOLR support.³⁶ Furthermore, this programme was the first step towards a QE programme. The ECB did not consider the SMP as QE as all purchases were sterilized. Gros et. al. however argue that due to a large amount of money flowing into the banking sector, sterilization cannot be separated.³⁷ Their article furthermore points out that the SMP bought small amounts of risky assets.³⁸ This strategy is different from the US counterpart, the FED, who did not purchase any risky assets.³⁹

The SMP went largely unnoticed but it can be considered a predecessor of the programme directly following it: the Outright Monetary Transaction.

³⁴ Decision of the European Central Bank of 14 May 2010 establishing a securities markets programme (ECB/2010/5)

³⁵ European Central Bank Press Release, 'Details on securities holdings acquired under the Securities Markets Programme' (21 February 2013).

³⁶ Willem H. Buiter and Ebrahim Rahbari, 'The ECB as lender of last resort for sovereigns in the Euro Area' (2012) CEPR Discussion paper 8974, p. 17.

³⁷ Daniel Gros, Cinzia Alcidi and Alessandro Giovanni, 'Central Banks in Times of Crisis: The FED vs. The ECB' (2012) 276 CEPS Policy Brief, pp. 1-2.

³⁸ Ibid, p. 6-7.

³⁹ Ibid.

5.4. Outright Monetary Transaction

5.4.1. Technical features:

On the 6th of September 2012, the ECB announced its 'Outright Monetary Transaction'-programme or OMT.⁴⁰ The objective of this programme was to safeguard an appropriate monetary policy. The ECB would buy government bonds on the secondary market without a previously set limit of bonds it would buy. The programme would focus on short-term bonds of one to three years. To provide full transparency, the ECB would provide weekly statements on the bonds bought under the programme. Two aspects of this programme are important: conditionality and no previously set limit to the number of purchases.⁴¹

5.4.2. Quantity:

The ECB did not set a limitation to the quantity of bonds that it would or would not buy. The unlimited aspect of the programme in relation to the structure of the ECB meant that it would be hard to predict the costs of such a programme. In the event of losses, the ECB first will turn to its reserves then future profits but if those fail it will look for recapitalisation through NCBs. It is impossible for the ECB to reach the state of insolvency as they can generate money. If losses however continue it must look to the national governments for extra finance. This would be difficult for most governments during a state of a financial crisis.⁴² This burden-sharing lead to a later complaint by Germany, that it violated its parliament's budgetary rights.⁴³

The OMT programme furthermore focused on short-term bonds with a maturity rate of 1-3 years. This short-term maturity rate is interesting, on the one hand, it seems to clash with the medium-term focus of the ECB. On the other hand, however, by purchasing short-term bonds the ECB can more effectively restore its transmission channels.

⁴⁰ European Central Bank (2012). *Technical features of Outright Monetary Transactions*. [online] Available at: https://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html [Accessed 23 Feb. 2018].

⁴¹ Guntram B. Wolff, 'The ECB's OMT Programme and German Constitutional Concerns.' (2017) Think Tank 20: The G-20 and Central Banks in the New World of Unconventional Monetary Policy. [online] pp.26-31. Available at: https://www.brookings.edu/wp-content/uploads/2016/07/TT20-european-union_wolff-2.pdf [Accessed 8 Nov. 2017],, p. 26.

⁴² Daniela Bunea, Polychronis Karakitsos, Niall Merriman and Werner Studener, 'Profit distribution and loss coverage rules for central banks', *ECB Occasional Paper Series*, No. 169/ April 2016, pp.13-14

⁴³ Wolff 2017, p. 27.

5.4.3. Conditionality:

For the ECB to buy bonds on the secondary market the governments issuing the bonds would have to comply with either an ESM or an ESFS programme. The ESM aims to ‘to provide financial assistance to euro area countries experiencing or threatened by severe financing problems’.⁴⁴ To do so they have several financial tools. Two of these tools have been used during the euro crisis, the most infamous are the loans combined with the macroeconomic adjustment programme. It is this programme that Greece, Ireland, Portugal, and Cyprus have received aid from.

The macroeconomic reform programmes that are conditional upon receiving such aid are negotiated by the European Commission, the European Central Bank and when needed the International Monetary Fund (IMF). These institutions are also those charged with monitoring and compliance. The ECB powers of negotiation through the ESM are worth further exploration.

5.5. European Stability Mechanism

The ESM was created in 2012 and provided a mechanism for ESM members in financial need. The interesting part of the ESM Treaty is the role and powers granted to the ECB as part of the infamous ‘Troika’. The Troika is a combination of the IMF, European Commission and ECB. This unit has been carrying out various negotiations during the euro crisis and the role of the ECB has been much debated. This debate centred on the range of the consequent Memoranda of Understanding cover countries’ fiscal policy and other national policies.⁴⁵ In the case of Greece, this included not only the fiscal policy but also labour market reforms, energy regulation and anti-corruption policies.⁴⁶ The question was what role the ECB played in these negotiations. Considering the link between the MoU and fiscal policies, a more active role would mean a higher level of accountability is warranted.

An interesting point in this discussion in the *Gauweiler* case is that made by Advocate General Villalón about the ECB’s participation in the Troika. In his argument, he states that “*The ESM Treaty does in fact confer multiple responsibilities on the ECB in the course of a financial assistance programme, including participation in negotiations and*

⁴⁴ Esm.europa.eu >> assistance >> lending toolkit

⁴⁵ European Parliament Monetary Dialogue, ‘The role of the European Central Bank in the design and implementation of financial measures in crisis hit countries’, November 2015.
<[www.europarl.europa.eu/RegData/etudes/ATAG/2016/570000/IPOL_ATA\(2016\)570000_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/ATAG/2016/570000/IPOL_ATA(2016)570000_EN.pdf)>

⁴⁶ Greece: Technical Memorandum of Understanding 5 July 2017; Supplemental Memorandum of Understanding: Greece Eufin 99/2017.

*monitoring.*⁴⁷ In his opinion, however, tasks are shared with the Commission who has the more important functions.⁴⁸ According to Hofmann the ECB is creating the condition for government bond purchase and thereby in effect reinforcing the incentives to comply with the conditions.⁴⁹ It, therefore, seems to be actively pursuing economic policy objectives rather than incidentally influencing them.

It is within the mandate of the ECB to set the collateral rules through its decisions and acts. It is therefore not strange that the ECB has judged the Greek situation and adapted the collateral standing. What is however interesting to note is that these changes occurred simultaneously to Greek failure to comply with the Troika decisions. This would give rise to the argument that the ECB did indeed conduct economic policy. It can however be argued that the lack of compliance with various agreements has a serious impact upon the economic value of the Greek bonds and therefore their collateral standing. What however should also be noted is that these changes were used as part of a pressure mechanism. Something that seems to deviate from the original idea that collateral would be set in a broad manner to include many trading partners.⁵⁰ Thereby demonstrating that the ECB can use the collateral rules as an instrument to ensure country compliance. This is made more interesting because of the involvement of the ECB within the Troika as a whole.

The debate pivots around the question of whether the ECB was merely an advisory body with technical expertise or an active and equal partner. The ECB is acting upon its powers granted by the ESM-Treaty⁵¹, this Treaty includes the ECB in decision making in the area of economic policy.⁵² In addition, the ECB is given the task to assess the financial needs of the Member State and whether public debt is sustainable.⁵³ Gros argues the term Troika refers to three equal partners making it unlikely the ECB's role was merely advisory.⁵⁴ The term Troika, however, came from newspapers rather than the institutes. Dermine argues a similar point, stating that the Troika strives for consensus and a co-equal partnership where all members have a veto right.⁵⁵ Tasks that are dangerously close to economic policy. Furthermore, the ECB has received criticism for pushing countries into applying for emergency assistance. Despite Draghi's statement, that it

⁴⁷ Villalon, p. 144.

⁴⁸ Ibid.

⁴⁹ Hofmann 2018, p. 18.

⁵⁰ Ulrich Bindseill, Marco Corsi, Benjamin Sahel & Ad Visser, 'The Eurosystem collateral framework explained', Occasional Paper Series (2017) 189, <<https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op189.en.pdf>>, p. 19-20.

⁵¹ Article 13(3) ESM-Treaty.

⁵² Articles 4(3)(4) ESM-Treaty.

⁵³ Article 13(1) ESM-Treaty.

⁵⁴ Gros 2015, p. 6.

⁵⁵ Paul Dermine, 'Out of the comfort zone? The ECB, financial assistance, independence and accountability' (2019) 26(1) *Maastricht Journal of European and Comparative Law*, p. 8.

was not up to the ECB to push countries to apply for emergency funding⁵⁶ This role of the ECB is difficult to place; the ESM Treaty has certainly increased the instruments at its disposal. The European Parliament responded by considering the actions of the ECB to be outside its mandate and finds the role of the Parliament too little.⁵⁷

Pisani-Ferry et. al. state that it is unclear what the exact role of the ECB in the Troika was and there was no clear rationale.⁵⁸ According to their research, there are however three possibilities. The first reason may have been the amount of exposure to the ECB. The second reason their research puts forward is that the European leaders trusted the ECB. Third and final the European leaders may have wanted to include the ECB to ensure the effectiveness of its policies.⁵⁹ If the first were indeed the true motive of the ECB being part of the Troika, this may interfere with its monetary objective. Its objective is to safeguard price stability rather than its budget. It has on the other hand also been considered that a haircut on the holdings of the ECB would be questionable in relation to article 123 TFEU.⁶⁰ It is therefore not without reason for the ECB to wish to avoid this situation. Their research further suggests that there was no clear division of labour rather a contribution of expertise of each of the participants.⁶¹ This seems to be confirmed in statements made by the ECB members.

Zilioli considers the ECB to be the 'junior partner'⁶² and in his contribution, Athanassiou argues that the Troika was there only for technical assessment.⁶³ He refers to the *Pringle* judgement where the CJEU stated that "*Secondly, the duties conferred on the Commission and ECB within the ESM Treaty, important as they are, do not entail any power to make decisions of their own. Further, the activities pursued by those two institutions within the ESM Treaty solely commit the ESM.*"⁶⁴ His work further refers to the decisions being made by the Council.⁶⁵ He further states that ECB was an advisory body for technical advice. Stating that only due to "[t]he heightened visibility of the ECB, as Troika member, was attributable to the weight of its advice rather than to the

⁵⁶ Ajai Chopra, Daniel Gros & Karl Whelan, 'The ECB's role in the design and implementation of (financial) measures in crisis-hit countries.' (2015) *Monetary Dialogue* 12 November 2015, p. 5.

⁵⁷ European Parliament Resolution 13 March 2014, on Employment and social aspects of the role and operations of the Troika (ECB, Commission and IMF) with regard to euro area programme countries, paraf. 2.

⁵⁸ Pisani-Ferry et al 2013, p. 24-25.

⁵⁹ Pisani-Ferry et al 2013, p. 25.

⁶⁰ Grund & Grle, p. 26.

⁶¹ Ibid, p. 26-27.

⁶² Zilioli 2001, p. 179.

⁶³ Phoebus Athanassiou, 'The institutional architecture and tasks of the European Central Bank' in Federico Fabbrini and Marco Ventoruzzo (eds), *Research Handbook on EU Economic Law* (Elgar 2019) p.160-161.

⁶⁴ Ibid; Pringle paraf. 161.

⁶⁵ Council Decision (EU) 320/2010 addressed to Greece with a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit [2010] L145/6.

assumption, by the ECB Governing Council, of any actual decision-making powers."⁶⁶ If this view is considered to be true the ECB was no more than exercising its power conferred by article 132(1) TFEU. This article provides the ECB with the right to deliver opinions.

It, therefore, seems that the participation of the ECB within the Troika is an expansion of its role. The ESM Treaty formalized the role of the letter-writing by the ECB. The ECB has been given additional instruments to co-negotiate and monitor the agreements with states wishing to avail of the ESM budget. Though this role has been considered legal by the CJEU, it should be taken into consideration when discussing the increased role. This role should furthermore be read in combination with the letters that were sent to the Irish, Spanish and Italian governments. As stated in the previous chapter these letters would likely be considered legal. The ECB is at liberty with a 2/3rds majority of the governing board to cut off ELA. The letters however show that the ECB does not shy away from making economic judgements. It further raises the question that if the ECB is capable of making very specific economic recommendations in letters, why would it shy away from making similar demands in its role in the Troika? Thus reducing the credibility of the argument that the ECB was simply the junior partner. The role of the ECB seems to go beyond that of a junior partner. The AG in *Gauweiler* felt the programme was monetary until implementation. This was however not the view of everyone.

Antpohler does not agree that the moment that the OMT programme is enforced it is no longer monetary in nature. He states that the nature of the OMT programme does not change after the programme is activated. The actions of the Troika are, in his view, already economic in nature and should cease. This is, however, regardless of the implementation of the programme.⁶⁷ Furthermore, he refers to extent of the actions of the ECB with the letters it sent to various governments. He sees these letters as potentially unlawful when considered in retrospect. Mainly due to the informal relationship these letters established with the Single Markets Programme (SMP).⁶⁸ Both arguments are interesting to consider.

After the OMT programme is activated it means a country has been submitted under the ESM/EFSS plan and is eligible for coverage under the OMT programme. If one indeed agrees with Antpohler's point of view that little changes after implementation, this would indicate the OMT programme to be economic. This line of reasoning is very understandable. The major change of role for the ECB would be to go from negotiator to moderator. In Antpohler's view, this is not enough to justify and classify the OMT programme as monetary rather than economic, therefore making the actions unlawful.

⁶⁶ Phoebus Athanassiou, 'The institutional architecture and tasks of the European Central Bank' in Federico Fabbrini and Marco Ventoruzzo (eds), *Research Handbook on EU Economic Law* (Elgar 2019) p. 162.

⁶⁷ Antpohler 2015.

⁶⁸ Antpohler 2015.

He, however, also considers that if the ECB left the Troika this may mean the end of the Troika.⁶⁹ Furthermore, he argues that the ECB has established an informal relationship with the SMP. This has been done via the letters that the ECB sent to various governments and institutions.⁷⁰ The OMT programme followed the SMP it is arguable that these informal relations continued with the OMT. The argument of the Advocate General in *Gauweiler* is, however, also very understandable. It, therefore, seems that both points of view are valid and mostly rely upon the perception of the role of the ECB within the Troika. This role is, however, difficult to define.

5.5.1. ESM Reforms

The role of the ECB within the euro crisis might have been difficult to define it is not a persistent issue. Under the new reforms, the Troika will change into the ESM in cooperation with the European Commission. Thus both the IMF and the ECB will no longer participate. Giammaroli and Strauch describe the process of the IMF gradually becoming less financially evolved. The ECB they argue became more focused on tasks closer to its mandate.⁷¹ The ECB leaving the ESM is the temporary and crisis nature of the role of the ECB within the ESM. With the ESM maturing as a facility, it is placing primary emphasis on institutions that will play a long-term role within the ESM. The ECB may have been excluded because of the criticism upon the inclusion of the ECB. It however indicates that whilst the ECB might have been a good institution to include in case of crisis its role is not permanent. It also shows that the ECB is capable of taking a role in the Troika as it did within the crisis.

5.1. Single Supervisory Mechanism

The Single Supervisory Mechanism (SSM) was introduced in 2014.⁷² The SSM was created in response to the euro crisis which showed the interconnectedness of the banking system. The SSM is the mechanism by which commercial banks are supervised and ensured they operate in a financially stable method. The SSM is important to discuss because it provides the ECB with novel tasks.

⁶⁹ Ibid.

⁷⁰ Antpoehler 2015.

⁷¹ Nicola Giammaroli and Rolf Strauch, 'ESM reform – healing the euro area's pandemic scars and beyond' (*ESM Blog*, 14 December 2020).

⁷² Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17)

The ECB is granted the task of supervising large banks and is entitled to provide instructions to these banks. According to Witte this type of instruction right is new as the ECB is entitled to give instructions in an operational capacity rather than under specific circumstances.⁷³ By granting these supervisory tasks Chiti and Recine argue the EU has circumvented the *Meroni* doctrine.⁷⁴ Their article, however, also states that the ECB is limited to its sector.⁷⁵ Within this sector, however, the ECB has reinforced its own prominent position.⁷⁶ Chiti and Recine argue this statement using the example of the Joint Supervisory Teams (JST). Whereby the national coordinators prepare a proposal for approval by the ECB.⁷⁷ This method of decision making is a clear demonstration of the new role of the ECB. Whereby the ECB has gained the central role in a transnational network. Chiti and Recine describe this phenomenon as “*Transnationalism is put at the service of supranationalism*”.⁷⁸ In the *Landesbank* case, the CJEU confirmed that the SSM provides exclusive power to the ECB to be implemented via delegation.⁷⁹ This type of instructional power seems to increase the role of the ECB.

However concerning independence Chiti and Recine also describe that though the ECB is independent, the national supervisory representatives in the SSM board may not be.⁸⁰ Thus decreasing the independence of the decision making with regard to the SSM. The accountability between the national supervisors and the ECB is not yet clarified.⁸¹

The SSM generated a system of financial supervision that is largely separate from monetary policy. It is subjected to a different legal regime which is similar to that of monetary policymaking. As the CJEU considers both technical decisions the legal considerations are similar.⁸² The SSM’s supervisory nature and the involvement of national authorities make that this is beyond the scope of this research. As stated in the first chapter this research’s interest is that of monetary policy. It is therefore important to note the addition of supervisory tasks to the ECB mandate. However, it is beyond the scope of this research to further examine the exact impact upon the independence and accountability of the ECB.

⁷³ Andreas Witte, ‘The application of national banking supervision law by the ECB: three parallel modes of executing EU law?’ (2014)21(1) MJ, p. 98.

⁷⁴ Edoardo Chiti and Fabio Recine, ‘The Single Supervisory Mechanism in Action: Institutional Adjustment and the Reform of the ECB Position’ (2018) 24(1) European Public Law, p. 107.

⁷⁵ Ibid, p. 106.

⁷⁶ Ibid, p. 112.

⁷⁷ Ibid, p. 111.

⁷⁸ Ibid.

⁷⁹ Case T-122/15 *Landeskreditbank Baden-Württemberg – Förderbank v European Central Bank* [2017] ECLI:EU:T:2017:337, para. 54.

⁸⁰ Chiti and Recine 2018, pp. 113-114.

⁸¹ Argyro Karagianni and Miroslava Scholten, ‘Accountability Gaps in the Single Supervisory Mechanism (SSM) Framework’ (2018) 34(2) Utrecht Journal of International and European Law.

⁸² Henning Berger, ‘How to challenge the ECB: Lessons from first EU court cases on the SSM’ (*Financial Regulatory Observer* – December 2019. White & Case, 20 December 2019) <<https://www.whitecase.com/publications/insight/financial-regulatory-observer-december-2019/how-challenge-ecb-lessons>>.

5.2. Asset Purchasing Programme

The programme following OMT is the Public Sector Asset Purchasing Programme (PSPP), more commonly known as “Quantitative Easing” or “QE”. It is one of the four programmes conducted under the Asset Purchasing Programme. This programme buys private sector assets that are linked to the real economy via loans that banks grant to households. In addition, the programme has a signalling effect aiming to reduce the volatility and uncertainty of the markets.⁸³ It is the first programme of this size and scope to be conducted by the ECB.⁸⁴

The programme aims to increase household spending, by easing financial conditions.⁸⁵ It was taken as part of *“the single monetary policy in view of [...] the objective of maintaining price stability”*.⁸⁶ The phrasing of this decision is interesting as it seems that price stability is part of the single monetary policy, thereby inferring these two are not synonyms. Countries that are under a financial assistance programme are only eligible for participation after a positive programme review.⁸⁷

The programme only allows for the purchase of bonds that mature no less than 1 year and less than 31 years. These include marketable debt instruments of regional and local governments. The different national Banks buy these instruments according to a division key made by the ECB.⁸⁸ The programme was announced to run at least till September 2016.⁸⁹ The end of this programme was announced in June 2018, the programme was reducing in size starting from September 2018 and ended in December 2018.⁹⁰ The programme was then restarted in January 2019 with reinvestments and net purchasing was continued in November 2019.

⁸³ How does the ECB’s asset purchase programme work? < <https://www.ecb.europa.eu/explainers/tell-me-more/html/app.en.html> > updated 28th of February 2019.

⁸⁴ Domenico Lombardi & Manuela Moschella, ‘The government bond buying programmes of the European Central Bank: an analysis of their policy settings’ (2016) 23 Journal of European Public Policy, p. 14.

⁸⁵ DECISION (EU) 2015/774 OF THE EUROPEAN CENTRAL BANK of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10), p. 1.

⁸⁶ Ibid, p. 1.

⁸⁷ DECISION (EU) 2015/774 OF THE EUROPEAN CENTRAL BANK of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10), art. 4.2

⁸⁸ Capital subscription <<https://www.ecb.europa.eu/ecb/orga/capital/html/index.en.html>> , accessed 03 May 2019.

⁸⁹ European Central Bank, Press Release ‘ECB announces expanded asset purchasing programme’, 22 January 2015.

⁹⁰ European Central Bank, Press Release ‘Monetary policy decisions’, 14 June 2018, www.ecb.europa.eu/press/pr/date/2018/html/ecb.mp180614.en.html, visited 20 December 2018.

5.3. The US FED Mandate

As stated in the introduction of this research the impact of the crises will be compared to the impact upon the US Federal Reserve Bank. By comparing with this bank context will be created for assessing the ECB's actions. The following paragraphs will describe and analyse the role of the FED during the euro crisis. Furthermore, compare the role of the FED to that of the ECB.

When looking at the unconventional programmes the FED seems to be faster and more determined to fight the crisis than the ECB. The FED started its quantitative easing programme in 2009 with a value of 1000 billion. It bought various private assets thereby taking significant credit risk.⁹¹ The ECB's programme in comparison was limited to 300 billion⁹² and the ECB remained more risk-averse than the FED.⁹³ The further balance sheet increase of the FED is on a much larger scale than that of the ECB.⁹⁴ It thus seems that during the initial phase of the crisis the actions of the ECB were on the cautious side compared to those of the US.

The ECB, however, has actively counteracted the crisis through unconventional policy. It negotiated with individual countries to relieve the crisis. As argued in earlier paragraphs these form of negotiations has been considered unconventional. From these cases, it can be concluded that the mandate of the ECB is interpreted in a broad manner. The question is if and to what extent has the FED undertaken similar actions with similar lessons for its mandate?

The answer to this question is simple yet complicated. Simply put the FED has not negotiated with individual countries, as it doesn't operate in an area of multiple countries as with the ECB. This does not however mean that the FED has not undertaken other unconventional methods. Unlike the ECB the responses of the FED were aimed at the bailout (or lack thereof) of large companies. These actions often coincided with various legal changes and power definitions. They thus deserve further examination. Before starting with the actions and legal changes the next paragraph will provide a brief overview of the FED's legal framework before the financial crisis.

⁹¹ European Parliament, 'Central Banks In Times Of Crisis The FED Versus The ECB' (2012), p. 7.

⁹² Ibid.

⁹³ Marcel Aloy and Gilles Dufrénot, 'A Comparison Of The Fed'S And ECB'S Strategies During The Subprime Crisis' In Monetary Policy In The Context Of The Financial Crisis: New Challenges And Lessons.' [2015] Emerald Insight, p. 445.

⁹⁴ European Parliament, p. 8.

5.3.1. Legal Framework

According to the Federal Reserve Act the FED can lend via the discount window but under normal circumstances not to non-depository institutions.⁹⁵ The exception to this rule is found in section 13(3) of the Federal Reserve Act. There are three conditions to be fulfilled. As described by Ball the first two conditions were met, namely that there were unusual circumstances and that it was not possible to lend from the market.⁹⁶ The third condition is that there is “satisfactory security”. This condition is more difficult to define and remained vague. As Bell argues this criterion is possibly violated by the FED with regards to the Lehmann bailout.⁹⁷ There are several observations to take into consideration when discussing this section.

The first observation is that of the first criterion of section 13(3) namely that of the unusual circumstances. It seems uncontested that the financial crisis classified as unusual circumstances.⁹⁸ The classification of the ECJ of the crisis as unusual circumstances should therefore not be considered unusual. Especially when considering that the ECB was also facing a crisis within the Eurozone.

The second observation at this point is that the FED is given more power during unusual circumstances. Hence it seems that it is not unusual for central banks to have more powers during a crisis than under normal circumstances. The difference, however, between the FED and ECB at this point is that the extra powers of the FED are codified within the Federal Reserve Act.

5.3.2. Policy responses

5.3.2.1. *Bear Stearns and AIG*

Loans under section 13(3) were made only on sparse occasions before 2008.⁹⁹ In 2007 the FED had opened the Term Auction Facility. This lending facility operates against

⁹⁵ Section 10B and 13(3) Federal Reserve Act.

⁹⁶ Laurence M. Ball, *The Fed And Lehman Brothers* (Cambridge University Press 2018), p. 50.

⁹⁷ Ibid, pp. 50-54.

⁹⁸ See: Bell 2018, Christian A. Johnson, ‘Exigent and Unusual Circumstances: The Federal Reserve and the U.S. Financial Crisis’ (2011) *Law Reform and Financial Markets* and Alexander Mehra, *Legal Authority in Unusual and Exigent Circumstances: The Federal Reserve and the Financial Crisis*, 13 U. Pa. J. Bus. L. 221 (2010).

⁹⁹ Mehra 2010, p. 229.

broader collateral to provide liquidity without the stigma of discount window lending. This facility was considered to have been effective for a while and legally uncontested.¹⁰⁰

When in March Bear Stearns faced serious liquidity issues, it prompted the FED to open their discount window. As Cox explains *“the inability of Bear Stearns to borrow against even high-quality collateral on March 13th and March 14th — an unprecedented occurrence — has prompted the Federal Reserve’s action to open the discount window to investment banks.”*¹⁰¹ The situation for Bear Stearns was unusual as despite its solvent position it could not secure liquidity. The various explanations brought forward by Ball suggest that it was the right decision for the FED to open its discount window.¹⁰² This situation was then further used to trigger section 13(3) for two further programmes; the Term Securities Lending Facility (TSLF) and the Primary Dealer Credit Facility (PDCF).¹⁰³

Bear Stearns received \$12.9 billion in loans on the 14th of March 2008, a few months before Lehman Brothers received aid.¹⁰⁴ Bear Stearns was able to provide \$13.8 billion in collateral for this transaction and the loan carried the primary interest rate.¹⁰⁵ The FED’s aid aimed to ensure that the firm could meet its upcoming liabilities and find alternatives on the private market. The alternative came through JP Morgan Chase. The interesting aspect of this case is that of the political response. Paul Volcker stated that this had led *“[...] the Federal Reserve judged it necessary to take actions that extend to the very edge of its lawful and implied powers, transcending certain long embedded central banking principles and practices.”*¹⁰⁶ Various other public and influential figures expressed their dislike over the rescue of this firm.¹⁰⁷ In his conclusion Ball states that Lehman Brothers was later not rescued due to the fear of political backlash.¹⁰⁸ The FED, however, did initiate several programmes as a result of the Bear Stearns crisis.

The TSLF was a weekly auction that started in March 2008 and ended in February 2010. This programme aimed to free up liquidity on the market by auctioning Treasury bonds against collateral.¹⁰⁹ The collateral classes set were investment-grade corporate, municipal, mortgage and asset-backed securities.¹¹⁰ The use of mortgage-backed

¹⁰⁰ Philip A. Wallach, *Legality, Legitimacy, and the responses to the 2008 financial crisis. To the Edge*, (Brookings Institution Press 2015), p. 45.

¹⁰¹ Christopher Cox, *Testimony Concerning Recent Events in the Credit Markets* (03 April 2008), <<https://www.sec.gov/news/testimony/2008/ts040308cc.htm>>

¹⁰² Ball 2018, pp. 24-25.

¹⁰³ Ball 2018, p. 27.

¹⁰⁴ Ball 2018, p. 179.

¹⁰⁵ Board of Governors of the Federal Reserve System, *Bear Stearns, JPMorgan Chase, And Maiden Lane LCC* <<https://www.federalreserve.gov/regreform/reform-bearstearns.htm>>

¹⁰⁶ Paul Volcker, ‘Remarks’ Luncheon of the Economic Club of New York (New York, 08 April 2008), p. 2. <<http://blogs.denverpost.com/lewis/files/2008/04/volckernyeconclubspeech04-08-2008.pdf>>

¹⁰⁷ Ball 2018, p. 210.

¹⁰⁸ Ball 2018, p. 209.

¹⁰⁹ Term Securities Lending Facility <<https://www.federalreserve.gov/monetarypolicy/tslf.htm>>

¹¹⁰ Term Securities Lending Facility: Program Terms and Conditions (25 June 2009) <https://www.newyorkfed.org/markets/tslf_terms.html>

securities is an interesting choice. This form of collateral was generally considered unsafe by the market.¹¹¹ It is furthermore interesting for the FED to have used section 13(3) as a legal basis for its actions. This legal authority has not been used since 1934.¹¹²

The Primary Dealer Credit Facility (PDCF) was announced by the New York Fed on the 25th of June 2009 and took effect on the 25th of September. It aimed at providing loans, against eligible collateral, for primary market dealers.¹¹³ The PDCF programme accepted low and even unrated collateral.¹¹⁴ According to Posner, the FED has discretion considering the assets must be “*secured to [the FED’s] satisfaction*”.¹¹⁵ To remain within the limits of the law Posner however argues that the FED could take assets with low value because the value was suppressed by the crisis. The FED, however, could not take assets that have no or little core value, to begin with.¹¹⁶ He furthermore states that this programme is difficult to evaluate because the FED’s asset-valuation considerations were unpublished.¹¹⁷

Interestingly it was created on the 16th of March just after the Bear Stearns crisis. As Wallach describes the PDCF would have included Bear Stearns. With access to the PDCF Bear Stearns would perhaps not have needed a buyout from JP Morgan.¹¹⁸ Wallach further describes that this ad hoc reactive policymaking often creates the impression of favouritism and arbitrariness.¹¹⁹ He furthermore finds that this deal is noteworthy from a legal aspect due to the amount of risk. The FED “[b]y exposing itself to such a clear possibility of a loss, the Fed invited charges that it was basically subsidizing the deal”.¹²⁰ Cecchetti states about the rescue of Bear Stearns that “*The subsidy implicit in the loan to Bear Stearns is clearly a fiscal, not a monetary, operation. The Federal Reserve is effectively acting as the fiscal agent for the Treasury. As an aside, note that actions in which the fiscal authority dictates how the central bank holds its assets can run the risk of compromising central bank independence if they become a regular occurrence.*”¹²¹ This inter-relation between the fiscal and monetary policy is furthermore emphasized by the “all money is green” relationship. As Wessel describes, neither the FED nor the Treasury wanted to take the heat resulting from the bailout. The Treasury and the FED were however in agreement that Bear Stearns needed a bailout. The Treasury took the standpoint that “all money is green” meaning that regardless of whether the FED or

¹¹¹ Wallach 2015, p. 46.

¹¹² Ibid.

¹¹³ Term Securities Lending Facility: Program Terms and Conditions (25 June 2009)
<https://www.newyorkfed.org/markets/tslf_terms.html>

¹¹⁴ Ibid.

¹¹⁵ Posner, p. 1550.

¹¹⁶ Ibid.

¹¹⁷ Ibid.

¹¹⁸ Wallach 2015, p. 50.

¹¹⁹ Ibid.

¹²⁰ Ibid.

¹²¹ Stephen G. Cecchetti, ‘Crisis and Responses: The Federal Reserve in the Early Stages of the Financial Crisis’ (2009) 23(1) *Journal of Economic Perspectives*, p. 70.

Treasury would bailout, it would be done with tax money. The FED was uncomfortable with transgressing over the lines of normal monetary policy. Bernanke and Geithner thus wanted the endorsement of the Treasury – which was offered through a note stemming from Secretary Paulson.¹²² The bailout for Bear was later hindered and restructured. In the second restructure the FED did not give a loan to JP Morgan to buy Bear but created a Special Purpose Vehicle (SPV) called Maiden Lane. It then lent the money to this SPV.¹²³ Coy described this manoeuvre by the FED as *“The Federal Reserve has stretched its mandate up, down, and sideways to prevent a financial market deluge. Now it appears to be stretching the English language a bit as well”*.¹²⁴ The reason Coy describes the actions of the FED in this way is that in his view what was called a “loan” to the SPV practically ensured that the FED was buying Bear assets.¹²⁵

There are interesting conclusions and comparisons to be drawn between the actions of the FED and the ECB. The ECB has been faulted for acting at a late stage of the crisis as a reaction to the political stand-still of the rest of the EU. This is interesting in comparison to the FED’s game of hot-potato with the Treasury. Both central banks seemed to have been reluctant to act. In both cases, the political will to counteract specific issues, Bear Stearns and Greece, was complex too. It can be reasonably assumed that all political bodies involved wanted to counteract the financial instability. The institutions, however, feared the political backlash and thereby forced both central banks to take, perhaps uncomfortable, unconventional methods. In the case of Bear Stearns, it was, however, the US Treasurer who encouraged a low offering by JP Morgan. Thereby aiming to send a strong signal that bailouts were not a desirable option.¹²⁶ This is slightly different from the ECB who tried to negotiate conditions during its letter-writing campaign. The close relationship between the Treasury and the FED is, however, comparable to the relationship between the ECB and Troika. As we see the close cooperation, on an assumingly equal level, with a political body and central bank.

In addition to the Bear Stearns bailout, the FED saw no other option than to rescue another financial giant namely AIG. Bernanke explained that *“[...] the failure of AIG would have been basically the end. It was interacting with so many different firms. It was so interconnected with both the U.S. and the European financial systems and global banks. We were quite concerned that if AIG went bankrupt, we would not be able to control the crisis any further.”*¹²⁷ In this statement, Bernanke indicates the level of urgency and the extraordinary conditions as they were perceived by the FED’s governing council. Thus perhaps justifying the unusual measures it took to bail out AIG.

¹²²David Wessel, *In FED We Trust: Ben Bernanke’s War on the Great Panic* (1st edn, Crown Publishing Group 2009), p. 169.

¹²³ Wallach 2015, p. 53.

¹²⁴ Peter Coy, ‘Where No Fed Has Gone Before’ *Bloomberg Businessweek* (26 March 2008).

¹²⁵ Ibid.

¹²⁶ Wallach 2015, p. 51.

¹²⁷ Ben Bernanke, *The Federal Reserve and the Financial Crisis* (Princeton University Press, 2013), p. 71.

To bailout AIG the FED created two new SPVs, Maiden Lane II and Maiden Lane III to buy various assets from AIG and its counterparties.¹²⁸ The FED was to share in the loss or potential profits of this enterprise.¹²⁹ The FED also took around 80% of AIG's equity and placed this in trust for the benefit of the Treasury.¹³⁰ This transaction was later challenged in front of the courts. In *Starr International Co. v. United States* the Court decided that the FED was not mandated to take equity in AIG.¹³¹ Thereby defining the FED's powers narrowly rather than broad, something some consider troubling.¹³² The Court found in *Starr* that the FED only has the express power under article 13(3) to charge interest. The incidental powers that the Act refers to are those only expressly authorized before in the Banking Act.¹³³ An interesting difference in flexibility, whilst the CJEU was quick to give the ECB a flexible mandate during the euro crisis – the US court seems to remain rigid. This view, also, seems conflicting with the view of the Circuit Court in the case of *Arnold Tours*. In this case, the Court held that incidental banking powers may be different from those expressly stated in the Banking Act. As long as these incidental powers are directly related to its expressed powers.¹³⁴ An article therefore comments it is likely that the *Starr International* case would be appealed.¹³⁵ In appeal, it was decided that the shareholders didn't have standing. The question of FED powers was not discussed as it concluded that "*the other issues regarding the merits of those claims are rendered moot*".¹³⁶ This decision was upheld by the Supreme Court in appeal.¹³⁷ This judgement, perhaps, gives little finality to the question of the FED's powers and how they were wielded. It should not be considered the new approach for the FED. In his lectures, Bernanke states that within the board the approach towards Bear Stearns and AIG was considered "difficult" and "distasteful" but it was needed to prevent full collapse.¹³⁸

It, therefore, seems that these past actions should not be considered the new standard approach. When comparing these actions to those of the ECB another interesting discovery can be made. The FED worked with the Treasury and was later questioned on this behaviour. The ECB when considering bailouts worked with the Commission. They

¹²⁸ Posner 2016, p. 1550.

¹²⁹ Ibid.

¹³⁰ Ibid.

¹³¹ Case- 121 Fed. Cl. 428 (2015), *Starr International Co. V. United State. Court of Federal Claims Holds that Government Acquisition of Equity Share in AIG effected an Illegal Exaction.* <<https://harvardlawreview.org/2016/01/starr-international-co-v-united-states/>>

¹³² Ibid.

¹³³ Ibid.

¹³⁴ *Arnould Tours, Inc. v. Camp* – 472 F.2d427 (1st Cir. 1972), LexisNexis Law School Case Brief

¹³⁵ Case- 121 Fed. Cl. 428 (2015), *Starr International Co. V. United State. Court of Federal Claims Holds that Government Acquisition of Equity Share in AIG effected an Illegal Exaction.* <<https://harvardlawreview.org/2016/01/starr-international-co-v-united-states/>>

¹³⁶ Case 856 F3d 953 (Fed. Cir. 2017), *Starr Int'l Co. v. United States*, p. 2.

¹³⁷ *Starr International Company Inc. V. Unites States* <<https://www.scotusblog.com/case-files/cases/starr-international-company-inc-v-united-states/>>

¹³⁸ Ben S. Bernanke, *The Federal Reserve and the Financial Crisis* (Princeton Press 2013), p. 71.

placed austerity measures upon the Member States without being the preferential creditor. The increased risk associated with that status was a topic of discussion in the *Gauweiler* case.¹³⁹ These actions of the ECB have furthermore been questioned because of the bailout effect on the large banks.¹⁴⁰ The opposite happened in the US where the FED was questioned for taking equity from the investors to benefit the Treasury. A perhaps even more interesting response of the FED was that to Freddie Mac and Fannie Mae.

5.3.2.2. Freddie Mac and Fannie Mae

The companies Freddie Mac and Fannie Mae (Federal National Mortgage Association) were owned by shareholders were public institutions that turned into for-profit companies.¹⁴¹ The federal government however held preferred stock in Fannie Mae whilst shareholders held common shares. Additionally, the company was given tax and regulatory benefits.¹⁴² Freddie Mac was created as the Federal Home Loan Mortgage Company in 1970 by congress through the Emergency Home Finance Act.¹⁴³ Freddie became a private company for profit in 1989.¹⁴⁴

Their business was to create liquidity for the mortgage market via buying and selling mortgages, they had a government monopoly to do so. They borrowed against low-interest rates because they appeared to be government guaranteed. The government, however, had no legal obligation to guarantee these companies.¹⁴⁵ The companies ended up in financial bad weather when the housing prices fell long and low and many people stopped paying their mortgages. The conditions of both companies worsened rapidly.

The US secretary of Treasury Paulson stated that Freddie and Fannie would need help before the weekend was up. He asked Congress for the power to lend money to these firms, however, Congress would not be able to decide before the markets opened. This led to the FED declaring these to be “unusual and exigent” circumstances and responding that they would lend them money.¹⁴⁶ Despite the FED lending the money, the rescue was perceived as led by the Treasury.¹⁴⁷ The FED was then assigned a consultative role in overseeing the two institutions.¹⁴⁸ This is interesting in a

¹³⁹ *Gauweiler*, paraf. 126.

¹⁴⁰ Stiglitz 2016, p. 183.

¹⁴¹ Wessel 2015, p. 180.

¹⁴² Ball 2018, p. 57

¹⁴³ *Ibid.*

¹⁴⁴ *Ibid.*

¹⁴⁵ Wessel 2015, p. 180.

¹⁴⁶ *Ibid.*, p. 182.

¹⁴⁷ *Ibid.*, p. 183.

¹⁴⁸ *Ibid.*

comparative aspect as there is a formal role for the FED in a rescue primarily led by a political organ. The role is however also consultative rather than undetermined. Thus showing similarities but also differences with the situation occurring with the ECB and the Troika.

The bad financial situation with Freddie Mac and Fannie Mae eventually led to the Treasury agreeing to an unusual bailout strategy. Due to the \$1.6tn debt that was build up because of falling housing prices the Treasury decided to buy up preferential shares of both companies. The companies were under the conservation of the Federal Housing Finance Agency. The voting rights moved to the government as did 80% of common stock. Thereby eliminating any value for the residual shareholders.¹⁴⁹ The decision was further made to transfer the profits in perpetuity to the Treasury. This decision was challenged in front of the Courts by hedge funds.¹⁵⁰

The hedge funds state that the FHFA's director can only be removed "for cause" and that this ground is unconstitutional.¹⁵¹ The Court agrees with this claim as it violates the separation of powers.¹⁵² This is an interesting view for the Court to take. The Court referred to the FHFA being run by a single Director serving for a term of five years. The Director is appointed by the President and removed by Congress and can only be removed "for cause". The agency furthermore runs on the budget collected by Freddie and Fannie rather than allocated public money. According to the Court, these are all signs of a highly independent agency.¹⁵³ Under the agreements, the Treasury was entitled to the first 10% dividends. When it turned out to be not possible to pay the 10% dividends the agreement was changed to dividends equal to the net worth minus a capital reserve, which was slowly reduced to zero.¹⁵⁴

The Court states that by introducing this net worth sweep the FHFA has overstepped its powers as conservator. Rather than conserving, it is winding down Freddie Mac and Fannie Mae.¹⁵⁵ The Treasury, according to the Court, is entitled to compensation for its credit line to the two agencies. It has however been compensated and the indefinite sweep, therefore, transgresses the powers of a conservator.¹⁵⁶ The Court however also considers that the agency, FHFA, is too independent. It states that it has a "unique

¹⁴⁹ Ashley Seager and Phillip Inman, 'US housing crisis: Freddie and Fannie are nationalised' *The Guardian* (08 September 2008).

¹⁵⁰ Noah Feldman, 'Hedge Funds Get a Crack at Weakening the Administrative Stae' *Bloomberg* (11 September 2019).

¹⁵¹ United States Court of Appeals, Fifth Circuit. Patrick J. COLLINS; Marcus J. Liotta; William M. Hitchcock, Plaintiffs–Appellants, v. Steven T. MNUCHIN, Secretary, U.S. Department of Treasury; Department of the Treasury; Federal Housing Finance Agency; Mark A. Calabria, Director of the Federal Housing Finance Agency, Defendants–Appellees. No. 17-20364 | FILED September 6, 2019 <<https://static.reuters.com/resources/media/editorial/20190909/collinsvfhfa--5thcircuitenbanc.pdf>>

¹⁵² Ibid.

¹⁵³ Ibid, section B page 3.

¹⁵⁴ Ibid, sII, p. 5.

¹⁵⁵ Ibid, p. 13.

¹⁵⁶ Ibid.

constellation of independence-enhancing features".¹⁵⁷ Such an independent agency is unconstitutional. This is interesting as the Court further refers back to a Supreme Court case stating that "the separation of powers does not depend on the views of individual Presidents, nor on whether 'the encroached upon branch approves the encroachment.'" ¹⁵⁸ As Feldman explains in this decision the Court is effectively limiting the possibility for agencies being fully independent of voters.¹⁵⁹ Though not directly related to the Central Bank this is an interesting development. It indicates that the United States Court is moving towards a more conservative view of agency independence. As noted by Feldman however there is a split between various Courts and it may have to go to the Supreme Court.¹⁶⁰ It is however noteworthy as it shows the precarious relationship of independent agencies. In this case, it was not the FED but an independent agency that (tried to) counteracted the financial instability. This high level of independence is what led to the Court deciding to consider the agency unconstitutional and in violation of the separation of powers. Thereby demonstrating that in the US view an agency and in length a central bank cannot be too independent. The case also indicates that an agency solely accountable to the president is not enough according to the Court. In this case, the judges decided it should be accountable to Congress. Thereby demonstrating the importance for the Court of accountability. Regardless of the technicality of the decision an agency dealing with the crisis must be accountable.

The previous paragraphs have discussed situations where the FED dealt with the financial crisis. The following paragraphs will analyse the Lehmann Brothers bankruptcy. A situation where the FED was criticized for not responding.

5.3.2.3. The bankruptcy of Lehman Brothers

Whilst the ECB has been criticized for its programmes going beyond their mandates, Ball criticizes the FED for not taking enough actions to mitigate the crisis. According to his work the Primary Dealer Credit Facility would have allowed the FED to lend \$84 billion to the Lehman brothers.¹⁶¹ In his view, the three criteria mentioned earlier for discount lending were met. There were unusual circumstances and Lehman was cut off from market funding. Furthermore, according to Ball, Lehman could have provided collateral worth \$114 billion to the FED. Hence complying with the third criterion of collateral.¹⁶² The chair of the FED Mr Bernanke on the other hand states that Lehman did have access

¹⁵⁷ Ibid, p. 36.

¹⁵⁸ Ibid, p. 15.

¹⁵⁹ Feldman 2019

¹⁶⁰ Ibid.

¹⁶¹ Ball 2018, p. 96.

¹⁶² Ibid.

to their emergency lending. The reason for bankruptcy he states *“It was clear, though, that Lehman needed both substantial capital and an open-ended guarantee of its obligations to open for business on Monday, September 15th. At that time, neither the Federal Reserve nor any other agency had the authority to provide capital or an unsecured guarantee; and, thus, no means of preventing Lehman's failure existed.”*¹⁶³ Bernanke thus disagrees with the view that the FED had the authority to prevent Lehman's bankruptcy despite that *“[t]he Federal Reserve fully understood that the failure of Lehman would shake the financial system and the economy.”* In an interview with the Financial Crisis enquiry committee, he further repeats that *“I will maintain to my deathbed that we made every effort to save Lehman, but we were just unable to do so because of a lack of legal authority”*.¹⁶⁴ The FED was therefore of the clear opinion that they had no legal authority to act. According to Bernanke AIG had, unlike Lehman, enough underlying assets and was in practice a solvent firm.¹⁶⁵

The responses of the FED are interesting to examine and provide context to the response of the ECB. The responses and circumstances have impacted the role of both institutions and forced them to act within the boundaries of their mandate. The legislator in the case of the ECB has granted the ECB additional powers through the ESM and SSM. The legislation covering the FED as with the ECB also changed during the crisis.

5.3.3. Legal Changes

An interesting last change to examine is that of the introduction of the Emergency Economic Stabilization Act 2008 and the introduction of the Troubled Asset Relief Programme. The first version of which was voted down with a narrow majority against the programme.¹⁶⁶ There were various concerns against the programme.

The first congress concern was that of oversight. A series of congressmen felt that the draft plan was insufficiently defined.¹⁶⁷ Several others were immediately put off due to Paulson's relation to Wall Street.¹⁶⁸ Stating that *“this essentially is Mr. Paulson's bill to help his friends”*.¹⁶⁹ The response to the failure to pass the EESA was the largest stock market drop in US history. A revised version with more controls was passed.¹⁷⁰

¹⁶³ House Hearing, 111 Congress, 'Hearing before the committee on financial services U.S. House of Representatives one hundred eleven congress second session' (20 April 2010)

<<https://www.govinfo.gov/content/pkg/CHRG-111hhrg57742/html/CHRG-111hhrg57742.htm>>

¹⁶⁴ James B. Stewart and Peter Eavis, 'Revisiting the Lehman Brothers Bailout That Never Was' *The New York Times* (29 September 2014).

¹⁶⁵ Ibid, p. 77.

¹⁶⁶ Wallach 2015, p. 87.

¹⁶⁷ Ibid, p. 83-84.

¹⁶⁸ Ibid, p. 85.

¹⁶⁹ Ibid.

¹⁷⁰ Ibid.

The EESA provides the Secretary with the possibility to buy “Troubled Assets” from “Financial Assets”. Both definitions have been given a broad definition with the possibility for the Treasury to interpret.¹⁷¹ One of the oversight mechanisms that is introduced is the establishment of the Financial Stability Oversight Board. In this board, the Chairman of the Board of Governors of the Federal Reserve System has a seat.¹⁷² The latter is relevant with regards to the second definition of the EESA. The first definition is rather specific to mortgages.¹⁷³ The second definition, however, is any troubled assets as defined in consultation with the FED.¹⁷⁴ Hence providing the FED with the power to co-define which assets are “troubled”. These purchases must be made to promote financial market stability.¹⁷⁵ When such purchases are made this must be reported to the appropriate bodies in congress.¹⁷⁶ A similar advisory capacity was given to the FED in consideration of the preferred shared buying. Whereby banks could opt for voluntary purchase of preferred shares. If the bank wished to apply for this construction it needed to send its application to its local regulator, such as the FED. The FED would then advise the Treasurer on whether it should or should not purchase the shares.¹⁷⁷ This is an interesting division of tasks when compared to the ECB.

As discussed before the ECB has been given an advisory capacity under the ESM Treaty. The ESM was granted the power to provide rescue packages and negotiated the terms with the ECB and the IMF. In addition to these rescues, the ECB has conducted its own policies. Similarly, the FED has been put into an advisory capacity when the Treasury wishes to determine the definition of “Troubled Assets”. In both cases, the decision is taken by a body different from the Central Bank but their advice is considered. There are however two interesting differences to be considered. The first difference is that of who is the final decision taker. In the case of the United States, the final decision on TARP is taken by the Treasury, a political body with indirect democratic accountability. In the US the Treasurer is appointed by the president and hence is indirectly elected. The governing board of the ESM, however, are appointed one governor per member. These appointments can be revoked at any point.¹⁷⁸ The governors are thus accountable to their states but take less of a political spotlight compared to the Treasury. Additionally, there is another interesting comparison to be made, that of the goal pursued.

¹⁷¹ Joshua Robinson, ‘An Overview Of The Emergency Economic Stabilization Act Of 2008’ *Corporate Counsel Business Journal* (01 November 2008).

¹⁷² Ibid.

¹⁷³ Baird Webel & Edward V. Murphy, *CRS Report for Congress. The Emergency Economic Stabilization Act and Current Financial Turmoil: Issues and Analysis*. 25 November 2008

<<https://fas.org/sgp/crs/misc/RL34730.pdf>>

¹⁷⁴ Ibid.

¹⁷⁵ Ibid, p. 7.

¹⁷⁶ Ibid.

¹⁷⁷ Ibid, p. 8-9.

¹⁷⁸ Section 5(1)(2), ESM-Treaty.

The goal that the Treasury and the FED must pursue when defining “Troubled Assets” is to promote financial market stability. As discussed earlier the official mandate of the FED is to pursue price stability and full employment. Though it has been difficult to define either of these goals, price stability is closely linked to inflation (see discussion of Humphrey Hawkins act in paragraphs 3.2). The FED is through the EESA given a new purpose namely that of financial market stability. Considering the broad dual mandate the FED has it however seems rather uncomplicated to read this goal into the dual mandate. Financial market stability leads to greater certainty and hence to lower unemployment. The goal of price stability is, however, further emphasized in the Price Stability and Inflation Targeting Act of 2008.¹⁷⁹

In H.R. 6042 congress explicitly states that the primary purpose of monetary policy is to achieve price stability. Interestingly this act asks the Board of Governors and Open Market Committee to define a price stability goal, develop a framework and a timeline for achieving this framework.¹⁸⁰ Thereby creating a similar situation as the ECB whereby the Bank may set its own goal but keeps to a clear goal. This action towards a stronger definition of price stability by congress seems to be contrary to the addition of ‘financial market stability’ to the FED’s tasks. The same legislation, however, gives another interesting option it “[a]uthorizes the Board and the Committee to suspend such goal [price stability] if the Committee, by a majority vote, and the President jointly determine such suspension necessary due to war or an economic emergency.”¹⁸¹ Interestingly the economic circumstances have led to congress giving the FED in agreement with the President the possibility to suspend its price stability goal. This is interesting as it gives a broader interpretation to the mandate, whilst the CJEU and ECB continuously put the limits of the ECB mandate in the first place. The US Congress, however, openly admits the FED’s mandate can be pushed aside for economic necessity. As time progressed Congress did however limit the powers under the TARP programme. It first introduced the need for Congressional approval when spending more than \$350 billion.¹⁸²

Furthermore, in section 110 specifically the Secretary, Federal Housing Finance Agency and the FED are given the task to provide a plan to assist homeowners.¹⁸³ Thereby demonstrating the varied amount of tasks the FED was given. Posner furthermore states that many of the assistance facilities opened by the FED in 2008 were legally problematic.¹⁸⁴ During this period the FED opened, based upon article 13(3), the “*Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) and the Money Market Investor Funding Facility (MMIF)*. It also opened the *Commercial Paper*

¹⁷⁹ H.R. 6042 – Price Stability and Inflation Targeting Act of 2008

¹⁸⁰ Ibid.

¹⁸¹ Ibid.

¹⁸² S.3694 – A bill to amend the Emergency Economic Stabilization Act to limit obligations to \$350,000,000,000 absent majority approval by the Congress.

¹⁸³ Ibid, p. 5.

¹⁸⁴ Eric A. Posner, 'What Legal Authority Does The Fed Need During A Financial Crisis?' [2016] SSRN Electronic Journal, p. 1551.

Funding Facility (CPFF) and the Term Asset-Backed Securities Loan Facility (TALF)."¹⁸⁵ With the exception of the TALF Posen argues that each of these programmes invoked legal issues.¹⁸⁶

5.4. Role of the ECB during euro-crisis

The previous paragraphs have described the different unconventional policies. This included the letters sent to the various governments. The letters have been analysed in previous paragraphs as demonstrating the way the ECB can use some of its powers to exert pressure. It is further argued that the ECB was not shy to get involved in economic policy from an early stage of the crisis. The responses furthermore show an interesting development of the ECB.

The transformation from the letters to the SMP and the OMT programme indicate the ECB becoming openly involved in crisis management. Thereby changing the role of the ECB from targeting individual issues to an EU crisis institute. The transformation from targeting individual nations to EU policies might be due to ECB internal institutional wishes. It is however too easy to simply blame the ECB for its increasing role in crisis management. Pisani-Fery argues that as the crisis progressed the underlying issues of the EMU become more prevalent. Pisani-Fery describes the issues as the 'impossible trinity'.¹⁸⁷ The impossible trinity is described as no co-responsibility for public debt, the prohibition of monetary finance and the bank-sovereign interdependence.¹⁸⁸ The lack of co-responsible debt became an issue after the Greek government threatened to default.¹⁸⁹ This led to the increased spread of sovereign bond yields. The third aspect of the bank-sovereign interdependence is where the national banks would have to be rescued by their national governments.¹⁹⁰ This issue was combined with the national banks' large purchases of their domestic debt.¹⁹¹ This double exposure created risks. One of these risks is shown through the case of Ireland, which had to rescue its national banks. This led Ireland from deemed safe to having to file for IMF assistance with a 108% debt to GDP ratio in 2011.¹⁹² Vice versa Pisani-Fery argues that in 2010 national banks had purchased high levels of domestic debt. Leaving the banks of Greece, Spain and Portugal particularly vulnerable.¹⁹³ Before discussing the second aspect of the

¹⁸⁵ Ibid.

¹⁸⁶ Ibid.

¹⁸⁷ Jean Pisani-Ferry, 'The Euro crisis and the new impossible trinity' (2012) 1 Bruegel Policy Contribution, p. 4.

¹⁸⁸ Ibid, pp. 4-8.

¹⁸⁹ Ibid, p. 5.

¹⁹⁰ Ibid, p. 6.

¹⁹¹ Ibid, p. 7.

¹⁹² Ibid, p. 6.

¹⁹³ Ibid, p. 7.

impossible trinity, some observations need to be made. Pisani-Fery's work indicates the underlying issues of the EMU. These issues came to play in the period around 2010-2011. The bond yield spreads started to differ a few years before 2011 but rose climactically in 2010-2011.¹⁹⁴ Similarly, the home bias of government debt became visible in 2010.¹⁹⁵ These underlying issues became larger and it became clear they were not solving themselves. The Greek bailout had been agreed upon in 2010 but it became clear in 2011 that new bailouts were needed.¹⁹⁶ Lim et. al. argue in their work that the initial negotiation process had been difficult. Though in their opinion Germany had received most of their goals during the negotiation, the article also recognizes the uncertainty that was still present.¹⁹⁷ Uncertainty is not a good quality for financial markets, nor is it for the ECB transmission channels. This uncertainty combined with the need for new agreements with Greece may have motivated the ECB to play a more active role. Furthermore, the number of countries in potential difficulties grew. In addition, the letter the ECB sent to the Italian government was published in September 2011. Which provided fuel to the Syriza party in Greece to attack the ECB.¹⁹⁸ The letter to Spain was not published till 2013 and the Irish letter surfaced in 2014. Additionally, the SMP programme that allowed for the purchase of these bonds was failing. Gros et. al. describe that in the SMP the ECB claimed preferential creditor status. By changing the international securities identification numbers of the purchased bonds the ECB held preferential status.¹⁹⁹ This led to private investors calculating the insubordination effect into their risk premium. Further SMP purchases would therefore have the opposite effect.²⁰⁰ Though difficult to say with certainty, the publication of the letter to Italy and the failure of SMP may have stirred the ECB to act in open waters through the OMT Programme. The remaining question is why the ECB opted for a targeted approach rather than a pan-European programme. This choice is partially explained by Pisani-Fery's second flaw of the EMU.

The second underlying issue described by Pisani-Fery is that of strict no-monetary financing rule.²⁰¹ In his article, he describes that the underlying philosophy of this prohibition, namely that of strict separation between fiscal and monetary policy, made the ECB uneasy about buying government bonds.²⁰² He furthermore argues that the ECB might be uncomfortable with this policy because of the unclear financial stability

¹⁹⁴ Ibid, p. 5.

¹⁹⁵ Ibid, p. 7.

¹⁹⁶ Darren J. Lim et. al., 'Puzzled out? The unsurprising outcome of the Greek bailout negotiations' (2018) 26(3) *Journal of European Public Policy*, p. 333.

¹⁹⁷ Ibid, pp. 332-333.

¹⁹⁸ Michel Rose, 'Trichet's letter to Rome published, urged cuts' *Reuters* (29 September 2011).

¹⁹⁹ Daniel Gros et. al., 'Central Banks in Times of Crisis: The FED vs. The ECB' (2012) 276 CEPS Policy Brief, pp. 9-10.

²⁰⁰ Ibid.

²⁰¹ Pisani-Ferry 2012, p. 5.

²⁰² Ibid, p. 6.

mandate.²⁰³ Both the OMT and SMP were targeted at the restoration of smooth transmission channels. Thus demonstrating the ECB was perhaps not yet prepared to take up a pan-EU approach, as this might be interpreted as restoring financial stability. This approach, however, was not without criticism. De Grauwe argued in 2011 that only if the ECB took up the function of Lender of Last Resort (LOLR) through bond buying it could save the Eurozone. He considers the EFSF and ESM to be poor substitutes.²⁰⁴ The criticism along with the development of the euro crisis may explain why the ECB chose to conduct a policy of quantitative easing. Before discussing the APP, the role of the ECB within the ESM deserves attention.

The role of the ECB within the ESM remains open for debate. It however seems clear that ECB has been playing an active role. It is more knowledgeable than the Commission on financial affairs and it held the financial firepower. According to the CJEU, the ESM has to be considered part of the monetary policy (more on its judicial review in chapter 7). Critics however argue the ECB acted beyond its mandate. It certainly is difficult to see how negotiating with countries on labour policies is part of the ECB's mandate, junior partner or not. Though legal, it certainly shows the new and increased role the ECB played during the crisis. The OMT and the role of the ECB within the Troika attracted fierce criticism. The programme was furthermore criticised for aiming to bring the bond spreads down. By bringing down the bond spreads the ECB is counteracting the financial market perspectives. According to De Grauwe, this constitutes economic policy.²⁰⁵ The criticism may have led to a different approach in 2014.

The APP was a large asset purchasing programme. The ECB hereby took up the role of LOLR more clearly by purchasing large quantities of public assets. The approach also signalled a more pan-EU approach rather than specifically targeting the members most in need. This changes the role of the ECB to a central bank more focussed on financial stability. This change was unclear and may have been driven by the criticism of the OMT. There is however another explanation for this change as well. Ferrara's paper researches the ECB's "battle of ideas" through ECB speeches.²⁰⁶ In his paper, he indicates the gradual change of perspective over the cause of the crisis. Whereby there is a shift from the perspective of fiscal discipline as the root cause of the crisis to systemic issues.²⁰⁷ The turning point is in early 2012.²⁰⁸ This turning point indicates the ECB's search for a new approach to the crisis. This change in opinion among the ECB Executive Board

²⁰³ Ibid.

²⁰⁴ Paul de Grauwe, 'Only a More Active ECB can Solve the Euro Crisis' (2011) Research Gate, pp. 4-5

²⁰⁵ Paul De Grauwe and Yuemei Ji, 'Correcting for the Eurozone Design Failures: The Role of the ECB' (2015) 37(7) *Journal of European Integration*, p. 743.

²⁰⁶ Federico Maria Ferrara, 'The battle of ideas on the euro crisis: evidence from ECB inter-meeting speeches' (2019) 27(10) *Journal of European Public Policy*.

²⁰⁷ Ibid, p. 1475.

²⁰⁸ Ibid.

Members is reflected in the APP, whereby the programme targets the Eurozone as a whole.

The APP shows the ECB's change from a relatively cautious to an active central bank. In the past, ECB's governor stated the ECB would never conduct quantitative easing programme's. The APP, however, is exactly that. It furthermore shows the ECB to act in a truly pan-European approach. Unlike the OMT, the APP targeted all the Eurozone countries. The role of the ECB has therefore changed into a European institution, willing to act.

5.5. Conclusion

As described by Schmidt the European Central Bank underwent several changes throughout the Euro-crisis. Whereby the ECB under Duisenberg and Trichet was more conservative, insisting that the ECB would not undertake Quantitative Easing such as the UK and US counterparts.²⁰⁹ According to Schmidt, the measures became increasingly bold over the course of 2012.²¹⁰ They even led to the ECB becoming a LOLR, all but in name. In her opinion, the only way forward is for the ECB to go back to its core mandate.²¹¹

Having discussed the different actions of the FED the question becomes what the general impact of the crisis is upon the general mandate. Or better phrased what does the mandate of the FED post-financial crisis look like and how does it compare to the ECB?

Not unlike the mandate of the ECB, that of the FED seems to have been liberally interpreted by the bank. Posner argues that during the bail-out of AIG and Bear Stearns the FED "*violated the law, or interpreted it in an extremely narrow way, [...]*".²¹² Posner, however, further states "*rather than refraining from the emergency actions that events called for.*"²¹³ The mandate of the FED has thus been widely interpreted or stretched during the financial instability according to Posner. However, he also states that these actions were necessary. It thus seems that not unlike the ECB the FED was in a situation whereby a liberal interpretation of its mandate was necessary. Posner furthermore argues that the law has restrained the FED from acting. Stating that the legal hurdles

²⁰⁹ Vivien A. Schmidt, 'The Eurozone's Crisis of Democratic Legitimacy: Can the EU Rebuild Public Trust and Support for European Economic Integration?' (2015)15 *European Commission*, Discussion Paper 015, p. 32.

²¹⁰ Ibid.

²¹¹ Ibid, p. 36.

²¹² Eric A. Posner, 'What Legal Authority Does The Fed Need During A Financial Crisis?' [2016] SSRN Electronic Journal, p. 1529.

²¹³ Ibid.

allowed them to blame their inaction on the law.²¹⁴ Posner however also argues that with the Maiden Lane deal, the FED effectively violated the law.²¹⁵

The financial crisis, therefore, shows that it brought central banks into a difficult position. The actions of the ECB may therefore have increased its role but it should not be considered strange. The FED's actions have also been unprecedented and were considered to stretch (or violate) the law. The latter occurred even despite the dual mandate which is broader than that of the ECB. Though the actions of the ECB should not be considered strange they have increased the (expected) role of the ECB. From an accountability perspective, the ECB warrants a higher level of accountability with this new role.

²¹⁴ Ibid, p. 1530.

²¹⁵ Ibid, p. 1549.

6. COVID19 and the ECB

6.1. Introduction

While the prior chapter covered the ECB response to the euro crisis (in comparison with the Fed), this chapter will cover the responses of the ECB to the economic fallout of the COVID19 virus (in comparison with the Fed).

In late 2019 the first Corona cases popped up in China, reaching Europe in early 2020. To stop the spreading of the disease many European nations took countermeasures. The responses to the novel virus varied per country from full lockdown in the southern nations such as Spain and Italy to lesser or “intelligent” lockdowns in the Netherlands.¹ The economic impact upon the nations, however, is big. The European Commission predicted that the European economy will contract by 7.5% in 2020.² The recession so predicted, will not be evenly distributed as the Greek economy is predicted to contract with 9.75%.³ These numbers indicate the difficulty of a pan-European approach as not all countries are hit equally, thus making it difficult to generate a one-size-fits-all approach.

To mitigate the economic impact the European Central Bank responded fast. The ECB had two overarching principles in this policy response. The first objective was to stabilize the volatility of the markets and the second to ensure the mitigation of the recession in all areas of the economy.⁴ The main response program of the ECB has been the Pandemic Emergency Purchase Programme (PEPP).⁵ The PEPP was not the only program implemented by the ECB. In addition to PEPP, it introduced Pandemic Emergency Long Term Operations (PELTRO).⁶ Furthermore, the ECB conducted Targeted Longer-Term Refinancing Operations (TLTRO).⁷ The following paragraphs will start with a discussion of the PELTRO and TLTRO before discussing the impact of the PEPP.

This chapter will start in section 6.2. with an analysis of the liquidity facilities TLTRO and the PELTRO. It will then continue by discussing the largest programme of the PEPP in section 6.3. The ECB response to the COVID19 pandemic will be compared to that of the

¹ Localfocus2.appspot.com. 2020. *NOS Corona Maatregelen Europa*. [online] Available at: <<https://localfocus2.appspot.com/5ea96168be999>> [Accessed 28 April 2020].

² Press Release European Commission Spring 2020 Economic Forecast: A deep and uneven recession, an uncertain recovery.

³ Ibid.

⁴ Isabel Schnabel, 2020. *The ECB'S Response To The COVID-19 Pandemic*.

⁵ European Central Bank, 2020. *ECB Announces €750 Billion Pandemic Emergency Purchase Programme (PEPP)*. [online] [Accessed 28 May 2020].

⁶ Press Release ECB announces new pandemic emergency long-term finance operations, 30 April 2020.

⁷ Press Release ECB recalibrates targeted lending operations to further support real economy, 30 April 2020.

FED in section 6.4. The next section 6.5. will continue by discussing the factors driving the ECB into the role it has taken. This chapter will end with a conclusion in chapter 6.6.

6.2. TLTRO & PELTRO.

The TLTRO is a policy that was first introduced during the euro crisis and was further used in response to the COVID19 crisis. The first TLTROs were introduced in June 2014.⁸ These operations were aimed at improving the monetary transmission channels. Under the first-tier, banks were allowed an initial TLTRO borrowing allowance equal to 7% of the total amount of their loans to the euro area non-financial private sector, excluding loans to households for house purchase.⁹ The interest rates upon these loans were the MRO rate plus a fixed spread of 10 basis points.¹⁰ The second line of TLTRO was announced on the 10th of March 2016 with a four-year maturity rate and at an interest rate equal to the deposit facility rate.¹¹ The third line of Targeted Longer-Term Refinancing Operations was announced on the 22nd of July 2019 to contribute to the ECB's inflation aim.¹² The initial maturity rate was 2-years¹³ but this was later amended to three years.¹⁴ The interest rate was set at the MRO rate plus 10 base points¹⁵ but this also decreased to the MRO rate.¹⁶ Then the pandemic started to reach the European economy and the ECB responded with further amendments. The ECB firstly increased the volume of TLTRO borrowing from 30% to 50%.¹⁷ The second amendment in April further reduced the interest rate to *“the average interest rate on the deposit facility over that period minus 50 basis points. The resulting interest rate shall not, in any case, be*

⁸ Press Release ECB announces monetary policy measures to enhance the functioning of the monetary policy transmission mechanism, 05 June 2014

⁹ Ibid.

¹⁰ Article 5, Decision of the European Central Bank of 29 July 2014 on measures relating to targeted longer-term refinancing operations (ECB/2014/34).

¹¹ Press Release ECB announces new series of targeted longer-term refinancing operations (TLTRO II), 10 March 2016.

¹² Recital 2, Decision (EU) 2019/1311 of the European Central Bank of 22 July 2019 on a third series of targeted longer-term refinancing operations (ECB/2019/21).

¹³ Article 2 paragraph 2, Decision (EU) 2019/1311 of the European Central Bank of 22 July 2019 on a third series of targeted longer-term refinancing operations (ECB/2019/21).

¹⁴ Article 1, Decision (EU) 2019/1558 of the European Central Bank of 12 September 2019 amending Decision (EU) 2019/1311 on a third series of targeted longer-term refinancing operations (ECB/2019/28).

¹⁵ Article 5 paragraph 1, Decision (EU) 2019/1311 of the European Central Bank of 22 July 2019 on a third series of targeted longer-term refinancing operations (ECB/2019/21).

¹⁶ Article 1, Decision (EU) 2019/1558 of the European Central Bank of 12 September 2019 amending Decision (EU) 2019/1311 on a third series of targeted longer-term refinancing operations (ECB/2019/28).

¹⁷ Article 1, Decision (EU) 2020/407 of the European Central Bank of 16 March 2020 amending Decision (EU) 2019/1311 on a third series of targeted longer-term refinancing operations (ECB/2020/13).

higher than minus 100 basis points".¹⁸ A further change in December included an extension of the TLTROIII, increased borrowing opportunity and new lending targets for Banks.¹⁹ To further improve the liquidity the ECB decided to relax its collateral standards.²⁰ In addition to its TLTRO, the ECB introduced its Pandemic Emergency Longer-Term Refinancing Operations (PELTRO).

PELTRO was announced on the 30th of April and aim to increase the liquidity available on the market. The programme included a series of loans to the financial sector with a fixed rate set at 25 below basis points. The tenors of the programme start with 16 months and decrease as the PELTRO progresses.²¹ This programme further increased on the 10th of December with four additional operations.²² The programme is thereby injecting cheap liquidity into the financial sector. Both the TLTRO and PELTRO aim to increase the liquidity supply and are not unlike some of the measures the ECB has taken at the beginning of the financial crisis.

At the beginning of the financial crisis, the ECB responded by using its power to set interest rates and different measures which are classified as "non-standard".²³ Its first tool, that of interest rates, was adjusted downwards both in the financial crisis and the pandemic. The interest rates continue to decrease into the negative which it reached during the euro-crisis.²⁴ The more interesting response is that of the ECB using the Enhanced Credit support.

The Enhanced Credit support in mid-2007 filled a liquidity gap of €95 billion.²⁵ It was based upon five building blocks. Firstly the ECB provided "*unlimited provision of liquidity through "fixed rate tenders with full allotment"*".²⁶ The ECB further increased the list of eligible collateral, increased the length of the maturity to a year and fourthly it started to provide foreign currency.²⁷ Last but not least the ECB began to purchase covered bonds.²⁸ Interesting to note is that in his speech Trichet, then president of the ECB, clearly emphasized the separation of monetary and economic policy. Whereby he considered that these purchases did not violate that separation.²⁹ It furthermore

¹⁸ Article 1, Decision (EU) 2020/614 of the European Central Bank of 30 April 2020 amending Decision (EU) 2019/1311 on a third series of targeted longer-term refinancing operations (ECB/2020/25).

¹⁹ Introductory Statement Christine Lagarde & Luis de Guindos, Press Conference 10 December 2020.

²⁰ Ibid.

²¹ Press Release ECB announces new pandemic emergency longer-term refinancing operations, 30 April 2020

²² Introductory Statement Christine Lagarde & Luis de Guindos, Press Conference 10 December 2020.

²³ Keynote address by Jean-Claude Trichet, University of Munich, Munich 13 July 2009.

²⁴ ECB Key interest rates,

https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.htm [last accessed 23 September 2020]

²⁵ Ibid.

²⁶ Ibid.

²⁷ Ibid.

²⁸ Ibid.

²⁹ Ibid.

combined the objective of price stability and the restoration of monetary transmission channels.³⁰ The monetary transmission channels referred to by González-Páramo are those in the inter-bank lending sector.³¹ The restoration of these channels received very little challenge. The BVerfG considers that “[t]he ability of the ESCB to influence price developments by means of its monetary policy decisions in fact depends, to a great extent, on the transmission of the ‘impulses’ which the ESCB sends out across the money market to the various sectors of the economy.”³² Yet when it considers the monetary transmission channels related to the public sector bonds it states that “[i]f purchases of government bonds were admissible every time the monetary policy transmission mechanism is disrupted, it would amount to granting the European Central Bank the power to remedy any deterioration of the credit rating of a euro area Member State through the purchase of that state’s government bonds.”³³ This makes for an interesting comparison as it seems the role of the ECB is not challenged when operating on the private sector market but is when operating on the public sector market. Both the public and private sectors can be accused of being at risk of moral hazard. The next response of the ECB to the economic fallout was that of the Pandemic Emergency Purchase Programme.

6.3. Pandemic Emergency Purchase Programme

The Pandemic Emergency Purchase Programme (PEPP) is the most important ECB response to the COVID-19 economic crisis. It entails an asset-buying programme of primarily 750 billion EUR. This was increased to include another €600 billion on June 4th³⁴ and increased again with €500 billion on the 10th of December.³⁵ The programme, therefore, totals €1850 billion and lasts till at least the end of March 2022 with reinvestments of returns till the end of 2023.³⁶ There are four different types of assets eligible for purchase under the programme. The first are marketable debt securities.³⁷ Secondly, the programme covers corporate bonds³⁸, thirdly the programme foresees the

³⁰ Speech José Manuel González-Páramo, Málaga 18 June 2010

³¹ Ibid.

³² judgment of the Second Senate of 21 June 2016 2 BvR 2728/13 2 BvR 2729/13 2 BvR 2730/13 2 BvR 2731/13 2 BvE 13/13, paraf. 50.

³³ BVerfG, Order of the Second Senate of 14 January 2014 – 2 BvR 2728/13-, parafs. 1-24, http://www.bverfg.de/e/rs20140114_2bvr272813en.html, paraf. 97

³⁴ Press Release ECB, Monetary policy decisions 04 June 2020.

³⁵ Introductory Statement Christine Lagarde & Luis de Guindos, Press Conference 10 December 2020.

³⁶ Ibid.

³⁷ DECISION (EU) 2020/440 OF THE EUROPEAN CENTRAL BANK of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17), section 1(2)(a).

³⁸ Ibid, section 1(2)(b)

purchase of covered bonds³⁹ and lastly the programme allows for the purchase of asset-backed securities.⁴⁰

Interesting to compare is that both the corporate bonds and the purchase of covered bonds are of the same nature as those of the Asset Purchasing Programme conducted by the ECB during the euro crisis. The eligibility of those assets is determined by the same decision as the implementation decisions of the Asset Purchasing Programmes. The marketable debt securities and the asset-backed securities on the other hand are different from those purchased by the ECB on earlier occasions. The assets eligible for purchase must have a maturity rate of between 70 days and 30 years.⁴¹

The ECB has furthermore decided to include Greek assets without public credit rating conducted by an external credit assessment institution. These assets were exempted from previous ECB programmes. The Hellenic assets, however, are only eligible for purchase if they can comply with section 3(4) of Decision (EU) 2020/188 (ECB/2020/9). This section states that “[p]urchases of nominal marketable debt instruments at a negative yield to maturity (or yield to worst) equal to or above the deposit facility rate are permitted. Purchases of nominal marketable debt instruments at a negative yield to maturity (or yield to worst) below the deposit facility rate are permitted to the extent necessary.”⁴² Thereby granting the purchasing powers to central banks to buy Greek bonds at negative rates. The governing council based this decision upon the necessity to relieve the financial pressure caused by Covid-19. The council furthermore took into consideration the commitments made by the Greek government and the dependence of ESM support upon those commitments. Additionally, the ECB has taken its direct access to information and the recently gained market access into account. The only side-note is that there currently are no Greek bonds on the market with a negative yield. The lowest yield is that of a 3-month maturity rate (which is close to 70 days minimum) which has a current yield of 0.68.⁴³ Because the section referred to states that negative bonds ‘may be purchased’ it leaves space for interpretation whether Greek bonds can only be purchased at the negative interest rate or if negative yields may be purchased. The ECB states the credit requirements have been waived but without much explanation.⁴⁴ The lack of explanation indicates the purchase of all Greek bonds. The PEPP decision’s explicit reference to section 3(4) however seems to indicate that Greek bonds can only be purchased with negative yields.

³⁹ Ibid, section 1(2)(c)

⁴⁰ Ibid, section 1(2)(d)

⁴¹ Ibid, section 2.

⁴² DECISION (EU) 2020/188 OF THE EUROPEAN CENTRAL BANK of 3 February 2020 on a secondary markets public sector asset purchase programme (ECB/2020/9)

⁴³ Tradingeconomics.com. 2020. *Greece Government Bond 10Y | 1998-2020 Data | 2021-2022 Forecast / Quote / Chart*. [online] Available at: <<https://tradingeconomics.com/greece/government-bond-yield>> [Accessed 30 April 2020].

⁴⁴ 'Pandemic Emergency Purchase Programme (PEPP) -Q&A' (European Central Bank, 2020) accessed 8 May 2020

The PEPP decision furthermore emphasizes the flexible purchase of these assets, section 5 leaves the allocation of purchases open. It states that “[p]urchases under the PEPP shall be conducted in a flexible manner allowing for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions.”⁴⁵ In theory, this could mean a large purchase of peripheral assets and limited other purchases.

The ECB’s PEPP seems to closely resemble the structure of the Asset Purchasing Programme. There are, however, two noteworthy differences such as the inclusion of Hellenic Assets and the lack of direct reference to the capital allocation key. Or in the words of the Financial Times *“The European Central Bank has given itself an unprecedented level of flexibility in its plan to buy €750bn in additional bonds to contain the financial fallout from the coronavirus pandemic, which analysts say could leave it open to legal challenges. Almost all constraints that applied to the ECB’s previous asset-purchase programmes have been removed or significantly loosened”*⁴⁶ These strong words and has given rise to the question of whether the ECB overstepped its mandate. The following paragraphs will therefore assess the legality of the PEPP and the role of the ECB. The structure of both of these assessments will follow the legal framework.

6.3.1. Legal Framework

As with the previous ECB responses the legal mandate of the ECB is assessed against three specific criteria and the criterion of proportionality. The first question to ask is whether the measure falls within the mandate of the ECB. The second and third criteria ask the question of whether the measures violate the prohibition on direct lending (article 123 TFEU) or the bail-out prohibition (Article 125 TFEU). These latter two questions are strongly connected and will be covered together. The legal mandate will further include reference to the judgement of the BVerfG in the Weiss case.⁴⁷ Though *“the BVerfG has no power to compel the ECB to do anything”* and the CJEU has declared the BVerfG cannot make such claims it provides an interesting comparison.⁴⁸ The BVerfG’s disagreement is demonstrating the current tensions between ECB and BVerfG. Indicating the potential discrepancy between independence and accountability. The

⁴⁵ Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17), section 5(2).

⁴⁶ M. Arnold, and T. Stubbington, 'ECB Shakes Off Limits On New €750Bn Bond Buying Plan' *Financial Times* (2020) <<https://www.ft.com/content/d775a99e-13b2-444e-8de5-fd2ec6caf4bf>> accessed 4 May 2020

⁴⁷ BVerfG, Judgment of the Second Senate of 05 May 2020 – 2 BvR 859/15 -, parafrs. (1-237), http://www.bverfg.de/e/rs20200505_2bvr085915en.html

⁴⁸ Federico Fabbrini, 'Eurozone Auf Wiedersehen?' <<https://bridgenetwork.eu/2020/05/05/1369/>> accessed 5 May 2020; Beatriz Rios, 'European Court Of Justice Says Rulings Are Binding, As German Court Fallout Continues', *Euractive* 09 May 2020.

judgement of the BVerfG will be included to evaluate whether they are indicative of a discrepancy of independence and accountability.

6.3.2. Monetary or Economic Policy?

The first step in determining whether a policy should be considered economic or monetary is that of the aim.⁴⁹ The aims of the PEPP can be found in Recital 2 of the decision which lists several different aims.⁵⁰ *“The APP aims to enhance the transmission of monetary policy, facilitate the provision of credit to the euro area economy, ease borrowing conditions for households and firms, and support the sustained convergence of inflation rates to levels below, but close to, 2%.”*⁵¹ These aims are slightly different in nature and will be discussed individually. The first aim of the PEPP is to counter the effect of the COVID-19 crisis on the monetary transmission channels.⁵² This aim is not unlike those under discussion in the *Gauweiler* and *Weiss* cases. In *Gauweiler* the CJEU stated that “[i]n the first place, as regards the objectives of a programme such as that at issue in the main proceedings, it can be seen from the press release that the aim of the programme is to safeguard both ‘an appropriate monetary policy transmission and the singleness of the monetary policy’.”⁵³ The CJEU furthermore considered that “[t]he ability of the ESCB to influence price developments by means of its monetary policy decisions in fact depends, to a great extent, on the transmission of the ‘impulses’ which the ESCB sends out across the money market to the various sectors of the economy. Consequently, if the monetary policy transmission mechanism is disrupted, that is likely to render the ESCB’s decisions ineffective in a part of the euro area and, accordingly, to undermine the singleness of monetary policy.”⁵⁴ Thereby accepting the argument of the ECB that the restoration of monetary transmission mechanisms is part of monetary policy.

The second set of objectives is that of provision of credit to the euro area economy and easing borrowing conditions for households and firms. These objectives should be read as the method for the ECB to restore inflation to close but under 2%. In the PSPP decision, the ECB explains that easing credit conditions drive up aggregate demand. Thereby restoring inflation levels to the goal of under but close to 2%.⁵⁵ This argument

⁴⁹ Case C-370/12, *Thomas Pringle v. Government of Ireland* a.o., 2008, paraf. 47.

⁵⁰ Recital 2, DECISION (EU) 2020/440 OF THE EUROPEAN CENTRAL BANK of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17).

⁵¹ Ibid.

⁵² European Central Bank, 2020. *ECB Announces €750 Billion Pandemic Emergency Purchase Programme (PEPP)*. [online] [Accessed 28 May 2020].

⁵³ Case C-62/14, *Peter Gauweiler a.o. v. Deutscher Bundestag*, 2015, paraf. 47.

⁵⁴ Ibid, paraf. 50.

⁵⁵ Recital 4, Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10).

was quickly accepted by the CJEU in the *Weiss* case⁵⁶ and thus does not seem to render the aim illegal.

According to Schnabel the PEPP further aims to mitigate the economic impact of the Pandemic.⁵⁷ Though this is an economic aim it does not render the program unlawful. The CJEU confirmed that the ECB can support the Member States in general economic policy.⁵⁸ It is thus likely that the aim of the PEPP will be considered as part of monetary policy. The aim is however not enough to classify the policy, attention must also be paid to the indirect effects. The next question is thus whether the indirect effects are of such gravity that despite the aim the policy should be considered economic.

The interpretation of indirect effects was most prominently discussed in the *Weiss* case. In its referencing procedure, the BVerfG had argued that these measures can only be considered indirect, when they are connected to the challenged measures and when the consequences were unforeseeable. If the effects are intended or foreseeable they can still be considered indirect when they are “[...] *comparable in weight to the monetary policy objective pursued*.”⁵⁹ The Court however disagrees and determined that indirect effects can be foreseeable and accepted.⁶⁰ These effects have no consequence upon the classification of economic or monetary.⁶¹ The indirect effects, however, cannot be contrary to the policy of price stability.⁶² In the *Weiss* case, the ECJ considered the Public Sector Purchasing Programme to be compatible with monetary policy. The main differences between the PSPP discussed in the *Weiss* case and the PEPP, being the inclusion of Greek bonds and the increased flexibility, do not lead to expect a different judgement for the PEPP. The indirect effects flowing forth from this program are not heavier than those flowing forth from the PSPP. It thus seems the PEPP falls within the monetary mandate of the ECB. As with all policies conducted by EU institutions, the PEPP must meet the requirement of proportionality.

6.3.3. Proportionality

The proportionality criterion consists of two parts the suitability and necessity. This will be discussed as will the BVerfG’s addition to this framework.

⁵⁶ Case C-493/17, *Heinrich Weiss a.o. v. Bundesregierung* a.o., 2018, paraf 64.

⁵⁷ Isabel Schnabel, 2020. *The ECB’S Response To The COVID-19 Pandemic*.

⁵⁸ *Gauweiler*, paraf. 43.

⁵⁹ BVerfG, Order of the Second Senate of 18 July 2017 – 2 BvR 859/15 – parafs. (1-137), ECLI:DE:BVerfG:2017:rs20170718.2bvr085915, paraf. 119.

⁶⁰ Case C-493/17, *Heinrich Weiss a.o. v. Bundesregierung* a.o., 2018, paraf 63.

⁶¹ *Ibid*, paraf. 63.

⁶² *Gauweiler*, paraf. 59.

6.3.3.1. *Suitable*

In the *Gauweiler* case, the CJEU stated that *“It follows from Articles 119(2) TFEU and 127(1) TFEU, read in conjunction with Article 5(4) TEU, that a bond-buying programme forming part of monetary policy may be validly adopted and implemented only in so far as the measures that it entails are proportionate to the objectives of that policy.”*⁶³ Proportionality is defined by the CJEU as the *“acts of the EU institutions be appropriate for attaining the legitimate objectives pursued by the legislation at issue and do not go beyond what is necessary in order to achieve those objectives”*⁶⁴ The PEPP must therefore be suitable to achieve the aim and not go beyond what is necessary. The ECB on this account has a large margin of discretion.⁶⁵ For the measure to be considered proportionate, it is thus only necessary to confirm the ECB has complied with its duty to motivate and its decision is not a manifest error of judgement.

Regarding suitability, the CJEU held in *Weiss* that buying large amounts of government bonds is a measure suitable to reduce interest rates. The reduction of these interest rates could, according to the CJEU, bring inflation levels closer to 2%.⁶⁶ In a similar fashion recital 2 and 3 of the preamble of the PEPP decision explains that the PEPP aims to bring inflation closer to 2%. The ECB explains that the corona measures *“[...]place acute strains on the cash-flows of businesses and workers and put the survival of businesses and jobs at risk. It is also clear that this situation hampers the transmission of the monetary policy impulses”*.⁶⁷ Grund argues that the PEPP primarily addresses the same risks as the PSPP measures did. He, therefore, considers it likely that the PEPP is suitable to attain the desired goal.⁶⁸ This however seems to lack nuance.

The PSPP addressed a different crisis than the PEPP. The financial crisis was (and is) a crisis of confidence. The financial system underwent some severe financial shocks leading to a decrease in confidence in the market. The PSPP aimed to increase the attractiveness of riskier investments such as non-government bonds. This whilst PEPP intends to keep low borrowing costs for countries to mitigate the national economic recessions. There are several differences in the aim and surely the effectiveness of the PEPP can be challenged. The ECB is however given a wide margin of discretion when making decisions of a technical nature. Considering the ECB's plans have also been described as those that might save the euro,⁶⁹ the PEPP does not seem as a manifest

⁶³ *ibid*, paraf. 66.

⁶⁴ *Ibid*, paraf. 67.

⁶⁵ *Weiss*, paraf. 73.

⁶⁶ *Weiss*, parafs. 74-76.

⁶⁷ Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17), preamble 4.

⁶⁸ Sebastian Grund, 'The Legality Of The European Central Bank's Pandemic Emergency Purchase Programme' [2020] Jacques Delors Centre, p. 4.

⁶⁹ Martin Wolf, 'Why The European Central Bank Can Save The Eurozone' *Financial Times* (2020)

error in judgement. Thus, complying with the first criterion of proportionality under the EU legal framework. Leading to the second question that of necessity.

6.3.3.2. *Necessary*

The necessity requirement is defined by the CJEU as “*do not go beyond what is necessary in order to achieve those objectives*”.⁷⁰ There are several issues to take into consideration when applying this criterion. In the *Weiss* case, the ECB gave two arguments to support the PSPP was not going beyond what was necessary. It argued that the circumstances were of such nature, consistent low inflation risking deflation, that a program like PSPP was necessary. Secondly, the ECB had argued that it had no other alternatives, such as interest rates, that could increase inflation.⁷¹ The CJEU considered that the interest rates at the time of the PSPP decision had been close to the bottom.⁷² The interest rates at the time of PEPP are even lower than those in mid-2014.⁷³ It is hence likely lowering the interest rates is not possible, or as efficient as the PEPP. Lowering the interest rates is therefore unlikely to be considered an effective alternative. The circumstances referred to by the ECB when defending the PSPP are like those of the PEPP. In the sense that the Eurozone faces recession leading to lower inflation and possible deflation. It is, therefore, reasonable to consider the PEPP legal upon these counts. Special attention should however be given to the bond spreads and monetary transmission channels.

The pandemic increased the difference in bond yields increased.⁷⁴ These spreads were effectively brought closer together by the PEPP.⁷⁵ This happened despite Lagarde’s statement “we are not here to close spreads” though she also stated later that high spreads would impair monetary transmission.⁷⁶ The aim of restoring or preserving the monetary transmission channels disturbed by increased bond spreads is similar to that of the OMT program. The OMT focused on preserving the monetary transmission channels via the secondary market.⁷⁷ The CJEU accepted this program as necessary because the ECB argued that the bond spreads were extreme.⁷⁸ Furthermore, there

⁷⁰ *Gauweiler*, paraf. 67.

⁷¹ *Weiss*, paraf. 80.

⁷² *Ibid.*

⁷³ 'Official Interest Rates' (*European Central Bank*, 2020)

<https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html> accessed 4 May 2020

⁷⁴ European Commission, *European Economic Forecast Spring 2020* (INSTITUTIONAL PAPER 125 | MAY 2020), p. 34-35

⁷⁵ *Ibid.*

⁷⁶ Press Conference, Christine Lagarde, President of the ECB, Luis de Guindos, Vice-President of the ECB, Frankfurt am Main, 12 March 2020

⁷⁷ ECB PRESS RELEASE Technical features of Outright Monetary Transactions, 6 September 2012

⁷⁸ *Gauweiler*, paraf. 72.

were fears and speculation premiums charged out of fear of the euro-area breakup.⁷⁹ The CJEU accepted that *“th[is] special situation severely undermined the ESCB’s monetary policy transmission mechanism in that it gave rise to fragmentation as regards bank refinancing conditions and credit costs, which greatly limited the effects of the impulses transmitted by the ESCB to the economy in a significant part of the euro area.”* As shown in the latest assessment by the European Economic Forecast bond spreads widened significantly during the start of the pandemic.⁸⁰ There is, however, no fear of the euro-area breakup nor are speculation rates charged. It could therefore be argued that the transmission channels are thus not as particularly impaired. Though it is valid to argue that the spreads are perhaps not as extreme due to the lack of break-up speculation rates this argument would be incomplete. The OMT, if implemented, would have targeted individual Member States rather than the euro area. The individual targeting was accepted because of the speculation rates and the strict conditionality. The PEPP is like OMT in restoring the monetary transmission channels but differs because it is generally implemented. This difference makes it likely the CJEU would accept the current spreads as sufficient to prove the necessity. More problematic is the implementation criteria used by the CJEU.

For the PSPP to be considered not to go beyond what was necessary, the CJEU looked at five different limitations. These limitations were first the lack of selectiveness.⁸¹ Secondly the strict eligibility criteria⁸², third the temporary nature⁸³, fourth the limited volume⁸⁴ and lastly the limits to purchase from single origins.⁸⁵ Due to a combination of these restrictions, the CJEU felt there were significant safeguards to ensure proportionality. The PEPP as with the PSPP is temporary and is currently envisioned to stop at the end of 2022.⁸⁶ It is limited in volume to a total of €750 billion.⁸⁷ This volume has been later expanded to include an additional €600 and €500 billion.⁸⁸ Questionable is whether this is considered a reasonable limit. There are two arguments to take into consideration. In comparison, this program carries a much larger volume than the PSPP.⁸⁹ It can thus be argued to be too large to be necessary to repair the market transmission channels. The large limit associated with the PEPP, and ECB in general, is

⁷⁹ Ibid.

⁸⁰ European Commission, *European Economic Forecast Spring 2020* (INSTITUTIONAL PAPER 125 | MAY 2020), p. 35.

⁸¹ Weiss, para. 82.

⁸² Ibid, para. 83.

⁸³ Ibid, para. 84.

⁸⁴ Ibid, para. 88.

⁸⁵ Ibid, para. 89.

⁸⁶ European Central Bank, 2020. *ECB Announces €750 Billion Pandemic Emergency Purchase Programme (PEPP)*. [online] [Accessed 12 December 2020].

⁸⁷ Ibid.

⁸⁸ Press Release Monetary Policy Decisions, 04 June 2020;

⁸⁹ The PSPP was limited to 60billion per month, the PEPP by comparison has a limit of a little over 90billion per month.

exactly why Wolf argues the ECB might be the only organ able to save the Eurozone.⁹⁰ Considering this argument combined with the exceptional circumstances and the large margin of discretion it is unlikely the CJEU will find the ECB has gone beyond what is necessary. It should furthermore be noted that the increase was based upon the economic findings of Philip Lane head economist at the ECB. These observations included the increased contraction and the initial success of PEPP in lowering bond spreads.⁹¹ Considering this economic observation the ECB has fulfilled its duty to gather information. The resulting decision of increasing the volume seems correct or at least not incorrect based upon this information. The ECB has thereby fulfilled the necessity requirement. The problem might arise with selectivity and eligibility.

In paragraph 82 of the *Weiss* case, the CJEU comments upon the procedural implementation of the PSPP. The CJEU states that *“the way that programme is set up also helps to guarantee that its effects are limited to what is necessary to achieve the objective concerned, in particular because, since the PSPP is not selective, the ESCB’s action will have an impact on financial conditions across the whole of the euro area and will not meet the specific financing needs of certain Member States of that area.”*⁹² Stating that one reason the PSPP is within the limits of the law is that it is not selective. This question leaves space for debate within the PEPP. Schnabel in a speech on the PEPP states that one of the objectives is *“to ensure that our accommodative monetary policy continued to be transmitted to all parts of the single currency area”*.⁹³ Wolff and Grund interpret this statement as that the ECB will purchase bonds from all countries.⁹⁴ This would thus comply with the PSPP approach.⁹⁵ The ECB on the other hand has kept flexibility in its purchase plans. Schnabel in the same speech states that *“Within PEPP, purchases can therefore be allocated flexibly across time, asset classes and jurisdictions.”*⁹⁶ It has been estimated that near 68% of Italian assets will be purchased.⁹⁷ As stated by Bobic and Dawson this may become a problem when considering article 123 TFEU.⁹⁸ It may, however, also form a proportionality issue. If the ECB indeed buys significantly more assets of the peripheral countries this may violate the non-selectivity requirement. The non-selectiveness is, however, not a requirement set in stone. In the

⁹⁰ Martin Wolf, 'Why The European Central Bank Can Save The Eurozone' *Financial Times* (2020)

⁹¹ ECB Account of the monetary policy meeting of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday and Thursday, 3-4 June 2020; Introductory Statement Christine Lagarde & Luis de Guindos, Press Conference 10 December 2020.

⁹² *Weiss*, para 82.

⁹³ Isabel Schnabel, 2020. *The ECB’S Response To The COVID-19 Pandemic*.

⁹⁴ Grund 2020.

⁹⁵ Sebastian Grund, 'The Legality Of The European Central Bank's Pandemic Emergency Purchase Programme' [2020] Jacques Delors Centre, p.4.

⁹⁶ Isabel Schnabel, 2020. *The ECB’S Response To The COVID-19 Pandemic*.

⁹⁷ B Hall, M Arnold, and S Fleming, 'Coronavirus: Can The ECB’S ‘Bazooka’ Avert A Eurozone Crisis?' *Financial Times* (2020)

⁹⁸ A. Bobić, 'COVID-19 And The European Central Bank: The Legal Foundations Of EMU As The Next Victim?' <<https://verfassungsblog.de/covid-19-and-the-european-central-bank-the-legal-foundations-of-emu-as-the-next-victim/>> accessed 30 March 2020

Gauweiler the CJEU accepted the OMT's selectivity because this selectivity enabled the ECB to restore its monetary transmission channels.⁹⁹ It is therefore not unlikely the CJEU will accept a slight selectiveness if the ECB can demonstrate it is in the benefit of achieving its objectives. As the latter was the accepted argument in *Gauweiler*.¹⁰⁰ The CJEU has however commented in *Weiss* that "*the ESCB's action will have an impact on financial conditions across the whole of the euro area and will not meet the specific financing needs of certain Member States of that area.*"¹⁰¹ If several bonds are bought more than others it will be important for the ECB to demonstrate that these purchases remain for the benefit of the Eurozone as a whole. Rather than the ECB accommodating the individual Member States. As discussed earlier the OMT program was accepted by the CJEU with strict fiscal safeguards and under very specific conditions. The concerns are valid but seem not to apply in practice. In January 2021 the cumulative holdings of the ECB both APP and PEPP of Italian bonds were negligible.¹⁰² The division of bond purchases furthermore complied fairly accurately with the capital key. The worries listed at the start of the programme, therefore, seem not to apply in practice. In this context article 4 of the PEPP decision requires some attention.

Article 4 of the Decision states that "*Article 5 of Decision (EU) 2020/188 (ECB/2020/9) shall not apply to PEPP holdings.*"¹⁰³ The article refers to limits the number of shares which can be purchased per issuer. This was one of the *Weiss* case considered important limitations to the PSPP.¹⁰⁴ This requirement will be further explored in the following paragraphs when examining the prohibitions laid down in articles 123 and 125 TFEU. At current it is difficult to state whether the PEPP should be considered not to go beyond what is necessary. The PEPP meets several of the requirements laid down in the *Weiss* case. The criterion of issuer limitation is not met, and the question is whether bonds will be purchased without meeting specific financing needs of individual Member States. It would however be too early to conclude that this would render the measures unproportionate and ipso facto unlawful. The restrictions in *Weiss* were not generated as an exclusive and exhaustive list. Rather the CJEU used them to determine whether "*the PSPP does not go manifestly beyond what is necessary*".¹⁰⁵ The current PEPP allows the ECB a lot of flexibility. This flexibility can be considered necessary given the circumstances. It can also be considered as the ECB took too much liberty.

In the *Gauweiler* case, the CJEU stated that "*the question whether the obligation to provide a statement of reasons has been satisfied must be assessed with reference not only to the wording of the measure but also to its context and the whole body of legal*

⁹⁹ *Gauweiler*, paraf. 89.

¹⁰⁰ *Ibid*, paraf. 90.

¹⁰¹ *Gauweiler*, paraf. 82.

¹⁰² Based upon a calculation of total debt and percentage held ECB APP and PEPP holdings of Italy.

¹⁰³ DECISION (EU) 2020/440 OF THE EUROPEAN CENTRAL BANK of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17), section 4.

¹⁰⁴ *Weiss*, paraf. 89.

¹⁰⁵ *Weiss*, paraf. 79.

rules governing the matter in question".¹⁰⁶ If we assume that the context that should be used to assess the decisions includes all public statements, certain communications give rise to concern. Lagarde has stated that "*Coronavirus represents a new form of economic shock that cannot be tackled using the textbooks of the past*".¹⁰⁷ This statement has caused some fall-out¹⁰⁸ questioning the legality and necessity of the measures. The length the ECB is willing to go to may give cause to question whether such lengths are necessary. Though the PEPP is of a large scale it does not seem to go beyond what is necessary. In its communications, the ECB is willing to act but also refers to its mandate and the current extraordinary circumstances. The expected fallout of the COVID19 lockdowns is expected to be severe, because of this severity it is difficult to conclude the measures go beyond what is necessary. Especially because the amount as clarified by the ECB in article 4 of the Decision will only purchase "*to the extent deemed necessary and proportionate to counter the threats posed by the extraordinary economic and market conditions*".¹⁰⁹

Another necessity issue that is interesting to look at is that of termination of the programme. PEPP is currently limited to the end of 2020 but was extended. The current termination clause is "*until the COVID-19 crisis phase is over*".¹¹⁰ When the crisis phase is over is not specified but instead is left up to the Governing Council to decide. This arrangement is perfectly compliant with the legal mandate of the ECB. What should, however, be noted is that it allows a broad interpretation to the Governing Council. This is further emphasized by president Lagarde's statement that "[w]e are fully prepared to increase the size of our asset purchase programmes and adjust their composition, by as much as necessary and for as long as needed."¹¹¹ The possibility to continue or increase the size of the program does not need to be an objection to its legality. It is however particularly broad because the PEPP does not necessarily terminate when COVID-19 is no longer a serious threat. Instead, the definition speaks of the 'crisis phase' which may include and is likely to include a phase of economic recovery. To include the aftermath of the crisis is prudent and gives the ECB the flexibility to slowly decrease its programmes rather than abruptly. There is, however, a risk of disagreement.

The previous chapter on the euro crisis, however, argued that the measures are not without their questions. The Dutch and German central bank governors criticized the ECB policies. The origins of the critics seem to suggest a divide among periphery and core countries. This divide is further shown in the public debt and decline of GDP

¹⁰⁶ Gauweiler, para. 70.

¹⁰⁷ Tweet Christine Lagarde 09 April.

¹⁰⁸ M. Arnold, 'ECB Dissenters Resisted Christine Lagarde's 'No Limits' Virus Response' *Financial Times* (2020)

¹⁰⁹ Decision (EU) 2020/440 OF THE EUROPEAN CENTRAL BANK of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17), article 4.

¹¹⁰ <https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html>

¹¹¹ Christine Lagarde, 'Our response to the coronavirus emergency' (*The ECB Blog*, 19 March 2020) <<https://www.ecb.europa.eu/press/blog/date/2020/html/ecb.blog200319~11f421e25e.en.html>>

predictions. Per the predictions of the EU Commission the average decline is 7.25%.¹¹² The countries that hit above average are (starting from worse to less): Greece, Italy, Spain, France, Ireland, Lithuania and Cyprus. When comparing this to the expectance of public debt to GDP none of these will remain within 60% and only Ireland will remain under 100%.¹¹³ The Netherlands is expected to remain just at 60% and Germany slightly above 70%.¹¹⁴ The impact upon the core countries' structural GDP demand is expected to be lower than that of the periphery.¹¹⁵ With these differences across the Eurozone lines, the answer to the question "*when will the crisis phase be over?*" will likely be divided among the same lines. This means that there is likely to be future disagreement within the Governing Council. This disagreement is worrisome as it indicates an element of choice. As stated before an element of choice requires higher levels of accountability as it decreases the technocratic element.

The PEPP measures should thus be considered proportional and within the monetary mandate of the ECB. Before the measures can be judged as lawful it first needs to be tested against article 123 and 125 TFEU. These two articles will be discussed after the discussion of potential issues stemming from the BVerfG.

6.3.4. Transparency issues raised by BVerfG

Despite stating that the judgement in the Weiss case does not impact the PEPP it does generate a new framework as to which the PEPP will be judged in Germany. Regarding proportionality, the BVerfG judged differently from the CJEU. The first difference is that for the BVerfG the statements of the ECB cannot be merely accepted.¹¹⁶ For the PEPP to be considered proportional would thus require extra explanation. According to the BVerfG, the economic implications of the measure were not adequately considered.¹¹⁷

The BVerfG considers that the PSPP would be suitable to achieve the restoration of transmission channels.¹¹⁸ It however considers that the ECB did not sufficiently take into consideration the economic impact upon national economies.¹¹⁹ Emphasis is placed upon the low interest rates in Germany and the lack of analysis of this point.¹²⁰ The CJEU states that the ECB has not provided an adequate balancing of interest whereby the

¹¹² Based upon calculations from: https://ec.europa.eu/info/sites/info/files/economy-finance/ip125_en.pdf

¹¹³ European Commission, *European Economic Forecast. Spring 2020* (Institutional paper 125-2020), p. 59.

¹¹⁴ Ibid.

¹¹⁵ Ibid, p. 72 (with the exception of Ireland as part of low impact).

¹¹⁶ BVerfG, Judgment of the Second Senate of 05 May 2020 – 2 BvR 859/15 -, paraf. 162.

¹¹⁷ Ibid, paraf. 166.

¹¹⁸ Ibid.

¹¹⁹ Ibid.

¹²⁰ Ibid.

advantages and disadvantages of the said program were balanced.¹²¹ This difference goes back to the referring decision whereby the BVerfG interpreted the indirect effects. It considered that indirect effects should be “*comparable in weight to the monetary policy objective pursued*”.¹²² The BVerfG by these standards would consider the PEPP to be unproportioned as it does not contain an analysis of the economic effects of the program. It is, however, difficult to expect such an analysis of the ECB. The ECB, as the BVerfG, also states has a monetary mandate which is defined as achieving an under but close to 2% inflation rate. It is not up to the ECB to assess the economic impact and weighing up the benefits and disadvantages. The ECB must achieve its monetary objectives without concerning itself with the economic impact upon different nations. The BVerfG, however, states the ECB should consider the impact upon the banking sector¹²³, real estate and housing sector¹²⁴ and economically unviable companies.¹²⁵ In conclusion, it was likely that the BVerfG would find the PEPP to be unproportioned. This conclusion may however be changed by recent developments with the BVerfG.

The president of the BVerfG’s term ended and he was replaced by the more pro-European Wallrabenstein.¹²⁶ In the *Frankfurter Allgemeine*, she has stated she would rather see solutions.¹²⁷ Whereby she emphasizes that the importance is the ECB addresses the issue of explanation but emphasizing less on the ECB taking a new decision.¹²⁸ Thus showing an open approach towards the ECB. Furthermore, the German Parliament on the 2nd of July that the ECB has met the proportionality requirement. The Parliament based this decision upon the minutes they received from the ECB.¹²⁹ Combining the new approach of the BVerfG and the extensive material that is available for the PEPP decision¹³⁰ it might just be the BVerfG would find the measure proportionate. What should, however, be noted is the BVerfG’s exact problem with proportionality.

¹²¹ Ibid, para. 168.

¹²² BVerfG, Order of the Second Senate of 18 July 2017 – 2 BvR 859/15 – paras. (1-137), ECLI:DE:BVerfG:2017:rs20170718.2bvr085915, https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2017/07/rs20170718_2bvr085915en.html, para. 114.

¹²³ Ibid, para. 172.

¹²⁴ Ibid, para. 173.

¹²⁵ Ibid, para. 174.

¹²⁶ Madeline Chambers & Thomas Escritt, ‘Changing of guard at top German court signals de-escalation for ECB’ *Reuters* (21 June 2020).

¹²⁷ Von Konrad Schuller, ‘Wallrabenstein sieht Lösungen im Streit zwischen Karlsruhe und EZB’ *Frankfurter Allgemeine* (Berlin 21 June 2020)

¹²⁸ Ibid.

¹²⁹ Birgit Jennen, ‘German Parliament Backs ECB Bond-Buying After Court Standoff’, *Bloomberg* 02 July 2020.

¹³⁰ In addition to minutes, decisions and financial statements the ECB also published blogs, Q&A and more. Monetary Policy Instruments, Pandemic Emergency Purchase Programme, <https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html> (accessed 04 August 2020)

The BVerfG does not find the measure to be disproportionate per se but finds there is too little information to establish proportionality. The argument indicates a lack of transparency on the part of the ECB. As discussed in chapter 3 transparency is part of accountability, therefore the BVerfG's finding that there is a lack of transparency indicates an accountability issue. This will be further reflected upon in the chapter on accountability. It should, however, be noted that despite the extra information sent by the ECB there is no permanent requirement for additional information. The additional information sent to the European Parliament is currently a one-off approach.

6.3.5. No credit & No bail-out

Article 123 TFEU prohibits the ECB and National Central Banks from providing direct credit towards the Member States and their institutions. Article 125 TFEU prohibits the assumption of debts by the ECB and National Central Banks (NCB), this article is also known as the 'no-bailout'. Before the euro crisis, these articles were interpreted in three different ways: literal, purposive and ultima ratio.¹³¹ In the *Gauweiler* and *Weiss* case, the CJEU has interpreted them in a combination of purposive and ultima ratio. The financial crisis case law has shown that the CJEU uses an ultima ratio approach towards articles 123 and 125 TFEU. This means that to assess legality the wording of the article cannot be violated but neither can a de-facto violation take place.¹³² The articles must furthermore be examined keeping the purpose of the measure¹³³ and spirit of the articles (sound budgetary policy) in mind.¹³⁴

The CJEU has further interpreted that the ECB cannot purchase bonds directly from public institutions but must do so on the secondary market.¹³⁵ Furthermore, two criteria must be met, firstly the ECB cannot purchase bonds in such a way that it would be a de facto purchase on the primary market.¹³⁶ Secondly, the purchases cannot reduce the impetus of a sound budgetary policy.¹³⁷

To prevent a de facto primary market purchase, the ECB must prevent the financial institutions from acting as intermediaries. This would be the case when these institutions knew exactly when what bonds would be purchased.¹³⁸ In the PSPP decision, a blackout period was included that prevented certainty of purchase.¹³⁹ Such a blackout

¹³¹ Vestert Borger, 'The ESM and the European Court's Predicament in Pringle', *German L.J.* (2013) 14(01), p. 129.

¹³² *Gauweiler*, para. 97.

¹³³ *Ibid*, para. 98.

¹³⁴ *Ibid*, para. 109.

¹³⁵ *Weiss*, para. 104.

¹³⁶ *Weiss*, para. 106.

¹³⁷ *Weiss*, para. 107.

¹³⁸ *Weiss*, para. 110.

¹³⁹ *Weiss*, para. 114; Article 4 Decision 215/744.

period has not been explicitly included in the PEPP Decision. Grund accepts that because the PEPP will be conducted in a flexible manner this is sufficient to consider the purchases uncertain.¹⁴⁰ Bobic and Dawson on the other hand consider the legality of the program to be disputable. They argue that the current program will buy so many assets it will result in a purchase on the primary market.¹⁴¹ An argument that is shared by others such as Ducrozet who says “[i]n a nutshell, the decision removes virtually all constraints on asset purchases, in a further boost to the credibility of the ECB’s commitment”.¹⁴² Both arguments are valid to consider and would impact the legality of the measures and the role of the ECB.

The CJEU may preliminarily accept the flexibility that the ECB is eager to keep.¹⁴³ Flexibility does make it unpredictable which bonds will be purchased. If the ECB, however, starts to buy too large quantities of bonds this might result in a violation of article 123 TFEU. If large too many bonds are bought primary dealers are near certain their bonds will be bought and they become intermediaries. It should however be noted that despite the flexibility recital 10 of the decision does state the PSPP framework is applicable unless the decision specifically deviates from this framework.¹⁴⁴ Thus making it unlikely that the ECB will not keep a blackout period.

The second criterion that needs to be respected is that of preserving the impetus for a sound budgetary policy for the Member States.¹⁴⁵ In the *Weiss* case, the PSPP was considered to preserve the impetus for a sound budgetary policy because governments were not certain of future purchases. The foreseeability of a significant amount of bonds being purchased on the other hand does not create a circumvention of Article 123 TFEU.¹⁴⁶ The PSPP was considered sufficiently safe regarding the budgetary impetus due to several factors. The first being the temporary nature aimed at bringing back the 2%¹⁴⁷ and the option to sell bonds when the government does not keep a sound budgetary impetus.¹⁴⁸ The question is whether the PEPP will keep the incentive for a sound budget.

According to Grund et. al., the economy will be severely hit leaving two scenarios. The first is one where governments are overwhelmed with debt. The second scenario is one whereby the government spends less and is worse off than if it could spend more.¹⁴⁹

¹⁴⁰ Grund 2020, p. 7-8.

¹⁴¹ Bobic 2020.

¹⁴² B. Koranyi and F. Canepa, 'ECB Primes Money-Printing Gun To Combat Coronavirus' *Reuters* (2020)

¹⁴³ Christine Lagarde, 'Our Response To The Coronavirus Emergency'

<<https://www.ecb.europa.eu/press/blog/date/2020/html/ecb.blog200319~11f421e25e.en.html>> accessed 3 May 2020

¹⁴⁴ Recital 10, DECISION (EU) 2020/440 OF THE EUROPEAN CENTRAL BANK of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17)

¹⁴⁵ *Weiss*, para. 129.

¹⁴⁶ *Weiss*, para. 131.

¹⁴⁷ *Weiss*, para. 133.

¹⁴⁸ *Weiss*, para. 135.

¹⁴⁹ S Grund, L Guttenberg, and C Odendahl, 'Sharing The Fiscal Burden Of The Crisis: A Pandemic Solidarity Instrument For The EU' *Vox* (2020)

Within this logic, the approach of the PEPP to keep interest rates down is to be encouraged. On the other hand, the PEPP has no reference to conditionality and is flexible with the capital key. The PEPP Decision states in article 5(1) that the purchases will be made according to the ECB's capital subscription key. It however also states in 5(2) that the PEPP purchases will be conducted flexibly. Thus allowing some flexibility over time and space with the subscription key. Bobic and Dawson argue that this lack of conditionality casts doubts upon the legality of the program.¹⁵⁰ The CJEU will have to interpret whether the lack of conditionality is acceptable considering the circumstances. The most likely answer depends on the CJEU's interpretation of the restriction on meeting the financing needs of one Member State.

As stated, before the CJEU stated that the ECB may bring down interest rates in the Eurozone but must do so without answering to the financing needs of a single member state. It stands to reason that if the purchases are made following the capital key, the interest rate in the whole Eurozone will go down but there will be a difference in interest rates between "good" and "bad" budgets. Thus, keeping an impetus for countries to keep a financially sound budget. This capital key was strictly referenced in the PSPP decision.¹⁵¹ The ECB, however, retains the right to sell its bonds if a country decides to conduct a bad fiscal policy. This argument was part of the valued restrictions in PSPP.¹⁵² The question is whether this is enough to ensure the legality of the program. Especially without formal restrictions and Lagarde's statement to potentially remove further "self-imposed constraints"¹⁵³ of the ECB. Another interesting aspect of article 123TFEU is that of the short maturity rates.

The inclusion of short-maturity rates under PEPP has been discussed relating to the blackout period. It is, however, also relevant to the discussion of the impetus to keep a sound budgetary policy. In the OMT the ECB included shorter maturity bonds to restore their monetary transmission channels. The CJEU accepted this program partially on the condition that a sound budgetary impetus was kept because of the conditionality attached to the program.¹⁵⁴ It is thus arguable that the ECB would need a fiscal counterweight to ensure a sound budget is kept when restoring these transmission channels. This argument is not wrong but unlikely to be accepted by the CJEU. The OMT transactions were country-specific rather than general policy. Secondly though in both cases there was financial unrest the nature of this unrest is rather different. The OMT program responded to a balance of payment crisis whilst the PEPP responds to a pandemic. The pandemic is caused by a virus rather than bad lending and borrowing

¹⁵⁰ Bobic & Dawson 2020.

¹⁵¹ Article 6, DECISION (EU) 2015/774 OF THE EUROPEAN CENTRAL BANK of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10)

¹⁵² Weiss, para. 143.

¹⁵³ F. Canepa, and B. Koranyi, 'Exclusive: ECB's Lagarde Overruled German And Dutch Resistance To 'No-Limits' Pledge - Sources' *Reuters* (2020)

¹⁵⁴ Gauweiler, para. 120.

behaviour. This, however, does not mean governments cannot lose the impetus to keep a sound budget during a pandemic. The argument for a fiscal counterpart is thus strong, yet is unlikely to impair the legality of the ECB's actions. The conditionality attached to the OMT and the ECB's behaviour in the Troika has been questioned concerning its monetary mandate.¹⁵⁵ This conditionality was attached to OMT purchases only. If the ECB were to include a fiscal measure to general purchases it would be entering economic policy. Instead of requiring a fiscal counterweight to ensure the sound budgetary impetus is kept, it is more likely the CJEU will focus on the blackout period. Thus likely establishing the legality of the measure. This leaves the next question with regards to legality: article 125 TFEU.

5.3.5.1. No bail-out

Article 123 and 125 TFEU are closely related, article 125 TFEU however focuses on the assumption of debt by the ESCB. In the preliminary questions in *Weiss*, the BVerfG feared that risk-sharing between NCBs would violate the no-bailout clause.¹⁵⁶ It was concerned that the Governing Council of the ESCB could change its risk-sharing policy. The BVerfG was afraid of this possibility because it was not prohibited in European Primary law.¹⁵⁷ For that reason, it suggested the CJEU assess this question.¹⁵⁸ The CJEU, however, found this fifth preliminary question concerning risk sharing to be hypothetical. It thus considered it to be inadmissible.¹⁵⁹ Under the current program, the ECB has allowed itself more flexibility, but it has referred to how these purchases will be conducted and to risk sharing.

Article 5(1) of the PEPP Decision states that purchases will be conducted following Article 29 of the statute of the ESCB. Article 29 of the Statute of the ESCB regulates the capital subscription key.¹⁶⁰ These conditions are the same as those of the APP, the PSPP was part of the APP and the risk-sharing conditions were within the limits of the law. It

¹⁵⁵ See for further discussion: C. Antpoehler, 'Die OMT-Schlussanträge als Anfang vom Ende der Troika?', 16 January 2015 <https://verfassungsblog.de/die-omt-schlussantraege-als-anfang-vom-ende-der-troika/#.VYGhZ_ntmko>; Jean Pisani-Ferry et al., 'EU-IMF assistance to euro-area countries: an early assessment' (2013) 19 *Bruegel Blueprint Series*, p. 24-25; Sebastian Grund & F. Grle, 'The European Central Bank's public sector purchase programme (PSPP) the prohibition of monetary financing and sovereign debt restructuring scenarios' (2016) *European Law Review*, p. 26.

¹⁵⁶ BVerfG, Order of the Second Senate of 18 July 2017 – 2 BvR 859/15 – paras. 5 (summary), ECLI:DE:BVerfG:2017:rs20170718.2bvr085915, <https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2017/07/rs20170718_2bvr085915en.html>.

¹⁵⁷ *Ibid*, para. 133.

¹⁵⁸ *Ibid*, para. 134.

¹⁵⁹ *Weiss*, para. 166.

¹⁶⁰ PROTOCOL (No 4) ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK.

is therefore unlikely that with the same conditions the PEPP will be or should be considered illegal. In practice on the first of January 2021, the number of bonds purchased closely resembled the capital subscription key. Whereby the Italian bond purchase is slightly below its capital key.¹⁶¹ Furthermore, recent purchases indicate the PEPP is conducted within the framework of the subscription key.¹⁶²

In conclusion, it is unlikely that the CJEU will consider the PEPP illegal. The main question will be how the ECB decides to purchase the bonds. It will have to ensure that the purchase behaviour does not provide for the financing needs of a specific member state. The remaining question is whether this programme would cause discrepancies with the BVerfG.

6.3.6. Disagreement with BVerfG

The BVerfG was less critical of the CJEU's interpretation of Article 123 TFEU than of proportionality. It did however disagree with the CJEU on several aspects making it unlikely for the BVerfG to approve of the PEPP.

The first difference is that the BVerfG found that the announcement of the volume of bonds together with the capital key creates an amount of certainty for the market players.¹⁶³ If the BVerfG finds this to be the case for the PSPP it is likely to find the same for the PEPP. The PEPP volume is large and in addition to the other purchase programs. This combined with the earlier discussed fears about the number of peripheral purchases, makes the pandemic purchases unlawful under the BVerfG framework. The perhaps increased flexibility of the ECB might change the mind of the BVerfG. This is, however, unlikely as little is explained with the flexibility and the BVerfG seems attached to lengthy and detailed explanations from the ECB (see proportionality section). It attaches similar explanations regarding the blackout period to prevent certainty from arising.¹⁶⁴ Whereby the BVerfG states that the market players have adjusted their behaviour to the blackout period. Because the period is a matter of days rather than weeks.¹⁶⁵ The significantly lower maturity minimum in the PEPP may be of issue for the BVerfG. The minimum maturity of 70 days is dangerously close to the primary issuing of the 3-month state bond. In its decision, in May the BVerfG considered that the *"mere existence of a blackout period does not justify the conclusion that purchases of government bonds were not foreseeable"*.¹⁶⁶ Considering the lack of further information

¹⁶¹ Based upon calculations from ECB net holdings on 01 January 2021.

¹⁶² Purchase history at end of May,

<https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html> <accessed 30 July 2020>

¹⁶³ BVerfG, Order of the Second Senate of 18 July 2017 – 2 BvR 859/15, paraf. 185.

¹⁶⁴ Ibid, parafs. 189-190.

¹⁶⁵ Ibid.

¹⁶⁶ BVerfG, Judgement of the Second Senate of 05 May 2020 – 2 BvR 859/15 -, paraf. 189.

on the blackout period in combination with the low maturity rate it is unlikely the BVerfG would consider art. 123 TFEU safeguarded.

The PEPP, however, let go of the issuer limitation that was clear in the PSPP. This criterion was one the BVerfG considered to aid to the unpredictability of the purchases.¹⁶⁷ The large volume of PEPP in theory would increase the confidence of purchase thereby decreasing the unpredictability required by 123 TFEU. On the statement of the ECB on the 24th of July, the actual purchases of the PEPP on the other hand were €422.6 billion. A substantial sum, but compared to the €2,260.2 of the PSPP it is relatively low.¹⁶⁸ The increase in recent purchases is, however, more substantial for the PEPP (€19.3 billion) compared to PSPP (€9.5 billion). When both purchases are combined there is a substantial amount of public assets being purchased which might increase the BVerfG's scepticism towards the required uncertainty. It is thus unlikely the BVerfG will consider the PEPP legal under its own newly generated framework. This said the core of article 123 TFEU is sound budget discipline.

It is generally accepted that during a recession a government should have an expansionary budget to counteract the recession. Considering the global recession such a policy seems warranted. The BVerfG in *Weiss*, however, stated the CJEU did not subject the safeguards to prevent a bad fiscal policy to enough scrutiny.¹⁶⁹ The level of scrutiny the CJEU would apply is difficult to predict, however, the ECB does not mention sound budgetary policy in the PEPP Decision, explanation by Philip Lane or its decision to increase the program.¹⁷⁰

With this program's legality under EU law established. It is necessary to provide context via a comparison with the FED.

6.4. US FED response to COVID19

The response of the FED knows different facets.¹⁷¹ It would be too much to go into detail for each response. The following paragraphs will thus focus on the general liquidity provision and the public bond-buying programme of the FED.

¹⁶⁷ BVerfG, Order of the Second Senate of 18 July 2017 – 2 BvR 859/15, paraf. 185., parafs. 201-202.

¹⁶⁸ ECB Consolidated financial statement of the Eurosystem as at 24 July 2020, 28 July 2020

¹⁶⁹ Ibid, paraf. 184.

¹⁷⁰ DECISION (EU) 2020/440 OF THE EUROPEAN CENTRAL BANK of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17): Press Release Monetary Policy Decisions, 04 June 2020

¹⁷¹ Federal Reserve System, 'Coronavirus Disease 2019 (COVID-19)' <<https://www.federalreserve.gov/supervisory-regulatory-action-response-covid-19.htm>> [last accessed 10 December 2020].

The response of the FED has been labelled as a “bazooka moment”, with the large provision of liquidity.¹⁷² The initial response of the FED to the covid19 crisis is like the ECB large in scale. Similar to the ECB the FED increased the direct liquidity availability for banks. It did so by lowering its interest rates on its discount window.¹⁷³

To support local and state governments, the FED introduced its Municipal Liquidity Facility (MLF). This programme was introduced in August and was aimed at supporting states, cities and counties. Under this programme, the Reserve Bank of New York would buy loans up to a total of \$500 billion with an initial purchase of \$35 billion.¹⁷⁴ Interesting to compare is that the ECB’s PEPP, which is comparable in nature and aim, started a lot larger. The PEPP programme started in March with €15,444 million and by August the ECB had made a total of nearly 500 billion euros of total purchases. The total of both programmes is substantially different with the FED’s maximum of \$500 versus the ECB’s €1350 billion. When considering the relative size of both economies, the ECB has spent even more compared to its US counterpart. Compared to the financial instability of 2007 the ECB has responded announced its programme one month earlier with a much more rapid introduction. The ECB furthermore argues a larger financial willingness to act. There are several reasons why this might be happening.

The first reason to explain this is that whilst the ECB’s approach was limited to increasing its APP and the introduction of the PEPP (together good for 1470 billion euros) the FED introduced several programmes. The FED introduced five asset purchasing programmes one of which its System Open Market Account is unlimited.¹⁷⁵ The total budget of the programmes of the FED is, therefore, larger than the ECB. The FED furthermore introduced programmes that focussed on short-term liquidity through MLF. In which it purchased assets with a maximum maturity rate of 36 months.¹⁷⁶ Its System Open Market Account (SOMA) on the other hand includes long-term liquidity.¹⁷⁷ The MLF is aimed at facilitating local governments to deal with the economic fallout of the COVID19 crisis.¹⁷⁸ Interesting to compare is that the Treasury has guaranteed up to \$35 billion of the losses resulting from this programme.¹⁷⁹ This is interesting because unlike within the

¹⁷² Howard Schneider and Ann Saphier, ‘U.S. Fed aims ‘bazooka’ to backstop coronavirus hit economy’ *Reuters* (23 March 2020).

¹⁷³ Federal Reserve Press Release, ‘Federal Reserve Actions to Support the Flow Credit to Households and Businesses’ (15 March 2020).

¹⁷⁴ Federal Reserve, ‘Municipal Liquidity Facility’ (11 August 2020) <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf> [last accessed 10 December 2020]

¹⁷⁵ Federal Reserve Bank of New York, ‘System Open Market Account Holdings of Domestic Securities’ https://www.newyorkfed.org/markets/soma/sysopen_accholdings.html [accessed 10 December 2020]

¹⁷⁶ Federal Reserve, ‘Municipal Liquidity Facility’ (11 August 2020)

¹⁷⁷ Federal Reserve Bank of New York, ‘System Open Market Account Holdings of Domestic Securities’ https://www.newyorkfed.org/markets/soma/sysopen_accholdings.html [accessed 10 December 2020]

¹⁷⁸ Federal Reserve Bank of Cleveland, ‘The Fed’s Municipal Liquidity Facility, explained’ (07 August 2020) < <https://www.clevelandfed.org/en/newsroom-and-events/infographics-library/mlf.aspx> > [accessed 10 December 2020].

¹⁷⁹ Ibid.

European Union the US government was not able to negotiate a recovery programme, as the Republican Party was fiercely against.¹⁸⁰ The programme furthermore provides direct lending to government entities.¹⁸¹ Unlike the ECB programme which buys assets on the secondary market. It does so against penalty rate interests.¹⁸² The programme's effectiveness and legality of the programme have created disagreement.¹⁸³

Senator Elizabeth Warren argues in a letter to the FED and Treasury that the policy is too little and discriminatory.¹⁸⁴ In the letter, it is argued that the MLF is too stringent and therefore it is likely the public sector will cut expenditure on public jobs. This is likely to affect women and minorities to a larger extent as they have found more opportunities in this sector. Additionally, it is argued that it is weak compared to the aid offered to the private sector,¹⁸⁵ other senators however argue it is excessively punitive.¹⁸⁶ On the other hand, Senator Toomey and Powell the chair of the FED have argued that the programme did achieve its goal. They argue the capital bond market is back to pre-crisis levels.¹⁸⁷ Despite the arguments on the effectiveness, the relationship between the FED, Treasury and Congress is interesting to note.

The FED MLF programme is based upon the CARES Act 2020.¹⁸⁸ The FED's programme is thus based upon a newly introduced act. Unlike the ECB who is basing its programmes upon its general mandate. Furthermore, the FED and the Treasury are aligning their policies. It can thus be observed that the FED's mandate is arguably narrower than that of the ECB. Whilst the ECB has been able to generate crisis-fighting measures based upon its general mandate, the FED based them upon special legislation tailored to the crisis. The FED however also based some of its programmes on section 13(3).

¹⁸⁰ 'Illinois taps Federal Reserve for \$1.2bn emergency funding' *Financial Times* (03 June 2020)

¹⁸¹ Federal Reserve Bank of Cleveland, 'The Fed's Municipal Liquidity Facility, explained' (07 August 2020) < <https://www.clevelandfed.org/en/newsroom-and-events/infographics-library/mlf.aspx> > [accessed 10 December 2020].

¹⁸² Sean Fulmer, 'Disagreements over the Municipal Liquidity Facility Erupt' (2020) Yale Blog.

¹⁸³ Sean Fulmer, 'Disagreements over the Municipal Liquidity Facility Erupt' (2020) Yale Blog.

¹⁸⁴ United States Senate DC20510 letter to Jerome H. Powell Chairman Board of Governors of the Federal Reserve System 10 July 2020.

¹⁸⁵ Ibid.

¹⁸⁶ The Fifth Report of the Congressional Oversight Commission October 15, 2020 Commission Members U.S. Representative French Hill Bharat Ramamurti U.S. Representative Donna E. Shalala U.S. Senator Pat Toomey, p. 30.

¹⁸⁷ Ibid, pp. 27-28.

¹⁸⁸ S.3548 — 116th Congress (2019-2020), A bill to provide emergency assistance and health care response for individuals, families, and businesses affected by the 2020 coronavirus pandemic.

6.5. The impact of the COVID19 Pandemic

6.5.1. Interests & Motivation

The previous paragraphs have analysed the objectives and instruments of the ECB and how these have been impacted by the crisis policy measures. The crisis has shown that the objective of the ECB should be considered wider than the mere 2% inflation target. It also includes the restoration of transmission mechanisms and the singleness of monetary policy. Therefore a wider objective has been established than previously expected. Concerning the instruments, there is a larger impact to be seen.

New instruments have developed such as a type of Lender of Last Resort function for the ECB, previously not considered part of the ECB's tasks. This has been established partially through the interest rates and the OMT programme. The crisis has further given rise to the ESM Treaty which puts the ECB in a position as co-negotiator and compliance organ. Additionally, the letters and collateral cases have shown that the ECB has instruments at its disposal to apply additional pressure. Furthermore, a new instrument has been adopted namely that of Quantitative Easing. There has been some restriction to the instruments namely that they must be used to fit within the objectives of the ECB.

It thus seems that the role of the ECB has expanded, whereby the line between the economic and monetary policy is fading. The remaining question is why this occurred and who was the driving organ behind this expansion? This question is important to answer as it indicates the needed nature of accountability. It is also easier to answer in hindsight of two crises rather than just the euro crisis.

This expansion has been argued to be crisis-related.¹⁸⁹ Such expansion is arguably caused by the crisis circumstance rather than the internal drive of EU institutions. Others such as Heldt and Mueller describe it as a competency creep from the ECB.¹⁹⁰ Whereby the ECB was able to self-empower because the ECB was a strong and specialized institution.¹⁹¹ Furthermore, the Member States could not find a solution themselves and hence relied upon the ECB.¹⁹² This boils down to the distinction between intergovernmentalism and supranationalism. The intergovernmental approach failed during the euro crisis and hence the Member States relied upon a supranational organ. This vision is complemented by Kreuder-Sonnen.¹⁹³ In his paper, he argues that the ECB

¹⁸⁹ See Pennesi's Catch-22 example discussed earlier.

¹⁹⁰ Eugénia C. Heldt & Tony Mueller, 'The (self-)empowerment of the European Central Bank during the sovereign debt crisis [2020] *Journal of European Integration*.

¹⁹¹ Ibid, p. 7.

¹⁹² Ibid, p.

¹⁹³ Christian Kreuder-Sonnen, 'International authority and the emergency problematic: IO empowerment through crisis' (2019) 11 *International Theory*.

gained power by something he describes as the ‘constitutional perspective’.¹⁹⁴ This perspective is not unlike that of self-empowerment, he too examines the agents and recipients involved. His theory however adds the question of constitutional constraint.¹⁹⁵ Kreuder-Sonnen furthermore argues that the ECB underwent self-empowerment not through the usual process of mission creep but rather gained its powers abruptly.¹⁹⁶ It could do so because of a crisis and the more powerful Member States agreed with the ECB’s policy. The ECB was furthermore at liberty to argue that it was the best course of action.¹⁹⁷ The author argues the ECB infringed in horizontal powers via the ESM Treaty as it was able to enter into economic policy and infringed vertically by taking away the power from the Greek parliament. It could enforce its will because the need for funds was high.¹⁹⁸ Both visions thus agree that the ECB gained power and that important factors were those of specialization and lack of an alternative. The difference lies in whether the ECB gained power through mission creep or by abrupt empowerment.

The last vision that should be discussed is that of Tesche who argues a form of New Intergovernmentalism (NI) is best to describe the European Union process to deal with the pandemic.¹⁹⁹ This NI is defined by the Member States demanding a deeper integration of the Union through new organs such as the ECB.²⁰⁰ In earlier work, Bickerton et. al. describe this as a delegation to ‘de novo’ organs.²⁰¹ Whereby the ECB is such a de novo organisation that was granted more tasks during the euro crisis.

The difference with the previous authors is, that the drive for additional powers is not found within the ECB but the Member States who seek to empower the ECB.²⁰² The article gives a potential reason that the Member States keep oversight when granting powers to such bodies. The article describes that the new tasks given to the ECB through the ESM keep an intergovernmental approach. The governors of the ESM board consist of representatives from each Member State.²⁰³ Despite the increased role of the ECB the Member States have not lost their influence. Such an approach enhances the accountability of its actions under ESM to the Member States. The NI approach therefore potentially requires less additional accountability.

¹⁹⁴ Ibid, p. 183.

¹⁹⁵ Ibid.

¹⁹⁶ Ibid, p. 187.

¹⁹⁷ Ibid, p. 190.

¹⁹⁸ Ibid, pp. 198-199.

¹⁹⁹ Tobian Tesche, ‘The European Union’s Response to the Coronavirus Emergency: An Early Assessment’ [2020] *LSE ‘Europe in Question’ Discussion Paper Series No. 157*, p. 3.

²⁰⁰ Ibid.

²⁰¹ Christopher J. Bickerton et. al., ‘The New Intergovernmentalism: European Integration in the Post-Maastricht Era’ (2015) 53(4) *JCMS*, p. 705.

²⁰² Tesche, pp. 24-25.

²⁰³ Bickerton et. al. 2015, pp. 713-714.

These visions are important to consider when discussing the change in the role of the ECB. If the change in the role of the ECB is caused by external crisis circumstances, the need for accountability is different. Rather than increased accountability, there is a need for a new EU framework to deal with crisis situations. If the ECB was the primary driver for the increased role it would require an increase in ECB limitations. Last but not least if the Member States were the primary driver for the increased role of the ECB this means the accountability of the ECB should be stronger. This is the case because there is a general will to increase the role of the ECB which should be reflected in its accountability.

The following paragraphs will discuss the impact of the ECB response to the COVID19 pandemic in light of its mandate. It will do so to answer whether the same impact upon its mandate can be seen in its response to COVID19 as to the euro crisis. Additionally, it will discuss the potential motivation behind this change to assess how this reflects upon its accountability. The COVID19 pandemic furthermore will indicate whether or not the measures were permanent. The euro crisis was the first period of real financial instability the ECB faced. The permanency of the responses has been highly debated. The ECB response to the COVID19 pandemic can offer the first hint as to what measures are permanent.

6.5.2. Enhanced liquidity

The absence of initial response to the covid-19 pandemic by inter-governmental institutions led the ECB to increase its role in liquidity providers through the TLTRO and PELTRO programmes. Within these programmes, we see the Catch-22 scenario as described by Pennesi come into play.²⁰⁴ The ECB could have remained on the conservative side and observed the old Bagehot principles. Thus, only lending to financial institutions against good collateral and a penalty interest rate.²⁰⁵ Instead, the ECB opted to restore its transmission mechanism by increasing the accepted collateral and lowering interest rates. Similar behaviour can be observed during the COVID19 pandemic. The TLTRO and PELTRO programmes are aiming to restore the transmission mechanisms of the ECB. They increase the available liquidity against lower interest rates and reduced collateral demands. Tesche further observes that with PELTRO the ECB lets go of another taboo by using dual interest rates. By using a different interest rate for deposits and borrowing the ECB avoids savers grudge.²⁰⁶ According to Tesche by using the dual interest rates the ECB has let go of its one-size-fits-all policy. Though indeed the

²⁰⁴ Pennesi 2016.

²⁰⁵ Rhiannon Sowerbutts, The demise of Overend Gurney (2016)2 Bank of England Quarterly Bulletin

²⁰⁶ Tobian Tesche, 'The European Union's Response to the Coronavirus Emergency: An Early Assessment' [2020] LSE 'Europe in Question' Discussion Paper Series No. 157, p. 15.

ECB hereby seems to respond to the worries in the countries where interest rates on savings are zero or close to zero, it does not let go of the one-size-fits-all policy. The ECB uses these interest rates for the whole Eurozone and though it responds to a concern that is greater in some countries compared to others, using dual interest rates seems appropriate with the current negative interest rate policy. A further taboo that was broken is that of helicopter money. This debate was put on the table by the governor of the French Central Bank who introduced the debate of the ECB engaging in helicopter money.²⁰⁷ This is considered a sensitive topic as some consider its fiscal policy. Placing such a sensitive policy on the table is the first step in a potential implementation. The helicopter money policy might not be implemented soon or ever but with such a first step to implementing, a mission creep can be found.

Comparing TLTRO and PELTRO to the enhanced credit support of the ECB during the financial crisis there are a few similarities. The previously mentioned similarities indicate the permanency of the ECB in liquidity provisions to counter a crisis. These provisions became more flexible in collateral and with lower interest rates than during the financial turmoil. Therefore, it can be argued the ECB is slowly increasing its powers. Thus, confirming the theory of Heldt-Mueller as rather than an abrupt increase of powers as the ECB slowly increased the boundaries of its liquidity provisions. This idea is however slightly simplistic.

The Eurozone had not yet fully recovered when faced with the pandemic. The interest rates and other factors were still coping with the recovery of the euro crisis. Because the ECB was faced with another crisis it had to lower its interest rates and increase its collateral lists. This argument thus stirs towards the “Catch-22” scenario of Pennesi²⁰⁸ whereby the ECB had to increase its measures to fight the crisis or face the disruption of its monetary transmission channels. Rather than an internal drive for additional powers. It can, however, not be ignored that some of that internal drive may be present. The ECB not only increased its liquidity provisions but also broke through some previously held taboos such as dual interest rates and the discussion of helicopter money. These factors arguably indicate that some of that internal drive towards a mission creep is there. If the ECB were to implement helicopter money it could even be argued, it would abruptly increase its power as Kreuder-Sonnen describes. This is for the future to demonstrate which leads to the next question namely that of the ECB’s main response; the Pandemic Emergency Purchase Programme (PEPP).

6.5.3. Pandemic Emergency Purchase Programme

²⁰⁷ Martin Arnold, French central banker floats printing money to hand to companies, *Financial Times* 08 April 2020

²⁰⁸ Pennesi 2016.

The PEPP is larger than the APP and has a quicker pace. This increase in volume and speediness of the PEPP shows an indication that the ECB wishes to increase the impact of its policies. A comparison of bond spreads of 10-year bonds of Germany and Greece shows that the spreads were more volatile during the euro crisis. However, the spreads were at an extreme low when COVID19 hit and thus hindering potential transmission signals.²⁰⁹ This shows two things. Firstly, the increase of the programme does not correspond to the increase in bond volatility, thus suggesting a slow competence creep that was observed by Heldt and Mueller. The ECB is slowly increasing its programme's volume. It is thereby helped by being likely the only EU organ with enough financial firepower to counteract the economic fallout.²¹⁰ However, when the PEPP was implemented the bond yields were much lower than at the start of the euro crisis. Thus, justifying a stronger approach forced by a crisis on top of which a not fully resolved previous crisis. It is unlikely that a more limited approach would have the appropriate impact. The increased volume, therefore, indicates a slow competence creep, not rapid as the PEPP is not completely new in comparison with the APP, with the increase forced by another catch-22 scenario. Secondly, the PEPP's large volume indicates the ECB's continued willingness to implement large-scale policies to restore the financial markets. It thus would indicate that quantitative easing is part of its permanent tools.

The ECB PEPP seems to closely resemble the structure of the Asset Purchasing Programme. There are, however, two noteworthy differences such as the inclusion of Hellenic Assets and the lack of direct reference to the capital allocation key. Or in the words of the Financial Times *"The European Central Bank has given itself an unprecedented level of flexibility in its plan to buy €750bn in additional bonds to contain the financial fallout from the coronavirus pandemic, which analysts say could leave it open to legal challenges. Almost all constraints that applied to the ECB's previous asset-purchase programmes have been removed or significantly loosened"*²¹¹ It should, however, be noted that the PEPP not only resembles the APP but also largely follows its framework. Recital 10 of the decision states *"Purchases under the PEPP will take place in accordance with the existing frameworks established for the APP, except as specifically set out in this Decision."*²¹² The flexibility can be considered a form of self-empowerment, however, the flexibility is less because unless otherwise provided the PEPP follows the APP framework (including the subscription key). It is unlikely the ECB will significantly deviate from the subscription key, thus not resulting in a real self-empowerment in that regard. It also shows that despite the increase in pace, the legal

²⁰⁹ Greek 10y bonds, Data obtained from investing.com [last accessed 21 September 2020]; German 10y bonds, Data obtained from investing.com [last accessed 21 September 2020].

²¹⁰ Martin Wolf, 'Why The European Central Bank Can Save The Eurozone' *Financial Times* (2020)

²¹¹ M. Arnold, and T. Stubbington, 'ECB Shakes Off Limits On New €750Bn Bond Buying Plan' *Financial Times* (2020) <<https://www.ft.com/content/d775a99e-13b2-444e-8de5-fd2ec6caf4bf>> accessed 4 May 2020

²¹² Recital 10, DECISION (EU) 2020/440 OF THE EUROPEAN CENTRAL BANK of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17).

framework for the PEPP remains similar. Thus the role of the ECB has increased in volume but does not differ much concerning the type of action compared to APP. The latter is also reflected in the ECB's withdrawal from the ESM. Demonstrating a return to more conventional policies (see section 5.5.).

6.5.4. Drawing up the balance

The previous paragraph asked two questions, firstly whether the ECB has increased its role throughout the COVID19 economic fallout compared to the euro crisis. Secondly, if it has increased its role what type of process has it used to achieve this increase?

When examining the PELTRO and PEPP there seems to be an expansion of the measures compared to previous policies. The expansion can be observed in the volume and swiftness of the PEPP and the increasingly better conditions of the PELTRO and TLTRO. The expansion of these responses is a form of self-empowerment that mainly arises from the Catch-22 scenario (less does not work). Based purely on this observation one can argue the ECB has expanded its powers through self-empowerment and has done so out of necessity. This observation would be incomplete as it is only based on what the ECB has done and not what it has not done.

As mentioned in the earlier section on the ECB and the euro crisis there were several debates regarding the ECB's powers. Beukers argued that the ECB had demonstrated a shift from the pre-crisis era due to its ability to pressurize the Member States, the conditionality placed upon the secondary market purchasing programmes and the negotiating powers it was granted in the Troika.²¹³ Though it is impossible to say with certainty whether the ECB has sent letters to the Member States (as these would not be made public for several years) there is no indication at current that such letters have been sent. However, the ECB is leaving the ESM and hence it is unlikely for the ECB to become involved again. The ECB furthermore has not used more targeted programmes as it did with OMT. In the case of the OMT country-specific measures were accepted as they involved a form of conditionality the ECB has not created such specific policies. Nor has the ECB involved itself in fiscal negotiations. Part of the reason might be the stimulus package agreed upon in July.

The stimulus package agreed upon on July 21st entailed a new plan for the Member States to counteract the economic fallout of the COVID19 pandemic.²¹⁴ According to Pernice, this deal has taken several taboos off the table and whilst it is a pragmatic

²¹³ Thomas Beukers, 'The new ECB and its relationship with the Eurozone Member States: Between Central Bank Independence and Central Bank Intervention' [2013] *CML* (50), p. 1580.

²¹⁴ General Secretariat of the Council, Special meeting of the European Council (17, 18, 19, 20 and 21 July 2020) – Conclusions, <https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf>

approach towards the crisis it indicates further European integration.²¹⁵ This deal shows an interesting shift compared to the euro crisis for two reasons. As described by Heldt and Mueller during the euro crisis the ECB grew its powers largely because the Member States could not find a solution themselves.²¹⁶ Though it took some negotiating it seems that the Member States have now reached an agreement and thus limiting the need for ECB interference. Secondly, the recovery plan focuses on the creation of a more resilient EU and forms a blueprint for further economically destabilizing issues.²¹⁷ If this intention is indeed pursued it would permanently limit the need for ECB intervention in stabilizing the markets.

It thus seems that whilst the programmes of the ECB have increased in size and reach, the role of the ECB during the pandemic has decreased. The main financial recovery plan was negotiated between the Member States and there is no indication that the ECB has interfered with national fiscal policy. Therefore, though the circumstances of an unresolved euro crisis and the global fallout of the pandemic may have increased the programme and confirmed the ECB's crisis mitigating objective. The programmes the ECB conducted seem to have become more conservative. This does not mean that there are not tensions to be found.

De Boer and Van 't Klooster argue that both the PEPP and the APP programme challenge the ECB's narrow role.²¹⁸ Their argument in this regard is the increased volume of the PEPP and the self-imposed limits of the ECB.²¹⁹ This is interesting to develop further on. In their article, they state that the alternative for the ECB would have been to lower their inflation output.²²⁰ The latter is interesting as it relates to choices given to the ECB. The ECB's mandate is vague on what price stability means and the inflation target is self-generated. This means that the ECB could adjust their inflation goals to the crisis circumstances. The costs of low inflation are debated and largely depend upon one's vision of whether there is a natural rate of unemployment.²²¹ On the other hand, there is evidence that the unconventional policies did have reflationary effects.²²² This raising the question of which of the two policies should have been given preference or a combination of both?

The choice between reducing inflation and increasing unconventional methods is political and depends largely on economic beliefs. The fact that the choice was left to

²¹⁵ Ingolf Pernice, 'The July 21 Big Deal: Towards an Ever Closer Union', *Bridge Network* 22 July 2020

²¹⁶ Heldt & Mueller 2020.

²¹⁷ Recovery plan for Europe agreed on 21 July 2020, https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe_en

²¹⁸ Boer & Kloosterhuis 2020, p. 15.

²¹⁹ Ibid, pp. 15-16.

²²⁰ Ibid, p. 12.

²²¹ George A. Akerlof, William T. Dickens, George L. Perry, Robert J. Gordon and N. Gregory Mankiw, 'The Macroeconomics of Low Inflation' (1996) 1 *Brookings Institution Press*, p.1.

²²² Matteo Ciccarelli & Chiara Osbat, 'Low inflation in the euro area: Causes and consequences' (2017)

181 *ECB Occasional Paper*, p. 47.

the ECB indicates an authorization gap as referred to by De Boer and Van 't Klooster. Leaving crisis decision making to the ECB is perhaps not a fundamentally bad decision, as can be recalled political will was limited during the euro-crisis. It does however indicate the need for an increase in accountability for the ECB. The crisis objective is an interesting one to further compare permanency to that of the euro crisis.

The PEPP confirms that the ECB has adopted a crisis mitigating objective and is ready to act more swiftly. When the financial crisis hit the continent in 2007 and 2008 the ECB responded quite late. When considering the PEPP the ECB responded rather swiftly. The first COVID19 case in the EU was reported in Italy on the 21st of February. The PEPP was in place by the 24th of March, hardly a month later. The first two presidents of the ECB, Duisenberg and Trichet, said the ECB would never participate in purchasing programmes.²²³ With the introduction of the PEPP, the adoption of quantitative easing programmes seems to be permanently added to the ECB toolbox.

In conclusion, it seems that compared to the euro crisis a further process of self-empowerment has continued with relation to the PEPP and PELTRO and TLTRO programmes. This process is mainly noticeable in the increase of scope and volume of the programme. The approach of the ECB towards the pandemic indicates it has permanently added programmes of quantitative easing to its toolbox and is ready to mitigate in a crisis. The programmes are less abrupt as described by Kreuder-Sonnen during the euro crisis. Concerning the pandemic response, the ECB seems to continue previous policies rather than abruptly introducing new ones. The drive for this increase in scope is largely due to a Catch-22 scenario whereby the crisis forces the ECB to take more drastic policies or lose their transmission channels.

The agreement between the Member States in the July stimulus package furthermore shows that self-empowerment is limited. It furthermore is not Tesche's description of New Intergovernmentalism²²⁴ since the Member States have agreed upon an economic recovery plan themselves rather than transferring powers on the ECB. Additionally, the ECB has not generated a shift in its role, as large as that observed by Beukers during the euro crisis. The ECB has stuck to rather conservative central bank measures such as quantitative easing and increasing liquidity to financial markets. The reason for the lack of economic interference may be a combination of increased Member State cooperation and the cause for the economic fallout to be more universal to all Member States. The debate however did introduce a controversial topic to the discussion that of helicopter money. Thereby indicating the ECB is open to discuss new policies, but this has not yet been introduced. The permanency of the Troika and ECB letter writing seems limited.

Concretely this means that the mandate of the ECB does seem to have grown to include a Lender of Last Resort function and a bank ready to mitigate a crisis. The ECB however

²²³ Schmidt 2015, p. 32.

²²⁴ Tesche 2020, p. 3.

has taken a step back from direct interference with the economic policy of the Member States. This means that there should be an initial increase in its accountability. It has however not grown at such significant levels as with the euro crisis thereby limiting the need for increased accountability. The response of the ECB to COVID19 seems limited, even when compared to the FED. In relation to the main research question, this means that concerning the COVID19 response there is a reduced impact upon the mandate of the ECB. This warrants less accountability than the changes observed during the euro crisis. The decreased role and the ECB moving more towards conservative policies suggests a decreased need for accountability.

6.6. Conclusion

In conclusion, the ECB has taken various, extremely important steps to mitigate the impact of the economic fallout of COVID19. These steps included measures to further increase the liquidity and introducing a large asset-buying programme. These measures should be viewed as within the ECB's mandate. The BVerfG would however be critical towards the large volume of the PEPP. The measures are also more conservative compared to some of the responses to the euro crisis. Conservative as a description does not carry any value judgment. In the case of the ECB, conservative should be interpreted as closer to the role of the ECB as interpreted before the crises. This would be the pan-European approach focussing on price stability through the increase of liquidity. Whether conservatism is the best approach from an economic perspective is not discussed. From a legal perspective, however, the narrow approach focussing on price stability through the conservative route is closer to the original expectation of the ECB and balances the independence and accountability (see chapter 3).

The PEPP is less related to fiscal policy than the OMT programme, or the letters sent by the ECB. This makes the programme more conservative. The new responses of the ECB indicated that the ECB is more quickly to respond but is also more conservative in its measures. Compared to the US it indicates that the ECB is perhaps even more conservative in its approach. The ECB targets price stability only whilst the FED programme also (aims) to target employment levels. This makes the programme of the FED more debated than that of the ECB. However, this policy is also primarily based upon an act introduced by the democratic legislator.

The motivation behind the ECB acting as a crisis fighter seems to be less of an internal drive and more due to circumstances and lack of an alternative framework. This framework is slowly being developed through the ESM reform and the EU New Deal. The growth of this framework allows the ECB to return to more conservative policies and warrants less accountability. The ability of the ECB, however, to undertake the role it did means it could do so again if another crisis presented itself and institutions are not (yet)

capable of acting. Therefore even though the ECB is returning to policies closer to its original role, the question of whether there is enough accountability remains. Not only is it important to reflect upon accountability over the current role of the ECB but also as a reflection of future potential actions. The next chapter will continue therefore by discussing accountability as per chapter 3. Starting with the level of judicial review taken by the CJEU.

7. Judicial Review

7.1. Introduction

In chapter 3 this research defined accountability to include the level of judicial review. This chapter will evaluate the crisis case law. It will analyze the case law with regard to the level of judicial review and the impact this level has on the independence and accountability of the ECB. The previous chapters have analyzed the changing role of the ECB during the different crises. This chapter will continue by discussing the first aspect of accountability. Section 7.2 will discuss the *Gauweiler* judgement. Section 7.3 will discuss the second crisis case, namely *Weiss* judgement. These cases will be analyzed in light of the role of the ECB in section 7.4. Section 7.5 will turn towards accountability and analyze the level of judicial review. This chapter will close in section 7.6 in the conclusion.

7.2. *Gauweiler* Judgement

7.2.1. Referral Judgement

The *Gauweiler* judgement concerned the OMT programme. To fully understand the *Gauweiler* case one must start at the national procedure in which it was decided by the Bundesverfassungsgericht to ask preliminary questions.¹ The decision combined the complaints of 11.699 plaintiffs. The main plaintiff was Peter *Gauweiler* a politician and member of the Bavarian Christian Social Union (CSU). To bring the case in front of the BVerfG the complaint had to fall within the reach of article 93 Grundgesetz (GG).

Article 93 GG provides for the type of complaints the BVerfG is competent to examine. To stay within the competence of the BVerfG the plaintiffs had formulated their complaints to the inaction of the Bundestag. The plaintiffs argued that the OMT decision taken by the ECB was outside its mandate. Because of this transgression, the German Parliament should have acted against the decision. More precisely they demanded that Parliament would use their article 263 TFEU right and bring the decision in front of the CJEU. The lack of this type of action is what the plaintiffs put forward as unconstitutional. Additionally, rulings were asked concerning a possible Organstreit. The plaintiffs feared

¹ Combined cases of 2 BvR 2728/13; 2 BvR 2729/13; 2 BvR 2730/13; 2 BvR 2731/13; 2 be 13/13, *Gauweiler 1*.

that parliament would lose its budget rights due to liabilities. The OMT decision carried high risks and had no ex-ante limits to the number of bonds that would be bought. As central bank losses are compensated by the government, parliament would lose its budget rights, hence the Organstreit.

The BVerfG decided to send two main preliminary questions to the ECJ. These will be discussed in the following paragraphs.

7.2.1.1. Preliminary Question 1: the validity of the OMT-decision

The first legal hurdle the BVerfG has to take is that of admissibility. It considers the possible lack of external effects to qualify the decision as an act rather than the mere announcement of an act, irrelevant. Additionally, the requirement of direct effect is also considered irrelevant. What is relevant according to the BVerfG is that the German conditions for preventative legal action have been met.² The reason the BVerfG seems to take such a liberal decision is the irreversibility of the decision. Had the OMT decision been executed the effects would be of such a nature that they cannot be reversed.³

7.2.1.2. Preliminary Question 2: Ultra Vires

The first consideration the BVerfG makes when examining the possibility of ultra vires is referring to the Honeywell decision.⁴ It is interesting that the BVerfG would refer to the Honeywell case in this matter.

The BVerfG's position on supporting the ECJ's decisions has changed over the course of its decisions.⁵ Starting with accepting the priority of EU law in Solange I, with the sole exception of human rights under basic law.⁶ This was reversed in Solange II with the stance that as long as the protection of the fundamental rights within the Community was equal to that of the Basic Law.⁷ The open view, arguably, became more restricted in the Maastricht and Lisbon Decisions. In these decisions, the BVerfG not only took control over fundamental rights but also focused on democracy, representation, and legitimization.⁸ The position of the BVerfG is strong in these judgements and seem determined to remain in control over its Basic Law. Interestingly this perspective seems

² Ibid, paraf. 34.

³ Ibid, paraf. 35.

⁴ Ibid, paraf. 36.

⁵ Stein, p. 219.

⁶ BVerfGE 37, 271 [1974] CMLR 540

⁷ BVerfGE, [1987] 3 CMLR 225.

⁸ Stein, p. 223.

to shift again in the Honeywell decision.⁹ In the Honeywell decision, the BVerfG states that '*Ultra vires review by the Federal Constitutional Court can only be considered if a breach of competencies on the part of the European bodies is sufficiently qualified*'.¹⁰ The term sufficiently qualified indicates that the BVerfG is not willing to look at each breach. Only when the breach is significant is the BVerfG willing to examine the case. Before willing to declare such a breach the CJEU must be granted the opportunity to clarify. It furthermore emphasizes that such a review must be done in a Euro-friendly manner¹¹ and should be correlated to the principle of sincere cooperation.¹² These words are far friendlier than those uttered in the Maastricht and Lisbon Decisions. Thus, referring to the Honeywell case rather than decisions taken before the BVerfG shows a level of tolerance. Stein even goes so far as to argue that the Honeywell case has placed the bar so high that the ECJ will most probably never cross it.¹³

These soft words are complemented by the BVerfG's explanation of qualified as a violation that is manifest.¹⁴ It explains that manifest would be if the ECB violated its monetary policy mandate or the prohibition of monetary financing. The *Pringle* case clearly shows that economic and monetary policy are difficult to separate. It is thus difficult to establish when this would be 'manifestly' so. According to further explanations the BVerfG would consider it manifestly so if the ECB pursued an independent act of economic policy.¹⁵ The BVerfG seems to consider this the case because the OMT decision could be superimposed. It however also considers that economic instruments in the Member States depend on the political process. The ECB's decision making is not dependent upon political processes and could thus take decisions no longer possible to achieve via the democratic process.¹⁶ The BVerfG however argues the OMT decision could lead to redistribution between budgets and taxpayers of the different Member States. This it considers was not part of the integration of the European Union.¹⁷ It then continues with the question of the prohibition of monetary financing of the budget.

The BVerfG opens its reasoning that a violation of this prohibition too would constitute a significant transgression of powers. The transgression would be significant because the treaties contain an explicit prohibition on monetary finance.¹⁸ It has been argued that the BVerfG was under strong political pressure after its strong words in the

⁹ Ibid, p. 226.

¹⁰ BVerfG, Order of the Second Senate of 06 July 2010 – 2 BvR 2661/06-, paras. 1-116, http://www.bverfg.de/e/rs20100706_2bvr266106en.html, paraff. 1.

¹¹ Ibid, paraf. 58.

¹² Ibid, paraf. 100.

¹³ Torsten Stein, 'Always Steering a Straight Course? The German Federal Constitutional Court and European Integration' *Springer* (2011)12, p. 227.

¹⁴ *Gauweiler I*, p. 37.

¹⁵ Ibid, paraf. 39.

¹⁶ Ibid, paraf. 40.

¹⁷ Ibid, paraf. 41.

¹⁸ Ibid, paraf. 43.

Maastricht and Lisbon cases.¹⁹ Potentially that is why they argue that prohibition of monetary finance is one of the fundamental rules ‘*that guarantee the design of the monetary union as a “community of stability”*’.²⁰ Thus seemingly arguing pro-integration whilst criticizing the OMT decision.

7.2.1.3. Interpretation of EU law:

To evaluate whether there is a manifest error the BVerfG gives its interpretation of EU Law. The BVerfG starts with the *Pringle* case.²¹ In this case, the Court of Justice confirmed that when a policy merely affects monetary policy, it cannot directly be qualified as a measure of economic policy. To qualify an act as either monetary or economic the aims and measures must be evaluated. The BVerfG takes this judgement and then argues that clear acts of monetary policy are interest rates and the release of currency. It however considers giving financial assistance to be an act clearly outside of monetary policy.²² Added to that the BVerfG considers that the ECB only has the power of budgetary control when in a hearing in an excessive deficit procedure and even then to a limited degree. Thus the ECB participating in monitoring missions of the Troika is according to the BVerfG far beyond its mandate.²³ With reference to the *Pringle* case, the BVerfG also states that to interpret art. 123 TFEU a teleological approach must be used. This approach would prohibit the circumvention of the article.²⁴ This circumvention would take place in case the Eurosystem would partially waive security claims. As it is not planned for the Eurosystem to be maintaining a preferred creditor status this risks the Eurosystem having to participate in a debt cut. Which would thus constitute a circumvention of the prohibition on monetary finance as stated in art. 123 TFEU.²⁵ Added to the potential debt cuts is the increased risk of these bonds, though it is not prohibited to take losses, the BVerfG considers these bonds to be of such risk that they violate the prohibition of monetary finance. Furthermore, the BVerfG considers the quantities of these purchases of such volume that they are prohibited especially because they are to be held unto maturity. The maturity aspect indicates that the purpose of these purchases is not monetary in nature but economic.²⁶ The assumption that the bonds are held unto maturity is however only a possibility, though economically likely due to a lack of demand. The German BVerfG also considers some of the press statements made by the President of the European Central Bank Mario Draghi.

¹⁹ Stein 2011, p. 227.

²⁰ *Gauweiler I*, p. 43.

²¹ ECJ, Judgment of 27 November 2012, Case C-370/12, *Pringle*)

²² *Gauweiler I*, p. 64-65.

²³ *Ibid*, paraf. 67.

²⁴ *Ibid*, paraf. 86.

²⁵ *Ibid*, paraf. 88.

²⁶ *Ibid*, parafs. 89-90.

The press statement of 26 July 2012 and the hearing at the BVerfG clarified that market participants are encouraged to buy government bonds. The participants are encouraged via the prospect of little risk and the ECB performing the function of lender of last resort. Which is according to the BVerfG unlikely to be compatible with article 123 TFEU.²⁷ This encouragement through the famous '*Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.*'²⁸ Is indeed suggestive of a major bond-buying scheme, however, it could also be a mere psychological speech. In the Eurozone one country may experience financial difficulty and investor fear will dry up liquidity throughout multiple countries. De Grauwe explains that when one country such as Greece is in financial difficulty, investors may fear a full crisis. They will thus sell their Spanish bonds and use the returns to invest in Germany. Other investors will then fear a lack of liquidity to pay out their bonds and sell their assets too, thereby indeed leaving too little money to pay out bondholders. This phenomenon is the so-called self-fulfilling prophecy. The ECB has the chance to prevent this by acting as a lender of last resort.²⁹ Interestingly the argument of redistribution put forward by *Gauweiler* is thus working both ways. The German Bundesrat fears German funds being transferred to Greece, whilst the crisis is transferring liquidity from Greece to Germany. Though the latter is a transaction of private investors, it does slightly neutralize the drastic effects of the OMT decision. This in combination with the guidelines that were yet to be established and the fact that OMT was never used, seem to indicate that the decision was more psychological in nature. Though this does not change the effect as psychological statements only work when there is the possibility to back them up, it does add perspective to the decision. The crisis circumstances however do not seem to influence the opinion of the BVerfG.

The BVerfG considers that in every crisis, mechanisms of monetary transmission will be distorted. Neither does this transform the OMT decision into a monetary action nor does it excuse the ECB from transgressing its mandate. It considers that if in every crisis the ECB is allowed to purchase bonds, the ECB would indeed have a mandate to finance the Member States.³⁰

Despite the fierce criticisms, the BVerfG is giving the OMT Decision could be interpreted in conformity with Union law. This would be the case if a possible debt cut was excluded, market prices were used and the number of government bonds to be bought limited.³¹

These arguments sum up the majority decision of the BVerfG, there were two dissenting opinions from Justice Lubbe-Wolf and Justice Gerhardt. The first mostly considers the motions as inadmissible due to the political nature of the claim. The second also argues

²⁷ Ibid, paraf. 94.

²⁸ Press release 26 July 2012, President of the European Central Bank.

²⁹ De Grauwe CESifo Economic Studies, Vol. 59, 3/2013, 520–535 – 521.

³⁰ *Gauweiler* I, p. 95-98.

³¹ Ibid, paraf. 100.

the claims to be inadmissible, arguing that the BVerfG is not responsible for general constitutional supervision. Justice Gerhardt states that there is a difference between a substantive fundamental right to be violated and a general constitutional review. The first is indeed within the mandate of the BVerfG but the latter is not and the budget violation of the Bundestag seems to be the latter. The case was then sent to the ECJ whereby Advocate General Villalón took a conclusion.

7.2.2. Conclusion Advocate General:

In his conclusion, the Advocate General (AG) responds to the arguments provided by the different parties in order to answer the preliminary questions. Before doing so AG Villalón enters the debate on the admissibility of the case. Most of these questions are not relevant to this research. What is worthwhile mentioning is that the AG considers the mere announcement of the OMT decision to be part of the intervention plan.³² Therefore the case is admissible for preliminary questions.

Regarding the first preliminary questions, those concerning monetary policy, the AG considers the OMT decision categorizes as monetary policy. He considers the mandate of the ECB to be very narrow and closely tied to (the fight against) inflation.³³ Additionally, the AG considers the unique and identifying independence of the ECB. Considering that it was the clear intention of the legislators to keep the ECB from the political debate.³⁴ Furthermore, the AG warns the CJEU from taking place in the decision-making seat of the ECB. The ECB has the technical expertise the CJEU has not, hence the CJEU must be cautious when judging such a technical area.³⁵ Interesting to note is that the arguments the AG is referring to, are the classic arguments used to defend independent central banks. As discovered in previous chapters CBI defends an independent central bank on the premise that it is an expert body. Independence eliminates short-term political influences and thereby increases the effectiveness of a central bank's fight against inflation. As further discovered in chapter 3, these theories have also been criticized and the level of independence of the ECB was novel and relatively extreme. The AG concludes that the OMT decision falls within monetary policy but should be qualified as an "unconventional monetary policy".³⁶

The unconventional monetary policy argument is quite interesting as it seems to generate a new category of monetary policy. The Member States and the Commission defend the idea of unconventional monetary policy.³⁷ Interestingly the theory of

³² AG *Gauweiler*, paraf. 84.

³³ *Ibid*, paraf. 107.

³⁴ *Ibid*, parafs. 108-109.

³⁵ *Ibid*, paraf. 111.

³⁶ *Ibid*, paraf. 114.

³⁷ *Ibid*, paraf. 117.

unconventional monetary policies takes away the need for the Member States to make politically difficult decisions, an argument which shall be discussed later. The Commission however argues that unconventional policy should be surrounded by checks and balances.

The unconventional monetary policy is defined by the AG as normal monetary mechanisms used in an exceptional way. Which is only allowed under exceptional circumstances, such as the financial crisis.³⁸ To answer the first preliminary question the AG considers that the measure must be tested against the proportionality principle.³⁹ If the measure is proportionate and has monetary aims then the ECB is pursuing monetary policy, whilst if it is not proportionate the AG considers the actions economic. This line of reasoning indicates that the ECB has a flexible mandate, it is allowed to do more under extreme circumstances. To define between monetary policy and economic policy the AG generated four criteria. The first is to aim and serve price stability, second, it should be via an explicitly mentioned policy instrument, three not conflicting with fiscal discipline and no co-responsibilities of debts. The AG adds that if there are aspects of economic policy this should be only to support economic policy and they should not be undermining the monetary aims.⁴⁰ Though these criteria seem to be in line with the treaties and generally well defined, the AG does not indicate how to define what aim is submissive to the other.

The AG considers that the extraordinary circumstances allow the ECB the need to improve the transmission channels. As this is the goal the decision should be considered monetary in nature.⁴¹ An argument the AG is more susceptible to is that of the important role the ECB plays in the aid. The financial aid programme may counter the moral hazard and increase budgetary responsibility, the ECB is not passive. The ECB is negotiating and checking the compliance of the countries involved. The active involvement of the ECB in this matter should be considered more than general support of the economic policy.⁴² The ECB is involved in both providing financial aid and negotiating and monitoring the conditions. Via the bond-buying scheme, the ECB can enforce budgetary changes upon the countries. The active involvement of the ECB must, according to the AG, be separated from a passive observer. The passive observer is indeed a justified position to prevent the moral hazard, the active engagement of the ECB is not.⁴³ This seems to be the only matter whereby the AG agrees with the plaintiffs.

Regarding selectivity and circumvention, the AG does not see this as a problem. The ECB is selective to unblock particular transmission mechanisms, which does not make it a

³⁸ Ibid, parafs. 120-121.

³⁹ Ibid, paraf. 124.

⁴⁰ Ibid, paraf. 130.

⁴¹ Ibid, paraf. 136.

⁴² Ibid, parafs. 141-143.

⁴³ Ibid, parafs. 143-147.

part of economic policy. The circumvention of the aid mechanism created by possible differences by the ECB and the ESM are not worrisome.⁴⁴ More interesting is the AG's reasoning regarding the testing of unconventional measures.

With regard to unconventional measures, the AG argues that there are two important criteria. The first is no violation of other treaty provisions and the second is proportionality. Interesting in this case is that an unconventional measure is warranted if it is not in violation of other treaty provisions.⁴⁵ Rather than vice versa, is there a foundation in the treaties for such an unconventional policy? The AG might be taking into account that the policy is monetary and the ECB has a lot of freedom within its mandate. It would however not be unreasonable to argue that a better approach is to assess whether the treaties provide grounds for such unconventional measures rather than whether they oppose them.

In addition to and before discussing the proportionality principle, the AG discusses a standard complementary to that of proportionality. This factor is the transparency requirement. Without transparency, the AG cannot consider a measure proportionate. To consider proportionality the ECB must be fully transparent in what constitutes the special circumstances.⁴⁶ The AG, therefore, recommends that the ECB shows evidence demonstrating the blockage of the transmission channels. The evidence the ECB has provided for these circumstances in their press release is too little to confirm.⁴⁷

Another interesting point in this regard is the AG's judgement of the strictu sensu proportionality test. He states that to make a decision, the costs and benefits must be weighed. The benefit is that the ECB can regain her transmission channels and thereby secure the effectiveness of her mandate. The costs are only financial.⁴⁸ The AG seems very careful to avoid the potential economic benefits or the costs of an ECB with little checks and balances. Neither does the AG discuss alternative options for the ECB, most likely because the AG has too little expertise in such matters.

In answer to the first preliminary question, the AG concludes that the OMT decision should be considered legitimate and monetary in nature. The ECB however must continue to show transparency and motivate its decisions, mostly so when the decision will be implemented. He then went to answer the second preliminary question: the compatibility of the OMT decision with article 123 sub 1 TFEU the prohibition on monetary financing of Member States.

Regarding the second preliminary question, the AG refers to the idea behind article 123 TFEU with the concern of budget discipline. According to the AG, the drafters of the

⁴⁴ Ibid, parafs. 152-157.

⁴⁵ Ibid, paraf. 160.

⁴⁶ Ibid, paraf. 167.

⁴⁷ Ibid, parafs. 167-169.

⁴⁸ Ibid, paraf. 186.

Maastricht treaty were mainly concerned with preventing the Member States from keeping a hazardous budget. Hence article 123 can neither be broken in theory nor in spirit.⁴⁹ The Advocate General is however not overly impressed by the arguments given by the BVerfG. The idea of a potential debt cut is too hypothetical to form an argument.⁵⁰ The second argument relating to the lack of preferential treatment for the ECB is considered to be part of the effectiveness of the OMT programme. The AG, therefore, does not see a reason to qualify this as monetary financing.⁵¹ This seems like a very reasonable argument. Preferential treatment would scare off other investors and thereby increase the interest rates on these bonds which would be the opposite of the programme's aim. Concerning the possibility of the ECB keeping the bonds until maturity level, the AG argues that this is unlikely. He considers that this is neither the intention of the OMT programme nor did it occur in previous ECB programmes.⁵² It is interesting that the AG refers to the earlier conventional programmes to determine the actions of an unconventional programme. Though arguably keeping the bonds until maturity would not result in the financing of a state either. If the bond is kept until maturity the payment received by the ECB will be deferred until maturity not cancelled. More importantly, is however the embargo period.

The bonds will be bought on the secondary market, therefore technically not violating art. 123 TFEU. Concerning the price, the AG considers that the embargo period allows a proper market price to form.⁵³ Not considered is that the market price includes a risk default rate, that sets interest. These default rates are usually based on the state's finances and fiscal discipline. However, with the ECB buying these bonds the risk default for investors is low because they can sell the bond to the ECB. Thus, the level of perceived risk and thereby the interest rate will decrease. Therefore, the ECB is financing these states by allowing the interest rate to decrease. Though the conditionality aspect of the OMT decision will ensure that in spirit article 123 TFEU is not violated. It however emphasizes the importance of proper monitoring of the financial aid programmes. The answer of the AG to the second preliminary question is that the OMT programme does not violate article 123 TFEU as long as there is a good embargo period.⁵⁴ Which concludes the contribution of the Advocate General.

⁴⁹ Ibid, paraf. 217.

⁵⁰ Ibid, paraf. 234.

⁵¹ Ibid, paraf. 236.

⁵² Ibid, paraf. 245.

⁵³ Ibid, paraf. 247-254.

⁵⁴ Ibid, paraf. 262.

7.2.3. Judgment of the Court of Justice European Union:

The following paragraphs will describe the decision and motivation of the Court of Justice European Union in *Gauweiler*. The CJEU starts with the statement that any actions of the ESCB must be explicitly within the mandate given by the treaties.⁵⁵ The treaties however only specify the goals and means of monetary policy.⁵⁶ The CJEU accepts the main goal of the programme as trying to ensure the adequate transmission of monetary policy.⁵⁷ It considers that restoring the transmission channels contributes to the 'singleness' of monetary policy, as per 119(2)TFEU.⁵⁸ According to the CJEU, the singleness of monetary policy further contributes to the primary objective of price stability.⁵⁹ It further considers that this objective is enforced through the ESCB statutes.⁶⁰

The CJEU further considers that because the ESCB relies upon impulses the restoration of these channels constitutes monetary policy.⁶¹ The effect such measures have upon economic stability does not make the policy economic in nature.⁶² The use of such a programme is considered within the instruments of the ESCB as they are described within the Statutes of the ESCB.⁶³ With regard to selectivity, the CJEU considers that the transmission mechanisms have been disturbed only on specific bonds. Hence the selectivity is required, plus there is no prohibition of selective measures in the treaties.⁶⁴ Thus the CJEU does not consider that selective monetary policy is not a 'single' monetary policy. Additionally, this strategy prevents the Member States from avoiding the financial aid programmes they have accepted.⁶⁵ The CJEU, however, does make an interesting leap when coming to this conclusion. It first considers that the purchasing is conditional upon the Member State's compliance with the ESFS or ESM.⁶⁶ It then considers "*It is, of course, possible that a government bond-buying programme may, indirectly, increase the impetus to comply with those adjustment programmes and thus, to some extent, further the economic-policy objectives of those programmes.*"⁶⁷ Interesting is the use of the words 'may' and 'indirectly'. The CJEU in this paragraph seems to indicate only an indirect influence on the economic goals of the financial support programme. The CJEU hereby chooses to classify the OMT as part of monetary

⁵⁵ *Gauweiler*, p.41.

⁵⁶ *Ibid*, paraf. 42.

⁵⁷ *Ibid*, paraf. 47.

⁵⁸ *Ibid*, paraf. 48.

⁵⁹ *Ibid*, paraf. 49.

⁶⁰ *Ibid*, paraf. 44.

⁶¹ *Ibid*, paraf. 50.

⁶² *Ibid*, paraf. 52.

⁶³ *Ibid*, paraf. 54.

⁶⁴ *Ibid*, paraf. 55.

⁶⁵ *Ibid*, paraf.59

⁶⁶ *Ibid*, paraf. 57.

⁶⁷ *Ibid*, paraf. 58.

policy, with an indirect impact on economic policy. The CJEU could have taken the approach of classifying OMT as part of the ECB's role in supporting economic policy. The OMT could be considered primarily in support of economic policy with secondary monetary effects in line with the ECB's monetary mandate. It is likely the CJEU did not opt for this approach because of the ECB's role in the Troika, which is not commented upon in the judgement. By classifying the OMT as economic support, would indirectly classify the role of the ECB in the Troika as economic. The position of the ECB within the Troika remains open for discussion (see section 5.5). By classifying the OMT as an economic policy it makes it less likely the role of the ECB in the Troika would be classified as monetary. The ECB's role would then raise questions when it is conducting economic policy rather than supporting economic policy. The reasoning of the CJEU concerning the ECB's monetary mandate raises further questions.

The ECB is allowed to support the general economic policy of the Union. The ESM, however, is not an EU institute. In the following paragraphs, the CJEU bypasses this issue by considering the ESM as “[...] *economic policies followed by the Member States*”.⁶⁸ Though indeed the ESM programme is an economic policy followed by the Member States (of the Eurozone), it is not the same as the economic policy of the Union. One could also interpret this statement as the ECB not obstructing the economic policy of individual Member States. There is, however, no obligation for the ECB to consider economic policy when conducting monetary policy. In the same paragraph, the CJEU states *“The point should also be made that the ESCB, in a wholly independent manner, made implementation of the programme announced in the press release conditional upon full compliance with EFSF or ESM macroeconomic adjustment programmes, thereby ensuring that its monetary policy will not give the Member States whose sovereign bonds it purchases financing opportunities which would enable them to depart from the adjustment programmes to which they have subscribed.”*⁶⁹ The CJEU hereby reaffirms the incentive OMT provides to comply with the adjustment programme. The insurance in the CJEU is one whereby monetary policy does not obstruct general economic policy. The ECB in article 127 TFEU is instructed to conduct monetary policy without prejudice to economic policy but not vice versa. By observing the coherence of the monetary policy to economic policy the CJEU is creating such an obligation. From a practical perspective, it is very reasonable to argue that monetary policy should not counteract economic policy. This link is, however, not in line with the technical monetarist view when the Treaty was drafted. Furthermore, by interlinking the two policies the CJEU is creating very vague boundaries. The reasoning is shaky and indicates the CJEU's limited review of the complex materials. Especially considering this is a matter of the legal framework of EU law. It does not ask the CJEU to adjudicate complex matters on economic or monetary policy but rather the difference between EU

⁶⁸ Ibid, paraf. 60.

⁶⁹ Ibid, paraf. 60.

economic policy and that of Member States. The boundary difficulty continues with the next paragraph.

In paragraph 61 the CJEU links the conditionality clause with article 119(3) TFEU.⁷⁰ This article includes the obligation for the ECB to incorporate sound public finances. The definition of sound public finances is not specified in the Treaty. Moral hazard is specifically targeted through articles 123 and 125 TFEU. By incorporating article 119(3)'s 'sound public finance' the CJEU is using an open term. It could have opted to interpret 'sound public finance' as not violating articles 123 and 125 TFEU. By using the open term definition in article 119(3) TFEU the CJEU does not exclude other aspects of sound public finance. These would include the topics discussed in the MoU between the Troika and the Member States. Using such terminology the CJEU carefully refrains from indirectly commenting upon the role of the ECB in the Troika. This role does become more precarious when the CJEU states that the ESM is economic policy.

The CJEU considers that the ECB may use the ESM as part of monetary policy without changing the nature of its programme.⁷¹ It comes to this conclusion based upon para. 60 of the *Pringle* case. In this paragraph, the CJEU refers to the objectives as laid down in Decision 2011/199. These objectives include the safeguarding of financial stability. Financial stability to a large extent is also what influences the ECB's transmission of impulses. The qualification of one as economic and the other as monetary policy muddies the waters between the two. The CJEU concludes the difference the ECB's OMT can only be used to restore price stability whilst the ESM can be implemented longer to ensure financial stability.⁷² Though this reasoning is slightly difficult to follow it can be understood. The CJEU, however, does not further elaborate on the role of the ECB within the ESM. Thus making this separation difficult to follow. The CJEU then continues with proportionality.

The CJEU, like the AG, looks at the proportionality of the measure and combines this with the obligation to state reasons.⁷³ The CJEU, however, seems to be more lenient in their judgement of when the Bank has met the obligation to provide reasons. The CJEU considers light level review is warranted as the ECB is undertaking complex and highly technical decisions.⁷⁴ Taking into account statements and combining this with the general context the CJEU has enough to conduct a judicial review.⁷⁵ It further considers that the ECB conducted a thorough economic analysis which was not a manifest error of judgement.⁷⁶ Whereby it considered the ECB's programme proportionate to eliminate

⁷⁰ Ibid, paraf. 61.

⁷¹ Ibid, paraf. 63.

⁷² Ibid, paraf. 64.

⁷³ Ibid, paraf. 70.

⁷⁴ Ibid, paraf. 68.

⁷⁵ Ibid, paraf. 71.

⁷⁶ Ibid, paraf. 74.

the legitimate fear of the break-up of the Eurozone.⁷⁷ Interestingly enough the CJEU also observes that monetary decisions are often controversial in nature.⁷⁸ This observation is interesting because the monetary decisions were not controversial before the euro crisis. Nor was the ECB granted its independence because of the controversy but rather the opposite. The decisions should be technical and thus (fairly) uncontroversial. The independence is there to limit the political influence (see section 2.5.). The CJEU continues by considering that the programme is limited in its potential size in various ways. The first limitation according to the CJEU is that of the objectives.⁷⁹ Secondly, the ECB can only buy bonds with a maturity of up to 3 years and these purchases are limited to the Member States with ESM support.⁸⁰ These criteria are linked to the objectives rather than selected at random.⁸¹ Based upon the previous the CJEU finds the programme proportional.⁸²

The CJEU then continued by looking at article 123 TFEU. The CJEU finds that this provision bans a direct credit line but not the purchases of bonds from countries in need on the secondary market.⁸³ It agrees that the prohibition on monetary finance should neither be broken in practice nor in spirit.⁸⁴ The spirit is to promote sound budgetary policy among the Member States.⁸⁵ The limitations of the OMT programme prevent the Eurozone from getting access to cheap credit. The conditionality of the programme ensures that the Member States involved keep tight financial discipline.⁸⁶ The impact of lower interest rates upon Member States' budget does not change violate the spirit of this article.⁸⁷ The potential risks for the ECB are qualified by the CJEU as inherent to open market transactions.⁸⁸ Thereby concluding the actions of the ECB to be monetary and within the limits of its mandate, without violating the prohibition on monetary policy. Which sent the case back to the BVerfG for the final decision.

7.2.4. German final decision:

After the conclusions of the ECJ in the *Gauweiler* case, the BVerfG had the difficult assignment to align the decision with its laws and consciousness. Interesting to note is

⁷⁷ Ibid, paraf. 76.

⁷⁸ Ibid, paraf. 75.

⁷⁹ Ibid, paraf. 85.

⁸⁰ Ibid, parafs. 86-87.

⁸¹ Ibid, paraf. 90.

⁸² Ibid, paraf. 92.

⁸³ Ibid, paraf. 95.

⁸⁴ Ibid, paraf. 97.

⁸⁵ Ibid, paraf. 100.

⁸⁶ Ibid, paraf. 120.

⁸⁷ Ibid, paraf. 110.

⁸⁸ Ibid, paraf. 125.

that the BVerfG did so in a decision that extends to 90 pages.⁸⁹ Though reluctantly⁹⁰ the BVerfG accepted the decision made by the CJEU and made some interesting additional comments of its own. In these paragraphs, only the considerations relevant to this research will be examined. There where the judgement is specific to German law the paragraphs will not be discussed.

The BVerfG considers that the programme targets ‘an appropriate monetary policy transmission and the singleness of the monetary policy’. It considers that under article 119(2) TFEU the monetary policy must be that of a single monetary policy.⁹¹ It is an interesting choice that the BVerfG chose this article as a foundation for the ECB to keep the single currency. Article 119(2) asks the Member States and the Union to set up and run a single currency. Interesting too is that BVerfG not only considers the conditionality to be a factor that prevents incentivizing improper fiscal discipline but also of economic support. The BVerfG states ‘*The ESCB thus ensures that the monetary policy measures it has adopted will not work against the effectiveness of the economic policies followed by the Member States.*’⁹² Though it is not stating it outright it sounds as if the BVerfG wishes to classify such actions as part of the ESCB’s mandate to support general economic policy. The latter knowing a broader interpretation as it refers to the objectives laid down in article 3 TEU. Concerning the other arguments, the BVerfG judged that the ECB did not violate its mandate manifestly.⁹³ It then ends its judgement with the obligation for the Bundestag to closely monitor the situation.⁹⁴ Thereby considering the act to be within the mandate of the ECB, or at least not to be manifestly ultra vires.

This concludes the *Gauweiler* case and leads to the second case referred to by the BVerfG which concerns the Asset Purchasing Programme.

7.3. Weiss Case

7.3.1. Referring Case

The case of *Gauweiler* and *Weiss* are both crucial in understanding the impact of the euro crisis upon the mandate of the ECB. To fully understand the *Weiss* case, this research will briefly analyse the arguments from the referring court. The referring court, in this case, is, again, the Federal Constitutional Court of Germany (BVerfG). The two

⁸⁹ Urteil des Zweiten Senats vom 21. Juni 2016, 2 BvR 2728/13, 2 BvR 2729/13, 2 BvR 2731/13, 2 BvR 2732/13 (Gauweiler II)

⁹⁰ Asteris Pliakos and Georgios Anagnostaras ‘Saving face? The German Federal Constitutional Court Decides *Gauweiler*’ (2017) 18 *German Law Journal*, p. 215.

⁹¹ *Gauweiler II*, p. 47-48.

⁹² *Gauweiler II*, p. 60.

⁹³ *Ibid*, p. 193.

⁹⁴ *Ibid*, p. 220.

most important questions, in this case, are the possible violation of article 123 TFEU and Article 119 TFEU. Interesting to note is that the referral document is only 19 pages in length.⁹⁵ The *Gauweiler* document on the other hand was much longer. In addition, the tone of the referral document was much milder.⁹⁶

This analysis will be divided into two sections, the first looking at the arguments on the possible violation of art. 123 TFEU and the second will look at article 119 TFEU.

7.3.1.1. A violation of article 123 TFEU?

The first question the BVerfG asks boils down to whether the PSPP violates article 123 TFEU. In particular, they consider that the purchases are communicated as a de facto certainty of purchase by the ESCB from the markets. The second consideration they have is that no details are given about compliance after the purchase and therefore, according to the BVerfG, judicial review is impossible.⁹⁷ The third concern is that all bonds are held until maturity and therefore withdrawn from the market. The fourth consideration is that the Eurosystem buys debts with negative yields.⁹⁸ The final concern is that the programme may generate a shortage of debts, thereby forcing the Bank to relax its purchase policy.

With regard to the certainty, the BVerfG argues that despite there being no legal certainty there is a de facto certainty.⁹⁹ Creating a de facto certainty of purchases is beyond the authority of the ESCB, according to the BVerfG.¹⁰⁰ The argument that a de facto certainty is created rests upon two different arguments. The first argument the BVerfG considers is that the information on eligibility criteria of the bonds and the market value of these bonds is readily available.¹⁰¹ The second argument the Court gives is that of the number of bonds available. The bonds are so scarce that “*the probability that bonds will be purchased comes close to de facto certainty*”.¹⁰² The combination of scarcity and details on eligibility is what the BVerfG considers creating de facto certainty

⁹⁵ BVerfG, Order of the Second Senate of 18 July 2017 – 2 BvR 859/15 – parafs. (1-137), ECLI:DE:BVerfG:2017:rs20170718.2bvr085915, <https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2017/07/rs20170718_2bvr085915en.html>.

⁹⁶ For more discussion on the relationship between the BVerfG and ECJ in *Gauweiler* see: Federico Fabbrini, ‘Guest Editor’s Introduction. The European Court of Justice, The European Central Bank, and the Supremacy of EU Law’, 23 *Maastricht Journal* 2016, p.3.

⁹⁷ Referring Court decision, paraf. 94.

⁹⁸ Ibid, paraf 99.

⁹⁹ Referring court decision, paraf. 80.

¹⁰⁰ Ibid, paraf.78.

¹⁰¹ Ibid, paraf. 89.

¹⁰² Ibid, paraf. 90.

of purchase. The reason this certainty is important refers back to arguments from the *Gauweiler* case.

If there is a de facto certainty the market conditions will be distorted and the risk of moral hazard increases. The BVerfG considers this danger to be present not only in situations with absolute certainty but also when there is 'sufficient' certainty. The question the BVerfG then asks is whether "*one Member State is sufficiently sure that a specific share of its bonds will be purchased*"?¹⁰³ Interesting to note is that the BVerfG finds it sufficient for the ECB to have gone beyond its mandate if one Member State is exposed to the risk of moral hazard. The decisive factor thereby is the certainty that market operators have on whether their bonds will be bought.¹⁰⁴ This largely depends on whether there is a minimum period between the purchase on the primary market and the purchase on the secondary market. The period, though important for judicial review, remains unknown. The explanation for this is to prevent the markets from adjusting their price to the period. Arguably this period could, however, be disclosed ex-post from the purchases.¹⁰⁵ These arguments combined form a violation of article 123 TFEU which, according to the BVerfG is strengthened by the maturity argument.

The BVerfG considers that from the *Gauweiler*-case it flows forth that article 123 TFEU is not violated if bonds are not held until maturity.¹⁰⁶ The PSPP however has not sold, nor foresees in the sale of bonds in addition selling the bonds would be opposing the goal the programme tries to achieve.¹⁰⁷ The question, therefore, becomes whether the programme can be prolonged. If prolonged the risk is present that bonds remain permanently off the market. This would, according to the BVerfG, expose the Member States to too favourable credit rating. In addition, the Court seems to argue that article 18(1) of the ESCB and ECB Statute demands both the purchase AND sale of bonds.¹⁰⁸

The third issue the BVerfG considers is that of the bonds carrying a negative yield. The Court considers that markets can come to expect to sell bonds with negative yields. This in turn will form relief for the issuing governments and transfers the losses to the various national central banks. This system undermines, according to the BVerfG, the objective of Article 123 TFEU.¹⁰⁹ In conclusion, the BVerfG considers article 123 TFEU to be undermined because of the de facto certainty of purchase and the negative yield. The BVerfG then continues to consider the possible violation of article 119 TFEU.

¹⁰³ Ibid, paraf. 92.

¹⁰⁴ Ibid, paraf. 92.

¹⁰⁵ Ibid, paraf. 94-95.

¹⁰⁶ Ibid, paraf. 96.

¹⁰⁷ Ibid, paraf. 97.

¹⁰⁸ Ibid, paraf. 98.

¹⁰⁹ Ibid, paraf. 99.

7.3.1.2. A violation of article 119 TFEU?

Article 119 TFEU deals with the separation of monetary and economic policy. Taking note of the *Pringle* and *Gauweiler* cases the BVerfG states that the decisive factor is whether a policy directly pursues economic objectives.¹¹⁰ Added to the objectives the chosen means and effects must be considered.¹¹¹ The BVerfG then contrasts this to granting financial assistance to the Member States, which is outside the ECB's competence.¹¹² Additionally, the ECB has the power to support general economic policy, however, this does not allow a steering influence.¹¹³ Last but not least the BVerfG states that in these cases review of compliance with procedural guarantees is fundamental.¹¹⁴

The BVerfG considers that the PSPP officially pursues a monetary policy objective. Due to its volume and the two-year duration it, however, seems to be beyond the mandate of the ECB. In addition, the BVerfG considers that the economic impacts are vested within the nature and design of the programme. The PSPP, therefore, seems disproportionate to the underlying monetary policy.¹¹⁵ The BVerfG then continues by considering how to distinguish between monetary and economic policy.

According to the BVerfG, it is insufficient to only consider the objectives and measures chosen. The indirect effects must be taken into account as well. These measures, the BVerfG states, can only be considered indirect when they are connected to the challenged measures and when the consequences were unforeseeable. If the effects are intended or foreseeable, they can still be considered indirect when they are "[...] *comparable in weight to the monetary policy objective pursued.*" The BVerfG, therefore, considers it necessary to conduct an overall assessment.¹¹⁶ The BVerfG concludes that the PSPP programme is a measure of economic policy. The reason it gives is the effect of relaxed borrowing conditions in combination with the de facto certainty and a large volume of purchases.¹¹⁷ Last but not least it considers that the PSPP programme may have been disproportionate. This can only be confirmed with certainty if the ECB has weighed the economic effects against the monetary effects. The ECB, however, has not given specific reasons regarding necessity, scope, and duration.¹¹⁸ With this in mind, the BVerfG sends the questions to the ECJ to be answered.

¹¹⁰ Ibid, paraf. 108.

¹¹¹ Ibid, paraf. 109.

¹¹² Ibid, paraf. 110.

¹¹³ Ibid, paraf. 113.

¹¹⁴ Ibid, paraf. 111.

¹¹⁵ Ibid, paraf. 114.

¹¹⁶ Ibid, paraf. 119.

¹¹⁷ Ibid, parafs. 120-121.

¹¹⁸ Ibid, parafs. 122-123.

7.3.2. Opinion Advocate General

According to the Advocate General all preliminary questions, except for the fifth, are admissible and the ASPP as a whole should be considered lawful and proportionate. Advocate General Wathelet advises the CJEU to consider the PSPP compatible with the EU Treaties. He affirms that in analysing the challenge to the PSPP the CJEU should use the legal framework derived from the *Gauweiler* judgment. Within this framework, he notes that the CJEU confirmed that art. 123 TFEU prohibits the ESCB from financial assistance but not the purchase of bonds on the secondary market. Thereby two limits should be kept in mind; the measure may not amount to effective purchase on the primary market nor take away a sound budget keeping impetus for the Member States.¹¹⁹ The AG, therefore, considers that for the decision to be valid it will have to apply these guarantees.¹²⁰

According to Advocate General, five guarantees prevent the private actors from becoming de facto intermediaries from the ESCB.¹²¹ First, APP is continuously evaluated by the Governing Council and can be adjusted when necessary.¹²² Secondly, the PSPP is only a part of the APP. Therefore, making it difficult to predict the exact purchasing volume per part of APP.¹²³ Thirdly there is an absence of selectivity in the programme. This makes it impossible to predict the practical implementation of the programme.¹²⁴ Fourth there is no obligation or certainty of purchase whilst maximum limits are in place.¹²⁵ Fifthly the AG considers that there is a minimum period between the purchases on the secondary market. This period is unknown and enables the formation of a market price. Last, the information given is a balance between ensuring the effective reach of the programme targets without making it possible to predict the exact bonds that will be bought.¹²⁶ These conditions are enough for the Advocate General to conclude that there is no certainty of purchase.¹²⁷ He then continues by considering the maturity and negative yields of bonds.

Regarding holding the bonds until maturity the AG considers this to be part of the purpose of the programme. Article 18.1 of the Protocol¹²⁸ does not prohibit keeping

¹¹⁹ C-439/17, *Weiss and others v Bundesregierung* [2018] ECLI:EU:C:2018:815, Opinion of AG Wathelet, parafs. 49-50.

¹²⁰ *Ibid*, paraf. 53.

¹²¹ *Ibid*, paraf. 54.

¹²² *Ibid*, paraf. 55.

¹²³ *Ibid*, paraf. 56.

¹²⁴ *Ibid*, paraf. 57.

¹²⁵ *Ibid*, paraf. 58.

¹²⁶ *Ibid*, paraf. 59.

¹²⁷ *Ibid*, parafs. 55-65.

¹²⁸ PROTOCOL ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK

bonds until maturity.¹²⁹ It is not clear to the AG that all bonds will be held until maturity as the ESCB may sell the bonds at any given time when this fits the purpose of the programme.¹³⁰ He also considers that the bonds will only be resold when it does not compromise the integrity of the programme.¹³¹ Then the AG continues by discussing the question of negative yields. Whereby he considers that open market operations always carry a risk of loss and priority is given to the purchase of assets with a positive return.¹³² In addition, not purchasing these bonds would be contrary to the objectives of the programme and the principle of market neutrality.¹³³ With regard to further certainty of purchase, the Advocate General considers this to be non-existent. Because the effects of the measure cannot be foreseen it can only be incorrect if the ECB's decision is manifestly incorrect given the available information.¹³⁴ The certainty of purchase is only on a macro-economic level not on a micro-economic level.¹³⁵ In addition, by extending the type of bonds available for purchase the shortage has been alleviated.¹³⁶ He, therefore, concludes that there is no de facto certainty of purchase and continues by discussing budgetary policy.

In order not to violate article 123 TFEU the programme may not interfere with the incentive for governments to follow a sound budgetary policy.¹³⁷ Important to consider in this case, according to the AG, is that all bonds must be fully guaranteed by the issuing government.¹³⁸ If the issuing government does not follow a sound budgetary policy, they risk losing the purchase of these bonds.¹³⁹ Furthermore, the conclusion points out that only France has been subjected to an excessive budgetary policy ex article 126 TFEU.¹⁴⁰ In 2011, however, 24 nations were conducting excessive budgetary policies. *'That objective situation suggests that euro area Member States are pursuing a sound budgetary policy.'*¹⁴¹ The AG, therefore, concludes that the risk of moral hazard is mitigated.¹⁴² Thereby concluding his remarks on the possible violation of article 123 TFEU and continuing to the mandate of the ECB.

In order to consider whether a decision is within the mandate of the ECB, the *Gauweiler* case has provided two criteria. First, the opinion looks at whether the objectives and

¹²⁹ Opinion AG Wathelet, paraf. 67.

¹³⁰ Ibid, paraf. 67.

¹³¹ Ibid, parafs. 67-71.

¹³² Ibid, paraf. 73.

¹³³ Ibid, parafs. 72-75.

¹³⁴ Ibid, paraf. 81.

¹³⁵ Ibid, paraf. 79.

¹³⁶ Ibid, parafs. 77-83.

¹³⁷ Ibid, paraf. 84.

¹³⁸ Ibid, paraf. 86.

¹³⁹ Ibid, parafs. 84-87.

¹⁴⁰ Ibid, paraf. 91.

¹⁴¹ Ibid, paraf 91.

¹⁴² Ibid, paraf. 92.

instruments fall within the monetary policy.¹⁴³ Any indirect effects on economic policy, however, do not classify the measure as economic.¹⁴⁴ The second question is that of proportionality and judicial review.¹⁴⁵ Judicial review cannot be too strict as the decisions are mostly of a technical nature. In this area, the ESCB has a broad margin of discretion which must be respected by the CJEU.¹⁴⁶ The ECB, however, is under the obligation to “*examine carefully and impartially all the relevant elements of the situation in question and to give an adequate statement of the reasons for its decisions*”.¹⁴⁷

Concerning monetary policy AG, Wathelet finds that the objective of the programme is to contribute to price stability by countering deflationary trends.¹⁴⁸ The PSPP aims to ease monetary and financial conditions and thereby stimulate household consumption.¹⁴⁹ Adding to which the duration of the programme is linked to the financial conditions in the market. The Advocate General, therefore, concludes that the PSPP programme falls within the mandate of the ESCB.¹⁵⁰ The conclusion furthermore considers that ex article 18.1 Protocol the buying of bonds is an accepted monetary instrument. This instrument is also appropriate for increasing the liquidity of private banks lending to households.¹⁵¹

In relation to the judicial review regarding indirect effects, the Advocate General takes a different approach from the BVerfG. The BVerfG viewed that indirect effects must be unforeseen and unintended.¹⁵² Instead of considering indirect effects to be unforeseen, the AG considers that these effects can be more than probable and still qualify as indirect.¹⁵³ He considers that the ESCB may support general economic programmes and therefore indirect effects may not undermine these programmes.¹⁵⁴ Combining these factors with the broad discretion that the ECB holds the AG states that “*it is necessary but sufficient for the judicial body to find [...] guarantees which are theoretically sufficient [...] to prevent that programme from pursuing, in reality an overriding economic policy objective or from undermining the objective of price stability.*”¹⁵⁵ In his opinion, any further review would not be of a judicial but of an economic nature which

¹⁴³ Ibid, paras. 102-123.

¹⁴⁴ Ibid, paraf. 98.

¹⁴⁵ Ibid, paras, 125-152.

¹⁴⁶ Ibid, paras 96-101.

¹⁴⁷ Ibid, paras. 101.

¹⁴⁸ Ibid, paraf 102.

¹⁴⁹ Ibid, paraf 103.

¹⁵⁰ Ibid, paras 103-105.

¹⁵¹ Ibid, paras 106-107.

¹⁵² BVerfG, Order of the Second Senate of 18 July 2017 – 2 BvR 859/15 – paras. (1-137), ECLI:DE:BVerfG:2017:rs20170718.2bvr085915, <https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2017/07/rs20170718_2bvr085915en.html>, paraf. 119.

¹⁵³ C-439/17, *Weiss and others v Bundesregierung* [2018] ECLI:EU:C:2018:815, Opinion of AG Wathelet, paraf. 112.

¹⁵⁴ Ibid, paraf. 113.

¹⁵⁵ Ibid, paraf. 115.

lies outside of the competence of the CJEU.¹⁵⁶ He considers that in accordance with 3(2)(a) of Decision 2015/774, the PSPP only accepts step 3 bonds (BBB). This measure both guarantees the impetus to follow a sound budget for the Member States but also ensures commercial banks cannot unload their risky securities.¹⁵⁷ Therefore the programme has a monetary rather than economic objective. The impact upon the financing conditions of Member States is considered by the Advocate General to be an indirect effect. This effect, however, does not make the policy economic in nature.¹⁵⁸ Having examined the guarantees in place the AG finds they are sufficient and ensures the programmes monetary nature.¹⁵⁹ The AG, therefore, concludes the ECB does not seem to have made a manifest error in judgement.¹⁶⁰

Regarding proportionality, the AG considers that the danger of inflation is unquestionable.¹⁶¹ He furthermore considers that the economic doctrine upon which the ECB has founded its discussion, confirms the programme to contribute to maintaining price stability.¹⁶² The programme was necessary because the other instruments had already been used.¹⁶³ In addition, the programme was the subject of discussion and debate within the governing council of the ECB. This discussion shows that all sides of the argument have been considered.¹⁶⁴ To conclude the programme to be proportionate, the Advocate General considers the programme must be necessary and not go beyond what is necessary.¹⁶⁵ The AG does not consider EUR 60bn per month to go beyond what is necessary to maintain price stability.¹⁶⁶ He also considers that the *“unfavourable developments observed in 2015 – 2016”* justify the change in duration and volume.¹⁶⁷ The programme was subject to discussion and consequent changes, these indicate that the programme is indeed necessary.¹⁶⁸ Furthermore, the programme is subject to limitations as it is only one of four programmes, purchases are divided over the different states and there are limits to the purchases.¹⁶⁹

In conclusion, the Advocate General reaffirms many of the arguments made in the *Gauweiler* case. With regard to the mandate of the ECB, the question of economic opinion remains. The ECB must be transparent in its reasoning, but its reasoning is not questioned. This seems consistent with the approach taken in previous cases.

¹⁵⁶ Ibid, paraf. 117.

¹⁵⁷ Ibid, paraf. 119.

¹⁵⁸ Ibid, paraf. 121.

¹⁵⁹ Ibid, paraf. 122.

¹⁶⁰ Ibid, paraf. 123.

¹⁶¹ Ibid, paraf. 127.

¹⁶² Ibid, paraf. 129.

¹⁶³ Ibid, paraf. 131.

¹⁶⁴ Ibid, parafs. 135-136.

¹⁶⁵ Ibid, paraf. 140.

¹⁶⁶ Ibid, paraf. 142.

¹⁶⁷ Ibid, paraf. 143.

¹⁶⁸ Ibid, parafs. 148.

¹⁶⁹ Ibid, paraf. 150.

7.3.3. Judgment of the European Court of Justice

With exception of the fifth preliminary question regarding burden-sharing and the potential bankruptcy of a Member State, the CJEU finds all questions admissible. Similar to the *Gauweiler* case the CJEU considers that this cases' legal framework exists between the limitation associated with the conferral of powers and the discretion associated with the technical nature of the decisions.¹⁷⁰ The CJEU merges in two main issues the questions that the German Court raised. First, the CJEU considers the balance between economic and monetary policy and then the compatibility of PSPP with Article 123 TFEU. This commentary will follow the order of the CJEU's judgement.

The first question that the CJEU addresses is that of the '*obligation to state reasons*'.¹⁷¹ This obligation is fundamental in decisions taken by institutions such as the ECB, which have an enormous amount of freedom.¹⁷² The CJEU considers that the ECB must clearly and unequivocally show its reasoning but "*it is not required to go into every relevant point of fact of law*".¹⁷³ Furthermore, the context of these decisions is important to take into account.¹⁷⁴ The CJEU considers the various documents supplied by the ECB enough to support its reasoning and thereby fulfil the transparency requirement.¹⁷⁵ The decisions following the PSPP have been clarified in the publication of press releases, introductory statements and question and answer sessions with the press.¹⁷⁶ These accounts included the evaluation of possible side-effects such as the impact of the programme on Member State decision making.¹⁷⁷ The CJEU concludes that considering the previously mentioned circumstances that Decision 2015/774 is not invalid.¹⁷⁸ The CJEU then continues with its analysis of the potential violation of Articles 119 and 127(1) TFEU.

7.3.3.1. Article 119 and 127(1) TFEU

Articles 119 TFEU allocates the power of economic policy to the Member States. Article 127 TFEU attributes the power of monetary policy to the ESCB. The CJEU starts by defining monetary policy. It, however, points out there is no exact definition of

¹⁷⁰ Case C-439/17 *Weiss and others v Bundesregierung* [2018] ECLI:EU:C:2018:1000, paras. 23-24.

¹⁷¹ *Ibid*, paraf. 29.

¹⁷² *Ibid*, paraf 30.

¹⁷³ *Ibid*, paraf. 31.

¹⁷⁴ *Ibid*, paraf. 32.

¹⁷⁵ *Ibid*, paraf. 36.

¹⁷⁶ *Ibid*, paraf. 37.

¹⁷⁷ *Ibid*, paraf. 38.

¹⁷⁸ *Ibid*, paraf. 44.

monetary policy, but its objectives and instruments are defined.¹⁷⁹ The main objective of monetary policy is price stability and secondly supporting the economic policy of the Union.¹⁸⁰ The CJEU defines monetary policy as measures necessary to carry out its tasks “in accordance with Articles 127 to 133 and Article 138 TFEU”¹⁸¹ thereby adopting a combination of positive and negative approaches towards monetary policy. Positive, because the policies must have the objection of carrying out the ECB’s monetary objectives. Negative, because it may not conflict with the treaty restrictions. It furthermore takes into account that the authors of the Treaty decided upon formulating monetary policy in a general and abstract manner.¹⁸² Interesting is also that the CJEU considers the establishment of the 2% interest rate to be a reasonable goal.¹⁸³ Whereby the CJEU directly comments upon the ECB’s self-set objective. The CJEU also considered that the separation between the two policies is not absolute, nor was it intended to be completely separated.¹⁸⁴ Indirect effects therefore cannot lead to the conclusion that the programme is economic rather than monetary.¹⁸⁵ This leads the CJEU to further discussing the definition of indirect effects.

The CJEU does not agree with the BVerfG that indirect effects should be unforeseen.¹⁸⁶ It argues firstly that in both the *Pringle* and *Gauweiler* cases the indirect effects were foreseeable and had no impact upon the classification of the programme.¹⁸⁷ Secondly, the CJEU considers that for monetary policy to impact inflation it must affect the real economy.¹⁸⁸ The CJEU considers that “if the ESCB were precluded altogether from adopting such measures when their effects are foreseeable and knowingly accepted, that would, in practice, prevent it from using the means made available [...] and might – in particular in the context of an economic crisis entailing a risk of deflation – represent an insurmountable obstacle to its accomplishing the task assigned to it by primary law.”¹⁸⁹ Therefore the CJEU concludes that the programme falls within the sphere of monetary policy.¹⁹⁰ The CJEU continues by analysing the proportionality.

Proportionality is defined by the CJEU as ‘suitable for attaining the legitimate objectives pursued by the legislation at issue and should not go beyond what is necessary to achieve those objectives’.¹⁹¹ The background in this case to judging proportionality is that of the

¹⁷⁹ Ibid, paraf. 50.

¹⁸⁰ Ibid, paraf. 51.

¹⁸¹ Ibid, paraf. 48.

¹⁸² Ibid, paraf. 55.

¹⁸³ Ibid, paraf. 56.

¹⁸⁴ Ibid, paraf. 60.

¹⁸⁵ Ibid, paraf. 61.

¹⁸⁶ Ibid, paraf. 62.

¹⁸⁷ Ibid, paraf. 63.

¹⁸⁸ Ibid, parafs. 64-66.

¹⁸⁹ Ibid, paraf. 67.

¹⁹⁰ Ibid, paraf. 70.

¹⁹¹ Ibid, paraf. 73.

economic crisis which posed a serious threat of deflation.¹⁹² The evidence shows a deflationary trend of 0.2% in December.¹⁹³ The CJEU decides that the ESCB's economic analysis concerning the PSPP was appropriate.¹⁹⁴ The CJEU then continues by assessing whether the programme is proportionate to achieve its goals. The CJEU considers that on the one hand there was persistent low inflation and on the other the inability to mitigate this risk via alternative measures.¹⁹⁵ The CJEU thus concludes that the PSPP *"does not manifestly go beyond what is necessary"*.¹⁹⁶ In addition, the programme is temporary and only applies during the period which is necessary to obtain these objectives.¹⁹⁷ The CJEU considers that due to the short nature of the extensions and the decisions were based upon the changes in inflation.¹⁹⁸ In addition, the CJEU finds that there was a set of rules to limit the volume of purchases.¹⁹⁹ Rules included purchasing limits per issue and per issuer and the purchase volume was regularly revised according to the impact data.²⁰⁰ The CJEU, therefore, finds that despite the dispute the ECB has not made a manifest error in judgement regarding its PSPP.²⁰¹ The CJEU also considers that the ESCB weighed up various interests. In its assessment, the ESCB analysed and minimised the risks.²⁰² The national central banks furthermore purchase only bonds from their jurisdiction. If a central bank suffers from significant losses, only those losses generated from the bonds emitted by an international organisation can be shared.²⁰³ The CJEU finds that there are sufficient safeguards against losses. A general rule for loss sharing was therefore not appropriate.²⁰⁴ The losses can be offset against the reserve fund or if necessary against relevant financial years in proportion to the respective paid-up shares in the ECB capital.²⁰⁵ The CJEU, therefore, finds the measure to be proportionate. It then continues by assessing article 123 TFEU.

7.3.3.2. Article 123 TFEU

The CJEU starts its analysis of article 123 TFEU recalling that this bans the ECB from providing any form of financial assistance or credit to the Member States.²⁰⁶ The CJEU,

¹⁹² Ibid, paraf 74.

¹⁹³ Ibid, paraf 75.

¹⁹⁴ Ibid, paraf. 78.

¹⁹⁵ Ibid, paraf. 78.

¹⁹⁶ Ibid, parafs. 80-81.

¹⁹⁷ Ibid, paraf. 84.

¹⁹⁸ Ibid, paraf 86.

¹⁹⁹ Ibid, paraf. 87.

²⁰⁰ Ibid, parafs. 88-89.

²⁰¹ Ibid, paraf. 91.

²⁰² Ibid, parafs. 93-95.

²⁰³ Ibid, parafs. 96-97.

²⁰⁴ Ibid, paraf. 98.

²⁰⁵ Ibid, paraf. 99.

²⁰⁶ Ibid, paraf. 102.

however, also considers the ECB is not banned from buying bonds on the secondary market. As per Decision 2015/774, the PSPP does not authorize the ECB to buy bonds from the primary market.²⁰⁷ The CJEU, however, recognizes two more conditions that need to be fulfilled in order to prevent a violation of Article 123 TFEU. The first requirement is that the measure cannot amount to a practical equivalent of direct purchase. Secondly, the programme must safeguard the member states' impetus to follow a sound budgetary policy. Both of these requirements are criteria directly flowing forth from the *Gauweiler* case.²⁰⁸ The argument about de facto certainty put forward by the BVerfG could therefore lead to the invalidity of the PSPP.

The CJEU, however, finds that there is no de facto certainty of purchase. The PSPP increases the number of bonds bought by the market which is the objective of the programme.²⁰⁹ The ECB, however, has put certain safeguards in place to prevent the bond-buyers from becoming ECB intermediaries. The first safeguard the CJEU considers to be in place is the 'blackout period'. This period prevents predictability of the purchasing date on the market.²¹⁰ In addition, the CJEU considers that the number of purchases made cannot be determined in advance. The total purchasing volume for APP is given by the ECB but not for the individual aspects of the programme.²¹¹ This total purchasing volume is divided over the different banks using a division key. This purchase division over the various central banks in combination with ad-hoc flexibility provides uncertainty about the volume of purchases that will be made by the various central banks.²¹² Furthermore, the CJEU considers the programme to have high flexibility in the maturity rate and type of governmental institutions whose bonds can be bought. This diversity allows for flexibility that is impossible for the market to predict.²¹³ Last, the banks are only allowed to purchase up to 33% of a particular issue of bonds of a central government or no more than 33% of the outstanding securities of those governments. This measure ensures that private operators cannot be certain of their assets being purchased.²¹⁴

The CJEU furthermore argues that open market programmes to some extent affect financing conditions.²¹⁵ This may in turn facilitate member state borrowing conditions.²¹⁶ These effects, however, do not form a violation of Article 123 TFEU.²¹⁷ The CJEU considers that the programme is temporary and the ESCB can sell the bonds

²⁰⁷ Ibid, parafs. 102-104.

²⁰⁸ Ibid, parafs. 105-107.

²⁰⁹ Ibid, paraf. 111.

²¹⁰ Ibid, paraf. 116.

²¹¹ Ibid, parafs. 117-118.

²¹² Ibid, paraf. 120.

²¹³ Ibid, parafs. 121-123.

²¹⁴ Ibid, parafs. 125-127.

²¹⁵ Ibid, paraf. 130.

²¹⁶ Ibid.

²¹⁷ Ibid, parafs. 130-131.

at any given time. This combination makes that the programme can be adapted to the attitude of member states. This keeps a strong incentive for member states to keep a solid budget.²¹⁸ Furthermore, the CJEU states that because the various central banks can only buy a small proportion of the available bonds, the main source of finance for member states, therefore, remains the market.²¹⁹

With regard to holding bonds until maturity, the CJEU decides this not forbidden. Neither does holding the bonds imply that payment by the member state is waived.²²⁰ Whether bonds are held until maturity is a technical decision for the ECB to make.²²¹ Furthermore, the CJEU refers back to the fact that the ESCB has the option to sell the bonds.²²² In addition, holding the bonds until maturity does not hold an obligation for the ESCB to buy more bonds should the member state cease to follow a sound budgetary policy.²²³ With respect to the negative yield of the bonds, the CJEU argues that article 18.1 of the Protocol on the ESCB does not prohibit purchasing bonds with negative yields.²²⁴ Neither does article 123 TFEU prevent programmes from being implemented that contain such bonds.²²⁵ In addition, opening the possibility for the purchase of bonds with a negative yield has made it more difficult to predict what bonds will be purchased.²²⁶ In conclusion, the CJEU adds that a negative yield indicates a positive assessment of the Member States' budget by the market. This assessment does not reduce the incentive for member states to keep a sound budgetary policy.²²⁷

The CJEU then continues to the fifth preliminary question regarding potential bankruptcy. As discussed earlier this question was considered inadmissible by both the Advocate General and the CJEU. The ECB has decided not to adopt a decision concerning loss sharing in case of failure.²²⁸ The situation that a Member State default would lead to a necessary loss sharing is hypothetical.²²⁹ It thus concludes the fifth question to be inadmissible.²³⁰ With these observations, the CJEU concludes that the PSPP is valid under EU law.

²¹⁸ Ibid, parafs. 135-136.

²¹⁹ Ibid, paraf. 141.

²²⁰ Ibid, paraf. 146.

²²¹ Ibid, parafs. 146-147.

²²² Ibid, paraf. 150.

²²³ Ibid, paraf. 151.

²²⁴ Ibid, paraf. 146.

²²⁵ Ibid, parafs. 153-154.

²²⁶ Ibid, paraf. 156.

²²⁷ Ibid, paraf. 157.

²²⁸ Ibid, paraf. 163.

²²⁹ Ibid, paraf. 166.

²³⁰ Ibid, paraf. 167.

7.3.4. Response of the BVerfG: the *Weiss* Incendiary?

The *Weiss* case was decided upon by the BVerfG in a rather unexpected way by declaring the judgement *ultra vires*. The following paragraphs will discuss the response of the BVerfG.²³¹ It must be noted that this judgement was given after the ECB introduced its Pandemic Emergency Purchase Programme. Both the APP and PEPP are asset purchasing programmes on a large scale. The *Weiss* case is thus considered to be the BVerfG legal reflection of the PEPP programme. Since it however concerns the programme conducted during the financial crisis it will be covered here. This research will not enter the discussion on the supremacy of EU law. This thesis accepts the premises of European supremacy but will analyse the impact upon the legal framework of the ECB.

The BVerfG starts by referring to the German right to vote as guaranteed in article 38(1) of the GG.²³² It furthermore continues with the discussion of the sovereignty of the German Bundestag. Stating that any act enacted in Germany must be traced back to its citizens.²³³ It further continues by discussing Kompetenz-Kompetenz and the prohibition for the European Union to create powers for itself.²³⁴ The BVerfG states that thus the European integration agenda may thus not go beyond the powers transferred.²³⁵ If however, the integration goes beyond the powers transferred the Bundestag should act against such encroachment.²³⁶ It furthermore considers that nations should not be able to easily undermine EU law through their own national courts. On the other hand, neither should national courts lose the ability to conduct *ultra vires* review as this would give free rein to treaty expansion.²³⁷ *Ultra vires* review should thus be done with restraint, according to the BVerfG.²³⁸ The CJEU should furthermore be given a margin of error.²³⁹ The BVerfG then continues by stating that the CJEU has acted beyond its mandate.

It considers that the German Bundestag should have acted against the ECB Decisions. Despite the CJEU's assessment of this decision. The German Court considers that the CJEU is "*simply not comprehensible*".²⁴⁰ It further considers that it cannot be determined whether the ECB's decisions are complying with the principle of proportionality. There

²³¹ BVerfG, Judgment of the Second Senate of 05 May 2020 – 2 BvR 859/15 -, parafs. (1-237), <http://www.bverfg.de/e/rs20200505_2bvr085915en.html>

²³² Ibid, paraf. 98.

²³³ Ibid, paraf. 99.

²³⁴ Ibid, paraf. 102.

²³⁵ Ibid, paraf. 106.

²³⁶ Ibid, paraf. 107.

²³⁷ Ibid, paraf. 111.

²³⁸ Ibid, paraf. 112.

²³⁹ Ibid.

²⁴⁰ Ibid, paraf. 116.

is too little information.²⁴¹ The BVerfG further states that the way of distinguishing between economic and monetary policy by the CJEU renders the difference meaningless.²⁴² The BVerfG emphasises that indirect effects should not be considered indirect when they are foreseeable and are comparable in weight to the monetary objectives.²⁴³ The BVerfG thereby seems to emphasize the separation that was so clearly present in the Treaties. It furthermore indicates its wish for the ECB to be limited in its influence upon economic policy. The BVerfG furthermore argues that the CJEU's reasoning would not prevent abuse of law.²⁴⁴ Thus demonstrating the high sentiments at the German Court on this matter. Interestingly the German Court also remarks that the approach chosen by the CJEU is not an effective review of ECB actions.²⁴⁵ This reasoning reflects not only that the BVerfG is hesitant towards the new role of the ECB within the crisis. It also reflects the BVerfG's concern over ECB accountability. The BVerfG does not accept such changes when the review of ECB actions is limited. It seems that the BVerfG would have preferred a stronger judicial review of the ECB, despite high ECB independence. It furthermore states its disrespect for the CJEU's acceptance of ECB arguments without further scrutiny.²⁴⁶

Despite legal hierarchy, the judgement of the BVerfG reflects a discrepancy between independence and accountability. The BVerfG rejected the CJEU's judgement based upon a lack of information. Thus demonstrating a potential lack of transparency. The BVerfG furthermore rejects the vague difference between monetary and economic policy. Whereby the arguments of the ECB are not scrutinized by the CJEU. This indicates a lack of judicial review and accountability. These will be discussed in the coming paragraphs, after discussing the impact of the judgement upon the role of the ECB.

7.4. Role assessment

The impact of the cases was substantial. Partially because the *Gauweiler* and *Weiss* cases were the first where the monetary policy of the ECB was adjudicated. The following paragraphs will discuss the effect of the CJEU's decision upon the role of the ECB. The first section will discuss the interpretation of the legal objectives and then the instruments. The leeway the CJEU provided in the interpretation of the legal mandate, either increases or decreases its independence and the potential role of the ECB in the future.

²⁴¹ Ibid.

²⁴² Ibid, paraf. 127.

²⁴³ Ibid, paraf. 135.

²⁴⁴ Ibid, paraf. 137.

²⁴⁵ Ibid, paraf. 141.

²⁴⁶ Ibid, paraf. 142.

7.4.1. Objectives

There are several aspects to consider when determining the impact of the euro-crisis case law upon the objective of the E(S)CB. The first, and perhaps most important, is the question of what constitutes monetary and what is economic policy. The second important question is what exactly falls under the objective of 'price stability'.

7.4.1.1. *Monetary v. Economic policy*

As discussed in the introduction the following paragraphs will discuss the impact of the *Gauweiler* case upon the objectives of the European Central Bank. The more broadly the objectives are interpreted, the more need for accountability. The objectives of the European System of Central Banks before the crisis were the implementation of monetary policy. This is the objective of price stability which is defined as reaching an under but close to 2% inflation target, plus the support of the general economic policy. The most important points of the *Gauweiler* case were; the definition of monetary policy and the question related to the difference between monetary and economic policy. In the *Weiss* case, the CJEU further defined the indirect effects and added further detail to the decision made in *Gauweiler*.

The differentiation between the economic and monetary policy is difficult to make. In his article, Goldmann puts two different perspectives on the relationship between monetary and economic policy forward. The first theory he puts forward is that of 'the separation theorem'.²⁴⁷ This theory separates monetary policy from other parts of fiscal and economic policy.²⁴⁸ The separation theorem separates, as the name suggests, monetary policy from other aspects of economic policy. This idea was initially created by Jan Tinbergen and is supported by monetary economists such as Milton Friedman.²⁴⁹ The criticism of this theory arises mainly from Keynesian economists. They suggest that monetary policy and thereby central banks should pay more attention to the interdependence of the different aspects of economic policy. A theory that during and after the euro-crisis has gained more attention. Gabor argues that part of the European crisis is attributable to central banking. The separation of macroeconomic concepts cannot be maintained in an ever more complex financial system.²⁵⁰ Goldmann then argues that regardless of the Central Bank's mandate the CJEU's will be faced with these two economic theorems. Theorems that the judges are not able to fully consider, as they

²⁴⁷ Matthias Goldmann, 'Adjudicating Economics: Central Bank Independence and the Appropriate Standard of Judicial' (2014) 15 German Law Review, pp. 269-270.

²⁴⁸ Pennesi, p. 5.

²⁴⁹ Ibid.

²⁵⁰ Daniela Gabor, 'The ECB and the European Debt Crisis'

<academia.edu/868218/The_ECB_and_the_European_Debt_Crisis> accessed 08 April 2019, p. 3.

are experts in law not in economics.²⁵¹ Nor should the CJEU be the institution that decides on what theorem should be followed. The decision on whether to follow the separation or interdependence theorem is ultimately for the legislator to take.

In the *Gauweiler* case, the CJEU had to test both the validity of the OMT decision and whether the ECB was conducting economic policy. Prima facie one can argue that the OMT decision can be adjudicated without entering into too many economic details. As Goldmann however describes, the OMT programme will be considered ineffective by economists arguing pro separation and effective by the others.²⁵² In *Pringle* the CJEU states that one policy may have effects upon the other policy, this view is repeated in the *Gauweiler* case. In which the CJEU states that '*Indeed, a monetary policy measure cannot be treated as equivalent to an economic policy measure merely because it may have indirect effects on the stability of the euro area*'.²⁵³ It comes to this conclusion by examining the intent of the ECB. The intent, it states, is to restore the transmission mechanisms. These transmission mechanisms can only be restored by financial stability and regenerating a certain level of market trust. This reasoning accepts a certain level of interdependence between the unrest on the markets and the functioning of monetary policy. This shows the CJEU's decision, conscious or not, to accept the interdependence rather than the separation theorem. This reasoning was further elaborated upon in the *Weiss* case where the CJEU decided on a broad definition of indirect effects.

As with the *Gauweiler* case the *Weiss* case had to distinguish between monetary and economic policy. The differentiation between the two policies, however, is difficult to make. Like the *Gauweiler* case, the CJEU looked at the instruments used and the objective of the policy under review.²⁵⁴ The CJEU first considered the delimitation of the Union's monetary policy. To classify a measure as either monetary or economic, the principal criterion is that of the objectives (para. 53). The CJEU then refers to recital 4 of the ECB Decision 2015/774. In this recital, the ECB states the PSPP is aimed at easing financial conditions for the private sector. The PSPP is considered an instrument that has a high transmission into the real economy. The ECB therein states the direct link between the economy and monetary policy. The simple fact that monetary policy influences economic policy however does not make it a matter of economic policy. The ECB may support general economic policy and monetary policy may have indirect effects upon economic policy. The question is to what extent?

The CJEU clarified the definition of indirect effects. The BVerfG, CJEU and the Advocate General had different views upon how to classify effects as indirect. According to the BVerfG effects should be considered indirect when they are unforeseen. The CJEU

²⁵¹ Ibid, pp. 270-271.

²⁵² Goldmann 2014, p. 270.

²⁵³ *Gauweiler*, p. 52.

²⁵⁴ *Weiss*, paraf. 53.

disagreed with the referring CJEU and took the approach of the Advocate General. The CJEU considered that indirect effects do not need to be unforeseen.²⁵⁵ If indirect measures cannot be foreseen it would prevent the ECB from implementing programmes to reach its monetary target. In addition, the ECB has the power to support general economic policy. The CJEU, however, is unclear when these indirect effects are supporting general economic policy and when the ECB conducts economic policy. The effects may not undermine economic policy but no further details are given. Similarly, the Advocate General considers that policies may not have an '*overriding economic policy objective*'.²⁵⁶ He examines the guarantees in place and considers these enough to consider the PSPP to be of monetary policy.²⁵⁷ The guarantees mentioned provide an indication of when a policy is monetary and when it is not. The exact line of when a policy would be considered overriding in economic objectives is still unclear. The CJEU also considers that to reach inflationary goals the ECB's policy will impact interest rates and the real economy.²⁵⁸ These interest rates will affect the borrowing conditions of Member States. It thus seems as if the CJEU attaches more value to the prohibitions laid down in the treaties. The ECB may influence and (in)directly ease borrowing conditions, as long as the impetus for a sound budgetary policy is kept. This lack of clarity may provide room for the ECB to encroach upon economic policy as the BVerfG was cautioning in their referral for the *Gauweiler* case.²⁵⁹ On the other hand, the broad definition of the two concepts makes it seem difficult to provide a more specific general framework for distinction. The wide interpretation gives further fuel to the argument that the CJEU accepts interdependence between economic and monetary policy. A reasoning that is not unlike that of the ECB.

In a speech given by Benoit Coeure one year after the start of the OMT programme, he explained the ECB OMT Decision.²⁶⁰ In this speech, he stated that the goal of the OMTs is '*to eliminate the unwarranted and self-reinforcing fears of a euro area break-up that have undermined our ability to effectively conduct monetary policy in the pursuit of price stability*'.²⁶¹ If the ECB believed that monetary policy was completely separated from financial instability, it would not have to restore the unrest to conduct normal monetary policy again. A bit further in his speech, Mr Coeure states that central banks have a narrow mandate. They should not engage in income redistribution but that monetary policy actions do sometimes have redistributive consequences.²⁶² It thus seems that the

²⁵⁵ *Weiss* case, paraf. 62.

²⁵⁶ Advocate general, paraf. 115.

²⁵⁷ *Ibid*, paraf. 122.

²⁵⁸ *Ibid*, parafs. 65-66.

²⁵⁹ D. Murswiek, 'ECB, ECJ, Democracy and the Federal Constitutional Court: Notes on the Federal Constitutional Court's Referral Order from 14 January 2014', (2015)15 *German Law Journal*, p. 147.

²⁶⁰ Benoît Coeuré, 'speech' (Conference The ECB and its OMT Programme, Berlin, 2 September 2013) <<https://www.ecb.europa.eu/press/key/date/2013/html/sp130902.en.html>> accessed 02 May 2019.

²⁶¹ *Ibid*.

²⁶² *Ibid*.

ECB is of the opinion that monetary policy and fiscal and economic policies are interrelated. This approach seems slightly inconsistent with the law.

The Treaty on the Functioning of the European Union gives member states the power to determine their economic policy in article 120 TFEU. Monetary policy on the other hand has been given to the ESCB in article 127 TFEU. The topics of economic and monetary policy are placed within the same title of the Treaty but are separated in chapters. The perspective drafted into the Maastricht Treaty was a clearly defined monetary union and loose cooperation on economic matters.²⁶³ It thus seems to be indicated that the legislator took the perspective of separation.²⁶⁴ It seems contradictory for the CJEU and the ECB to take the opposite view. On the other hand, Craig and Markakis argue that the legal divide is evidence of the factual linkage between the two domains. Therefore, the Maastricht Treaty incorporates some overview powers. These powers were however too weak to cope with the economic crisis.²⁶⁵ The argument is convincing in so far that linkage is not denied by the Treaty, there is however clear underdevelopment of economic cooperation compared to monetary policy. Economically it may have made sense to disregard the strict separation of both policies, from a legal perspective it seems odd. The broad interpretation of monetary policy principally demands a higher level of accountability. The divide though seemingly strict was not as strict as may seem.

De Boer and Van 't Klooster argue that the divide was limited within the Treaties.²⁶⁶ In their research, they argue that important mandate choices were left to the ECB.²⁶⁷ Regarding the objective of the ECB their paper argues that though the ECB objective is to achieve price stability, the concept of price stability is not defined.²⁶⁸ As was discussed in section 2.4 of this research, economic opinion varies on the optimum level of inflation. Theories are disproven and policy ideas adjusted. The concept of price stability is thus broad. They call these choices the “authorization gaps”. The authorization gaps are less strict than a monetarism definition would allow.²⁶⁹ The monetarism approach warrants little democratic oversight as it assumes very technical roles for central banks. De Boer and van 't Klooster argue that the current use by the ECB of these gaps warrants increased judicial review.²⁷⁰ It is however questionable that the authorization gaps truly depart from monetarism. There is not one set best level of inflation. López & Mignon

²⁶³ Herwig Hofmann, ‘Controlling the Powers of the ECB: delegation, discretion, reasoning and care *What Gauweiler, Weiss and others can teach us*’ (2015) working paper version 18 April 2018, p.4.

²⁶⁴ Siekman 2016, p.1.

²⁶⁵ Paul Craig and Menelaos Markakis, ‘*Gauweiler* and the Legality of Outright Monetary Transactions’ (2016) 41(1) *European Law Review*, p. 26.

²⁶⁶ Nik de Boer and Jens van 't Klooster, ‘The ECB, the courts and the issue of democratic legitimacy after *Weiss*’ (2020) 57(6) *Common Market Law Review*.

²⁶⁷ *Ibid*, pp. 10-11.

²⁶⁸ *Ibid*.

²⁶⁹ *Ibid*, p. 10.

²⁷⁰ *Ibid*.

argue that the optimum level of inflation for the growth of GDP depends.²⁷¹ There are several factors to take into account, such as the development level of the area, investment and population growth.²⁷² To determine what level of inflation is best for the euro area at any given point in time will be difficult. The determination of the optimum level of inflation is arguably open to discussion but depends on (macro)economic factors. A technical decision was best taken by the ECB. The “authorization gap” as argued by De Boer and Van ‘t Klooster is therefore not a significant deviation from monetarism. Monetarism in its very nature argues that monetary policy is a matter of technical calculations rather than political choices. The level of inflation can be seen as one of these technical choices. Their article, however, rightly points out that how much pressure is put on achieving the inflation output is a choice. This choice by nature is largely political and depends largely on inflation adverseness.²⁷³ Demonstrating the idea that the ECB opted for large pressure upon inflation goals, Hinarejos argues the approach to EMU has changed from a rule-based institution to a policy-based approach.²⁷⁴ Whereby the rules separate both policies but policy demands interdependence. This change is not welcomed by all parties.

Pennesi argues that from a German perspective this departure is very much against their wishes. When the euro was created Germany had to give up its own strong currency and only did so under the condition that the euro would be equally strong.²⁷⁵ The ECB then had to safeguard the strength of the currency exclusively, whilst national budgets would be left to national governments. With expansionary policies being considered illegal under the treaty.²⁷⁶ This German vision of the treaty seems very appropriate under circumstances whereby fiscal discipline is kept and no financial unrest is afoot. The financial crisis, however, showed the differences between the economic philosophies of the Member States. These differences have hindered a strong crisis approach.²⁷⁷ As Waibel puts it, if monetary policy is defined too narrowly this will put the ECB into a ‘straight-jacket’ unable to cope with modern central bank functions. In his opinion, these functions include coping with a financial crisis.²⁷⁸ The financial unrest, however, seems to have become a part of the ECB’s mandate.

One of the main factual differences is that the OMT programme was never implemented. Legally the CJEU made little distinction between implemented and non-implemented programmes.²⁷⁹ From an impact perspective, one could argue that the ECB

²⁷¹ Antonia López-Villavicencio & Valérie Mignon, ‘On the impact of inflation on output growth: Does the level of inflation matter?’, (2011) 33 *Journal of Macroeconomics*, p. 459.

²⁷² Ibid.

²⁷³ Boer & Kloosterhuis 2020, pp. 11-12.

²⁷⁴ Hinarejos 2015b.

²⁷⁵ Pennesi 2016, p. 6.

²⁷⁶ Ibid, p. 6-7.

²⁷⁷ Jackson 2009, p. 6.

²⁷⁸ Waibel 2017, p. 21.

²⁷⁹ Gauweiler, parafs. 27-28

has gone from a never implemented to an implemented programme. Legally, however, this does not seem correct as the OMT programme was judged as if it was or would be implemented. From a legal perspective, the difference between OMT and Asset Purchasing is the volume and the aim. The OMT programme was specifically aimed to counteract the speculation of the disintegration of the Eurozone.²⁸⁰ Therefore this programme was only aimed at certain Member States. This target is much more specific than that of the PSPP which has the more general aim of reaching the near 2% inflation. The inflationary aim is the definition of the more general price stability objective. The target, therefore, does not seem to be cumulative in nature. The second main difference in the OMT and PSP programmes is that of the volume, which will be discussed under instruments.

How to exactly define monetary policy remains difficult and no certainty came from the CJEU. In the *Pringle* case, the CJEU considered that both the objectives and instruments should be examined on equal footing.²⁸¹ In the *Gauweiler* and *Weiss* case the CJEU, however, considered the primary consideration should be that of the objectives and second the instruments. As these cases were adjudicated after the *Pringle* case and are more directly related to monetary policy these will be guiding. It thus seems that the objectives are more important in determining whether or not something is monetary in nature. Despite objectives being the most important, the exact distinction between economic and monetary remains difficult. The two concepts were rigorously separated by the Treaties. The euro crisis made it clear that these concepts are not that easy to split. As Hinarejos puts it *“while the Court could be accused of drawing an arbitrary line between measures of monetary and economic policy, it seems impossible not to engage on arbitrary distinctions of some kind—an arbitrariness that seems imposed not by the Court itself, but by the problematic separation of competences at the heart of Economic and Monetary Union”*.²⁸² The ECB has taken the clear view that monetary policies may and can impact economic policy. The CJEU has taken over this approach in the *Pringle*, *Gauweiler* and *Weiss* cases. It clearly states that the indirect effects of the monetary policy upon economic policy do not make it a matter of economic policy. Up until the *Weiss* case, it was unclear what exactly these indirect effects could be.

The unclear and largely arbitrary line between economic and monetary policy means the ECB is given the independence to decide the difference. These Treaties were drafted based upon clear separation. The newly discovered interdependence with vague differentiation increases the need for ECB accountability.

²⁸⁰ *ibid*, parafs. 72-78

²⁸¹ *Pringle* case, paraf 53 & 55.

²⁸² Hinarejos 2015, p. 575.

7.4.1.2. *Special circumstances*

The concept of the ECB as the organ to solve the financial crisis is reflected in the CJEU's discussion of the 'unusual circumstances'. The parties frequently refer to the unusual situation and unusual actions thereby giving the suspicion that the ECB enjoys more flexibility during a financial crisis. In the article written by Pennesi, the *Gauweiler* case is considered a demonstration of the ECB's capabilities. During the crisis, the Bank has transformed from a technocratic institution into a '*policy maker capable of preventing the breakup of the Eurozone with its unconventional monetary matters*'.²⁸³ The CJEU agrees that the objectives of the ECB, namely the restoration of transmission channels and the singleness of monetary policy are monetary objectives.

The CJEU referred to the special circumstances during the euro crisis.²⁸⁴ These unusual circumstances are referred to by the CJEU in paragraphs 72 and 73 of their judgment. The CJEU describes it as '*characterised by high volatility and extreme spreads*' and a '*special situation that severely undermined the ESCB's monetary transmission mechanism*'.²⁸⁵ It further states in paragraph 77 that '*In those circumstances, the ESCB was entitled [...] to safeguard the singleness of monetary policy*'.²⁸⁶ The question, in this case, is whether the CJEU's words should be interpreted as for the words monetary policy to include the singleness of the Eurozone. Article 119(2) TFEU provides that monetary policy should be single. Whether this means a single policy for the Eurozone or keeping the Eurozone together is unclear. A narrow reading would interpret it as a single policy. The special circumstances and the referral to the speculation rate, however, indicates the CJEU took the second definition. In its mandate, the CJEU includes the power for the ECB to eliminate the speculation interests charged upon different countries. The speculation rates were those rates charged for the risk of the breaking up of the Eurozone.²⁸⁷

Pennesi describes this situation as a 'Catch-22' scenario. In this scenario, the ECB can either save the euro and break the constitutional treaty provisions or not save the euro which it is supposed to keep stable. Pennesi does not consider it strange that the ECB chose to save the euro.²⁸⁸ Or in the words of De Grauwe and Markakis: '*The health of monetary union as manifested in a single currency, overseen by the ECB, can be markedly affected by the budgetary health of the individual economies that adopt the euro, since the market will use such data when adjudging the relative strength of that currency in relation to other currencies that are traded*'.²⁸⁹ A similar argument was made by Joerges

²⁸³ Pennesi 2016, p. 4.

²⁸⁴ Court in *Gauweiler*, paraf. 73.

²⁸⁵ *Gauweiler*, paraf. 72-73.

²⁸⁶ Court in *Gauweiler*, paraf. 77.

²⁸⁷ Court in *Gauweiler*, parafs. 76-77.

²⁸⁸ Pennesi 2016, p. 16.

²⁸⁹ Craig and Markakis 2016, p. 26.

who states *'the dynamics of the crisis which demands too much of the law and because compliance with the law as it stands would only have exacerbated the crisis aggravated damage'*.²⁹⁰ He argues that sometimes the consequences of strict adherence to the law are worse than flexibility. De Grauwe and Markakis further argue that any measure that falls strictly within either category of monetary or economic policy is doomed to fail.²⁹¹ Thereby suggesting that for the policy to be effective it will have to transcend strict separation. The CJEU does not use these terms but rather considers that *'[...]questions of monetary policy are usually of a controversial nature[...]*'.²⁹² Furthermore, it considered that the measure was not disproportionate to the means it aimed to reach.²⁹³

It seems, therefore, not unreasonable to consider the unity of the Eurozone within its mandate as well. The special circumstances in combination with the proportionality criterion make it attractive to state that the mandate of the ECB entails a form of crisis mandate. It is however difficult to pinpoint exactly how much the CJEU would allow the ECB to intervene. Under the circumstances, it seems that the ECB was successful in tackling the euro crisis. These factors combined provide arguments to say the ECB has gained the objective of keeping the monetary union whole.

The case law has provided a wide interpretation of the monetary policy. The CJEU has decided that monetary policy may overlap with economic policy. In addition, it seems that the CJEU has also added as objectives to the monetary mandate that of restoring the transmission channels and keeping the 'singleness of monetary policy'. The question, therefore, becomes what impact the case has had upon the instruments the Bank may use to achieve these objectives.

In addition, the objectives of the ECB seem to have grown slightly. Whilst the Treaties only speak of monetary policy, the ECB has defined this to inflation near but below 2%. During the course of the euro crisis, this has been extended with the broad interpretation of 'singleness of monetary policy' and the 'restauration of monetary transmission channels'. These two aims were first described in the OMT press release and confirmed by the CJEU in *Gauweiler*.²⁹⁴ The current definition of monetary policy is therefore extended to include these two aims. Interesting to note is that these two aims were discussed in combination with the "special circumstances". The combination seemingly gives the ECB the objective to counteract financial instability. Interesting in this case is to reflect upon Cafaro's observations. In her paper, she states that the Long-term Refinancing Operations, Emergency Liquidity Operations, Outright Monetary Transactions and the Quantitative Easing programme were only indirectly related to

²⁹⁰ Joerges 2014, p. 253.

²⁹¹ Ibid, p. 26-27.

²⁹² Court in *Gauweiler*, paraf. 75.

²⁹³ Ibid, paraf. 91.

²⁹⁴ *Gauweiler* paraf. 4; *ibid* parafs. 47-49.

price stability.²⁹⁵ In her research, however, she states the ECB has stretched its powers but never overstepped its mandate. The Treaty provisions were respected and reinterpreted rather than discarded.²⁹⁶

The objectives of monetary policy have grown in comparison with before the euro crisis. It may now include two extra objectives and overlap with economic policy. In addition, it has been determined that the objectives are more important than instruments in determining the nature of a policy. The following question is what effect the decisions had upon the instruments of the ECB.

7.4.2. Instruments

These paragraphs will examine the effects the policies had upon the instruments of the ECB. Instruments in this research are defined as all the actions or decisions taken by the ECB to achieve its objectives. These include the actions it took in its involvement in the Troika and the limitations of articles 123 and 125 TFEU. These two topics will be considered separately.

7.4.2.1. The Troika

When it comes to the *Gauweiler* case the Troika is not under discussion by the ECJ but has been considered by the Advocate General. The following paragraphs will first briefly discuss the nature of the Troika's action with regard to economic and monetary policy. Secondly, it will analyse the exact role of the ECB within the Troika and discuss this role in relation to its mandate.

An interesting point in this discussion in the *Gauweiler* case is that made by Advocate General Villalón about the ECB's participation in the Troika. In his argument, he states that "*The ESM Treaty does in fact confer multiple responsibilities on the ECB in the course of a financial assistance programme, including participation in negotiations and monitoring.*"²⁹⁷ In his opinion, however, tasks are shared with the Commission who has the more important functions.²⁹⁸ According to Hofmann the ECB is creating the condition for government bond purchase and thereby in effect reinforcing the incentives

²⁹⁵ Cafaro 2016, p. 5.

²⁹⁶ Ibid, p. 6.

²⁹⁷ AG Villalón, paraf. 144.

²⁹⁸ Ibid.

to comply with the conditions.²⁹⁹ It, therefore, seems to be actively pursuing economic policy objectives rather than incidentally influencing them. Adding to this debate is the question of how to view the influence exercised by the ECB upon Greece and Ireland during the negotiations.

The CJEU should have picked up on the issues surrounding the Troika according to Hofmann.³⁰⁰ The Advocate General, however, argues the problem arises only when the programme becomes effective. Before the programme becomes effective its goals must and are linked to the objectives of monetary policy. He gives the example of conditionality and its objective to prevent moral hazard.³⁰¹ He states that for the OMT to remain a monetary measure the ECB must detach itself from the compliance of the ESM/EFSF. If the ECB does not detach itself from the fund it cannot refer to the compliance as happening under a third party, as the ECB has such a large role in the compliance it will be its own third-party.³⁰² According to the Advocate General *“In those circumstances, the purchase of debt securities subject to conditions may become another instrument for enforcing the conditions of the financial assistance programmes. The mere fact that the purchase may be perceived in that way — as an instrument which serves macroeconomic conditionality — may be sufficient in its impact to detract from or even distort the monetary policy objectives that the OMT programme pursues.”*³⁰³ The AG, however, also admits that the ECB will always be able to pressure the Member States into accepting financial assistance.³⁰⁴ It remains, however, difficult to establish when the ECB’s participation in the Troika would cross into the domain of economic policy and not all authors agree with the argument of the AG.

Antpohler does not agree that the moment that the OMT programme is enforced it is not monetary in nature. He states that the nature of the OMT programme does not change after the programme is activated. The actions of the Troika are, in his view, already economic in nature and should cease. This is, however, regardless of the implementation of the programme.³⁰⁵ Furthermore, he refers to extent of the actions of the ECB with the letters it sent to various governments. He sees these letters as potentially unlawful when considered in retrospect. Mainly due to the informal relationship these letters established with the Single Markets Programme (SMP).³⁰⁶ Both arguments are interesting to consider.

After the OMT programme is activated it means a country has been submitted under the ESM/EFSF plan and is eligible for coverage under the OMT programme. If one indeed

²⁹⁹ Hofmann 2018, p. 18.

³⁰⁰ Hofmann 2018, p. 18-19.

³⁰¹ AG Villalon, p. 145.

³⁰² AG Villalon, pp. 140-151.

³⁰³ Ibid, p. 145.

³⁰⁴ Ibid.

³⁰⁵ Antpohler 2015.

³⁰⁶ Antpohler 2015.

agrees with Antpoehler's point of view that little changes, this would indicate the OMT programme to be economic in nature. This line of reasoning is very understandable. The major change of role for the ECB would be to go from negotiator to moderator. In Antpoehler's view, this is not enough to justify and classify the OMT programme as monetary rather than economic, therefore making the actions unlawful. He, however, also considers that if the ECB left the Troika this may mean the end of the Troika.³⁰⁷ Furthermore, he argues that the ECB has established an informal relationship with the SMP. This has been done via the letters that the ECB sent to various governments and institutions.³⁰⁸ The OMT programme followed the SMP it is arguable that these informal relations continued with the OMT. The argument of the Advocate General in *Gauweiler* is, however, also very understandable.

With the potential active participation of the ECB in the Troika and other actions taken, one can argue that the role of the ECB is broader than expected. The role of courts in these situations is to ensure that institutions stay within their constitutionally given mandate.³⁰⁹ Without making it, as Hinarejos rightly argues, seem that the CJEU is second-guessing an expert body.³¹⁰ The ECJ therefore could have been another check upon this power. In this case, however, the CJEU failed or chose not to conduct a (full) constitutional review of the ECB.³¹¹ It furthermore ignored the role of the ECB within the Troika and neither identified nor assessed legal limits. Combining this with the independence the ECB enjoys from the Parliament and other EU institutions, there are very few checks upon the ECB. The two other actors involved within the Troika were the Commission and the IMF. It is unlikely the IMF will be concerned with whether the ECB is or is not involved with economic policy. The then chair of the IMF, Christine Lagarde, has been called threatening to leave a meeting if the word Bundesverfassungsgericht would fall again.³¹² Interestingly she has now been elected president of the ECB. It is in the Commission's best interest to keep the operation of the Troika running smooth. It is therefore unlikely that the Commission will safeguard the mandate of the ECB. Observing from the outside in, it is unlikely the Troika is much concerned with the mandate of the ECB behind closed doors. This is increasingly difficult due to the few publications made by the ECB concerning its role within the Troika.³¹³ As Pisani-Ferry et. al. state the involvement of the ECB within the Troika leads to a potential conflict with its primary mandate of monetary policy. The ECB in such close cooperation, in their

³⁰⁷ Ibid.

³⁰⁸ Antpoehler 2015.

³⁰⁹ Finkel 2008, p. 4.

³¹⁰ Hinarejos 2015c.

³¹¹ Pennesi, p. 11.

³¹² Susanne K. Schmidt, 'A Sense of Deja Vu: The BVERFG's Preliminary European Stability Mechanism Verdict, (2013)14 German Law Journal, p. 1.

³¹³ Pisani-Ferry 2013, p. 110.

report, would lead to influence on fiscal policy and thereby cause a conflict of influence on its primary task.³¹⁴

It, therefore, seems that the participation of the ECB within the Troika is not limited by guidelines from the CJEU. This role should furthermore be read in combination with the letters that were sent to the Irish, Spanish and Italian governments. As stated in the previous chapter these letters would likely be considered legal. The ECB is at liberty, with a 2/3rds majority of the governing board, to cut off ELA. The letters however indicate that the ECB does not shy away from making economic judgements. It further raises the question that if the ECB is capable of making very specific economic recommendations in letters, why would it shy away from making similar demands in its role in the Troika? Reducing the credibility of the argument that the ECB was simply the junior partner.

With this expansion, the question rises of what influence the euro crisis had upon the implication of the article 123 and 125 TFEU limits. This will be discussed in the next paragraphs.

7.4.2.2. Articles 123 & 125 TFEU

When looking at instruments it is important to discover what the role is of articles 123 and 125 TFEU. These two articles effectively limit the extent to which the ECB can use its monetary toolkit. The interpretation of these articles was affected by the crisis and ECJ's interpretation. It should however be noted that the definition of the articles before the crisis was not precise.

Article 123 TFEU prohibits both overdraft facilities of governments or government organs with the ECB or NCBs. It furthermore prohibits the ECB and NCB from buying public bonds on the primary market. Though seemingly clear the two prohibitions were considered conflicting. De Grauwe argues that this article prohibits the ECB from credit provision to governments.³¹⁵ It, however, does not prevent the ECB from liquidity provision to the market.³¹⁶ The separation seems clear. In practice, however, liquidity and credit operations are less easy to distinguish according to Estella.³¹⁷ Estella furthermore argues that the purpose of the second prohibition within article 123 TFEU shows that the ECB can only purchase bonds on the secondary market to promote price stability. The purchases should not be aimed at providing liquidity.³¹⁸ Estella bases this

³¹⁴ Ibid, p. 111.

³¹⁵ Paul De Grauwe, *Economics of Monetary Union* (Oxford University Press 2018), p. 185.

³¹⁶ Ibid.

³¹⁷ Antonio Estella, *Legal Foundations of EU Economic Governance* (Cambridge University Press 2018), p. 83.

³¹⁸ Ibid, p. 84.

argument on a similar prohibition in the United States. This prohibition was introduced to prevent excessive government deficits. The FED however had not bought large quantities of government bonds directly from the market. According to Gabor, the prohibition was thus not necessary.³¹⁹ Estella's argument is further complemented by the Stability and Growth pact that limited government deficit. Although it can also be argued that the prohibition prevents the ECB from buying bonds at low rates. Both the opinion of De Grauwe and Estella have merit. The question is how this was interpreted during the crisis. Whether article 123 TFEU was interpreted limited to only include a focus on price stability, as argued by Estella. Or if it was interpreted more broadly to include both price stability and the provision of liquidity, as suggested by De Grauwe.

Articles 123 and 125 TFEU are the prohibitions of direct lending and bailout. Before the euro crisis, these articles were interpreted in three different ways: literal, purposive and ultima ratio.³²⁰ The literal explanation focuses on the wording of the texts. The purposive includes the purpose of the articles which is the market reasoning. States with a risky fiscal policy would have to borrow under higher premiums than states with a more prudent fiscal policy. Within this reasoning, any form of Member State assistance would distort the functioning of market premiums. The third explanation places the purpose of the no-bailout clause within the broader perspective of price stability.³²¹ The first interpretation is the most lenient. It only includes the wording of the text without taking the purpose of the articles. The second form of interpretation is slightly less lenient as it includes the purpose of the articles and therefore is more restrictive towards the ECB. The third is more restrictive than the first as the purpose is taken on board as part of the analysis. Unlike the second the third explanation allows the ECB to place its actions within the broader goal of price stability.

In the *Gauweiler* case, the CJEU takes the same approach as in the *Pringle* case. Starting with the literal application of article 123 TFEU,³²² then applying purpose³²³ and is brought to the higher purpose of the "singleness of monetary policy".³²⁴ There are multiple ways to interpret this interpretation by the CJEU. On the one hand, it can be argued that the CJEU has expanded the number of instruments the ECB has. Since the instruments may be applied to achieve the singleness of monetary policy. This application purpose that is added, however, seems more of an objective than an instrument. The CJEU's interpretation, therefore, has more likely decreased the amount of freedom the ECB has. The way the ECB applies its instruments is tested not only against the wording of article 123 TFEU but also against the purpose. This forms an extra

³¹⁹ Kenneth Garbade, 'Direct Purchases of U.S. Treasury Securities by Federal Reserve Banks' (2014) Federal Reserve Bank of New York Staff Reports, no. 684, p. 6.

³²⁰ Borger 2013, p. 129.

³²¹ Ibid, p. 130-131.

³²² Gauweiler, paraf. 94.

³²³ Ibid, paraf. 101.

³²⁴ Ibid, paraf. 112.

restriction upon what the ECB can and cannot do as their actions must also comply with the purpose of article 123 TFEU. A similar approach is used for article 125 TFEU. Though the CJEU has interpreted and elaborated on these articles within its judgement the approach is not new. In its Judgement, the CJEU refers to an earlier regulation providing further rules on applying the prohibitions.³²⁵ The preamble of this regulation states that “*purchases made on the secondary market must not be used to circumvent the objective of that Article*”.³²⁶ The CJEU using this purposive interpretation is therefore not unexpected.

Articles 125 and 123 TFEU are closely related to the function of lender of last resort. This function can be considered both as an objective or an instrument. Due to the close relationship with articles 123 and 125 TFEU this research has chosen to cover this debate under instruments. Eichler and Hielscher argued that when turmoil erupted the ECB chose to act as a LoLR by conducting fine-tuning operations with resulting lowering interest rates and increasing liquidity the ECB has acted as a lender of last resort.³²⁷ According to Buiter and Rahbari, the ECB has acted as a lender of last resort during the euro crisis.³²⁸ The outright purchases in SMP and the subsidized funding to Eurozone banks have been the conduct of a LoLR.³²⁹ Their paper was published in 2012 before the introduction of the OMT. In retrospect of the OMT, De Grauwe states that the ECB has taken on board the objective of stabilizing the financial bond market. This objective is that of a LoLR and therefore the ECB is acting as a LoLR.³³⁰ Winkler too concludes that the OMT programme has made the ECB de facto act as a lender of last resort.³³¹

It can therefore be concluded that before the OMT and *Gauweiler* case the status of the ECB as a Lender of Last Resort was unclear. The Treaty did not specifically prohibit the ECB from acting as a LoLR but due to the restrictions formulated in articles 123 and 125 TFEU, it was unclear if the ECB would act as LoLR. After the OMT programme, it can be argued that the ECB has displayed certain facets of a LoLR, or at least acted as such indirectly.³³² These would include concern over financial stability and ensuring access to liquidity for banks and governments. This financial stability concern is furthermore strengthened by the ‘special circumstances’ referred to by the CJEU. Together they form a strong indication that the ECB is given some form of lender of last resort role within

³²⁵ Council Regulation (EC) No 3603/93 of 13 December 1993

³²⁶ Ibid.

³²⁷ S. Eichler and K. Hielscher, ‘Does the ECB act as a lender of last resort during the subprime lending crisis? Evidence from monetary policy reaction models’ (2012) 31 *Journal of International Money and Finance*, p. 555.

³²⁸ Willem Buiter and Ebrahim Rahbari, ‘The European Central Bank as Lender of Last Resort for Sovereigns in the Eurozone’ (2012) 50 *Journal of Common Market Studies*.

³²⁹ Buiter & Rahbari 2012, p. 25

³³⁰ De Grauwe 2013, p. 530.

³³¹ Adalbert Winkler, ‘The ECB as Lender of Last Resort: Banks versus Governments’ (2016) 235(3) *Jahrbücher für Nationalökonomie und Statistik*.

³³² Cafaro 2016, p. 5.

the Eurozone. The next instrument used after the OMT is that of the Public Sector Purchasing Programme.

The Public Sector Purchasing Programme is a new instrument added to the toolbox of monetary policy. The CJEU refers to ECB Decision 2015/774 recital 4 for the purpose of the measure. This recital, however, also states that “*it is necessary to add to the Eurosystem's monetary policy measures the PSPP as an instrument that features a high transmission potential to the real economy*”. The ECB thereby seems to be adding the PSPP to its monetary toolkit.

The OMT programme did not have a released, pre-determined maximum volume for purchases. The CJEU considered that the programme was limited to specific purchases. This limit did not require any additional previously set limits as this might reduce the effectiveness of the programme.³³³ Without the implementation of the programme, it seems futile to speculate possible limits the ECB may have set. The Asset Purchase Programme, of which the PSPP was one, did have previously set limits.³³⁴ The referring CJEU found the volume of the purchasing a contributing factor to consider the programme beyond the mandate of the ECB. The APP conducted by the ECB totalled €2.5 trillion the other big QE programme conducted in the US totalled a volume of \$4.5 trillion. The ECB, therefore, spend 19.86% per cent compared to the GDP of the Eurozone in 2017, whereas the FED spent 23.21% of the US GDP in 2017.³³⁵ Both banks operate under different designs and economies with different needs, from general observation, however, the volume spent by the ECB seems on the moderate side. This is further emphasized by Gros et. al. who argue that the total balance sheet increase of the FED was 230% compared to 170% of the FED.³³⁶ Additionally, to question the volume of the programme seems contradictory to the law. The ECB is designed to have functional independence, including budgetary independence. The budget is under the control of the Governing Council and needs no approval from European bodies.³³⁷ If the CJEU could comment or strike down the budgetary proposals of the ECB this would amount to a circumvention of this independence. Member States could file a motion to the CJEU to have the proposal of the ECB struck down via the CJEU. This would seem like a bad fit with the high-level independence as given shape via the Treaties.

As with the *Gauweiler* case, the CJEU discussed the possible circumvention of article 123 TFEU. The CJEU decided, not unlike *Gauweiler*, that the PSPP may not amount to a

³³³ *ibid*, paraf. 88

³³⁴ ECB Asset Purchasing Programme, <https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html> [last accessed 20 September 2020].

³³⁵ Taking the GDP data of both respective economies from: www.tradingeconomics.com, visited 20 December 2018. The total volume of QE spending from the United States Federal Reserve Bank came from; E. Schulze, ‘The FED launched QE nine years ago- these four charts show its impact’, *CNBC*, 25 November 2017.

³³⁶ Gros et. al. 2012, p. 3.

³³⁷ C.S Weber and B. Forschner, ‘ECB: Independence at risk?’ (2014) 49 *Intereconomics*, p. 45 at. p. 49.

practical circumvention of article 123 TFEU and must keep a sound budgeting impetus for the Member States.³³⁸ Considering the use of both the literal and the purpose of the article, the CJEU seems to repeat its purposive interpretation of article 123 TFEU.

Before the euro crisis, the most notable instruments were those laid down in article 18.1 of the Protocol.³³⁹ The two instruments mentioned in this article are; the trade-in marketable instruments and credit operations. During the crisis, these instruments have seemed to increase. The most notable increases were those introduced via legislation.

The actions the ECB undertook as a member of the Troika were based upon the instruments described in the ESM treaty. These instruments included: deciding on stability support, assess the sustainability of public debt, assess the financing needs of ESM, negotiating the Memoranda of Understanding and the monetary compliance of these MoU. The actions taken by the ECB have formed a substantial increase in the instrument set. This increase was so substantial that both the AG and various amount of scholars would have considered it unlawful under certain circumstances. In addition to this increase, the ECB has increased its toolset with the PSPP programme. It did so in recital 4 of Decision 2015/774.³⁴⁰ This instrument is less drastic than that of the ESM but is worthwhile mentioning as it indicates the ECB increasing its own set of instruments.

The case law has furthermore shown that the instruments used by the ECB must not violate articles 123 and 125 TFEU. The CJEU hereby uses a purposive interpretation of the two articles. It considers not only the literal interpretation of the two articles but also the purpose behind the clauses. This slightly limits the use of the instruments as they may not violate either article literally or in its purpose. This interpretation has been used in both cases and can thus be considered the final interpretation. The purposive interpretation has, however, not been read to the extent that the ECB is fully prevented from acting as a Lender of Last Resort. This facet was unclear before the euro crisis but it seems clear that the ECB indeed may concern itself with financial stability. This characteristic is normally attributed to LoLR, though the CJEU has not directly considered the ECB as such. Whether the ECB would function as a LoLR was unclear. During the course of the euro crisis, the ESCB has provided emergency assistance to several financial institutions.³⁴¹ It did so using its Emergency Liquidity Assistance agreement.³⁴² The possibility of providing such assistance remains with the National Central Banks (NCB). This role traditionally was part of a central bank's function and it seems to have remained this way.

³³⁸ *Weiss*, parafs. 105-107.

³³⁹ PROTOCOL ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK

³⁴⁰ European Central Bank Decision (EU) 2015/774 of the 4th of March, on a secondary markets public sector asset purchase programme.

³⁴¹ Central Bank of Cyprus 2013.

³⁴² European Central Bank, ELA Procedures, 17 October 2013

Wolff argues that the stress in the sovereign bond market both affected sovereign markets but also undermined the ECB's ability to transmit monetary policy signals to the private sector.³⁴³ Wolff argues that the OMT programme was successful in re-establishing the monetary policy transmissions.³⁴⁴ Thereby emphasizing the economic success the ECB had. Concerning the question of whether this undermined the national budgetary sovereignty of the Bundestag, he argues the relation with the fiscal implications of the programme. His argument comes down to the idea that if a country defaults on its bonds the net value of the Eurozone would not decrease. Therefore the programme could result in distributional effects.³⁴⁵ In conclusion, he states that the measure was effective and appropriate in its relation to the crisis faced. Plus it managed to bring down the risks the Germans were exposed to through ordinary procedures of the ECB.³⁴⁶ His conclusion seems to concur with the vision of the ECB that there were unusual circumstances. Additionally, the OMT programme, in Wolff's opinion, seems to agree with the argued effectiveness. The judgement thereby gave the general reassurance that the ECB has the means to tackle these and future debt crises.³⁴⁷ Though the measure was effective it still had to abide by the prohibitions formulated in articles 123 and 125 TFEU. The measures taken by the ECB show that the interpretation of article 123 TFEU was liberally interpreted. The increased liquidity was considered not to be prohibited by article 123 TFEU. This shows the interpretation of De Grauwe was validated rather than the restricted interpretation of Estella.

Last but not least the *Weiss* case has shown that the ECB independence is to be respected concerning the usage of its instruments. The CJEU could have analysed the nature and extent of the PSPP but did not. This shows the independence the ECB has regarding the volume of its instruments. The impact on its mandate clearly warrants larger accountability. The first aspect of accountability that will be discussed is the level of judicial review.

7.5. Level of Judicial Review

The ECB's subjection to European Union law was firstly established in the OLAF case.³⁴⁸ The CJEU in this case decided that the ECB was created by the Treaty. Therefore it falls within the Community legal framework.³⁴⁹ ECB's independence was furthermore not

³⁴³ Wolff 2017, p. 29.

³⁴⁴ Ibid.

³⁴⁵ Ibid, p. 30.

³⁴⁶ Ibid, p. 30.

³⁴⁷ Thomas Horsley, 'Eurozone Crisis Management, Citizenship Rights and the Global Reach of EU Data Protection Law: EU Legal Developments in 2015', (2016)54 *Journal of Common Market Studies*, p. 118.

³⁴⁸ Case C-11/00 *Commission of the European Communities v. European Central Bank* ECLI identifier: ECLI:EU:C:2003:395.

³⁴⁹ Ibid, paraf. 92.

hampered by fraud prevention.³⁵⁰ This case shows that the ECB is subject to European law and can be part of judicial scrutiny. The level of judicial review with respect to the crisis has however has been questioned.

The in jure accountability of the ECB is hindered by their behaviour. The most obvious example is that of the Troika. The ECB and Commission argued that they were not bound by EU law. They based this argument upon the concept of being ‘borrowed organs’ but acting outside of EU law.³⁵¹ This type of argument does not instil faith in the ECB’s attitude towards accountability. By being willing to act outside of EU law the ECB indicates a lax attitude towards accountability. Dermine argues that it was difficult to challenge the ESM’s actions under EU law.³⁵² Other actions of the ECB such as the OMT and PSPP have been challenged in front of the CJEU. To conclude the effectiveness of the CJEU as an overriding mechanism, the level of review needs to be assessed.

The level of judicial review is widely debated in the *Gauweiler* and *Weiss* case. The main issue is that of balancing the assessment of a complex question with judicial review. As Athanassiou points out this is not the first case where the CJEU had to reflect upon a complex question.³⁵³ In the Hungarian Agriculture case, the Council had to decide on prolonging aid schemes for the purchase of agricultural land.³⁵⁴ This case did not concern a decision made by the European Central Bank but one made by the Council. As stated by the CJEU both the Central Bank and the Council enjoy a wide discretion “[...] *the exercise of which involves complex economic and social assessments which must be made in a European Union context.*”³⁵⁵ The CJEU, therefore, decided that a limited judicial review would be appropriate “*In that context, judicial review of the manner in which that discretion is exercised is confined to establishing that the rules of procedure and the rules relating to the duty to give reasons have been complied with and to verifying the accuracy of the facts relied on and ascertaining that there has been no error of law, manifest error in the assessment of the facts or misuse of powers [...]*”³⁵⁶ In complex cases, it is therefore expected that the CJEU will conduct its review limited to an error of law, manifest error in the assessment of facts or misuse of powers. The CJEU then continues by assessing whether the Council indeed made a manifest error in judgement. It considers that the counter-argument of the Commission is insufficient to demonstrate a manifest error in judgement.³⁵⁷ It is, therefore, to be expected in this case that the level of judicial review is limited.

³⁵⁰ Ibid, paraf. 111.

³⁵¹ Dermine 2019, p. 116.

³⁵² Ibid, p. 117.

³⁵³ Athanassiou 2019, p. 145.

³⁵⁴ Case C-121/10 *European Commission v Council* [2010] ECLI:EU:C:2013:784

³⁵⁵ Ibid, paraf. 98.

³⁵⁶ Ibid.

³⁵⁷ Ibid, parafs. 100-101.

This level of judicial review is repeated in one of its following cases whereby the CJEU was asked to judge the validity of an amendment by the Parliament and the Council on petrol, diesel and gas-oil emission reductions.³⁵⁸ The CJEU recognized that this case involved complex technology. It stated that when such complex matters are involved the legislator has broad discretion.³⁵⁹ The CJEU limits its review therefore to manifest error.³⁶⁰ To show manifest error the plaintiff referred to the report written by the Commission which was not followed by the Council or Parliament.³⁶¹ Rather than examining this report the CJEU merely establishes that the report is not binding.³⁶² It further establishes that the Council and Parliament have the duty to find facts but have a discretionary role in how they find these facts.³⁶³ The institutions must be able to show that they have exercised their duty to establish the facts and the institution must be able to *“produce and set out clearly and unequivocally the basic facts which had to be taken into account as the basis of the contested measures of the act and on which the exercise of their discretion depended.”*³⁶⁴ The review is therefore expected to be limited but the institutions are expected to show transparency into the considerations underlying the decisions.

An important part in discussing the level of review is that of transparency, without transparency the CJEU is blind. As described by Hofmann the CJEU reviews Article 123 and 125 TFEU in combination with the instruments available to the ECB. In his working paper, he points out the irony of the CJEU’s acceptance that the ECB must be transparent but does not have to fully communicate in order not to violate articles 123 and 125 TFEU.³⁶⁵ Hofmann states that because market parties are uncertain of the exact execution of the decisions articles 123 and 125 TFEU are not violated. Its transparency is therefore limited. This lack of information was also one of the underlying complaints in the *Weiss* judgement of the BVerfG. To which the ECB responded by sending more documents to the German parliament.

The CJEU has given a substantial amount of discretion to the ECB, exemplary is its decision to limit the number of bonds that can be bought. The CJEU has limited the amount to those necessary to attain the objective of the programme. This seems to be in line with the general proportionality review policy taken by the judges. As Pennessi points out, however, it is the ECB who may judge how many bonds need to be bought to reach the goal of the programme.³⁶⁶ The limitation, therefore, does not seem to be a

³⁵⁸ Case C343/09 *Afton Chemical Limited v Secretary of State for Transport* [2010] ECLI:EU:C:2010:419, Paraf. 1.

³⁵⁹ *Ibid*, paraf. 28.

³⁶⁰ *Ibid*.

³⁶¹ *Ibid*, paraf 29.

³⁶² *Ibid*, paraf. 30.

³⁶³ *Ibid*, parafs. 32-33.

³⁶⁴ Case 310/04 *Kingdom of Spain v Council of the European Union* [2006] I-7318, parafs. 122-123.

³⁶⁵ Hofmann 2015, p. 15.

³⁶⁶ Pennessi 2016, p. 14.

limitation, as the ECB will never buy more bonds than it will deem necessary and there is no external party checking the ECB's judgement. It, therefore, seems that the ECB has been given a large amount of freedom. In the case of the OMT programme, this freedom may not be of particular gravity but as Hinarejos warns accumulation must be considered. The OMT programme, she states, may not be sufficient change to the Economic and Monetary Union to be struck down.³⁶⁷ The transition however from the ECB as a rule-based, apolitical organ to a more policy focussed organ should not take place via the judicial process.³⁶⁸ Thus at the end of her reflections, she calls for caution of a cumulative process that is difficult to stop.³⁶⁹ Hinarejos, however, finds no surprise in the adjudication as she considers that the actions of the OMT are fully within the legal limits set by the treaties. In her opinion it is better to apply for a light-touched review, looking at procedural safeguards.³⁷⁰ The safeguards she refers to are the ECB not announcing what bonds they intend to purchase and the time lapse between the issuing of bonds and the purchase of bonds on the secondary market.³⁷¹ This limited level of review has been suggested by more scholars.

The level of review is difficult to establish and suggestions have been varied. As monetary policy requires predictions and involves judgement of uncertainties, Goldmann argues against a strict level of review.³⁷² Goldmann suggests that the CJEU approaches the matter at hand using a rationality check. This rationality check would allow the CJEU to review whether the '*discursive requisites were in place*'. Which he explains as a check upon whether the act can be rationally justified and legislative procedures were rational and have been adhered to.³⁷³ Goldmann thereby refers in his footnote to the theorem put forward by Habermas about discourse analyses.³⁷⁴ Habermas' theory on discourse analyses focuses on the discourse itself and explanation through discourse.³⁷⁵ The next chapter will discuss whether this discourse took place through monetary dialogue between the ECB and the EU Parliament. Whether this dialogue took place, however, was not examined by the CJEU.

Pennesi too argues that when discretionary acts are involved the Judiciary must take precautions not to get too rigid. He, however, also states that this case has shown that the '*singleness of monetary policy*' is too vague a standard. Additionally, he considers that the lack of constitutional review is strange.³⁷⁶ This is especially so because, though the CJEU may not be an expert in economics, they are the expert body in law. They are

³⁶⁷ Ibid, p. 576.

³⁶⁸ Ibid, p. 575.

³⁶⁹ Ibid, p. 576.

³⁷⁰ Hinarejos 2015c.

³⁷¹ Ibid.

³⁷² Goldmann 2014, pp. 266-268.

³⁷³ Goldmann 2014, pp. 273-274.

³⁷⁴ Goldmann 2014, 273.

³⁷⁵ De Vera 2014, 161-162.

³⁷⁶ Pennesi 2016, p. 11.

the most qualified to conduct a constitutional review. This is more the case when taking into consideration another argument which is the transformation of the ECB into a lender of last resort. During the OMT the ECB seemed willing to finance governments regardless of economic opinion. This is the classic definition of a lender of last resort,³⁷⁷ a function that has now been accepted without the conduct of the constitutional review. Though some may find the lack of review odd, Hinarejos argues that it is not the CJEU's place. In her paper, she argues that the debate around the nature and evolution of EMU and the ECB's place in the solidarity regime is not one for the CJEU to conduct.³⁷⁸ The lack of review may however lead to clashes between the BVerfG and the ECB.

Pennesi argues that if the BVerfG does not accept the mutation of the ECB there will always be clashes. The first of which was arguably seen in the BVerfG response to the *Weiss* judgement. Though the ECB did respond with additional information the change in nature is not systematically altered. According to Pennesi's views, the ECB has mutated during the crisis and abandoned the old price stability philosophy and replaced it with a broader principle. Furthermore, the ECB has shown to be the only true federal institution of the Union and is the only institution capable to act when a common response is needed.³⁷⁹ In practice arguably the ECB is indeed well equipped to act in case of a crisis. It is an institution with national banks in every euro member state and has an efficient decision-making process. The status of the European Union as a confederation or federation is open for debate. The EU cannot be considered a clear federation or confederation at this stage. The institutions therefore should not be judged as if part of a clear (con)federation but rather strictly according to the Treaties. Josselin and Marciano argued in 2007 that without checks and balances the CJEU would become a driving force to further federalization of Europe via the economic field.³⁸⁰ It seems as if their prediction has come to pass. They, however, also state that "*the sole existence of a Court of Justice does not suffice to transform a confederation into a federation*".³⁸¹ Neither is the CJEU the place where this should be resolved.³⁸²

If one indeed agrees that the ECB has changed its role into a federal institution then the question should be asked how it has changed. The ECB has acted as a federal institution with a crisis-solving mandate and has not been reviewed by the CJEU. It is questionable whether this level of review is the most appropriate.

In his contribution, Goldmann argues that the rationality check ensures proportionality without giving carte blanche to the ECB.³⁸³ According to his views, vagueness allows a system of review whereby mutual discretion is tolerated. This slightly opposes the view

³⁷⁷ Ibid, p. 12.

³⁷⁸ Hinarejos 2015b

³⁷⁹ Pennesi 2016, p. 17.

³⁸⁰ Josselin & Marciano 2007, p. 68.

³⁸¹ Josselin & Marciano 2007, p. 68.

³⁸² Pennesi, pp. 17-18.

³⁸³ Goldmann 2015.

given by Pliakos and Anagnostaras. In their article, they consider that the CJEU relies on the explanations given by the ECB. As an illustration, they provide the CJEU's agreement with the ECB on the effect of bond-buying at the secondary market. The CJEU relied on the explanation of the Bank to establish whether or not the OMT programme would generate the same effect as bond-buying on the primary market.³⁸⁴ This statement has been explained rather narrowly by the ECB. It would have been within the CJEU's mandate to call for an independent expert witness. Though it is difficult to test economic validity without stepping upon the discretionary nature of the mandate it is not impossible. If Pliakos and Anagnostaras indeed are correct and the CJEU often relies on the explanations of the ECB, there is no question of strict or rational review. When the CJEU solely relies on one party's explanations, it does not review. The lack of review is troublesome as it would theoretically allow the ECB to put forth any economic argument and the CJEU would accept it. The approach by the CJEU, however, seems to be fully in line with the discretion in fact-finding. As discussed earlier, in complex issues the Council and Commission have a level of discretion as to how they conduct their fact-finding.³⁸⁵ It, therefore, makes for a more uniform approach to allow the ECB similar levels of discretion. Pliakos and Anagnostaras, however, consider that the judgement imposed confidence that the ECB would remain acting within its competencies.³⁸⁶ Though it is difficult to find agreement in this statement when the CJEU indeed relied only on the statements and explanations given by the Bank without any form of engagement with the arguments given. The authors also conclude that under the current form of the proportionality test the chances of getting a legislative measure to be considered invalid is slim.³⁸⁷ To test whether the measure has indeed been effective the CJEU could examine the results of the decision.

Hofmann considers that the ex-post review is too vague, the mere establishment that the Eurozone did not break apart and the channels of monetary transmission are restored is insufficient. This reasoning relies on hindsight bias and does not answer the question of proportionality. He argues that in general there should be a clearer relationship between the criteria of a full review, scientific expertise and discretion.³⁸⁸ In this case, particular was the nature of the decision at stake. As pointed out in the conclusion by AG Villalón, it is an act intended to bind the very author of the act. In addition, the action adjudicated is broad and factual in nature. These circumstances make it difficult for any court to review according to Hofmann.³⁸⁹

³⁸⁴ Pliakos & Anagnostaras 2017, p. 218.

³⁸⁵ Case 310/04 Kingdom of Spain v Council of the European Union [2006] I-7318, para. 121.

³⁸⁶ Ibid, p. 218.

³⁸⁷ Ibid, p. 218-219.

³⁸⁸ Hofmann 2015, p. 15.

³⁸⁹ Hofmann 2015, p. 14.

Joerges argues that there are no constitutional guarantees in the EU after the crisis.³⁹⁰ In his, article Joerges discusses the constitutional paradox concerning the ESM Judgement. He admits that the judgment calmed the markets. He describes the judgement to be 'highly-troublesome' and 'ambivalent'. In the decision, the BVerfG judged the strict conditionality of financial aid to be in line with the German Budgetary Sovereignty. This conditionality is not democratic. Therefore he argues there is no constitutional court or guardian within the European Union. The BVerfG did and should not get this role but neither did the CJEU take up this role in the *Pringle* decision. The EU is therefore left without constitutional guarantees.³⁹¹ Furthermore, the judgements show their blessing to the European crisis policy. Arguing that the philosophy of the non-bailout clause, that of autonomy, is being replaced by collective governance. In addition, he argues that the law is delegating problems to political systems without considering the legitimacy of such decision making.³⁹²

Though it is expected to receive critical responses, not all authors were critical of the judgement by the CJEU. In his article, Goldmann criticizes the BVerfG for their judgement in the *Gauweiler* case.³⁹³ He argues that the BVerfG should not have reviewed the actions of the ECB in the first place because full judicial review is not required. In support of this argument, he refers to articles 130 TFEU and 88 Basic Law.³⁹⁴ Interestingly he argues that because the decision of the BVerfG affects the entire Union, too high a standard of review may harm the principles of democracy just as much as no judicial review.³⁹⁵ An interesting and not unreasonable comment. There are, however, multiple actions taken by EU organs that start at national courts. It is then up to the national courts to refer cases to the CJEU, as is their duty under 267 TFEU. The BVerfG makes a very clear argument as to what answer is expected. The matter is then sent on via a preliminary question procedure. It can be argued that the strong opinion of the BVerfG is unchivalrous towards the CJEU, however, the CJEU is the ultimate judge on the legitimacy of the actions of the ECB. The strong review can be viewed therefore as nothing more than strong words as long as the BVerfG follows the CJEU in their final judgement. The latter, however, did not happen during the *Weiss* case.

The level of review in this case, in conclusion, seems to be limited. Limited in the first place to review procedural standards, second to proportionality and finally, the CJEU does not review the arguments put forward by the ECB. Though the judiciary has to be careful not to second-guess monetary policy decisions, its current level of review is

³⁹⁰ Joerges 2014.

³⁹¹ Joerges 2014, pp. 252-253.

³⁹² Joerges 2014, p. 253.

³⁹³ Goldmann 2014, pp. 266-268.

³⁹⁴ Ibid. p. 266.

³⁹⁵ Ibid. p. 268; For more discussion on the supremacy of EU law see: Fabbrini 2015.

considered 'residual at best'.³⁹⁶ Neither extremes are good, and it seems the golden middle has not yet been found.

In the *Gauweiler* case, the CJEU had to decide on an approach for adjudicating monetary decisions. This approach needed to balance the broad discretion of the Bank with the CJEU's function of review. The CJEU was criticized that it relied solely on the arguments given by the ECB to adjudicate the economic arguments.³⁹⁷ These arguments can be repeated after the judgement in the *Weiss* case. In adjudicating the PSPP programme the CJEU and the Advocate General relied on the statements provided by the ECB. This allows for a certain level of self-adjudication for the ECB. This is shown when looking at the arguments given by the referring court about proportionality. Due to its duration and volume, the BVerfG considered the programme disproportionate to its monetary goals. The PSPP is indeed by far the largest programme under the general Asset Purchasing Programmes conducted by the ECB.³⁹⁸ In addition, the holdings in this programme are far larger than other assets held by the ECB.³⁹⁹ The argument that the PSPP is just 'one of the four programmes' conducted under the current circumstances seems debatable. Even without this argument, the programme can be considered legitimate, it does however indicate a superficial level of review. Similar issues may arise after the COVID19 pandemic. The PEPP decision states "*The Governing Council will terminate PEPP net asset purchases once it considers that the COVID-19 crisis phase is over, but in any event not before the end of 2020.*"⁴⁰⁰ Whereby the Governing Council will have to determine when the crisis phase is over. As discussed in chapter 6 this may result in disagreement. It is furthermore a decision that could have been more time-specified allowing more intense judicial review. The critical notes are given by Pennesi after the *Gauweiler* case remains valid.

In his article Pennesi argues that the judicial self-restraint in the *Gauweiler* case seems poorly fitting with the "*historical position of the Court, according to which no European Institution can escape scrutiny*".⁴⁰¹ By accepting the arguments from the ECB without further analysis the review of the CJEU will be no more than a formality.⁴⁰² This does not seem to have changed in the *Weiss* approach. The Advocate General, however, seems to aim for a middle ground.

³⁹⁶ Pennesi 2016, p. 11.

³⁹⁷ Pliakos and Anagnostaras 2017, p. 213 at p. 218.

Saving Face? The German Federal Constitutional Court Decides *Gauweiler*, 18 *German Law Journal* (2015), p. 214 at p. 218.

³⁹⁸ European Central Bank, 'Asset Purchasing Programme', www.ecb.europa.eu/mopo/implement/omt/html/index.en.html#pspp, visited 20 December 2018.

³⁹⁹ *ibid* >> cumulative holding breakdown

⁴⁰⁰ Preamble 4, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020D0440>

⁴⁰¹ F. Pennesi, 'The impossible constitutional reconciliation of the BVerfG and the ECJ in the OMT case. A legal analysis of the first preliminary referral of the BVerfG', 8 *Perspectives on Federalism* 2016, p. 1 at p. 11.

⁴⁰² *Ibid*.

Due to the high independence of the ECB, there are few checks and balances outside of the Bank's decision making procedure. The Advocate General considers that the amount of discussion within the governing council indicates that all sides of the arguments have been considered.⁴⁰³ This type of approach seems to find a process of checks and balances within the ECB. The CJEU takes note of this discussion but does not emphasize the importance of it in its judgement. It refers in paragraph 38 to the various reflections in further press releases and the effects of the programme on the Member States. This seemingly increases the independence of the ECB as an economic expert. There seems to be no alternative party to check the economic validity of the statements provided by the ECB. This argument, however, does not have to be entirely valid. The main decision-making body is the Governing Council. This Council is comprised of the Executive Board and the 19 Governors of the national central banks. Similar in the United States the Federal Reserve Banking System is comprised of the Regional central banks and a Board of Governors Washington. The combination of Regional central banks and a Federal board is considered a balancing mechanism in itself.⁴⁰⁴ The CJEU, however, does not refer to the interaction between national central banks and the ECB. Interestingly it only emphasizes these revisions and discussions in relation to transparency.

The CJEU considers it 'fundamental' for the ECB to abide by the obligation to state reasons.⁴⁰⁵ It adds in paragraph 38 that these explanations include a statement of reasons explaining the various inflationary effects.⁴⁰⁶ The emphasis on the obligation to state reasons is interesting due to the high level of independence enjoyed by the ESCB. The CJEU does not further analyse the reasons given by the ESCB. The other controlling entity, the European Parliament, may examine the documents and question the governors of the ECB but has no further mandate to undertake action. The CJEU, therefore, values transparency as an independent principle without further examining who is to benefit from the transparency. It can, however, also be argued that without the obligation to state reasons the CJEU cannot review proportionality nor examine whether the measure is monetary or economic.

Though it is difficult to assess what the right approach would be, it seems that the current level of review is light. The CJEU could have done a more critical constitutional analysis. In addition, the reliance of the CJEU on the arguments presented by the ECB is very high. This is particularly difficult to reconcile with the limited transparency regarding the full ECB documents. A more thorough level of review arguably came from the BVerfG. The BVerfG considered that the CJEU was acting *ultra vires* with the light level review. Raising the question is the German level of adjudication better?

⁴⁰³ AG Wathelet in *Weiss*, parafs 135-136.

⁴⁰⁴ Federal Reserve Bank of St. Louis, Annual Report 2009, p. 13.

⁴⁰⁵ *Weiss*, para. 30.

⁴⁰⁶ *Ibid*, para. 38.

There are similar issues that the BVerfG would face compared to the CJEU. The judges in Karlsruhe are competent in law but neither are they, monetary experts. Raising the general question of what is different in their approach? The first difference seems that the BVerfG and CJEU have different starting points. Whilst the BVerfG primarily recognizes the democratic deficit of the bank the CJEU is more permissive.⁴⁰⁷ It seems second that the CJEU looks at input rather than output. The CJEU assess objectives and instruments rather than economic effects. These economic effects are considered important by the BVerfG.⁴⁰⁸ According to De Boer and Van 't Kloosterhuis, the difference in approach does not make the ECB decision-making democratic. The restrictive approach taken by the BVerfG seems more appropriate due to the new role of the ECB.⁴⁰⁹ Arguably a more restrictive approach is prudent in the case of non-democratic institutions. The question is whether a more restrictive approach would lead to different results. Neither the BVerfG nor the ECJ engages with economic theory. The increase in judicial review would therefore be limited. A more restrictive approach might include a constitutional review. Whether such a review can be properly done without economic engagement is difficult to say.

It is, however, not the position of the CJEU to conduct a thorough economic review of the policies of the ECB. The CJEU neither should be a policy judge nor does it have the expertise to conduct such reviews. Within their mandate, the CJEU has looked at the various policies of the ECB and tested them against the legal framework. It seems difficult to demand the CJEU to conduct a more thorough review of the policies as this would place the independence of the ECB in jeopardy. In addition, it may do serious damage to the credibility of the ECB if the CJEU can relatively easily reverse their decisions after implementation. Parts of these decisions cannot be reversed and the impact of decisions made by the ECB will be decreased. It is difficult to assess whether the CJEU could have done a more serious judicial review. The situation whereby the CJEU tests the programme against the legal framework using only the arguments provided by the ECB seems like an undesirable situation. An extra check upon the ECB would not go amiss, this is however not the place of the CJEU but that of the legislator.

7.6. Conclusion

The first referral of the BVerfG was described by Schiek as representing “*a continuation of the BVerfG case law aimed at restricting the impact of European Union law[...]*”.⁴¹⁰ It is easy to conclude that the cases have done far from limiting the impact of European

⁴⁰⁷ Boer & Kloosterhuis 2020, pp. 18-19.

⁴⁰⁸ *ibid*, p. 19-20.

⁴⁰⁹ *Ibid*, pp. 23-25.

⁴¹⁰ Dagmar Schiek, ‘The German Federal Constitutional Court’s Ruling on Outright Monetary Transactions (OMT) – Another Step towards National Closure’ (2014)15 *German Law Journal*, p. 329.

Union law. This chapter has first summarized the *Gauweiler* judgement and *Weiss* judgement. The chapter then continued to analyse these cases in light of the difference between monetary and economic policy. This chapter concluded that the CJEU's distinction between monetary and economic policy was created rather arbitrarily. The discretion the ECB got in determining what is monetary policy and what is economic policy warrants a higher level of accountability. This arbitrary distinction is combined with a broad definition of indirect effects. Thus warranting higher accountability than a monetarist interpretation of the mandate. The CJEU decided not to review the role of the ECB in the Troika. This lack of review was strange because the AG decided to comment on this role. Additionally, it is a role where the ECB interacted with fiscal policy. It would have been good for the CJEU to have commented upon this role of the ECB. The current level of review provides very few limits upon the mandate of the ECB. From an accountability perspective, the role of the CJEU is limited. Both because it takes a light level of review and because it accepts the arguments of the ECB without question. The exception to this light-level review was the approach to articles 123 and 125 TFEU. In its examination, the CJEU considered the actions of the ECB both in the light of the letter of the article and in spirit. The CJEU is however not the place for primary accountability. As discussed in chapter 3 courts are slow, costly and no experts in (monetary) economics. The next chapter will therefore discuss the other mechanisms of accountability to the ECB.

It is however possible to conclude that the balance of independence and accountability can be distorted. The role of the ECB during the euro-crisis and COVID19 pandemic was larger than previously imagined. Thus requiring higher levels of accountability. If the accountability of the ECB has not increased or not function well, there is sufficient reason to conclude the balance to be upset. The functioning of accountability will be discussed in the next chapter.

8. Accountability of the ECB during the crises.

8.1. Introduction

The previous chapter examined the level of judicial review taken by the CJEU. This chapter will analyse the accountability of the ECB during the crises. In chapter 3 this research has defined accountability via a set of questions. These questions are divided into three main themes; objectives, transparency and final accountability. Final accountability includes in this research the level of judicial review by the CJEU. As explained in chapter 3 this is different from earlier research, since the euro-crisis judicial review has become a larger part of accountability. This was however discussed in the previous chapter and will not be discussed again in this chapter. It was furthermore discovered in chapter 3 that there was a balance between independence and accountability pre-euro crisis. This balance mainly consisted of high independence with a technical mandate that required lower accountability. As discovered in the previous chapters the role of the ECB has increased. Therefore a higher level of accountability is needed.

The following paragraphs will analyse whether accountability has increased by first discussing the objectives of the ECB. This chapter will then analyse what explanations and statements were given during the crisis and how transparent the Bank was. Furthermore, these paragraphs will discuss the amount of governor dissent. After transparency is discussed the question of final accountability will be discussed. Who can hold the Bank accountable and potentially override the ECB? The following paragraphs will discuss these questions with regard to the ECB and compare them to the FED for context.

8.2. Objectives & Instruments

In chapter 3 of this research the concept of accountability through objectives has been discussed. As argued by Amtenbrink the clearer the objectives and their ranking, the higher the accountability. When considering the euro crisis and the economic fallout from COVID19 there are several aspects to consider. The first is that of the definition of the monetary mandate.

In chapter 6 on the impact of the crises upon the ECB the objectives of the ECB have been discussed. The chapter concluded with overall growth in monetary objectives. This growth has an impact not only on the mandate but also on the accountability of the ECB.

The first and probably biggest impact is that of the economic and monetary entanglement.

In the euro crisis case law, the CJEU accepted the connection of monetary and economic policy. The acceptance of this interdependence theorem makes it more difficult to hold the ECB accountable. Especially with the 'arbitrary' line between the economic and monetary policy that is currently drawn.¹ The CJEU furthermore takes a broad approach to the indirect effects such policies may have.² Though perhaps for indirect effects to be unforeseeable is too stringent a criteria. The CJEU however gives very little grip upon the definition and impact of indirect effects. This decreases the potential for accountability. This increase of vagueness is further aided by the ECB's ability to restore its transmission mechanisms. Though it seems logical that the ECB is allowed to restore its monetary transmission mechanisms it decreases the possibility of accountability. In *Gauweiler* the CJEU however decided that the indirect effects cannot be contrary to price stability.³ The CJEU thereby clearly ranks price stability as the ECB's primary objective. The clear ranking increases accountability, but it has not gone without dispute.

Claeys argues that during the COVID19 pandemic the ECB is at a 'divine coincidence'.⁴ A place where the primary and secondary objectives of the ECB align perfectly. His paper however also points to the situation with the PSPP whereby the BVerfG asked for additional information from the ECB regarding the balancing of external effects. As Claeys argues this balancing act of price stability with potential externalities is where the ECB is weighing up its primary objective against secondary objectives.⁵ In his paper, Claeys warns against the ECB's compliance with the request for information.⁶ The ECB is under the jurisdiction of the European Court, not the German.⁷ The BVerfG's stricter conditionality rules should not apply to the ECB and may threaten its secondary objectives.⁸ In his paper, Claeys concludes by responding to the question of when the ECB is faced with a potential trade-off of primary and secondary objectives. An interesting situation he refers to is that of financial stability.

Claeys refers to the potential trade-off of full employment and environmental challenges.⁹ The ECB, unlike the FED, does not have a dual mandate and therefore it does not seem likely that this will become a big challenge. The ECB may support general economic policy, this policy is however primarily set by the Member States and thereby

¹ Hinarejos 2015, p. 575.

² Weiss, paraf. 62.

³ *Gauweiler*, paraf. 59.

⁴ Grégory Claeys, 'The European Central Bank in the COVID-19 crisis: Whatever it takes, within its mandate' (2020) 9 *Policy Contribution for ECON* 09/2020 Bruegel.p. 6.

⁵ Ibid, pp. 7-8.

⁶ Ibid, p. 8.

⁷ Ibid.

⁸ Ibid.

⁹ Ibid, p. 14.

has democratic accountability. The problems with trade-off can however be observed during the euro crisis.

The ECB's primary objective is that of price stability ex article 130 TFEU. This article also states that the ECB must act in accordance with certain principles. One of these principles is "*favouring an efficient allocation of resources*". The discussion in earlier chapters on the TARGET2 system indicates that the two objectives can conflict. TARGET2 cushioned some of the major economic shocks during the euro crisis. The system however does not favour an efficient allocation of resources and was described as the bailout of uncompetitive economies.¹⁰ The TARGET2 system thereby perfectly shows that the objective and principles are not always in line with each other. Similarly, the design of TARGET2 allows for the growth of debtor and creditor nations during crises. This is arguable contrary to its objective of the "singleness of monetary policy".

With regard to objectives and transparency, the impact of the euro crisis has shown a decrease in accountability. The permitted interaction with economic policy is vague and more difficult to account for than a clear separation. The CJEU, however, reaffirmed that price stability is the ECB's primary objective. Despite this confirmation, this objective has become less narrow as it now includes the restoration of transmission mechanisms as well, without a clear delineation of indirect effects. Reflecting on the work of the De Boer and Van 't Kloosterhuis the origins of this broad mandate is problematic. As discussed in an earlier chapter the ECB mandate seems clear but is not. De Boer and Van 't Kloosterhuis call these the 'authorization gaps' where the Treaties fail to provide clear guidance and leave the choice to the ECB.¹¹ Their article considers that it will be very difficult to provide democratic answers to these gaps.¹² Similar observations are made towards the instruments chosen by the ECB.

The instruments are not clearly defined by the Treaties nor in what order to be used. Originally this was done so the ESCB could respond to the changing nature of financial markets.¹³ De Boer and Van 't Kloosterhuis, however, argue the terms such as adequate collateral and other operational instruments as is seen fit are vague terms.¹⁴ From an accountability perspective, this provides problems. As stated in chapter 4.3.2. it is difficult to conclude whether the letters sent to the various governments and the pressure exerted upon Greece through the collateral lists are legal. The difficulty lies within this gap, whereby the ECB can use the vague terms from its mandate to its own interpretation. To hold the ECB accountable a new framework would have to be

¹⁰ Blake 2018, pg. 36.

¹¹ Boer & Kloosterhuis 2020, p. 3.

¹² Ibid.

¹³ CoG, Draft statutes of the European System of Central Banks and the European Central bank with an introductory report and a commentary, 12/1990, 16.

¹⁴ Boer & Kloosterhuis 2020.pdf, p. 11.

generated or the CJEU would have to accept ECB judgement. Neither of these options generates a high level of accountability.

The euro crisis and the COVID19 pandemic to a large degree indicate the size of the gaps. Thus leading to a need for improved accountability that did not occur with the ECB. The FED on the other hand did see improvements in this regard.

In 2012, just after the first crisis, the FED introduced its “Statement on Longer-run Goals and Monetary Policy Strategy”.¹⁵ This statement specified the FED’s determination to define its price stability policy as near 2%. This objective is less defined than the ECB but has increased the FED’s accountability. Furthermore, the statement says that the policy will be reviewed each year and thoroughly reviewed every five years. This review consequently allows the FED to adjust its aims according to the circumstances. It should furthermore be noted that the FED sees the review to cause “[...] *evolution not a revolution* [...]”¹⁶ Thus the review should not be considered to impact accountability very negatively. This does not mean there has not been criticism of the new system. The first criticism was that of reliability. Stephen Cecchetti and Kermit Schoenholtz argue that the FED has fallen short of their target consistently and is no longer reliable.¹⁷ Arguably fallen short without final consequences.

Interesting to compare between the FED and ECB is the market accountability. In chapter 2 a report from the DNB was considered. In this report, the DNB stated if central banks are too independent of policymakers they might lose their independence to the market.¹⁸ In the Maiden Lane deals the FED was sued by some of the shareholders of Freddie and Fannie. The argument was that the company was being wound down due to the profits going directly into the Treasury’s account.¹⁹ Demonstrating perhaps bigger accountability to the Treasury than the market players. The ECB has been accused of the exact opposite, whereby in its negotiations with Greece it put the big banks’ interests ahead of all else.²⁰ In his, work Stiglitz describes how the ECB avoided the use of Credit Default Swaps to save the large banks.²¹ The independence of the ECB therefore arguably gives rise to further questions as posed by the DNB report. This further indicates a potential lack of accountability.

¹⁵ Federal Reserve System, ‘Statement on Longer-Run Goals and Monetary Policy Strategy’ (effective 24 Jan 2012 and 27 August 2020) < <https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-statement-on-longer-run-goals-monetary-policy-strategy.htm> > [accessed 10 December 2020].

¹⁶ Richard. H. Clarida, ‘The Federal Reserve’s Review of Its Monetary Policy Strategy, Tools, and Communication Practices’ (“Fed Listens: Education, Employment, and Monetary Policy in the Third District” hosted by the Federal Reserve Bank of Philadelphia in Pennsylvania 17 May 2019.)

¹⁷ The Fed’s New Strategy: More discretion, Less Preemption, *Money Banking* 29 August 2020.

¹⁸ DNB Working paper 2016, p. 3.

¹⁹ See section in chapter 4 on Freddie Mac and Fannie Mae

²⁰ Joseph E. Stiglitz, *De Euro. Hoe de gemeenschappelijke munt de toekomst van Europa bedreigt* (Amsterdam: Athenaeum 2016).

²¹ Stiglitz 2016, pp. 182-183.

8.3. Transparency

Transparency is a difficult subject to give a conclusion as research is based upon what is given and it is difficult to assess what information is not given. Transparency has however been a well-debated topic during the euro crisis.

The ECB provides details to the European Parliament in three different ways. It produces an annual report, goes to hearings and Parliamentarians can submit written questions to the ECB. The ECB furthermore appears before the Parliament more than any other Central Bank.²² The ECB also holds regular press conferences to explain its decisions.²³ During the crisis, the ECB has furthermore increased the frequency of its reports and the details contained within the report.²⁴ The seeming increase in transparency during the crisis is not inconsistent with global trends.²⁵ Despite the positive stories, there are also indications for a less bright side.

The ECB has increased its transparency since 1998 from a score of 8.5 to 11. The score of 11 has however been reached in 2004 and remained constant.²⁶ Therefore the argument that the ECB has increased its transparency during the crisis seems void. The data produced by Dincear and Eichengreen indicates that in developed nations central bank transparency has remained stable since 2007.²⁷ The ECB has however achieved a very high score with 11 out of 15, thus its current score is no cause for alarm. Furthermore, as stated before, the ECB has started publishing the minutes of its meetings since 2015.²⁸ These publications increase their ranking of transparency since 2010 by a point. It thus seems that the ECB has a high level of transparency which is increasing rather than decreasing. Additionally, according to a report written by Transparency International EU, the ECB has greatly improved the understanding of data

²² Nicolo Fraccaroli, Alessandro Giovannini and Jean-Francois Jamet, 'The evolution of the ECB's accountability practices during the crisis' (2018) 5 *ECB Economic Bulletin*.

<https://www.ecb.europa.eu/pub/economic-bulletin/articles/2018/html/ecb.ebart201805_01.en.html#toc1>

²³ Ibid.

²⁴ Kerstin Bernoth & Geraldine Dany-Knedlik, 'The ECB's Communication Strategy: Limits and Challenges After the Financial Crisis' (2020) Monetary Dialogue Papers

<https://www.europarl.europa.eu/cmsdata/195429/DIW_final_original.pdf>, p. 16.

²⁵ Transparency International EU, *Two sides of the same coin? Independence and accountability of the European Central Bank* (2016) <https://transparency.eu/wp-content/uploads/2017/03/TI-EU_ECB_Report_DIGITAL.pdf>, p. 27.

²⁶ N. Nergiz Dincer & Barry Eichengreen, 'Central Bank Transparency and Independence Updates and New Measures' (2013) 21 BOK Working Paper <https://media.hotnews.ro/media_server1/document-2013-09-16-15587972-0-bok-13-21-1.pdf>, p. 11

²⁷ Ibid, p. 16.

²⁸ <https://www.ecb.europa.eu/press/accounts/html/index.en.html>

by the public by making use of visualization tools.²⁹ The use of visualization tools may help to promote large-scale understanding but does not add to transparency per se. Naurin considers there is a difference between transparency and publicity.³⁰ Publicity is where the information reaches the audience.³¹ In the case of the ECB, the visualization tools are not increasing transparency but rather aimed at increasing publicity. These tools may improve the European Parliament's ability to understand ECB communication. This may form the basis for improved accountability during monetary dialogue (more in the next paragraphs). In itself, it may however not be an improvement to transparency. The increased understanding may promote publicity and therefore accountability but this is not guaranteed.³²

The first issue when considering transparency is the case of the freezing of the ELA to the Greek financial industry. The ECB had asked a law firm to advise on the legality of this matter. The details of this advice were later requested by Fabio De Masi and Yanis Varoufakis.³³ The ECB responded negatively to this request stating that *"Legal opinions provided by external lawyers and related legal advice are protected by legal professional privilege (the so-called 'attorney-client privilege') in accordance with European Union case law."*³⁴ The ECB argued that *"The disclosure of such legal opinions would undermine the ECB's ability to obtain uncensored, objective and comprehensive legal advice, which is essential for well-informed and comprehensive deliberations of its decision-making bodies."*³⁵ The CJEU agreed with the arguments posed by the ECB.³⁶ It is prudent to allow the ECB a level of confidential decision-making space. Thus keeping the information confidential is not strange and does not decrease the ECB's transparency. It was however not the only document kept secret.

The letters sent to the Irish government were kept secret by both the ECB and the Irish government. Trichet was invited to speak before the Irish Banking Inquiry but denied this request as he did not consider it his task.³⁷ The case went before the Ombudsman who urged the ECB to publish the letters but did not force the institution to. The letters were eventually leaked in 2014 to the Irish press and consequently published. Curtin

²⁹ Transparency International EU, *Two sides of the same coin? Independence and accountability of the European Central Bank* (2016) <https://transparency.eu/wp-content/uploads/2017/03/TI-EU_ECB_Report_DIGITAL.pdf>, p. 31.

³⁰ Naurin 2007, p. 3.

³¹ Ibid.

³² Ibid.

³³ Francesco Canepa & Frank Siebelt, 'EU court shields ECB from disclosing key document in Greek crisis' *Reuters* (Frankfurt 12 March 2019).

³⁴ Letter Mario Draghi to Mr. Fabio De Masi, RE: Your letter (QZ-123), (Frankfurt, 17 September 2015) <https://www.ecb.europa.eu/pub/pdf/other/150918letter_demasi_3.en.pdf>

³⁵ Ibid.

³⁶ ECLI:EU:T:2019:154, paraf. 57.

³⁷ Letter from ECB president M. Draghi to C. Lynch, chairman of the Joint Committee of Inquiry into the Banking Crisis (15 December 2014), available at <http://www.irishtimes.com/news/politics/ecb-letter-full-text-of-correspondence-from-mario-draghi-to-ciaran-lynch-1.2040152>

argues that this secret-keeping keeps the financial recovery programmes out of democratic control.³⁸ Despite the lack of formal parliamentary input, Curtin argues that the transparency of the ECB works as a first-level accountability mechanism. Whereby transparency can institute change from the bottom up.³⁹ Consequently and in line with the new roles, she argues that the ECB should enhance its transparency.⁴⁰ Similar questions arose with regard to the diaries of the governing board. When the diary of ECB president Draghi was requested by a Dutch researcher, the access was denied. The ECB responded it could not provide this information as the agenda was the personal property of the president.⁴¹ The transparency on this account, however, has improved as the agenda of the governors have been made public. Thus increasing transparency.

It thus seems that whilst strides in transparency are made by publishing documents such as the board agenda and minutes. However, there are still important transparency issues concerning policy documents such as the Irish letters.

8.4. Internal Accountability & Governor Dissent

The ECB and the NCBs have been given their independence in article 130 TFEU. The ESCB as part of the European Union should act as an institution promoting the interests of the Union. When decisions are made within the interest of the Union less disagreement between the governors is expected. Certainly, the level of dissent should not present itself along national lines. The NCB governors voting according to the EU rather than national interests seems to be undermined. Berger and De Haan predicted in 2002 that there was too much power for small countries.⁴² This power would grow with the enlargement of the ECB.⁴³

The voting procedure is laid down within article 10.2 of the statutes of the ECB and ESCB. It states that each member of the executive council shall have one vote and the number of governors with voting rights is 15. When the number of governors exceeds 15 but no more than 22, the governors will be categorized into two groups depending on the respective GDP and balance sheets. The first group will be comprised of 5 governors with 4 voting rights and the second will have 11 voting rights. When the number of governors reaches 22 or more they will be categorized into three groups. The first group

³⁸ Deirdre Curtin, 'Accountable Independence' of the European Central Bank: Seeing the Logics of Transparency' (2017) 23(1-2) *European Law Journal*, pp. 40-41

³⁹ Ibid, p. 43.

⁴⁰ Ibid, pp. 43-44.

⁴¹ Edin Mujagic, *Geldmoord. Hoe De Centrale Banken Ons Geld Vernietigen* (4th edn, Balans 2013), p. 139-140.

⁴² Helge Berger and Jakob de Haan, 'Are Small Countries Too Powerful Within the ECB?' (2002) 30(3) *AEJ*, p. 280.

⁴³ Ibid.

will consist of five governors with four voting rights, the second group will be half the amount of total governors with eight voting rights in total, the third group consists of the remaining governors and has a total of three voting rights. Though the system was clearly defined within the statutes it was not enacted until rather late. In 2009 the two-group voting system was meant to come into place with the joining of Slovakia.⁴⁴ The European Central Bank decided, however, to postpone the system and did not start rotation until 2015.⁴⁵ It was considered that “[...] *the benefits of postponement until the number of governors exceeds 18 outweighs the benefits of implementing the rotation system when the number of governors exceeds 15, thereby avoiding the introduction of additional elements of complexity in the transitional two-group rotation system.*”⁴⁶ This citation suggests that the postponement was based (largely) upon reasons of complexity. It however seems that the new system was under more scrutiny than this decision suggests. The change in the voting system has sparked debate within the Parliament. The Parliament rejected the recommendations made by the ECB because it was: excessively complex. Instead, it preferred the ECB to continue with the system of one voting right for each and simple majority decision making.⁴⁷ This system however has been criticized.

In their research Hayo and Méon state that the voting system in the ECB grants a lot of influence to its participating countries.⁴⁸ Their research indicates that compared to the Bundesbank before 1999 and the US Federal Reserve the ECB has a relatively large influence from the regions. The increase in members also causes an increase in regional influence.⁴⁹ They however also argue that decision making is done via consensus. Thereby rendering the discussion on who has the most influence mute.⁵⁰ Theoretically, the system should not matter, if the governors vote in Eurozone interests.

Berger and De Haan’s article argues that the individual governors vote along with national interest (rather than EU).⁵¹ This voting behaviour creates an ECB that is more likely to act in the interest of a group of individual states rather than the Eurozone as a whole. From an accountability perspective, this is difficult. Berger and De Haan stated that this risk is mitigated when the ECB primarily focuses on price stability.⁵² The

⁴⁴ European Parliament 2015.

⁴⁵ European Central Bank Decision (EU) no. 29/2008 of 18 December 2008 to postpone the start of the rotation system in the Governing Council of the European Central Bank.

⁴⁶ Ibid, paragraph 4.

⁴⁷ European Parliament legislative Resolution (EU) no. (6162/2003 - C5-0038/2003 – 2003/0803(CNS) on the recommendation of the European Central Bank for a proposal for a Council decision on an amendment to Article 10.2 of the Statute of the European System of Central Banks and of the European Central Bank.

⁴⁸ Bernd Hayo and Guillaume Méon, ‘Why Countries Matter for Monetary Policy Decision-Making in the ESCB’ (2012) 1 CESifo, p. 22.

⁴⁹ Ibid., p. 23 (table 1).

⁵⁰ Ibid., p. 24.

⁵¹ Berger and De Haan 2002, p. 280.

⁵² Ibid.

COVID19 and euro-crisis have however shown that the ECB is willing to take up a more active role than expected. It took decisions that are no longer unanimous, as was the case under its first president. Disagreement in particular became public over the interest rates, demonstrating the loss of consensus that was present before the crisis. The ECB seemed to favour the smaller states who have more votes than the larger states. The latter is also corroborated by research of Hayo and Méon in 2013.⁵³ This favour might become problematic when COVID19 cases decrease and the limitation or termination of the various programmes are open for discussion. Research indicates that from an economic perspective the best results rise from majority-rule decision making which is weighted in accordance with GDP, rather than federal decision making.⁵⁴ By accepting that the ECB pursues national interests rather than federal interests, changes the political definition of the ECB.

The work of Nugent and Rhinard generates four different definitions of political organs: ideologically political, policy political, organisational political and administratively political.⁵⁵ The current status of the ECB closely fits the second definition of policy political. This definition is used for organisations defining public policy.⁵⁶ The current public policy regarding interest rates is focused primarily on the periphery. However, the opposite can be said when the ECB was acting as part of the Troika. Stieglitz has argued the Troika and austerity were much more towards the interests of the creditors than the debtors. The ECB could have not forced the Irish government to save banks or activate the CDs.⁵⁷ The incorporation of interests however increases the need for accountability.

Despite the criticism on transparency, the intensity of governor dissent has increased. The main criticisms have risen from the Dutch and German central banks. In September 2019 Knot the governor of the Dutch central bank published a statement criticizing the ECB's decision to reinstate the APP programme.⁵⁸ In this statement he considered the restarting of the APP to be unproportioned to the economic climate.⁵⁹ Two years before that he had criticized the interest rates of the ECB. Stating it would be counterproductive in the Netherlands.⁶⁰ His German colleague Weidmann was also critical of the ECB policy. He considered the reinstatement of APP excessive.⁶¹ A statement he has increased

⁵³ Bernd Hayo and Pierre-Guillaume Méon, 'Behind closed doors: Revealing the ECB's Decision Rule' (2013) . pp. 32-33.

⁵⁴ Ibid.

⁵⁵ Neill Nugent and Mark Rhinard, 'The 'political' roles of the European Commission' (2019) 41(2) *Journal of European Integration*.

⁵⁶ *ibid*, p. 206.

⁵⁷ Stieglitz 2016, p. 183.

⁵⁸ Press Release: Klaas Knot comments on ECB policy measures, DNB 13 September 2019.

⁵⁹ Ibid.

⁶⁰ Klaas Knot: Rentebeleid ECB werkt averechts in Nederland *RTL Nieuws* (13 april 2016); a similar point would be brought up by the BVERFG in Weiss.

⁶¹ ECB stimulus excessively large: Weidmann *Reuters* 13 September 2019.

during the PEPP to include a possible transgression into fiscal policy.⁶² It, therefore, seems that there was an increase in the governor's dissent during the euro-crisis and the COVID19 programme. As discussed in chapter 3 this indicates an element of choice in the ECB decision-making. The dissent, however, also increases transparency by bringing forth valid different arguments. Though this argument is not always agreed upon. Winkler argues that when considering transparency in ECB communication 'clarity' is important. Focussing on the public's understanding rather than communicating all information.⁶³ Governor's dissent in this theory would likely not improve clarity as it may seem contradictory and make the public's understanding more difficult. Though clarity may seem important the question is who decides on what is clear? It does not seem in line with democratic principles if the ECB is allowed what information falls under transparency and what does not.

The dissent of the governors shows another issue with the role of the ECB. In chapter four the internal interests of the ECB were discussed. The concern about the ECB's openness to national rather than EU interests was put forward. The concern mainly lies with the voting system of the national governors. The different policy approaches of the ECB did not demonstrate a clear promotion of national interests over time. The recent dissent by the Dutch and German governors in the media suggests a clear preference for national interests. If these governors felt the decision was taken with the interest of the EU, why seek the media in protest?

The dissent of governors is extremely rare according to Horvath et. al.⁶⁴ Their paper furthermore finds that dissent at BoE and the Fed during a crisis is less frequent.⁶⁵ Their research, however, finds that there is no one clear reason why governors dissent. Nor are the factors the same across different central banks.⁶⁶ What is interesting to note is that their research finds that the factors influencing dissent are not always economic.⁶⁷ Hayo and Neuenkirch add to this by considering regional speeches. Their paper finds that in the US the governor's speeches given in their local districts more often includes regional preferences.⁶⁸ This would suggest that the dissents of the German and Dutch governors may have been based upon their regional accountability. Hayo and Neuenkirch however also find that this relationship is stronger for nonvoting governors.⁶⁹ Their paper further theorizes that this relationship is similar in the

⁶² 'ECB's Weidmann warns against largescale bond buys' *Reuters* 30 September 2020

⁶³ B. Winkler, 'Which kind of Transparency? On the Need for Clarity in Monetary Policy-making' (2000) *ECB Working Paper No. 26*, p. 20.

⁶⁴ Roman Horvath et. al., 'The dissent voting behaviour of central bankers: what do we really know?' (2014) 46(4) *Applied Economics*, p. 455.

⁶⁵ *Ibid*, p. 459.

⁶⁶ *Ibid*, pp. 459-460.

⁶⁷ *Ibid*.

⁶⁸ Bernd Hayo and Matthias Neuenkirch, 'Do Federal Reserve presidents communicate with a regional bias?' (2013) 35 *Journal of Macroeconomics*, p. 70.

⁶⁹ *Ibid*.

Eurozone. Allowing governors to speak to their audience without having to dissent from actual decisions.⁷⁰ Taking this into consideration the governor dissent may have been a way to appease the home audience. Even if this is considered to be the reason the dissent from an accountability perspective remains difficult.

The recent dissent indicates an increase in transparency showing the multiple visions upon economic policy. Though therefore the increase in dissent may be considered beneficial for the accountability of the ECB it also raises issues. The criticism from both governors shows the need to appease or speak to their regions. This can be because of economic factors or psychological factors. Both of these indicate the decision making of the ECB oriented towards the periphery. Whereby the orientation is so strong the governors felt pressured to speak either because of concerns of an upset region or because of a strong disagreement. Both reasons demonstrate a need to balance the regional interests with greater accountability to the Eurozone as a whole.

Concluding it seems that the transparency mechanisms of the ECB are not sufficient for its current role. There seems to be a large number of documents that are kept hidden from the public eye. This leaves a large gap in the potential for accountability as it is one of its founding blocks.⁷¹ When we compare the ECB to the FED it seems the transparency of the ECB is truly lacking. During the past years, the FED has increased its publication speed of the meetings to 3 weeks and increased its congressional appearances to four times per year.⁷² This leads to the next question of whether final accountability has functioned well.

8.5. Final-Accountability non-judicial

There are little to no overriding mechanisms in place with regard to the ECB. The accountability mechanism is thereby low. The only overriding mechanism is that of the CJEU which will be discussed in the next few paragraphs. The main form of democratic accountability is however the opportunity for the European Parliament to question the ECB.

The accountability of the ECB is limited and the (individual) board members carry high independence. An example of this independence is the case of the Latvian Central Bank Governor. He was removed from office by the Latvian government on fraud charges. The CJEU however found that national governments could not move to dismiss the Central Bank Governors. It is up to the CJEU to judge whether there is serious misconduct

⁷⁰ Ibid, p. 71.

⁷¹ Mark Bovens, 'Analysing and Assessing Accountability: A Conceptual Framework' (2007) 13(4) *European Law Journal*, p. 453.

⁷² Philadelphia FED>> transparency

qualifying such an action.⁷³ Thereby demonstrating the high level of independence enjoyed by individual governors.

The main non-judicial option to hold the ECB accountable is through monetary dialogue (md) is the space for the ECB to be questioned by the European Parliament. To examine if the monetary dialogue has been efficient its effectiveness during the crisis must be evaluated. Collignon and Diessner researched the role of md during the euro crisis and found its role to be limited.⁷⁴ Their research argues that the parliament did not show an appropriate risk assessment throughout the crisis years.⁷⁵ The ECON committee members on the other hand performed better in asking questions. The participation committee members from euro-area countries were 79%.⁷⁶ The study however found that 55% of the members did not find the md made a difference in the management of the euro crisis and only 25% found it did.⁷⁷ The respondents additionally were the more active group of members. Thereby making it likely the number of no difference is higher. This indicates that there are some significant flaws within the md. To make them effective the participation should be higher and perhaps so should the impact on the decision-making of the ECB. The study finds that the most important partner is not the parliament but rather ECOFIN. However, only a minority of 30% find that the parliamentary input is not taken on board by the ECB.⁷⁸ This indicates that md has not been functioning at an optimum level. On the other hand, research conducted by Fraccaroli, Giovannini and Jamet argues a form of compensation. In their research, they argue that the number of questions submitted orally by MEPs is regulated.⁷⁹ The ECB, however, organized various additional exchanges of view. These are evidenced by the ECON hearings and the in-camera exchange of views in 2011 and 2012.⁸⁰ The limited engagement with md is thus compensated by the additional hearings. The accountability to the Parliament, therefore, seems to be complemented with additional occasions beyond md. The question is whether these are effective. The research of Collignon and Diessner shows that the problem with md is not the frequency but the level of participation. The ECON members were considered more likely to ask questions during md.⁸¹ The additional ECON hearings, therefore, increase the accountability levels, as it is likely there was high participation. It is questionable if the in-camera exchange of views has the same effect. It, therefore, seems that the effectiveness of Parliamentary accountability is open for improvement. This indicates that with the increased role of the ECB post-crisis and the limited accountability to the European Parliament the

⁷³ Case C-202/18 and C-238/18 *Ilmārs Rimšēvičs v. Latvia* [2019] ECLI:EU:C:2019:139.

⁷⁴ Stefan Collignon & Sebastian Diessner, 'The ECB's Monetary Dialogue with the European Parliament: Efficiency and Accountability during the Euro-Crisis?' (2016) 54(6) *Journal of Common Market Studies*.

⁷⁵ *Ibid*, pp. 1305-1306.

⁷⁶ *Ibid*, p. 1307.

⁷⁷ *Ibid*, p. 1308.

⁷⁸ *Ibid*, p. 1309.

⁷⁹ Fraccaroli, Giovannini & Jamet 2018, p. 59.

⁸⁰ *Ibid*.

⁸¹ Collignon & Diessner 2016, p. 1307.

balance is upset. It is, however, too early to conclude this. Attention must first be paid to Petit's research findings.

Petit finds that the number of written questions significantly increased after 2014.⁸² The ECB's annual report of 2015 shows that the questions asked by MEPs increased. In 2009 there were only 10 questions, in 2015 this had increased to 179.⁸³ This increase suggests that the accountability of the ECB improved after the euro crisis. Thus suggesting that despite the inadequacies that may have existed during the euro crisis, accountability has improved shortly after. To test this theory it is necessary to examine the question development after the euro-crisis and during the pandemic. The information on how many questions addressed is a little scattered over the ECB's annual report and the Parliament's website. A clear transparency improvement is to bundle the questions and answers to one page. When examining the different reports the observations are as follows. In 2016 the number of questions asked at hearings was a little over 100.⁸⁴ The main area of interest was the monetary policy and the macroeconomic adjustment programmes received only 6 questions.⁸⁵ The ECB furthermore replied to 77 written questions from MEPs.⁸⁶ These included various topics including questions on monetary policy and unconventional measures.⁸⁷ In 2017 the ECB replied to 58 written questions⁸⁸ and 138 questions in a total of which 53 were written to the ECB.⁸⁹ This number decreases over 2018 to 36 letters from MEPs⁹⁰ and 28 in 2019.⁹¹ This is a significant decline from 159 and over 100 in 2015 and 2016. This however supports the idea of intensified scrutiny during times of unconventional policy. The APP was introduced in mid-2014, hence a decline in questions over 2017 and beyond is understandable. To confirm whether monetary dialogue improved, the number of questions submitted in 2020 especially just after March, June and December and 2021 should increase. This would confirm extra questions just after the introduction of new ECB measures. In 2020 73 questions were asked from the Parliament to the ECB.⁹² This is in itself a significant increase from the 28 in 2019. The highest amount of letters were received in March, June and November, with 18 in March and June and November respectively per month 12.⁹³ March and June coincide with the introduction and increase of the PEPP. On March 20th of 2020, the ECB was asked to clarify its role in the pandemic by Fitto and other

⁸² Christy Ann Petit, 'Balancing independence with accountability: A third-metre waltz?' (2019) 26(1) *Maastricht Journal of European and Comparative Law*, p. 30.

⁸³ ECB Annual Report 2015, p. 91.

⁸⁴ ECB Annual Report 2016, p. 94.

⁸⁵ Ibid.

⁸⁶ Ecb.europa.eu >> Publications on international and European Co-operation.

⁸⁷ Ibid.

⁸⁸ Ibid.

⁸⁹ ECB Annual Report 2017, pp. 99-100.

⁹⁰ ECB Annual Report 2018, p. 97.

⁹¹ ECB Annual Report 2019, p. 93.

⁹² As per document search on European Parliament Document Repository.

⁹³ Ibid.

MEPs.⁹⁴ After the introduction of the PEPP on the 24th of March 2020, no questions related to the unconventional programme were asked. The most related was a letter by Simon which covered the side-effects of the PSPP.⁹⁵ This letter was however sent on 02 June, rather than a direct response to the introduction of PEPP. The PEPP was responded to with questions but this not with the level of engagement one might hope. MEP Tang and others responded to the PEPP but only in relation to climate goals.⁹⁶ Devesa, in response to a newspaper article, asked the ECB to confirm it would continue with PEPP.⁹⁷ The most scrutiny from the Parliament occurred via a letter from Ferber. His letter however did not address the PEPP but the TLTRO III programme.⁹⁸ One question came in after the increase in the volume of the PEPP on June 4th, but even this question remained superficial.⁹⁹ Despite the numerical coincidence that indicates the improved functioning of md, the questions themselves argue otherwise. This is disappointing and the cause of which is difficult to precisely define. Most of the ECON members have not uploaded their resumes. Of those who did only two were unqualified to discuss economic affairs, six members had a background in business, economics or finance and another 6 had a background in European Law and/or affairs.¹⁰⁰ It, therefore, seems that the ECON members are largely qualified to ask the ECB difficult and/or precise questions. The md, therefore, remains open to improvement concerning accountability, not the only mechanism that can be improved.

Dermine argues that in the crisis the accountability mechanism related to financial support remains open to improvement. The ECB could only be held accountable by ECON through economic dialogue. As argued in Dermine's research this happened twice.¹⁰¹ Dermine further shows Draghi and Trichet refused to appear for the Irish Parliament. And the ECB refused to cooperate with the ECA's investigation.¹⁰² Dermine concludes that either the ECB should withdraw from the newly gained territories or

⁹⁴ Question for written answer Z-018/2020 to the European Central Bank Rule 140 Raffaele Fitto (ECR), Sergio Berlato (ECR), Carlo Fidanza (ECR), Pietro Fiocchi (ECR), Nicola Procaccini (ECR), Raffaele Stancanelli (ECR).

⁹⁵ Question for written answer Z-036/2020 to the European Central Bank Rule 140 Sven Simon (PPE)

⁹⁶ Question for written answer Z-040/2020 to the European Central Bank Rule 140 Paul Tang (S&D); Question for written answer Z-050/2020 to the European Central Bank Rule 140 Marie Toussaint, David Cormand, Grace O'Sullivan, Bronis Ropé, Ville Niinistö, Tilly Metz, Bas Eickhout, Saskia Bricmont, Henrike Hahn, Anna Cavazzini, Margrete Auken, Kira Marie Peter-Hansen, Ernest Urtasun, Alice Kuhnke, Jakop G. Dalunde, Pär Holmgren, Ciarán Cuffe, Monika Vana, Mounir Satouri, Damien Carême, Yannick Jadot, Michèle Rivasi, Karima Delli, Caroline Roose, Salima Yenbou, François Alfonsi, Benoît Biteau, Gwendoline Delbos-Corfield, Claude Gruffat, Jutta Paulus, (all Verts/ALE)

⁹⁷ Question for written answer Z-048/2020 to the European Central Bank Rule 140 Domènec Ruiz Devesa (S&D)

⁹⁸ Question for written answer Z-053/2020 to the European Central Bank Rule 140 Markus Ferber (PPE)

⁹⁹ Question for written answer Z-057/2020 to the European Central Bank Rule 140 Manon Aubry (GUE/NGL)

¹⁰⁰ Via cv research uploaded to the ECON website.

¹⁰¹ Dermine 2019, p. 118.

¹⁰² Ibid, p. 118-119.

increase its accountability levels.¹⁰³ The newly gained territory, however, does deserve further attention.

With regard to the changing role of the ECB, the concept of New Intergovernmentalism was discussed. This idea describes the process of integration through delegation to *de novo* bodies. The relevance of this theory with regard to the COVID19 pandemic seems limited. It is however relevant to changes in the role of the ECB with regard to the euro crisis.¹⁰⁴ Regarding accountability, some of the observations made by Puetter are relevant to discuss.¹⁰⁵ Puetter describes the evolution of the Eurogroup which is chaired by the ECB. In this group, the case of the Irish budget in 2001 was discussed.¹⁰⁶ There is further evidence indicating an in-depth discussion of Member State finances within the Eurogroup.¹⁰⁷ No publications have been made from before 2015 and no evidence can be found from discussion of the letters or the unconventional policy of the ECB. It is, however, highly unlikely these were not discussed to one degree or another. The ECB may not have discussed the actual letters but it seems unlikely the situation of Ireland, Italy and Spain were not part of the agenda. The previous statement is based upon the discussion of the Greek situation.¹⁰⁸ The Eurogroup furthermore discussed the PEPP.¹⁰⁹ These discussions are relevant so far that it means the topics were discussed by the ministers of finance of the Eurozone. Since these meetings included the ECB there is an impact on the accountability of the ECB. The ECB is discussing these topics with the appropriate ministers of finance. Thus the ECB has an ex-ante opportunity to discuss certain discussions with the democratic representatives. Though this does increase informal accountability it also raises further issues. Firstly these meetings are informal and statements are published rather than minutes. This makes it difficult to evaluate the extent of democratic input. Especially considering that the ministers hold no power over the ECB. Secondly, this democratic deliberation is kept from the public eye, thus decreasing the level of transparency. Thus despite the Eurogroup in theory adding to the democratic accountability of the ECB decision making it remains out of sight. This makes it difficult to truly consider it an improvement of accountability. This is non-transparent process is especially interesting in comparison to the FED.

The FED's pandemic programmes were partially based upon the CARES Act. This act ensures cooperation between the Treasury and the FED. The programmes are partially

¹⁰³ Ibid, pp. 120-121.

¹⁰⁴ See chapter 6 for further elaboration

¹⁰⁵ Uwe Puetter, 'Governing informally: the role of the Eurogroup, EMU and the Stability and Growth Pact' (2004) 11(5) Journal of European Public Policy.

¹⁰⁶ Ibid, pp. 856-866

¹⁰⁷ Eurogroup Press Release, 'Eurogroup Statement on the Draft Budgetary plans for 2016' 23 November 2015

¹⁰⁸ Eurogroup Press Release, 'Eurogroup Statement on Greece' 30 November 2020.

¹⁰⁹ Eurogroup Press Release, 'Report on the comprehensive economic policy response to the COVID19 pandemic' 09 April 2020.

funded by the Treasury and the eligible assets are carefully defined in the act.¹¹⁰ This is a rather stark contrast to the ECB who chose its eligible assets. The Act furthermore ensures the applicability of article 13(3) Federal Reserve Act. This crisis act was also used during the financial instability and ensures oversight. The Act states that lending under those provisions must be done in consultation with the Treasury. It furthermore requires the FED to provide adequate reporting to Congress and the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives. The supervision of the FED is thereby much higher. Prior to enacting financial schemes it has to consult with the Treasury and ex-post it has to report to Congress. The resulting dialogue between the FED and the elected officials is more elaborate than that between the ECB and EU Parliament. An interesting example is that of the COC Report on the MLF.

The Fifth Report of the Congressional Oversight Committee is detailed.¹¹¹ The report is around 200 pages in length and contains various opinions of different senators. Additionally, the chair of the FED and the Treasurer provide their input in the discussions. The report and discussions are rich in detail. The discussions cover potential legality issues,¹¹² but also detailed discussions about the number of loans granted and the effect on employees.¹¹³ It can thus be stated the detailed reports with various discussions and opinions provides a higher level of dialogue than the ECB's md. The smooth functioning of the oversight is further evidenced by Waller.

In his research, Waller argues that the appearance of the FED before Congress was a lot higher during the financial insecurity.¹¹⁴ In the years 2007, 2008 and 2009 the appearances became increasingly frequent. This reduced again significantly in 2010.¹¹⁵ Thus demonstrating an increase in oversight during periods of financial instability. On the other hand, it is also considered that some of the questions are largely irrelevant and politicians use them to gain the FED's general support.¹¹⁶ Other issues that arose during the financial instability were those related to the lack of auditing.

As with the ECB, the FED acted in an unprecedented matter during the financial instability. The legality of its actions was questioned in academic papers but could not be audited. Emerson states that the FED used its partially private nature to evade the law and auditing would ensure the FED to stick closely to the law.¹¹⁷ The request for increased oversight and transparency became so large that Bernanke requested a

¹¹⁰ Section 4003 CARES Act 2020.

¹¹¹ Fifth Report of the Congressional Oversight Commission 2020.

¹¹² Ibid, p. 31.

¹¹³ Ibid, p. 34.

¹¹⁴ Waller 2011, p. 300.

¹¹⁵ Ibid.

¹¹⁶ Karl Whelan, 'Accountability at the Fed and the ECB' (2020) Monetary Dialogue Papers, p. 14

¹¹⁷ Chad Emerson, 'The illegal actions of the Federal Reserve: An analysis of how the nation's central bank has acted outside the law in responding to the current financial crisis' (2010) 109(1) *William & Mary Business Law Review*, pp. 136-137

general audit of the FED's actions related to AIG.¹¹⁸ Transparency and accountability through an audit, however, remained a problem.¹¹⁹ In 2019, however, Congress adopted an act mandating a general audit of the FED.¹²⁰ Thereby increasing the transparency and accountability of the FED. The balance between accountability and independence of the FED thus seems to move towards accountability. Its independence is significantly decreased by introducing specific and detailed acts for the basis of its crisis response. Whilst on the other hand accountability is increased during the crisis. The ECB so far seems to move in the opposite direction. Whilst its mandate increased its accountability did not increase by much (only its transparency). Additionally, the accountability mechanism of parliament seemed to be failing during the euro crisis.

8.6. Conclusions

This research asks the question of whether the role of the ECB has changed during two different crises, thereby upsetting the balance between independence and accountability. This chapter contributed to the answering of this question by analysing the level of accountability. It did so by looking at objectives, transparency and final accountability. These were identified in chapter 3 as the three main themes when considering accountability.

The first theme that of the objectives indicates problematic results. The objectives of the ECB has increased throughout the euro crisis and these are (partially) reaffirmed within the COVID19 response. The increase of objectives makes accountability difficult. First of all, there is no clear answer to what can be done in case of conflict between its primary goals. Secondly, the broad nature of the goals makes the (judicial) review more difficult. The increased objectives also enable the ECB to influence economic policy more strongly. Thus warranting larger accountability than currently available. Similarly, the instruments are described as rather vague and give the ECB a large amount of discretion. Thus making accountability more difficult as the interpretation of the vagueness was deliberately given to the ECB. This provides the ECB with the flexibility to respond to changing market circumstances but also make for very limited accountability.

The second theme that was discussed is that of transparency. This research concludes that pre-crisis the level of transparency of the ECB was rather high (11 out of 15). During the crisis, the transparency of decision-making has come under pressure. The ECB was unwilling to publish the letters sent to various governments. It does not seem to impact the transparency of the ECB that the legal advice is kept internal. To keep the letters, agenda of the president and many documents of the ECB confidential, however,

¹¹⁸ Federal Reserve System letter Ben S. Bernanke 20551 to Gene L. Dodaro 19 January 2010.

¹¹⁹ James E. Kelly, 'Transparency and Bank Supervision' (2010) 73(421) *Alb. L. Rev.*, p. 445.

¹²⁰ H.R.24 – Federal Reserve Transparency Act of 2019

decreases the (perceived) ECB transparency. These documents were however published later thereby increasing the transparency. This transparency issue however remains to a large degree. For example, the democratic input to policies of the ECB is likely increased by the Eurogroup. However, the informality of this group and lack of clear minutes makes it difficult to assess the role of this group in ECB decision making. The third theme that was discussed in this chapter is that of final accountability.

The main accountability mechanism of monetary dialogue did not function as well as it should have during the crisis. The monetary dialogue seemed to improve after 2014 but this has not persisted into 2020 and onwards. Combining the light level of review and the lack of non-judicial accountability with the changing nature of the increased role of the ECB during a crisis this likely have shifted the balance between independence and accountability. This will be discussed in the conclusion in the next chapter.

9. Conclusion: has the role of the ECB during the crises changed the balance between independence and accountability?

This research asked the question of whether the ECB's actions in response to the euro crisis and the economic fallout from the COVID19 pandemic upset the balance between independence and accountability. The reason to investigate this question was the increased criticism upon the ECB's actions leading to two of its actions challenged in front of the European Court of Justice. This research decided to compare to the FED to provide context to the actions taken by the ECB. To answer this question this research discussed the historical development of central banks and explained the concepts of independence and accountability of the ECB and the FED.

The definition of independence has been changed from the definition used by economists. Economists consider a narrower mandate as higher independence. This level of independence legally warrants less accountability. Independence in this research is thus considered as the type of role of the ECB. Whereby a more narrow (monetarist) role warrants less accountability than a broad and more active role. Accountability has been defined using the work of Amtenbrink and includes judicial review.

This research then continued by analysing the actions taken by the ECB during both the euro-crisis and the COVID19 pandemic. This has been assessed against the role of the ECB and its impact on its independence. Last but not least this research has assessed whether the accountability of the ECB has changed during the last decade. This conclusion will provide a final assessment to the question of *whether the ECB's crisis response measures have upset the balance between independence and accountability?* This assessment is structured the same as the research, starting with an analysis of central bank development and its independence.

The second chapter of this research discovered that there are several theories as to how central banks developed. Whereby the MFB school of thought is highly critical of central banks arguing they cause inflation as part of the government's taxation without legislation. This thought warrants a high amount of accountability. Whereas the FBS focuses more on trade improvements due to central banks. This trade improvement flows forth from private sector developments. This seems reflected in the story of the De Nederlandsche Bank, which developed as a bank of banks starting with currency exchange. This type of bank development is arguably more technical and warrants less accountability. The further interesting development is that of the Bank of England during the Overend-Gurney panic. During this crisis, the "Bagehot principles" were developed. This doctrine states that central banks should lend to solvent institutions against a penalty rate. This doctrine is again very technical, solvency and penalty rates are matters

of economics and warrant little accountability. Fast forward to modern central banks, an important doctrine becomes CBI.

The research of CBI has had a large impact on the design of central banks. The theory states that the more independent the bank the lower inflation. Most modern central banks incorporate this theory to a lesser or larger extent. The theory of CBI has however been developed further. Later research included that central bank independence is a factor but well-functioning institutions are also important. Campillo and Miron argue that the more important factor is that of checks and balances. Whereby the parliament, journalism and other balances have a more important role than legal independence. The second larger impact upon the shape of central banks is that of inflation. Most central banks have been designed to control inflation to prevent hyperinflation or a deflation trap. Though what level of inflation is ideal it is commonly agreed that zero to a little inflation is the best policy. In practice, this has given shape to different types of central banks. Some are very independent and have this independence ingrained in the constitution, such as the South African Central Bank. Some however are less independent such as that of the US FED and the German Bundesbank. Though the Bundesbank was considered highly independent all it would have taken is a simple act of legislation. The FED on the other hand is not considered very independent and has a dual mandate to warrant higher dependence. The FED is interesting as it has both the inflation (technical) mandate as a more social and open mandate of full employment. No central bank was however as independent as the ECB, who through its Treaties reached new heights of independence. This leads to the question of exactly how independent the ECB is and how it combines with its accountability.

The third chapter of this research has defined accountability using the general framework of Amtenbrink. The accountability was split into three different themes. The first theme was that of the mandate (narrow is more accountability). The second is that of transparency which is considered a founding block of final accountability. The third theme is that of final responsibility which includes overriding mechanisms. Unlike Amtenbrink this research included the judicial review. During the euro crisis, several cases occurred where the CJEU was asked for a verdict. This shows the increased role of the CJEU. Concerning the ECB pre-euro-crisis, it was concluded that there was a balance between accountability and independence. There was low accountability but the balance was kept by the highly technical and narrow mandate of the ECB. A mandate as seen in chapter 2 developed from the monetarist idea of technical central banks. The US FED also kept a balance between independence and accountability with its broader mandate and higher accountability. This was more based upon the Keynesian idea whereby monetary and economic policy is intertwined. The conclusions were made after corrections made for the difference in economic and legal understanding of independence. This chapter argued that the ECB developed rather like the idea of the FBS where the mandate was highly technical. Rather than that of MBS which focussed

on the political interference with monetary policy. This technicality allowed for low accountability but also indicated that if the ECB would increase its role it would easily upset the balance between accountability and independence. Which was a difficult beginning for a central bank whose function was not yet fully known.

In the fourth chapter, we see the ECB developing in its response to the crisis. The crisis response was primarily reflected through unconventional policies. The impact was, however, also noticeable on its conventional policies. The interest rates were lower, leading to the negative and its payment system TARGET2 saw a serious increase in its balances. These changes compared to the conventional policies of the FED appear slightly more extreme. Unlike the FED the ECB's interest rates became more volatile and its payment balances increased. This extremity is less when comparing unconventional policies. In this case, both banks seem to have made interesting choices.

The ECB has responded to the crisis using pressure upon nations to adjust their fiscal policies. The ECB used to access liquidity and collateral lists as leverage to force compliance. This usage is unprecedented and the legality is not without discussion. Additionally, the mandate of the ECB was increased via the ESM Treaty. This Treaty provided the ECB with the role of co-negotiator in aid assessment for ESM members in need. The ECB furthermore created its OMT Programme. This programme consisted of buying member state bonds if they complied with a financial aid programme. Though never implemented, the OMT was brought before the CJEU and considered legal. There was however disagreement between the CJEU and the AG about the ECB's role. The AG considered it unlawful for the ECB to continue as a combined negotiator and observer of potential financial agreements. The CJEU did not go into detail regarding this issue. This indicates the first accountability issue, whereby the AG finds a review necessary but the CJEU does not. The ECB's mandate further came to include large asset purchasing programmes through the *Weiss* case. Though this type of action is within most central banks' mandate it was previously considered unimaginable for the ECB to conduct. The role of the ECB during the financial crisis further grew through the SSM. This mechanism provided the ECB with the task to supervise banks.

Similarly, the FED took unprecedented actions which led to debates about its legality. The use of special-purpose vehicles was considered, by many, illegal and even the chairman of the FED stated it did not form a blueprint for the future. This indicates that though the ECB may have increased its mandate and pushed its boundaries, it was not the only bank to do so. The extraordinarily nature of the crisis circumstances pushed many banks to their limits. The ECB may have a wider mandate after the crisis but this was due to circumstances. It is doubtful whether the euro would have survived without ECB intervention. It does however raise questions as to how this new role compares to accountability. Before however making statements in this regard it is important to first discover the role the ECB gave in response to the COVID19 crisis.

During the COVID19 crisis, the ECB took several actions to respond to the economic fallout. It increased liquidity and started a large asset purchasing programme called PEPP. This response was larger and was installed more quickly than its APP in response to the euro crisis. Thus showing the ECB is willing to respond to economic unrest. The programme was different from the euro crisis as it included Greek bonds and more short-term assets. Thus showing the ECB's will to fight the short term effects of the economic fallout. The quick response of the ECB reaffirms some of the measures taken by the ECB during the euro crisis. Despite the large programme, the response of the ECB appeared more conventional. The size and inclusion of short-term assets gave rise to some debate around the PEPP. The debate focussed on whether the size would lead to a circumvention of articles 123 and 125 TFEU. The debate was however not focussed nor as urgent as that surrounding the Troika and the letters. In these cases, the ECB's decisions were much clearer entangled in economic policy. Decisions were taken that were more political. The discussion on the legality of the PEPP is more technical and only becomes an issue if the ECB lets go of certain safeguards and its capital subscription key. The difference in response may have been due to the different nature of the economic disruption. The euro crisis was economically more complex as its origins and economic needs differed per country. The economic fallout due to COVID19 was more universal than that of the euro crisis. The response of the ECB may have differed for this reason. It is thus not possible to state whether they permanently left behind the negotiation on fiscal policies. The ECB still has the capacity to conduct such negotiations. For the role of the ECB, this means that it has increased, thus creating a larger need for accountability.

The need for accountability increased because of the increased mandate. As seen in chapter 3 the balance between mandate and accountability was fragile. Largely based on the assumption of a technical and narrow mandate. With the mandate increased there is a need to increase accountability. This research decided to include a judicial review as accountability. The CJEU was not considered a form of accountability in many earlier discussions. The recent cases of *Gauweiler* and *Weiss* however indicated that the CJEU is used as a final accountability mechanism. Considering the increased appeal to the CJEU this research included the judiciary as part of accountability.

The CJEU is not the most efficient means of accountability for various reasons, it is costly, timely and has the potential to harm ECB credibility. During the euro crisis, the CJEU was however called upon to act as a final accountability mechanism. The CJEU's level of judicial review is, however, limited. The CJEU did not engage with the ECB's economic arguments and gave the ECB a wide margin of discretion in both fact-finding and decision making. Criticism was given on this level of judicial review as some argued it rendered judicial scrutiny moot. It is not the role of the CJEU to review the contents of monetary policy nor is the CJEU capable to do so. The CJEU is a difficult accountability mechanism but the limited approach currently taken does not compensate for the

limited accountability of the initial design of the ECB. The question, therefore, became whether other forms of accountability had been introduced or improved. Chapter eight analysed the effectiveness of accountability. Furthermore, it was discussed whether new accountability measures had been introduced.

The accountability was discussed in three themes that were developed in chapter three. These themes included objectives, transparency and final accountability. This research concluded that the objectives were increased over the course of the crisis to include the singleness of the Eurozone and the restoration of monetary transmission channels. The transparency of the ECB underwent some positive improvements via publication of the agendas, governor dissent and publishing minutes of the meetings. The ECB has furthermore incorporated visual tools to improve the public understanding of its decisions. Other improvements in transparency are the included communication to the public. Despite these improvements, serious issues remain. The ECB has improved transparency but it is questionable whether this is enough. Especially because transparency is necessary for accountability but is not a stand-alone mechanism for accountability by itself. Transparency is the building block to final accountability. This led to the question of the effectiveness of final accountability. This type of accountability is where the ECB is held accountable for its actions to other EU institutions. The main form of accountability is that of the monetary dialogue with the European Parliament. The monetary dialogue with the European Parliament was not as effective during the euro crisis as one may have wished for. The dialogue cannot override decisions taken by the ECB and the interaction was low during the crisis. Even though Petit's article saw some improvement over 2015 and 2016, the article concludes it was not enough to balance independence and accountability.¹ This is particularly troublesome during a crisis where unconventional measures are taken. The COVID19 pandemic response further showed that the questions submitted statistically indicated an improvement of md, practically did not improve scrutiny. Compared to the FED this result is particularly worrisome as the FED did increase its appearance before congress. The appearances furthermore indicated a high level of in-depth engagement of congress. Additionally, this research has observed that the FED's accountability with this regard is higher as its policies are primarily based upon acts of Congress responding to the crisis. These acts include congressional oversight. Additionally, Congress was able to improve accountability using an act of Congress.

Unfortunately, accountability has not significantly increased. The main increase was in transparency which is important but the improvements go hand-in-hand with various transparency issues. Furthermore, the main form of accountability, that in front of the Parliament, was not considered effective. The effectiveness of md seems to go up in 2015 and 2016, but when examining the questions in later years the effectiveness is not

¹ Christy Ann Petit, 'Balancing independence with accountability: A third-metre waltz?' (2019) 26(1) Maastricht Journal of European and Comparative Law, p. 33.

permanent. During the COVID19 crisis, the number of questions was relatively low and primarily focussed on other topics. The ECB crisis response has therefore upset the balance between independence and accountability.

In future research, more focus should be placed upon increasing means of accountability. Whether the crisis response is the only or main reason for the increased judicial review is difficult to say. The accountability during the crises proved ineffective and the CJEU was perhaps the last and only resort. However, important as well is that the ECB was created as the most independent central bank ever. With its independence founded in Treaties and very limited accountability, the Eurozone experimented. It is fair to say that this experiment failed and the ECB should lose some of its independence. The crisis response is however not the only cause for such a conclusion. As argued in chapter three more attention is paid to different ways to keep prices stable. Such as a system of checks and balances on monetary policy rather than plain independence. Additionally, Stiglitz argues that independent central banks did not perform better during the crisis.² Hence showing that the more independence does not equal the more efficient the outcome. Furthermore, there are pressures upon central banks to absorb some social goals in their policies. Though this is still in the early stages it is reflected in the ECB's decision to include climate goals as part of its strategy. Furthermore, the ECB has opened the dialogue to further developments such as central bank digital currencies. If the ECB is to perform a larger role during financial crises and contribute to reaching social goals, it is wise to introduce checks and balances and increased accountability to its (monetary) decisions. The alternative would be for the ECB to return to a strict monetarism interpretation of its mandate. The latter seems unrealistic based upon the recent ECB strategy review³ and undesirable.

² Joseph E. Stiglitz, *De euro. Hoe de gemeenschappelijke munt de toekomst van Europa bedreigt* (Amsterdam: Athenaeum 2016), p. 180.

³ The ECB's monetary policy strategy statement, 08 July 2021
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