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The Evolution of the European Central Bank

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1. Introduction

The European Central Bank (ECB) is a central bank whose array of functions and jurisdictional domain are determined by a Treaty instrument, the Maastricht Treaty. Following the adoption of the Lisbon Treaty, the treaty governing the ECB is now the Treaty for the Functioning of the European Union (TFEU).² This distinctive feature makes the ECB a unique institution amongst central banks.

The ECB is the monetary authority in those Member States of the European Union that have adopted the euro as their single currency. The euro area or eurozone comprises the EU Member States whose currency is the euro and in which a single monetary policy is

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² The term European Union was formally introduced by the 1992 Treaty on European Union (the so-called Maastricht Treaty), whose Article A stated that the Union was founded on the three existing European Communities, supplemented by the policies and forms of intergovernmental cooperation established in the [Maastricht] Treaty (common foreign and security policy and co-operation in the fields of justice and home affairs). Article G of the Maastricht Treaty renamed the European Economic Community as the European Community: “Throughout the Treaty the term European Economic Community shall be replaced by the term European Community”. (As acknowledged, the EEC was one of the three European Communities established by Germany, France, Italy, Belgium, Luxembourg and the Netherlands in the 1950s; the other two being the EURATOM or European Atomic Energy Community and the European Coal and Steel Community). The 1997 Treaty of Amsterdam amended both the EC Treaty and the Treaty on European Union and renumbered both. The Treaty of Nice signed on 26 February 2001 further amended the Treaties. The treaty of Nice entered into force on 1 February 2003. The consolidated version of the Treaty establishing the European Community (EC Treaty) and of the Treaty on European Union (EU Treaty), incorporating the amendments made by the Treaty of Nice, is to be found in the Official Journal of 14 December 2002 (No. C 325). The complex and intricate structure of the European Union makes it difficult some times for legislators and commentators to make the correct distinctions. The Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community was signed at Lisbon, on 13 December 2007. The Lisbon Treaty came into force on 1 December 2009 with some provisions taking effect at a later date. It amends, but does not replace, both the Treaty on European Union (formerly known as the Maastricht Treaty) and the Treaty establishing the European Community (formerly known as the EC Treaty or Treaty of Rome and now known as the Treaty on the Functioning of the European Union (TFEU), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:en:PDF> [visited 15 February 2012]).

conducted by the ECB. The current members are: Belgium, Germany, Greece, Spain, Estonia, Ireland, France, Italy, Cyprus, Luxembourg, Malta, the Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland.

The ECB is the centrepiece of the European System of Central Banks. The ESCB has a dual structure with the European Central Bank (ECB) at the centre, headquartered in Frankfurt, and the National Central Banks (NCBs) at the periphery. Since not all member states have adopted the euro as their single currency, a distinction is made between the ‘ins’ and the ‘outs’. According to its own website, ‘the ECB was established on 1 June 1998 in Frankfurt am Main as the body at the centre of the European System of Central Banks (ESCB) and the Eurosystem. Together with the national central banks of the EU Member States whose currency is the euro, the ECB defines and implements the monetary policy for the euro area. Since the entry into force of the Treaty of Lisbon on 1 December 2009, the ECB has been an EU institution’.³ While the ESCB is defined in the ECB website as ‘the central banking system of the European Union’,⁴ the Eurosystem is defined as ‘the central banking system of the euroarea’.⁵ This differential jurisdictional domain is the source of tensions and conflicts, which are explored in this paper. From the institutional and legal perspective, though, what counts is the ECB and the NCBs. Only the ECB and the NCBs have legal personality, powers to sue and to be sued.

According to Article 3(4) TEU, ‘The Union shall establish an economic and monetary union whose currency is the euro’. The Union’s monetary policy is the monetary policy of the Member States whose currency is the euro. Article 282 (1) TFEU is clear in this regard: ‘The European Central Bank, together with the national central banks of the Member States whose currency is the euro, which constitute the Eurosystem, shall conduct the monetary policy of the Union’.

This article surveys first the functions and objectives of the ECB and pays special attention to the increasing emphasis given to the goal of financial stability, a goal that was somewhat neglected when the ECB was created. The article also considers the complex structure of the ESCB, the status of independence and accountability and the challenges the institution

³ <http://www.ecb.int/home/glossary/html/glosse.en.html#190> [visited 15 February 2012].

⁴ <http://www.ecb.int/home/glossary/html/glosse.en.html#197> [visited 15 February 2012]. The ESCB comprises the ECB and the national central banks of all EU Member States (but the national central banks of EU Member States whose currency is not the euro are not involved in the conduct of the Eurosystem's monetary policy for the euro area because they retain responsibility for monetary policy under national law).

⁵ <http://www.ecb.int/home/glossary/html/glosse.en.html#198> [visited 15 February 2012].

currently faces in the light of the sovereign debt problems in Greece and other Eurozone member states. Like all EU institutions, the ECB has evolved since its inception and continues to evolve.

2. Objectives and functions of the ECB

In order to understand the functions and objectives of the ECB (and the key provision is Article 127 of TFEU), it is useful to revise the evolving nature of central banking generally.⁶

Central banking has evolved throughout its relatively short history, from the time in which the Swedish Riksbank (the first central bank in the world, created in 1668) and the Bank of England (set up in 1694) started operations to central banks in contemporary times, with the Federal Reserve System (the Fed) established in 1913 and the European Central Bank in 1999. While the original *raison d'être* for the establishment of the first central banks was note issue and government finance, this rationale has changed over time.⁷ The Fed was founded following the banking crisis of 1907: 'To provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes' (Introduction to the Federal Reserve Act of 1913). The main rationale for the creation of the Bundesbank in 1957, a country that had suffered from hyperinflation during the inter-war period, was price stability; this rationale was 'inherited' by the European System of Central Banks.

Vera Lutz Smith (a student of Hayek) explained in her excellent 1936 book, 'The Rationale of Central Banking' that the twin mandate of central banks was stable money and sound banking. The emphasis on stable money as the primary objective of monetary policy in the late 1980s and in the 1990s was often accompanied from a move away from the supervisory tasks that are an integral instrument to achieve sound banking and finance. Indeed, some countries (such as the UK and Australia) have moved prudential supervision outside of the central bank. But a crucial aspect of current reform proposals in response to the financial crisis 2007-2009 involves having the monetary authorities more closely involved in financial supervision, a

⁶ For an analysis of central banking functions see Lastra (1996), *Central Banking and Banking Regulation*, pp. 249-286 and Lastra, "Central Bank Independence and Financial Stability", *Estabilidad Financiera*, No. 18, Banco de España, May 2010, pp. 49-66. See also P. Pollard, 'A Look Inside Two Central Banks: The ECB and the Federal Reserve', *Federal Reserve Bank of St Louis*, Jan-Feb. 2003, p.18.

⁷ See generally Charles Goodhart (1988), *The Evolution of Central Banks*, MIT Press, Cambridge.

return to the financial stability mandate. The twin mandate of central banking to which Vera Lutz Smith referred is in modern terminology: monetary stability and financial stability.

The list of central bank functions is open-ended and dynamic, comprising note issue, government finance, monetary policy, banking supervision and regulation, banker's bank and lender of last resort, smooth operations of the payment systems, management of gold and foreign reserves, conduct of foreign exchange operations, debt management, exchange controls, development and promotional tasks and others. The scope of powers and the relative importance of the functions of a central bank have changed over time and across countries. Indeed, in the case of the ECB, the key function is monetary policy, though it has other functions as further discussed below.

One notable feature in central banking history is that there has always been a strong connection between the central bank and the government. They have built a special relationship: the central bank has been consciously awarded privileges by the government, and in exchange it has been expected to provide certain services and functions for the government. However, this special relationship has not always been easy; indeed, at times it has been rather confrontational. The nickname given to the Bank of England, the Old Lady of Threadneedle Street, is a reminder of this special relationship.⁸

It is this strong relationship that plays nowadays in the debate about the role of the European Central Bank during the financial and sovereign debt crisis and the instruments it has established to combat both crises.

Objectives and their evolution

The objectives of the ESCB are spelt out in Article 127.1 TFEU. The primary objective of the European Central Bank is price stability, i.e., the control of inflation. The ECB is heir to the stability culture of the Bundesbank and a creature of its time: economic theory and evidence supported the case for a price-stability oriented independent central bank since 1989, when the Reserve Bank of New Zealand Act, was introduced. This historical rationale – institutions of creatures of their time – is important to understand the limits of what the ECB can do in response to the crisis. If the Maastricht Treaty had been signed in 2010, the

⁸ The nickname comes from a Thomas Gillray cartoon published in May 1797, following a speech that a Member of Parliament, Richard Brinsley, had made in the House of Commons alluding to the Bank as an 'elderly lady in the City of great credit and long standing, who had unfortunately, fallen into bad company'. That bad company being the company of Prime Minister Pitt, who had required the Bank to make large loans to the Government to finance a war against France.

enumeration and prioritisation of objectives would have been different. But treaties are difficult to amend and an expanded European Union has made treaty reform ever more difficult (not to mention the opening of a Pandora's box that the negotiation of certain provisions would entail). What the treaty says provides the content of the obligations of the Member States. In this respect, it is worth pointing out that a degree of flexibility is embedded in the treaty provision through the ensuing language: the primary objective – the pursuit of the internal aspect of monetary stability – is to be pursued without prejudice to the secondary objective, the support of the general economic policies the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. The wording of this provision is heavily influenced by Article 12 of the 1957 Bundesbank Law.

In addition to price stability and support of the general economic policies of the Union, we must add financial stability (mentioned in Article 127.5 TFEU) to the enumeration of objectives. Financial stability has become an overriding policy objective in the aftermath of the financial crisis.

The other condition mentioned in Article 127.1 TFEU is to act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119.

Functions and their evolution

The functions of the ESCB are divided into 'basic tasks', which are defined in Article 127.2 of TFEU and reproduced in Article 3.1 of the ESCB Statute, and other functions (non-basic tasks) that are scattered throughout other provisions. Though this distinction is not always clear in my opinion (eg why is the issue of banknotes not included in the enumeration of basic tasks?), it is enshrined in the Treaty.

While the language applicable in Article 127.2 refers to the 'basic tasks to be carried out through the ESCB' (the ESCB being construed as the compound of its constituent parts, i.e., both the ECB and the NCBs), the language applicable to the other tasks typically mentions the ECB and the NCBs separately (with the one significant exception of Article 127.5 EC Treaty, which refers to the ESCB).

The basic tasks 'to be carried out through the ESCB' are four: (1) to define and implement the monetary policy of the Community, (2) to conduct foreign exchange operation consistent

with the provisions of Article 219, (3) to hold and manage the official foreign reserves of the Member States and, (4) to promote the smooth operation of payment systems.⁹ There are four other ‘non-basic’ tasks (i.e., not included under the umbrella of ‘basic tasks’): (1) issue of banknotes, (2) contribution to financial stability, (3) advisory functions and collection of statistical information and, (4) international co-operation and ‘external operations’.¹⁰

The key function of the ECB is monetary policy. The formulation and implementation of monetary policy is the first and most important basic function to be ‘carried out through’ the ESCB. Responsibility for monetary policy has been clearly transferred from the national arena to the supranational arena. In this sense, it is both accurate and entirely appropriate to talk about a ‘single monetary policy’ for the Member States whose currency is the euro.

Though monetary policy in the Eurosystem is ‘one and indivisible’, there still remains an operational distinction between the ECB and the NCBs in the sense that while the decision-making stage of monetary policy is fully centralized at the ECB, the implementation stage is decentralized. It is the responsibility of the twelve NCBs to conduct the monetary policy operations according to instructions set out by the Executive Board. Article 14.3 of the ESCB Statute clearly states that ‘[t]he NCBs are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB’.¹¹ Accordingly, in the implementation of their ESCB tasks, ie monetary policy and other responsibilities resulting from the EC Treaty and the ESCB Statute, the NCBs act in their capacity as a constituent part of the ESCB, and not as national agencies.

Monetary policy is a public function. A central bank conducts monetary policy operations and other central banking functions in the pursuit of the public interest.¹² The transfer of

⁹ Article 127.2 TFEU and Article 3.1 ESCB Statute.

¹⁰ See generally Rosa Lastra (2006), *Legal Foundations of International Monetary Stability*, Oxford: Oxford University Press, chapter 7.

¹¹ ESCB Statute Art. 14.3.

¹² Central banks act in a dual capacity: on the one hand they can perform central banking functions (*acta iure imperii*), and on the other they can perform corporate functions (*acta iure gestionis*). ‘Acta iure gestionis’ are activities of a commercial nature carried out by a foreign State or one of its subdivisions or agencies, which acts are not immune from the jurisdiction and process of local courts under the modern doctrine of restrictive foreign sovereign immunity. ‘Acta iure imperii’ are activities of a governmental or public nature carried out by a foreign State or one of its subdivisions, which qualify for State immunity under the modern doctrine of restrictive foreign sovereign immunity. When they perform central banking functions, central banks enjoy sovereign immunity. The recent judgment by the United States Court of Appeals for the Second Circuit in *NML Capital Ltd v Banco Central de la Republica Argentina* of 5 July 2011 provides a ringing endorsement of central bank immunity. The central bank enjoys sovereign immunity when it exercises central banking functions. As cited in the Brief for the United States of America as Amicus Curiae in support of reversal, presented to the United States Court of Appeals for the Second Circuit: ‘Central banking activities include, among other things, issuance of a country’s currency; holding of the country’s currency reserves or precious metal reserves; maintenance of domestic reserves of depository institutions; regulation of depository institutions; engaging in

monetary policy powers from the national to the supranational arena signifies the surrender of one of the classic attributes of sovereignty of the Nation-State.¹³ The inconsistency between a centralised monetary policy and decentralised fiscal policy which characterises the EMU project, has been magnified through the Greek debt crisis.

Monetary policy is also a key attribute of monetary sovereignty. The adoption of a single currency, the euro, and the creation of the European System of Central Banks signifies the voluntary surrender of monetary sovereignty by those Member States that have agreed to transfer sovereign rights to the European Union. This is a limited surrender, a non-exclusive transfer of sovereign powers. The members of the Euro zone retain their national sovereignty in those domains where no other consensual limitation has been agreed.¹⁴ The holder of monetary sovereignty for those Member States whose currency is the euro is not the ECB, but the Union in the composition of the 17 member states that have pooled monetary sovereignty and form the Eurosystem.¹⁵ The Union's 'exclusive competence' in monetary policy is exercised by the ESCB/ECB, and since the ECB is the institution that has legal personality (the ESCB and the Eurosystem do not), it is the ECB the holder of rights and obligations.

The ECB has used standard and non-standard measures of monetary policy in response to the crisis to ensure the proper working of monetary transmission and the provision of liquidity to the euro area banking system. Standard measures are open market and credit operations (Article 18 ESCB Statute), and minimum reserves (Article 19 ESCB Statute). Following

open market operations; setting monetary policy; settlement of clearing balances in the payments system; administration of credit controls; serving as a banker's bank to private sector banks and as lender of last resort; and providing general banking services to the parent government'. The Court invited the United States to offer its view on two questions: (1) whether the Banco Central de la República Argentina ("BCRA") is the "alter ego" of the Republic of Argentina under *First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba* ("Bancec"), 462 U.S. 611 (1983), and (2) if so, whether the BCRA's assets at the Federal Reserve Bank of New York ("FRBNY") are immune from post-judgment attachment under § 1611(b)(1) of the Foreign Sovereign Immunities Act ("FSIA"), 28 U.S.C. § 1611(b)(1).

¹³ See generally Rosa Lastra (2006) *Legal Foundation of International Monetary Stability*, Oxford: Oxford University Press, chapter 1.

¹⁴The European Court of Justice ruled in the *Costa/Enel* case that 'by creating a Community of unlimited duration, having its own institutions, its own personality, its own legal capacity and capacity of representation on the international stage and, more particularly, real powers stemming from a limitation of sovereignty or a transfer of sovereign powers from the States to the Community, the Member States have limited their sovereign rights, albeit within limited fields, and have thus created a body of law which binds their nationals and themselves'. See Case 6/64, *Costa/Enel*, (1964) ECR 585, para 9, 593.

¹⁵This is in line with the established doctrine of monetary sovereignty, where the state, as representative of the will of the people, is the holder of such sovereignty, even if the exercise or implementation of some of its prerogatives – such as the monopoly of note issue – is the responsibility of the central bank. See generally Rosa Lastra (2006), *Legal Foundations of International Monetary Stability*, Oxford: Oxford University Press, chapter 1.

‘standard measures,’ the ECB lowered interest rates by 25 basis points in November 2011, and by another 25 basis points in December 2011 (Since then, the rate on the main refinancing operations has been at the historically low 1%).¹⁶ Article 20 of the ESCB Statute allows for other instruments of monetary control.

An example of non-standard measures - aimed at preserving the proper transmission of monetary policy - is the Securities Markets Programme, which was established in May 2010 as an instrument of monetary policy in response to the emerging debt crisis in the eurozone. According to the preamble of the Decision of the European Central Bank of 14 May 2010 establishing a Securities Markets programme:

(1) Pursuant to Article 18.1 of the Statute of the ESCB, national central banks of Member States whose currency is the euro (hereinafter the ‘euro area NCBs’) and the European Central Bank (ECB) (hereinafter collectively referred to as the ‘Eurosysteem central banks’) may operate in the financial markets by, among other things, buying and selling outright marketable instruments.

(2) On 9 May 2010 the Governing Council decided and publicly announced that, in view of the current exceptional circumstances in financial markets, characterised by severe tensions in certain market segments which are hampering the monetary policy transmission mechanism and thereby the effective conduct of monetary policy oriented towards price stability in the medium term, a temporary securities markets programme (hereinafter the ‘programme’) should be initiated. Under the programme, the euro area NCBs, according to their percentage shares in the key for subscription of the ECB’s capital, and the ECB, in direct contact with counterparties, may conduct outright interventions in the euro area public and private debt securities markets.

(3) The programme forms part of the Eurosysteem’s single monetary policy and will apply temporarily. The programme’s objective is to address the malfunctioning of securities markets and restore an appropriate monetary policy transmission mechanism.

(4) The Governing Council will decide on the scope of the interventions. The Governing Council has taken note of the statement of the euro area Member State governments that they ‘will take all measures needed to meet their fiscal targets this year and the years ahead in line with excessive deficit procedures’ and the precise additional commitments taken by some euro area Member State governments to accelerate fiscal consolidation and ensure the sustainability of their public finances.

(5) As part of the Eurosysteem’s single monetary policy, the outright purchase of eligible marketable debt instruments by Eurosysteem central banks under the programme should be implemented in accordance with the terms of this Decision.

¹⁶ See See Lecture by Peter Praet, Member of the Executive Board of the ECB, at the International Center for Monetary and Banking Studies, Geneva, 20 February 2012, <http://www.ecb.europa.eu/press/key/date/2012/html/sp120220.en.html> [visited 21 February 2012].

Another non-standard measure is the provision to Eurosystem counterparties (European banks) of US Dollars that the ECB has obtained via the dollar swap lines offered to it by the Federal Reserve Bank of New York.¹⁷

The ECB has competence to provide market liquidity according to Article 18 of the ESCB Statute and Article 127 (2) TFEU, and the ECB has indeed provided hugely expanded liquidity operations during the twin crises (financial and sovereign debt crises) and has made ample use of the considerable set of operational tools at its disposal to handle a liquidity crisis. However, what constitutes ‘ordinary’ liquidity assistance as opposed to ‘emergency’/LOLR liquidity assistance becomes blurred during a crisis, since the drying of the inter-bank market gives the central bank a primary role in the provision of liquidity. Though the ECB is competent to provide liquidity assistance to ‘financially sound’ banks,¹⁸ the classic LOLR assistance (collateralized loans to troubled illiquid but solvent banks) remains a national competence (unless the problems originate in the payment system¹⁹). The ESCB adopted in 1998 a restrictive reading of the ECB competences, concluding that the provision of lender of last resort assistance to specific illiquid individual institutions was a national task of the National Central Banks (NCBs) in line with Article 14.4 of the ESCB Statute (a provision which allows NCBs to perform non-ESCB tasks on their own responsibility and liability).²⁰

¹⁷ See Decision of the ECB of 6 December 2011, ‘Tender Procedure for the Provision of US Dollars to Eurosystem counterparties’ and Annex I of Guideline ECB/2007/7 of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem (OJ L 310, 11.12.2000, p.1). Since December 2007, the Federal Open Market Committee (FOMC) has authorized dollar liquidity swap lines with the European Central Bank and other central banks to provide liquidity in U.S. dollars to overseas markets, in accordance with section 14 of the Federal Reserve Act and in compliance with authorizations, policies, and procedures established by the Federal Open Market Committee (FOMC). With its most recent measures since December 2011, the Eurosystem has helped maintain the credit flow to the real economy

¹⁸ See ECB, 2008 < <http://www.ecb.europa.eu/pub/pdf/other/gendoc2008en.pdf> > p. 11

¹⁹ According to Article 127.2 TFEU.

²⁰ Article 14.4 reads as follows: ‘National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB’. The ECB can assess whether a given LOLR operation by a National Central Bank (NCB) interferes with monetary policy and, if so, either prohibit it or subject it to conditions. To this effect, the ECB has some internal rules (MoU) requiring ex ante notification to the Governing Council of such LOLR operation (Article 14.4). The following is an excerpt from the ECB Annual Report 1999 (p. 98): ‘The institutional framework for financial stability in the EU and in the euro area is based on national competence and international cooperation.... Co-ordination mechanisms are primarily called for within the Eurosystem. This is the case for emergency liquidity assistance (ELA), which embraces the support given by central banks in exceptional circumstances and on a case-by-case basis to temporarily illiquid institutions and markets.... If and when appropriate, the necessary mechanisms to

In December 2011, the Governing Council of the European Central Bank (ECB) announced additional enhanced credit support measures to support bank lending and liquidity in the euro area money market.²¹ In particular, the Governing Council decided to conduct two longer-term refinancing operations (LTROs) with a maturity of 36 months and the option of early repayment after one year²², and to increase collateral availability by (i) reducing the rating threshold for certain asset-backed securities (ABS) and (ii) allowing national central banks (NCBs), as a temporary solution, to accept as collateral additional performing credit claims (i.e. bank loans) that satisfy specific eligibility criteria. LTRO (long-term refinancing operations) are non-standard measures designed to alleviate severe credit conditions among the countries of the Eurozone. Two LTRO tranches have been announced so far, one that took place in December 2011, and a second to occur in February 2012.

EMU rests upon a relatively strong ‘M’ and a weak ‘E’.²³ The weak economic pillar of EMU provides the background to understand the adoption in December 2011 by the Heads of State or Government of the Member States whose currency is the euro of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (‘fiscal compact’).²⁴ This is intended to move the eurozone towards a stronger economic union including a new fiscal compact and strengthened economic policy coordination to be implemented through an international agreement.

The architecture to deal with sovereign debt crisis in the eurozone will become more permanent once the Treaty establishing the European Stability Mechanism,²⁵ which was signed by euro area member states on 2 February 2012, is ratified by the 17 euro area member states. The ESM will be an international financial institution based in Luxembourg. Its purpose will be to provide financial assistance to its members (euro area member states),

tackle a financial crisis are in place. The main guiding principle is that the competent NCB takes the decision concerning the provision of ELA to an institution operating in its jurisdiction. This would take place under the responsibility and at the cost of the NCB in question. (...) The agreement on ELA is internal to the Eurosystem and does not affect the existing arrangements between central banks and supervisors at the national level or bilateral or multilateral co-operation among supervisors and between the latter and the Eurosystem’.

²¹ See http://www.ecb.int/press/pr/date/2011/html/pr111208_1.en.html [visited 15 February 2012].

²² Ibid. After one year counterparties will have the option to repay any part of the amounts they are allotted in the operations, on any day that coincides with the settlement day of a main refinancing operation. Counterparties must inform their respective NCB, giving one week’s notice, of the amount they wish to repay.

²³ According to Alexandre Lamfalussy, ‘the greatest weakness of EMU is the E. The M Part is institutionally well organised. We have a solid framework. We don’t have that for economic policy’. See Alexandre Lamfalussy, interview published in *The Guardian*, 16 August 2003.

²⁴ <http://www.european-council.europa.eu/media/579087/treaty.pdf> [visited 15 February 2012].

²⁵ http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/127788.pdf [visited 15 February 2012]

experiencing or being threatened by severe financing problems, if indispensable for safeguarding financial stability in the euro area as a whole.²⁶ As a permanent mechanism, the ESM will take over the tasks currently fulfilled by the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM).²⁷

These measures notwithstanding the eurozone still falls short of a fiscal union, with a centralised system of fiscal transfers. That will require another Treaty. The tension inherent in the differences in jurisdictional domain was also evidenced by the UK veto in December 2011.²⁸

A note on supervision and financial stability.

The consistency between one instrument (monetary policy) and one goal (price stability) that is present in the pursuit of monetary stability contrasts with the multiplicity of instruments and goals that exist with regard to the pursuit of financial stability. This makes the pursuit of financial stability a difficult endeavour, and this difficulty is further compounded by the problems of jurisdictional domain, since financial stability is a goal that transcends national boundaries. Like a tsunami that does not respect national boundaries, episodes of financial instability have a trans-national dimension, thus requiring a trans-national solution. Financial stability is also a goal that transcends institutional mandates.

The Draft Statute of the ESCB – released by the Committee of Governors of the EC Central Banks in November 1990 – included prudential supervision amongst the basic tasks of the ESCB. However, the opposition of some countries (notably Germany) to such an inclusion means that the final version of the ESCB Statute and of the EC Treaty (as revised by the Maastricht Treaty) only referred to supervision in a limited way, as a non-basic task,

²⁶ The original version of the treaty was signed on 11 July 2011, but it has been modified to incorporate decisions taken by the heads of state and government of the euro area on 21 July and 9 December 2011, aimed at improving the effectiveness of the mechanism. Once ratified by the 17 euro area Member States, the treaty will enter into force and the ESM become operational as soon as possible: the target date is July 2012, a year earlier than originally planned.

²⁷ Ibid. With the accelerated entry into force, the ESM will now operate alongside the EFSF for 12 months. Their joint lending capacity is currently set at € 500 billion, subject to reassessment in March 2012. With the subscribed capital of € 700 billion (€ 80 billion as paid in capital, the rest as callable), the initial maximum lending capacity of the ESM is set at € 500 billion.

²⁸ See e.g., <http://www.bbc.co.uk/news/uk-16104275> [visited 15 February 2012].

according to the language of Article 127.4 – 127.6 of TFEU and Article 25 of the ESCB Statute.²⁹

It is now widely accepted that the neglect of financial stability prior to the crisis was an important contributing factor. Financial stability should be the ultimate goal of supervision, regulation and crisis management. It is a national, a European and an international goal, but a commonly accepted definition is still lacking, complicating its pursuit.

A distinction is now made between macro-prudential supervision and micro-prudential supervision. According to the House of Lords Report on the Future of EU Supervision and Regulation,³⁰ ‘macro-prudential supervision is the analysis of trends and imbalances in the financial system and the detection of systemic risks that these trends may pose to financial institutions and the economy. The focus of macro-prudential supervision is the safety of the financial and economic system as a whole, the prevention of systemic risk. Micro-prudential supervision is the day-to-day supervision of individual financial institutions. The focus of micro-prudential supervision is the safety and soundness of individual institutions as well as consumer protection. The same or a separate supervisor can carry out these two functions. If different supervisors carry out these functions they must work together to provide mechanisms to counteract macro-prudential risks at a micro-prudential level’. While micro-prudential supervision remains a national competence, it is subject to increasing centralisation since the establishment of the European Supervisory Authorities (ESAs) – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) – while macro prudential supervision is a task entrusted to the European Systemic Risk Board,³¹ though the

²⁹ However, Article 127.6 EC Treaty left the door open for a possible expansion of supervisory responsibilities following a simplified procedure (simplified in the sense that it does not require the formal amendment of the Treaty, but not likely to be exercised lightly due to the requirement of unanimity in the Council plus, currently, the assent by the European Parliament). Though it is an anachronism to refer – as Article 105.6 EC Treaty and Article 127.5 of TFEU do – to ‘prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings’. Financial developments in the last decades have rendered this exception meaningless, since nowadays financial conglomerates encompass banking, securities and insurance undertakings.

³⁰ See <<http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeucom/106/106i.pdf>> [visited 12 December 2011]

³¹ The legal basis of the regulations is Art. 114 of the Treaty on the Functioning of the European Union (TFEU) and the legal basis of the decision granting certain tasks to the ECB is Article 127(5) TFEU. In October 2009 the Commission proposed a directive amending a number of directives in respect of the EBA, the EIOPA and the ESMA. ECOFIN reached a broad consensus regarding the main features of the ESRB at its meeting on 20 October 2009. The ECOFIN Council on 2 December 2009 approved the creation of the three new European Supervisory Authorities, which together with the European System Risk Board (for which broad political agreement was reached on 20 October 2009) form the new EU supervisory structure. See http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/111706.pdf The new authorities and the ESRB took up their duties at the beginning of 2011.

ECB and national central banks (NCBs) are also competent to contribute to prudential supervision and issues of financial stability. This can pose problems or tensions in particular with regard to non-eurozone NCBs.

A common trend in response to the crisis is to give the central bank responsibility for macro-prudential supervision.³² The reinforcement of the role of the central bank now coexists with greater political interference and reduced independence for central banks and supervisory agencies because of the fiscal costs of the bailout or rescue packages. This latter trend is in stark contrast with the movement towards independence that characterised the framework of central banks prior to the crisis. Of course, the ECB is better shielded from political pressure than other central banks, whose jurisdictional domain is the national arena. But it is not exempt from such pressure.

3. Organizational Complexity

The European System of Central Banks is a complex central banking system.³³ This complexity is multi-layered. First, there is the structural complexity, which is a permanent feature of the system. The ESCB is composed of the ECB and the NCBs. The complex duality of the ESCB is further compounded - for a transitional period of unknown duration - by the division between the 'ins' (i.e., member states whose currency is the euro) and the 'outs' (ie and member states not participating in the single currency or 'member states with a derogation' according to the language of the Treaty). The NCBs of the 'ins' and the ECB constitute the Eurosystem. The NCBs, in turn, are also characterised by a duality. On the one hand they are an integral part of the ESCB (operational arms of the ESCB), when carrying out operations that form part of the tasks of the ESCB.³⁴ On the other hand, they are also

³² For a review of these arguments see Luis Garicano and Rosa Lastra, 'Towards a new Architecture for Financial Stability: Seven Principles', *Journal of International Economic Law*, Vol. 13, No. 3, September 2010, pp. 597-621. The Financial Services Bill published in the UK on 27 January 2012 substantially expands the mandate of the Bank of England in terms of macro prudential supervision and the pursuit of financial stability. See http://www.hm-treasury.gov.uk/press_08_12.htm [visited 15 February 2012].

³³ This section draws on an article I wrote on "The Division of Responsibilities between the European Central Bank and the National Central Banks within the European System of Central Banks" 6 *Columbia Journal of European Law* 2 (2000) 167-180 and on Chapter 7 of *Legal Foundations of International Monetary Stability*, Oxford: Oxford University Press (2006).

³⁴ ESCB Statute, Articles 12.1 and 14.3.

national agencies when performing non-ESCB functions.³⁵ For these reasons, while the law governing the ECB is solely EU law, the laws governing the status of the NCBs emanate not only from EC sources, but also from their respective national legislation (though such legislation needs to be compatible with EU law before the adoption of the euro). Furthermore, there are substantial differences between the range of functions and responsibilities assigned to each NCB in the various jurisdictions that comprise the Euro zone.

In terms of the ECB internal organizational structure, the Eurosystem is governed by the Governing Council and the Executive Board, the two main decision making bodies of the ECB, by which the ESCB is governed. Only the NCBs of the member states whose currency is the euro participate in these two decision making bodies. The NCBs of those countries that do not participate in EMU ('Member States with a derogation') either because they have opted out (the UK and Denmark), rejected membership through a referendum (Sweden), or have not qualified yet still participate in the third governing body of the ESCB, the General Council.³⁶ The tasks of the General Council can be classified into co-ordinating functions (between the monetary policies of the 'outs' and that of the Eurozone) and preparatory functions (helping the 'outs' prepare for eventual Eurozone membership). The division of responsibilities between the ECB and the NCBs within the ESCB resembles to some extent the structure of the US Federal Reserve System (the 'Fed'). Indeed, while the ESCB functionally is reminiscent of the pre-1999 Bundesbank, geographically it resembles the Federal Reserve System. It is interesting to observe that in the congressional debates that led to the establishment of the Federal Reserve System in 1913, there was a considerable discussion as to the use of the name 'central bank' and that is why the name Federal Reserve System was adopted, to reflect the federal structure of the US, the balance of power between the Federal Government and the States.

The Federal Reserve System does not have legal personality. The entities with legal personality are the Board of Governors and the Federal Open Market Committee (which are both federal agencies and, as such, public legal persons) on the one hand, and the twelve Federal Reserve Banks on the other. However, in contrast to the NCBs, which are typically public legal persons (publicly managed and, for the most part, publicly owned), the Federal Reserve Banks have private legal personality, with private ownership (100% owned by the

³⁵ ESCB Statute, Article 14.4. The ECB can 'test' whether an NCB task is compatible with its ESCB functions.

³⁶ See ESCB Statute Articles 44-46

member banks in each district) and private management.³⁷ Nonetheless, the analogy between the Federal Reserve System and the ESCB is useful in understanding the duality of functions of the NCBs. In some instances, the NCBs act as a part of the ESCB, and in other instances on their own, i.e., separately and independently from the ECB. In term of its capital structure, it should be noted that the NCBs are the ECB's sole shareholders. A general principle applicable to the division of responsibilities between the ECB and the NCBs is Article 12.1 paragraph 3 of the ESCB Statute, which sets out that '[t]o the extent deemed possible and without prejudice to the provisions of this Article, the ECB shall have recourse to the national central banks'.

4. Status, independence and accountability

The structural and functional duality of the ESCB, its organizational complexity and the novelty of a truly 'independent institution' within the Community's institutional structure triggered a heated legal debate with regard to the constitutional position of the European Central Bank.³⁸

The OLAF case clarified the legal position of the European Central Bank. '[T]he ECB, pursuant to the EC Treaty, falls squarely within the Community framework'.³⁹ The Lisbon Treaty confirmed the position of the ECB as a core institution of the EU, according to Article 13 of the Treaty of the European Union. The ECB is in charge of a major 'area of exclusive competence' of the Union.

³⁷ Not all NCBs are public legal persons: the Banque Nationale de Belgique, the Banca d'Italia, the Bank of Greece and De Nederlandsche Bank N.V. are public limited companies, ie firms with private legal personality.

³⁸ Though the debate is now settled, in the beginning of the life of the ECB it generated a controversial debate. Chiara Zilioli and Martin Selmayr regarded the ECB as 'an independent specialised organisation of community law.' They first elaborated this theory in an article on 'The External Relations of the Euro area: Legal Aspects', 36 *Common Market Law Review* (1999) 286 drawing on the previous work done by Selmayr. They further polished their views in 'The European Central Bank: an Independent Specialized Organization of Community Law', 37 *Common Market Law Review* (2000) 591-644 and in *The Law of the European Central Bank* (Hart Publishing: Oxford, 2001) 29. Ramon Torrent argued that the ECB is the central bank of the European Community. See Ramon Torrent, 'Whom is the European Central Bank the Central Bank of? Reaction to Zilioli and Selmayr', 36 *Common Market Law Review* 1231 (1999). Smits suggests that the ECB is an organ of the European Community, 'not an organ in the same sense as the EC's institutions but as an independent agency of the performance of the monetary policy attributed to the Community level of government and for the execution of several other tasks within the overall price-stability objective'. See René Smits, 'The European Central Bank in the European Constitutional Order', Eleven International Publishing, The Netherlands (2003) 24-25. This was his inaugural address on accepting the Jean Monnet Chair of the Law of the Economic and Monetary Union at the Faculty of Law of the University of Amsterdam on 4 June 2003. See http://europa.eu.int/futurum/documents/speech/sp040603_2_en.pdf

³⁹ See Case 11/00 *Commission of the European Communities v European Central Bank* [2003] ECR 00, para 92. This case is referred to as 'the OLAF (European Anti-Fraud Office) case'.

The independence from governmental direction of the ECB and the independence of the National Central Banks constitute a key feature of the ESCB. Heir to the stability culture of the Bundesbank and a child of the economic theories of its time, the ECB is a highly independent institution. On the one hand, it is independent from the other institutions and bodies of the EU and, on the other hand, it is independent from the national authorities. This ‘dual independence’ is another expression of the duality that characterises the ESCB.

The independence of the NCBs is a criterion of ‘legal convergence’ for any prospective member of the euro area. Any country wishing to join the euro area needs ensure that its national legislation including the statutes of its national central bank is compatible with the Treaty and the ESCB Statute. The independence of the ECB is enshrined in Article 130 TFEU. The ECB and the NCBs are independent in the exercise of their powers and in the carrying out of their tasks and duties. Article 130 TFEU prohibits the ECB, the NCBs and the members of their decision-making bodies from seeking or taking any instruction from the Community institutions or bodies, from any government of a Member State or from any other body, and also prohibits those Community institutions or bodies and the national governments from seeking to influence the members of the decision making bodies of the ECB and the NCBs in the performance of their tasks.

The European Court of Justice has clarified the extent of the independence of the ECB in the OLAF case.⁴⁰ The Court advocates that the ECB ‘should be in a position to carry out independently the tasks conferred upon it by the Treaty.’⁴¹ The Court further states that ‘Article 108 [now Article 130 TFEU] seeks, in essence, to shield the ECB from all political pressure in order to enable it effectively to pursue the objectives attributed to its tasks, through the independent exercise of the specific powers conferred on it for that purpose by the EC Treaty and the ESCB statute’.⁴² The Court is clearly in favour of a limited notion of independence, limited by the functions, by the tasks and powers specifically conferred upon the ECB. The Court upholds a concept of ‘independence within the Community structure’ (not independence from the Community) that is reminiscent of the notion of ‘independence within government’.⁴³ The ‘recognition that the ECB has such independence does not have

⁴⁰ OLAF case, paragraphs 130-135.

⁴¹ *ibid* para 130.

⁴² *ibid* para 134.

⁴³ See Board of Governors of the Federal Reserve System, ‘The Federal Reserve System Purposes and Functions’ Washington DC (1984) 2.

the consequence of separating it entirely from the European Community and exempting it from every rule of Community law'.⁴⁴

The ECB is independent 'organically', 'functionally' and 'financially'. The 'organic independence' is evidenced by a number of safeguards or guarantees such as the appointment and removal procedures of the members of its governing bodies (eg Article 11.2 and 11.4 of the ESCB Statute with regard to the Executive Board and Article 10 ESCB Statute with regard to the Governing Council). The 'functional' independence is enshrined in Article 130 TFEU (as recognised by the Court of Justice in the OLAF case) and is also safeguarded by other provisions, such as those dealing with the prohibition to finance public sector deficits via central bank credit (eg Article 21.1 of the ESCB Statute) or those dealing with the regulatory powers of the ECB. The ECB is independent within the limits of the powers expressly conferred upon it by the Treaty and the ESCB Statute. The 'controls' to which the ECB is subject constitute another limit. The European Court of Justice in the OLAF case specifically mentions the review by the Court of Justice and the control by the Court of Auditors.⁴⁵ These are, in fact, important mechanisms of accountability.

Since 1992 I have advocated the need for 'accountable independence'.⁴⁶ The notion of independence that I support is the one which Geoffrey Miller and I have developed.⁴⁷ An independent central bank is a particular kind of institution that is independent in some respects, but highly constrained in others, constrained by the goal, by the statutory objective, and by the demands of democratic legitimacy and accountability.

Though a consensus has been reached on the definition and adequate *quantum* of independence, a debate is still going on regarding the definition and the adequate *quantum* of accountability. The ECB has often been criticised for its alleged lack of accountability and transparency. But what do we mean by accountability and transparency? There are several paradigms and forms of accountability.⁴⁸ And depending on which paradigm one judges the

⁴⁴ OLAF case, para 135.

⁴⁵ OLAF case, para 135.

⁴⁶ Rosa M Lastra, 'The Independence of the European System of Central Banks', 33 Harvard International Law Journal 475(1992) 476-482.

⁴⁷ See Rosa Lastra and Geoffrey Miller, 'Central Bank Independence in Ordinary and Extraordinary Times' in Jan Kleineman (ed), *Central Bank Independence. The Economic Foundations, the Constitutional Implications and Democratic Accountability*, (The Hague: Kluwer Law International, 2001) 31-50.

⁴⁸ See Rosa M. Lastra, 'How Much Accountability for Central Banks and Supervisors?' 12 (2) Central Banking 69 (2001) and the article I co-wrote with Ms. Heba Shams on 'Public Accountability in the Financial Sector' in Eilis Ferran and Charles Goodhart (eds), *Regulating Financial Services and Markets in the Twenty First Century*, (Oxford: Hart Publishing, 2001) 165-188.

institution [the ECB], one reaches different results. Amtenbrink⁴⁹ argues that the existing democratic deficit of the European Central Bank is an expression of the democratic deficit of the European Community at large, rather than a particular deficiency of the institution. Zilioli⁵⁰ argues that the ECB is accountable if we use a new ‘economic paradigm of accountability’ rather than the traditional ‘formalistic’ notion of accountability based on the theory of the division of powers and the existing system of checks and balances. The economic notion of accountability (performance accountability) is based on the assessment of the results achieved in relation to the specified statutory objective, namely price stability. In my opinion the new paradigm is also based on participation (consultation) and transparency (disclosure).

Accountability can only be judged through the life of the institution. Accountability cannot be guaranteed by the fact that the initial stage of its creation is legitimate democratically. It is in its continuing operations and policies that the institution must be subject to appropriate mechanisms of accountability. And if the ECB gives ‘proper account’, explains and justifies the actions or decisions taken (or omitted) in the exercise of its responsibilities, is subject to judicial review and to audit control and respond to Parliament through reports and testimonies, then it can be judged to be sufficiently accountable.

5. Concluding Observations

The European Central Bank has played a key role during the twin financial and sovereign debt crisis in Europe. It has been an institution that has proved adept at evolving, stretching the mandate granted to it by the Treaty to the limits of the law, but within the law. Ordinary times are not the same as extraordinary times. The success of institutions is to tread carefully on what is extraordinary and try to channel the instruments at their disposal towards a return to ordinary times. Central banks often act last resort: purchasers of last resort, lenders of last resort, liquidity of last resort, investors of last resort. These last resort considerations are suited for extraordinary times. It is the immediacy of the availability of central bank liquidity

⁴⁹ See Fabian Amtenbrink, *The Democratic Accountability of Central Banks: A Comparative Study of the European Central Bank* (Oxford: Hart Publishing, 1999), 9.

⁵⁰ See Chiara Zilioli, ‘Accountability and Independence: Irreconcilable Values or Complementary Instruments for Democracy? The Specific Case of the European Central Bank’ in Georges Vandensanden and others (eds) *Mélanges en Hommage à Jean-Victor Louis* (Brussels: ULB, 2003), 402-405.

that makes such liquidity essential when other sources either dry out or become prohibitively expensive.

Financial stability is a goal that transcends institutional mandates and geographic boundaries. The relative simplicity of one goal (price stability) – one instrument (monetary policy) that characterizes the monetary responsibilities of central banks contrasts with the multiplicity of instruments (supervision, regulation, crisis management, lender of last resort and others) that characterizes the pursuit of financial stability. Since supervision and regulation are also aimed at other goals (e.g., consumer protection), the mandate of central banks in the pursuit of financial stability and the design of central bank independence in such pursuit are more complex than the mandate of monetary stability and the design of monetary independence.