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Enlarged scope and competences of the ECB
Economic constitutional analysis[1]

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I Introduction – constitutional analysis of the European Central Bank and economic crisis

The financial and fiscal crises have dominated the economic policy agenda of the EU at least from mid 2008 onwards. One of the key EU level actors in handling the crises has been the European Central Bank (ECB). The role and actions of the central bank have far exceeded what is considered normal conduct of monetary policy and also what was envisaged at the time the system was designed. This evolution in the activities of the ECB has been mainly assessed from the efficiency point of view. These fundamentally economics-based assessments have ranged from the ECB being one of the ultimate causes of the crises and their worsening to a more positive view of praising the ECB for keeping the European economy barely functioning in the middle of the worst crises since WWII.

It is to be expected that economic analysis of the ECB's actions will continue at least for the next few decades and remain inconclusive[2]. However, there is another and potentially less inconclusive aspect to the role and actions of the ECB, namely the point of view of EU constitutional law. The ECB is an EU institution that performs functions on behalf of the Community and for the people of the community. Its role and actions are therefore inherently constitutional as well as economic.

The constitutional aspect of the ECB's role and actions has been scarcely discussed in the public sphere even though the ECB and the European System of Central Banks (jointly hereafter "Eurosystem") have a special legal and operational status. The ECB is designed to be a highly independent expert organisation that is effectively outside any political value-based decision-making. This special position needs to be based on a strong rationale and constitutional background. It should

[1] The paper was prepared for a Workshop on Constitutional Implications of the Economic Crisis in Helsinki 29 and 30 March 2012. It benefited from a number of helpful comments by Fernando Losada, Tuomas Ojanen and Kaarlo Tuori.

[2] As a point of reference, the great depression of the 1930s is still a hotly debated issue in economics particularly in the US.

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also have implications for assessing the role and activities of the ECB. The lack of democratic control or even impulses should affect the way the ECB can expand its role and actions to new territories. On the other hand, it is also clear that central banks need some amount of discretion in their policy implementation in ever changing economies and particularly financial markets. In the case of the ECB this underlying tension between innovative responses to new situations and a clear legal mandate is more profound than with other central banks because its legal position is defined in an international treaty that is very difficult to amend.

This paper aims to give guidance on the constitutional analysis of the ECB. In the first part, I assess the legal and other sources that should be taken into account when placing the ECB under constitutional scrutiny. In the second part, I use those sources to derive the key constitutional principles underlying the legal position of the ECB. At the same time, I must reveal the key assumptions behind those principles. In the concluding section, I try to apply those key principles to a number of actions that the ECB has taken in the course of its young life and particularly as part of economic crisis management. However, rather than aiming at a full autopsy of the institution, I will have to limit myself to just a few cases and tentative initial answers.

II Sources for legal analysis of the ECB

Economic and Monetary Union was introduced by the Treaty of Maastricht, and a large majority of relevant provisions for monetary policy are from the Treaty changes adopted on 1 November 1993. Three main preparatory works were conducted in the run up to eventual Treaty changes. First, the report by the Delors Committee was presented to the public in April 1989 after less than a year's work. The report suggested taking substantial steps towards economic convergence, price stability and budgetary discipline before irrevocably fixing exchange rates between currencies. The report also introduced a three–stage procedure that would guarantee sufficient convergence[3]. The Delors Committee was followed by a report by the Monetary Committee that was presented to the Ecofin Council in July 1990. In addition, alongside these reports, the Committee of Governors prepared a draft statute of the ECB and the ESCB and also provided an introductory report and a commentary[4].

From the Delors report onwards, the main principles of the Eurosystem were in place, including the objective of price stability and broad independence of the new central banking system. However, the level of detail increased as regards operational elements of the system, and the draft statute of the Committee of Governors was very close to the finalised legal act[5]. It is noteworthy that central banks were the driving force in the drafting process, as central bank governors were a majority in the Delors

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[3] It could be noted that a step-wise procedure was initially presented already in the background work for the Werner report at the beginning of the 1970s.
[4] René Smits. The European Central Bank: Institutional aspects. Kluwer Law International 1997. p. 31.
[5] For example, Committee of Governors Annual Report, April 1992. p. 13. The whole draft was published in Harold James (2012).

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Committee and comprised the Committee of Governors. The very short drafting process also made it difficult for non-central bank actors to influence the final outcome. This seems to have been the case particularly with regard to more technical provisions, which is shown by the fact that deviations from the draft statute at the IGC took place in the provisions that were explicitly fundamental by nature[6].

In order to understand the constitutional issues related to the ECB and the ESCB (Eurosystem) it does not suffice to limit legal sources to Treaty provisions. As with other constitutional analysis a broad list of other sources is needed to complement the analysis. The preparatory work mentioned above could shed some light on the meaning of some of the provisions. In particular, there were a few cases where the Council explicitly deviated from the wording of the Committee of Governors. In those cases, it should be clear that the content of the draft was firmly rejected. However, it should be kept in mind that preparatory material is generally given a very limited role in EU law.

The main external sources for legal analysis are threefold. First, the demands arising from the European economic constitution link the area of monetary policy to the broader context of the economic constitution at the European level. Second, and partly related to the first point, the template of the Deutche Bundesbank (hereafter "Bundesbank") should be helpful in filling the gaps as Bundesbank was an explicit model for the ECB and the Eurosystem. Third, the consensus of monetary economics on the appropriate conduct of monetary policy and the concepts therein are needed to understand what was meant by a number of more technical provisions as well as to understand what could be included under broader economic terms used in the Treaty. The economic consensus of the time preceding the Maastricht Treaty should also help to grasp the economic rationale behind the provisions.

II.1 Demands arising from the broader European Economic Constitution

The economic constitution is an economic and legal concept that was originally developed in Germany in the 1920s and 1930s by the ordo-liberal school of thought. It describes the fundamental legal framework that is supposed to safeguard the functioning of the economy. In a neutral interpretation, the concept does not necessarily contain any selection among different types of economic orders or economic paradigms. However, for ordo-liberals there was a strong underlying link between the concept and the performance-based competition type of economic order. A coherent (constitutional) legal framework was essential to guarantee individual freedoms and the market based economy. The main role of the state was to enforce the economic constitution[7].

In the ordo-liberal view, a community must establish the characteristics of its economic system by using the rules of its political constitution. "These fundamental choices determined a nation's

[6] Smits (1997) has comprehensively outlined differences between the draft statute and the final statute.
[7] Sauter, Wolf: The Economic Constitution of the European Union. Columbia Journal of European Law. 27 (1998). p.46.

economic constitution (*Wirtschaftsverfassung*)."[8] The economic constitution is "a comprehensive decision (*Gesamtentscheidung*) concerning the nature and form of the process of socio-economic cooperation"[9]. Later ordo-liberals have expanded the term to be used in two ways. The descriptive way refers to all legal rules that constrain the conduct of economic agents, and the functional way refers to "those legal rules, which, according to experience and research, are constitutive for or conducive to a specific type of economic system." In combining the two meanings, it can be stated whether and to what extent observable rules correspond to the functional requirements of the market system[10].

Although the ordo-liberal background is very important in understanding and using the concept of economic constitution, it hardly has a monopolistic claim on the concept. Kaarlo Tuori (2011) also points out that from the 1990s onwards the term "economic constitution" has been more broadly accepted and also given a more neutral content. A constitution is a relational concept, and "establishes a protective framework for what can be called the constitutional objects". In the case of the economic constitution, the objects of constitutional regulation are the fundamentals of the economic system[11]. Joerges (2004) continues that the economic constitution can be a theoretical yardstick to justify validity claims of constitutional norms, in order to complement other validity claims such as the supremacy doctrine and direct effect. However, it needs to find its own legitimacy through the theory of the economic constitution. In other words, a coherent and well-founded theory on the economic constitution would be required in order to give the concept of economic constitution power to bestow constitutional status on some economic rules. Joerges finds the majority of the building blocks for the theory on economic constitution from the historical development of the concept. As a conclusion "A core element of its constitutional messages and perspectives was the theory of the "economic constitution", the thesis that the constitution should respect the interdependence of a system of undistorted competition, individual freedoms and the rule of law – and to protect the precious balance against political influence."[12]

Hugh Collins (2009) starts his definition of the economic constitution with a reference to political and juridical constitutions and finds a similar claim of supremacy. The economic constitution concerns the social and economic order of a society and aims at cementing social and economic principles and structures and hence contains a commitment to a particular type of economic order. He further

[8] Gerber, David J.: Constitutionalizing the Economy: German Neoliberalism, Competition Law and the "New" Europe. 42 Am. J. Comp. L. 25 1994. p. 44.
[9] Franz Böhm. Wettbewerb und Monopolkampf - Eine Untersuchung zur Frage des wirtschaftlichen Kampfrechts und zur Frage der rechtlichen Struktur der geltenden Wirtschaftsordnung (1933).
[10] Manfred E. Streit and Werner Mussler. The Economic Constitution of the European Community: From Rome to Maastricht. Constitutional Political Economy, VOL. 5, NO. 3, 1994. p. 2
[11] Tuori (2011). La Constitution économique parmi les Constitutions européennes, Revue internationale de droit économique 2011/4 (t.XXV). Pp 559-599. p. 561-64.
[12] Christian Joerges. What is Left of the European Economic Constitution? A Melancholic Eulogy. International workshop on the European Union as a model for the development of Mercosur 2004, p. 10.

explains that all European countries currently commit to a market order, where the main emphasis is on facilitation of individual choices and on the balance between freedom of economic action and necessary constraints on that action. In addition, the market order economic constitution needs to strike a balance between individual freedoms, the necessity to protect those freedoms and the market in general, the need to take into account externalities of individual actions and other potential negative social outcomes of the market order. [13]

Two relatively recent dissertations also deserve a mention although they do not add much clarity or coherence to our definition of economic constitution. Maduro discusses the relationship between the Treaty Article on free movement of goods and economic constitutional models. He even finds three models of economic constitution, namely a centralised model, a competitive model and a decentralized model. However, he does not provide an explicit definition of the economic constitution. He describes the three models according to various elements of which the most important are regulation, deregulation and reregulation on the one hand and national versus supra-national on the other hand. For general analysis of economic constitution, the three models mentioned do not have a clear justification or theoretical background that could facilitate their broader use[14].

Baquero Cruz uses a very strict approach. He starts at the general level by introducing new supranational economic constitutionalism as a concept that includes the free movement principles, competition rules and more lately common monetary policy. However, for the purpose of his analysis he neglects the more general concept, and chooses to concentrate on economic constitutional law for which he has a relatively straightforward definition. In practice that definition is more the selection criteria on what material should be included in analysis of economic constitutional law. The definition does not in itself provide any information on substantive elements of the economic constitution let alone on the promising concept of new economic constitutionalism[15].

The analyses of Maduro and Baquero Cruz are telling examples of the difficulty of extending the European economic constitution to new areas such as monetary policy. Although economic constitutionalism and particularly the ordo-liberal conception of it contain monetary policy and monetary regime issues, even in a prominent role, other economic constitutional theories arising purely from the micro-economic foundations and regulatory principles of the EU do not allow for analysis of monetary issues. Hence, only the ordoliberal reading of the European economic constitution gives teleological guidance for the assessment of the common monetary regime.

[13] Hugh Collins. The European Economic Constitution and the Constitutional Dimension of Private Law. ERCL 2/2009 71-92. pp. 73-74.
[14] Miguel Poiares Maduro. We The Court. The European Court of Justice and the European Economic Constitution. 1998. pp. 105-150.
[15] Julio Baquero Cruz. Between Competition and Free Movement. The Economic Constitutional Law of the European Community. 2002. Hart Publishing Oxford – Portland Oregon. p. 7.

The general concept of an economic constitution has been the starting point for the concept of the European economic constitution, but due to the peculiar nature of the EU (EEC) the special concept has gained much more interest and even has led conceptual development. At the national level, the economic constitution has not necessarily gained wide acceptance and it has been less clear what kind of issues should be provided with constitutional protection. At the European level, economic constitutional elements have from the outset formed an integral part of the European Economic Community. Countries joining the EEC were willing to limit their democratic powers in order to achieve a functioning common market, which indeed was the starting point for the constitutional status of the economic sphere at the European level. Hence, the origin of the European economic constitution is the Treaty of Rome, and more precisely the four market freedoms of the Treaty that guarantee free movement of goods, services, capital and labour. In addition, competition and state aid rules and the European competition authority (Commission) are included in the European economic constitution.

It is a debated issue how much of the European economic constitution could be explained by ordo-liberal thought and hence to what extent ordo-liberal ideals should be included in the teleological interpretation of the economic constitution. From a historical perspective, it is claimed that ordo-liberal theories and ideals were the main building blocks for the European economic constitution via their influence on the German side of negotiation and the importance Germans put on achieving the same economic order at the EEC as was the case in the first decades of the German Federal Republic[16]. From an empirical perspective it has been analysed, for example, whether the teleological interpretation of the European Court of Justice (ECJ) could be explained by an ordo-liberal reading of the economic constitution. For the purpose of this paper it suffices to say that these analyses have been inconclusive.

The European economic constitution is a more limited concept than the general economic constitution. Only those elements of the economic constitution that have been explicitly or implicitly transferred to the European level can form a European economic constitution. However, those same elements could still form part of a national economic constitution. Naturally, this can give rise to legal conflicts with regard to the overlapping parts of the respective economic constitutions and require doctrines like supremacy to resolve those conflicts. For example, ordo-liberals used the term economic constitution first and foremost in the German context. It was the vehicle for economic prosperity and social development they proposed for Germany after WWII. However, as soon as the agenda of European economic integration became reality, the term and underlying ideas were

[16] Ivo Maes. On the Origins of the Franco-German EMU Controversies. European Journal of Law and Economics, 17: 21-39, 2004. p.26.

transferred to that context to the extent they were accepted and applicable. [17]At the beginning, i.e. the Treaty of Rome, the four freedoms were primarily targeted at Member States in order to curtail or limit restrictions imposed on the freedoms with the aim of creating a common market.

Another elementary feature of the European economic constitution is that although it has a clear starting point in the Treaty of Rome, a very important evolutionary element is also included. The ECJ has been a major driving force behind this feature. The evolution of market freedoms or the limiting restriction on those freedoms has had at least two trends in the case law of the ECJ that could be seen to have a constitutional meaning. Firstly, the bias has moved towards granting individuals and companies rights rather than limiting Member State actions as such. Second, the principle of free movement has been replaced by the market access concept, which is considerably broader than the free movement concept. It has been claimed that the evolution of the economic constitution both with regard to Treaty amendments and also to the evolutionary development primarily driven by the case law of the ECJ has led to restrictions on the original ordo-liberal views[18]. It is noteworthy that discussion on the monetary policy part is very limited and the main critique is indirect. Streit and Mussler see monetary union as a way “to induce further steps towards a political union by consciously producing an asymmetry between economic and political integration”[19].

Another major difference in the European economic constitution is the constitutional narrative, which is not a typical national level constitutional narrative that would have a strong link to the respective national constitution and constitutional culture. This has been analysed from several angles. One of the most crucial elements is the constitutional narrative introduced by the ECJ with its constitutional argumentation. This is particularly well seen in the teleological and systematic argumentation that has exceeded textual argumentation in a number of respects. This is seen to be typical of constitutional argumentation, as constitutional legal sources often fail to provide sufficient grounds for strict textual interpretation. Maduro talks about the “constitutionalisation of Community law and the European economic constitutional model arising from it.”[20]

For the purpose of this analysis, the concept of the European economic constitution should include a set of properties. First, it is based on development of the economic and legal thought of the ordo-liberal school so that the theoretical basis for the elements should be at minimum cross-checked with ordo-liberal theories. However, explicit deviation by the legislator or by the Court from ordo-liberal ideas should by no means be neglected. Second, the interdependence of rules is a fundamental

[17] For example Tuori (2010) sees the European context as a way to enforce the economic constitution after the German constitutional court had refused to consider it as part of the German constitution.
[18] The case has even been made by ordo-liberals themselves who have been very vocal in criticising amendments to the Treaties. SEA 1987 and TEU 1992 were particularly heavily attacked. See for example Streit and Mussler (1995). pp. 19-26.
[19] Streit and Mussler (1995). p. 27
[20] Maduro. p. 15.

characteristic of economic constitutional theory. This supports teleological interpretation and a top-down approach. Third, although the formal legislative process in the form of the Treaties should form the core of the analysis, no uniform or formal validation process is available that would help to limit some rules outside the scope of the economic constitution. In contrast, even relatively custom-based rules could be included, should they have strong validity claims from a theoretical coherence point of view. Fourth, although it is not possible to draw a definite borderline between economic and political constitution, that distinction could be important from a number of perspectives (e.g. legitimacy techniques, institutional choices).

Key requirements from the economic constitution standpoint

A number of legal or constitutional key elements could be derived from the arguably somewhat less than perfectly concise concept of the European economic constitution. The elements that would be most apparently in line with the broader European economic constitution include:

1. A prominent role for the market economy and in particular compatibility with the four basic freedoms.
2. The EU administrative role is based on expert organisation status with a limited role for political value judgements in administrative practices.
3. Preservation of price mechanisms as a key allocation tool for private individuals and companies. Since prices are the main form of organizing the economy in a market-based and de-centralised system, it is clear that using prices or price levels for active economic policy purposes could jeopardize the whole system and hence be counter to the objectives of the economic constitution[21].
4. Interdependence of rules or orders, i.e. strict interpretive role for systemic requirements

Concerning economic policy and particularly macroeconomic policy, it could be argued that both redistributive policies as well as a Keynesian type of cyclical demand management would be alien to the European economic constitution. This has been the case not only because of the limited budget of the Community but even more because of the limited legitimacy of this type of function at the European level. The initial European economic constitution was based on a micro-economic approach and theory. The inclusion of macro-economic elements in the Maastricht Treaty took place without an explicit realisation of the change in the underlying strands of economic assumptions. Specifically for monetary policy a number of requirements for economic constitutionalism come from the ordo-liberals. First of all, the primacy of monetary policy (stabilizing the value of money)[22] or in Eucken's

[21] Sauter 1998, pp 50 and Behrens, Peter Die wirtschaftsverfassung der Europäischen Gemainschaft, in Verfassung fur ein ziviles Europa (Gert Bruggemeier ed. 1994).

[22] Issing, Otmar. On the primacy of price stability. Speech at the Prager-Frulings-Vortrag Liberalni Institut 10.6.2004. p.1-2. In the speech Issing states that in Eucken Grundsätze "Of the constituent principles of a competitive order, the 'primacy of monetary policy' comes first and foremost."

words "All efforts to make a competitive order a reality are pointless unless a certain level of monetary stability can be ensured. Monetary policy thus has primacy for the competitive order"[23]. Second, cyclical activism is risky due to lack of information and also by opening the door for interventionist elements. Some cyclicality is part of the competition economy. Third, monetary policy should not expose itself to rent-seeking activities of interest groups. This should be safeguarded by both institutional elements as well as limiting some actions outside the scope of a central bank. In particular, lending to banks should be based on uniform market principles alone. Against this background, many ordo-liberals preferred a strongly rule-based monetary policy with limited discretion for policy makers. This would help to create correct expectations of the future path of monetary policy[24].

II.2 The Bundesbank as a template for the ECB

At the start of the section, it was pointed out that the monetary policy part of the Maastricht Treaty and the related statute of the ECB and the ESCB (Eurosystem) were drafted very quickly. This was possible because the mandate and structure of the ECB and the ESCB were to a large extent copied from the Bundesbank. The Bundesbank was *primus inter pares* among European central banks if not among central banks globally by the end of the 1980s. Among European central banks that practically drafted the ECB statute and more broadly the monetary policy provision of the Treaty, the Bundesbank enjoyed an incomparable reputation and respect if not fear. This was helped by the fact that many European central banks did not have much to look back at with any sense of pride concerning the preceding two decades. Indeed, for other Member States one of the perceived benefits of EMU was to benefit from the credibility and reputation of the Bundesbank, which was hoped to be transferred to the guardians of the new European monetary policy. Obviously, for some countries it was equally important to gain control over monetary policy, which had effectively been lost to the Bundesbank[25].

The fact that the Bundesbank was perceived to be the model for the ECB and Eurosystem should not need much evidence, but what was included in the template remains a somewhat open issue both with regard to actual provisions and more importantly with regard to underlying theoretical and constitutional principles. It has been argued that the ordo-liberal school of thought that was highly influential in determining the European economic constitution was also the main driving force behind the Bundesbank statute and particularly behind the role the Bundesbank took in German economic life. To what extent the Bundesbank model was a purely ordo-liberal concept or achievement has at

[23] Eucken (1952) p. 256, translated in Issing (2004) p. 2.
[24] Henry M. Oliver German Neoliberalism . The Quarterly Journal of Economics, Vol 74, No 1 1960. pp 145-146.
[25] Giandomenico Majone (2011). Monetary Union and Politicization of Europe. Keynote speech at the Euroacademia International Conference: "The European Union and the Politicization of Europe", Vienna, 8-10 December 2011. p.16.

least two different aspects: the actual influence of ordo-liberal and other thought in designing the Bundesbank act, and the role of ordo-liberal ideals in the actual conduct of post-war monetary policy in Germany. The behaviour and credibility of the Bundesbank can hardly be explained by the Bundesbank act alone.

The design of the Bundesbank act was a relatively long process that started right after the war and ended with finalization of the act in 1957. What was peculiar in the process was that in many respects the actual conduct of the acting central bank organization preceded the legal acts. One of the most important events in the post-war German monetary order was the so called shock therapy orchestrated by Ludwig Erhard. As the director of Economic Administration in the Bizone (US and UK occupied zones), Erhard was involved in the currency reform that replaced the old Reichsmarks with the new Deutsche mark in June 1948[26]. Erhard was advised by the leading ordo-liberals and took a very bold (and ordo-liberal) step to accompany currency reform with abolishing the majority of price controls and rationing. The changes were mostly considered to be successful, as the functioning of the economy improved in a very short period and a fundamentally barter economy was replaced by an effective monetary system based on the Deutsche mark[27]. The currency reform highlighted the pivotal role of prices in the ordo-liberal economic order. A freely functioning price mechanism was essential and should not be manipulated by the state.

It has occasionally been questioned whether the independence of the Bundesbank or its tasks and operations were compatible with the ordo-liberal line of thought[28]. One reason for this view could have arisen from the fact that the monetary policy regimes suggested by leading ordo-liberals seemed to differ markedly[29]. However, there was very little disagreement concerning the role to be played by prices and hence concerning the need to have "neutral" money as a basis for the economic regime. Similarly, ordo-liberals were in favour of an independent but not isolated central bank, which could have caused some misunderstandings. For example, the scientific advisory committee[30] with a number of ordo-liberals (incl. Eucken and Böhm) published a report in 1949 entitled "Monetary Order and economic control". The report stated that "The unity of economic and monetary order requires a

[26] Lawrence H. White. The Postwar German "Wonder Economy" and Ordoliberalism. Chapter 9 in the The Clash of Economic Ideas. August 2010. pp. 317-319.
[27] This was also the starting point for the so called Wirtschafswunder, i.e. the very rapid growth of the West German economy between 1948 and 1957 despite receiving for example less Marshall aid than France or the UK. See for example White (2010), Rittershausen (2007) or Allen (2004).
[28] Bibow, J. Investigating the Intellectual Origin of Euroland's Macroeconomic Policy Regime: Central Bank Institutions and Traditions in West Germany After the War. The Levy Economics Institute. Working Paper No. 406. 2004.
[29] For example, Eucken favoured his own development of commodity currency, while Röpke was in favour of the gold standard.
[30] Committee Wissenschaftlichen Beirat beim BMWi could naturally be claimed purely ordo-liberal. It had 20 members at the time it was founded, and non-ordo views were also well presented. However, it is probably fair to assume that the committee would not write a report on monetary order that was completely against its highly influential members Eucken, Böhn and Muller-Armack.

timely coordination between all authorities involved. This also includes the central bank, since the aspired economic order cannot be realised without a corresponding monetary constitution and monetary policy. Within this framework of cooperation the central bank needs to be independent to the extent that it bears responsibility for the currency. This independence is to be protected by law"[31] From the above, it is difficult to draw any other conclusion than that the committee advocated an independent central bank responsible for the currency (i.e. the value of the currency).

The committee report was only part of the discussion behind the Bundesbank act that took until 1957 to be finalised. It is therefore difficult to assess the weight of ordo-liberal thought on the final legislation. Actually, the committee also issued an opinion on draft legislation in 1954. By that time the Bundesbank act was shifted to be drafted by Erhard's economic ministry. The proposal was "The central bank has to orientate its monetary and credit policy in the interest of steady growth of the economy in such a way as to keep the purchasing power of the DM as far as possible stable, in a way that monetary and credit policy contributes to the employment of all resources, and that the balance of payment may balance on the basis of free international trade."[32]

It is difficult not to read the statement as a clear mandate to keep the purchasing power of money stable, which is clearly the same as price stability. Understanding that in the ordo-liberal view the employment of all resources takes place under a free competition economy, the paragraph could be read simply that the central bank has to aim for price stability and keep international trade free as far it is its responsibility.

Key elements from the Bundesbank template

The fact that the Bundesbank provided the template for the Eurosystem is as clear in the larger issues concerning the statute of the ECB as it is in the detailed set-up of the new central bank model. The most important issues that were designed according to the Bundesbank model include:

1. The prominent role of price stability as the primary objective. In the case of the Bundesbank, this was less clearly pointed out at the level of law. In textual terms, the Bundesbank was merely deemed to safeguard the currency. However, in practice the Bundesbank implemented a strict anti-inflationary monetary policy that gave a clear price stability based interpretation to safeguarding the currency.
2. The Bundesbank was the first major central bank to publish its monetary policy strategy. This was deemed useful in getting other actors in the economy to understand the policy and also help them to align their actions to those of the Bundesbank.
3. Independence of the Bundesbank had some statutory protection but was even more so based on the reputation of the institution and trust by the German people. This was increased by the

[31] Translation from Bibow p. 21.
[32] Becker W.-D. Diskussion uber..1982 translation Bibow.

fact that German states were prominently represented in Bundesbank decision-making bodies. Hence, the central government could not claim supremacy over the Bundesbank without questioning the federal structure.

4. Limited role in other areas such as banking supervision. Part of the Bundesbank's independence and discretion was the need to limit its role and actions in other fields. Hence, as long as the Bundesbank had power over monetary policy, it did not have a major role in banking supervision. German (ordo-liberal) views manifested a deep-rooted opposition to any concentration of power. On the other hand, the limited role in banking supervision was one way of guaranteeing a clear mandate and focus on price stability.

II.3 Consensus of the economic profession in the 1980s

A major parallel development occurred in monetary economics and central banking practices in the 1970s and early 1980s. With a hint of sarcasm, it could be described as a process in which Anglo-Saxon economics invented the Bundesbank a few decades after it was founded. In the following I will present some stylised facts about this development highlighting issues that could have been most important for laying the foundations for the common monetary policy.

The perception of inflation both theoretically and empirically changed in the course of the 1970s. The basic theoretical foundation of the quantity theory of money can be traced back to the 18th century and David Hume[33]. However, after the Great Depression of the 1930s inflation was seen to have mostly an instrumental value in cyclical balancing of the economy. In particular, work by Keynes proved to be highly influential in designing economic policy after WWII[34]. Early criticism of inflationary or Keynesian economic and monetary policy was raised, for example, by Milton Friedman in the 1950s[35]. However, outside Germany inflation was perceived among the smallest evils and the anti-inflationary approach did not gain firm ground.

Towards the late 1960s, inflationary tendencies of the major economies became harder to cope with and made sustaining the Bretton Woods system of semi-fixed exchange rates increasingly more difficult. Consequently, the system was effectively abolished in the early 1970s. At the same time and worsened by the oil price shock, major economies suffered from both increasing unemployment and high inflation, which questioned the very foundations of Keynesian economic policy. The only major exception was Germany, where the Bundesbank made efforts to keep inflation in check, even potentially against the will of the central government.

[33] David Hume, 1752. "Of Money," "Of Interest," and "Of the Balance of Trade" in Essays, Moral, Political, and Literary. Reprinted in Hume, 1955, Writings on Economics, Eugene Rotwein ed.
[34] John Maynard Keynes (1936). The General Theory of Employment, Interest and Money probably best explains the approach.
[35] Milton Friedman, 1956. "The Quantity Theory of Money: A Restatement," in Studies in the Quantity Theory of Money, Chicago. Reprinted in The Optimum Quantity of Money, 2005), pp. 51-67.

Against the experience of the 1970s, there was a flux of empirical analysis of inflation and economic development. There was a consensus in the empirical analysis that inflation is a monetary phenomenon at least in the long run[36], i.e. when the economy has fully adjusted to policy measures or shocks. However, there was less clear cut evidence on the shorter-term effects of inflation and inflationary policy. After the 1970s experience, the balance of analyses shifted towards highlighting the negative economic and social effects of inflation even in the short or medium term. In particular, high and variable inflation was seen have relatively clear negative effects on employment and growth[37], which was evidenced by increasing inflation and unemployment in the major economies from the late 1960s to the late 1970s, with the exception of Germany. Consequently, in the early 1980s a number of countries engaged in anti-inflationary policies, which in some cases involved high social costs. The most notable case was the nomination of Paul Volcker to chair the Federal Reserve Board by President Carter in 1979. The appointment came with a mandate to fight inflation. The result was price stability through a steep but short recession.

In parallel to the theoretical and in particular empirical advances in monetary theory, an even more pronounced development occurred in institutional theory that seemed to complement that of monetary theory. First of all, Kydland and Prescott wrote a seminal paper in 1977 "Rules Rather than Discretion: The inconsistency of optimal planning”[38] which was followed by Barro and Gordon[39](1983). These papers argued that the incentive structure of policy makers (and a non-independent central bank) lead them to stimulate the economy excessively, which causes higher inflation but not higher output. There is hence an inflation bias if short-term oriented policy makers believe that inflationary policy has a short term positive effect on growth and employment. Barro (1976) had also shown that assuming rational expectations among economic agents, it can be difficult or ineffective for policy-makers to try to make surprise shocks to the economy[40]. Hence it could be desirable for a society to tie the hands of policymakers so that households and companies do not expect them to try policy surprises. Finally, the impact of the so called Lucas critique should be mentioned. Lucas (1976) argued against trying to predict the effects of economic policy on the basis of relationships observed in historical data. Keynesian economic policy relied on a macro-model when it tried to fine-tune economic development. However, the parameters of macro-models were not structural and hence they changed when policy was changed: “[a]ny change in policy will

[36] Otmar Issing, Vıtor Gaspar, Ignazio Angeloni and Oreste Tristani. Monetary Policy in the Euro Area Strategy and Decision Making at the European Central Bank. Cambridge University Press. 2004. p. 10-12.
[37] Ibid. p. 12-19.
[38] Finn E. Kydland; Edward C. Prescott. Rules Rather than Discretion: The Inconsistency of Optimal Plans. The Journal of Political Economy, Vol. 85, No. 3. (Jun., 1977), pp. 473-492.
[39] Barro, R.J., Gordon, D.R., 1983. A positive theory of monetary policy in a natural rate model. Journal of Political Economy 91,589–610.
[40] Robert Barro (1976). "Rational expectations and the role of monetary policy". Journal of Monetary Economy 2 (1): 1–32.

systematically alter the structure of econometric models", and hence make them inefficient in guiding economic policy[41].

The short and arguably selective description of the change in the economic paradigm in the course of the 1970s and 1980s hopefully helped to explain what kind of influences came from empirical and theoretical economics to the conduct of monetary policy. These could be summarised under three major heads:

1. Perceptions concerning the role of inflation in the economy changed. The belief that there was a trade-off between inflation and employment was invalidated and even reversed to some extent. High and variable inflation was seen to be detrimental to growth and employment.
2. The ability of economic policy to fine-tune economic development was seriously questioned. Economic policy discretion, particularly in the hands of short-term oriented policy-makers, was seen to be penalised by the rational behaviour of households and companies. In specific areas, binding economic policy rules were seen to yield Pareto improvements[42].
3. Structural elements received more emphasis. Designing an economic framework based on micro-economic behaviour was gaining momentum at the expense of active cyclical economic policy often labelled as Keynesianism.

The change in the economic paradigm and parallel negative experiences of national economic policy explained above facilitated creation of EU common monetary policy in a number of ways. As it would have been impossible to get Germany to abandon its anti-inflationary monetary policy, the only possibility for agreement came from other EU countries starting to subscribe to the German type of perception of inflation. The main orientation of monetary policy no longer differed between countries, which was also visible in an improvement in the functioning of the EMS system in the course of the 1980s[43].

The fact that active cyclical economic policy and monetary policy as a subordinated part of it was no longer seen as a major national tool for improving prosperity and well-being made surrendering national monetary policy a limited cost. Similarly, submission of national fiscal policy to rules defined at the EU level became possible as the rules were seen to contain social benefits as well as social costs. In the same vein, the EU economic constitution and economic agenda are by nature biased towards structural solutions rather than cyclical policy implementation. The EU has the regulatory machinery to implement structural or framework solutions to problems while it lacks the information and financial resources to conduct any form of cyclical policy.

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[41] Lucas, Robert (1976), "Econometric Policy Evaluation: A Critique", in Brunner, K.; Meltzer, A., The Phillips Curve and Labor Markets, Carnegie-Rochester Conference Series on Public Policy, 1, New York: American Elsevier, pp. 19–46.

[42] Improvement in the position of at least some without anyone being worse off.

[43] Majone 2011, p.

It should be clear to the reader that the change in the economic paradigm has shifted economic consensus towards the principles of the European economic constitution and also German (ordo-liberal) economic tradition as manifested in the role and actions of the Bundesbank. This shift created conditions for a common monetary policy framework by aligning the three main sources of that framework. In other words, had the economic paradigm still believed in an active cyclical fiscal policy and using inflation to smooth growth, a common monetary policy framework would not have been possible. The main paradox in this development is that the economic paradigm became very close to ordo-liberal views without ever mentioning the fact[44].

III Key constitutional principles of EU monetary policy and central banking system in stage three of EMU

On the basis of assessment of the Treaty stipulations and the three sets of sources for legal analysis, it is possible to draw the key stylised facts concerning monetary policy and also key constitutional principles covering monetary policy and central banking in EMU.

III.1 Price stability plays a fundamental role

Price stability penetrates all provisions of the Treaties on economic policy. It plays a more prominent constitutional role than is the case with any other central bank. In the new consolidated Treaties, "provisions relating to the European Central Bank… are set out in the Treaty on the Functioning of the European Union", but still in the new TEU it is mentioned as an objective in Article 3.3 that "the Union shall … work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress." The objective of the Union is sustainable development based on both balanced economic growth and price stability. Even at the Union level price stability is not a means to achieve economic growth but is rather a parallel means to aim at full employment and social progress. This prominent role of price stability is closer to the fundamental ordo-liberal view of price stability as part of systemic choice and as a means to achieve social equality than it is to the more instrumental role of price stability in the anti-inflationary economic paradigm.

As regards EU Economic and monetary policy, the same fundamental emphasis continues. In Article 119 of TFEU indent 3: "the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability". Hence both the exchange-rate policy by Ecofin and monetary policy by the ECB are to have price stability as the primary objective. Furthermore, all economic and monetary policy activities "shall entail compliance

[44] The only visible link seems to have been Hayek, who knew ordo-liberals well and was also criticising Keynesianism.

with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments."(Article 119.3).

Concerning more specifically monetary policy and the ECB, it is made very clear in Article 127 TFEU that the "primary objective of the European System of Central Banks (hereinafter referred to as "the ESCB") shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in 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 provision is repeated in the statute of the European System of Central Banks and the European Central Bank.

Smits points out that the primary role of monetary policy had fundamentally the same formulation in the draft of the Committee of Governors[45]. It therefore shows how central banks (the Bundesbank) wanted to be objectivised at the constitutional level. Central bank governors must have been forced to perform a balancing act between a very clear and unconditional objective and the ability to have more discretion in formulating their own objective in an ever changing world. The fact that a more one-sided objective was chosen and at a higher constitutional level than is normally the case with central banks, was a German demand based on their more fundamental anti-inflationary background. It shows how stable prices are seen as part of the economic and social system choice rather than a question of economic optimisation and empirical research that needs to be revised when new evidence arises. For example, the statutes of the Federal Reserve System in the US or the Bank of England provide a clearly less fundamental role for price stability.

III.2 Prohibition of public financing

The TFEU and the statute of the ECB make it clear that monetising public sector debt should not be an option in any event. Article 123 of the TFEU states that "Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments." This is further elaborated in the ECB statute article 21. The definitions for application of Article 123 were made by Council regulation[46] with the main emphasis on clarifying the process towards stage three of EMU. The regulation also pointed out in the preamble that "purchases made on the secondary market must not be used to circumvent the objective of that Article".

[45] Rene Smits. The European Central Bank. Institutional Aspects. Kluwer Law International 1997. p. 180-181.
[46] Regulation 3603/93.

The background for the prohibition is very clear. The history of central banking is full of examples where monetising, i.e. financing government with the issuance of paper money, has led to the collapse of the currency or at least excessive inflation[47]. Hence, the most important reason from the monetary policy perspective is to protect price stability. i.e. achieving the primary objective[48]. This need for protection could be seen directly, i.e. maintaining central bank control over the money supply but also indirectly by reducing central incentives to create surprise inflation to reduce the real value of accumulated government debt.

In the European context, the prohibition has another role as well. It should protect Member States from accumulation of debt by the ECB and also protect the non-bail out clause of the TFEU (Article 125). If national central banks were allowed to continue or start practices where they could finance governments at any level, it would ultimately lead to assuming liability at the Eurosystem level[49]. In this regard, the provision also aims at imposing Member States to market discipline, i.e. that they cannot rely on privileged access to national central bank financing or to financing by credit institutions (Article 124).

One of the difficulties concerning prohibition of public financing comes from the fact that central banks may need to use government bonds as instruments in the conduct of monetary policy. Government bonds are normally the largest, most liquid and safest asset class in a modern economy. Hence, there are a number of areas where using them has strong efficiency arguments. For example, using government bonds as collateral for monetary policy operations is a norm in central banking. The balance struck in Maastricht was based on a strict prohibition of purchasing bonds directly from governments, signalling that a creditor role towards governments was outside the scope of the common central bank. This was further elaborated in the associated regulation pointing out that it should not be circumvented via purchases from the secondary markets. Hence, the ECB should not have any role in financing Member States.

III.3 Independence of the central bank

Independence of the ECB (and also the ESCB) is one of key elements of the common monetary policy framework. In the Treaty, independence is safeguarded in a number of ways. Most importantly according to Article 130 of the TFEU neither the ECB nor NCBs "shall seek or take instructions from

[47] Otmar Issing. The Birth of the Euro. Cambridge University Press 1998. p. 54-55.
[48] Committee of Governors (Document 1669/1670), p. 25, according to Smits (1997) p.289.
[49] The ECB has also been very explicit on the prohibition. A legal Opinion (CON/2008/46) states: "The monetary financing prohibition, as defined in Article 101 of the Treaty, is essential to ensure that the primary objective of monetary policy, namely to maintain price stability, is not impeded. Therefore, the prohibition must be interpreted extensively in order to ensure its strict application. It is noted that, under Article 237(d) of the Treaty, the ECB is entrusted with the task of monitoring the compliance of the NCBs with the prohibition on monetary financing and, as pointed out in a recent opinion, it is important, in the case of emergency liquidity assistance supported by a State guarantee, to provide for appropriate legal safeguards in terms of central bank independence and compliance with the monetary financing prohibition."

Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body." And similarly Union institutions and Member States should "respect this principle and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks."

In addition to this relatively general statement of independence, the TFEU and Statute contain a number of provisions that are meant to safeguard independence. These include provisions on the special audit procedure, terms of office and other working conditions of the Executive board and members of the Governing Council.

The area of independence is one of the key examples where the requirements coming from the (ordo-liberal) European economic constitution, the Bundesbank template and the economic consensus of the late 1980s happened to be mutually reinforcing at the time of the Maastricht Treaty. As explained in the previous chapter, a major development occurred in academic economics towards advocating central bank independence. This development was not by any means limited to the EU or European central banks.

Central bank independence and the detachment of monetary policy from other parts of national economic policy-making was also one of the reasons facilitating EMU. Countries that previously considered monetary policy as part and even a subordinate part of national economic policy had been forced to give central banks independence in order to facilitate balanced economic development. Hence, for national economic policy-makers, monetary policy was already "lost" even before it was transferred to the EU level.

III.4 Advancing and respecting the principle of open market economy with free competition

Article 119.1 on economic and monetary policy starts the emphasis on free competition by stating that "the activities of the Member States and the Union shall include…the adoption of an economic policy which is… conducted in accordance with the principle of an open market economy with free competition". The same is then repeated in article 127 on monetary policy with the addition of "favouring an efficient allocation of resources", which is then repeated in Article 2 of the statute on the objectives of the ESCB.

Strong emphasis on an open market economy and free competition in all the actions of the common economic and monetary policy and particularly the actions of the ECB can hardly be questioned. Without engaging in debate on whether the Community is based on the assumption of one type of economic order over another, it is without doubt that the ECB has to obey a market economy based economic rationale in its own actions[50]. In this regard, it could be stated that while the European economic constitution might still be interpreted in a neutral as well as in a more ordo-liberal way, the monetary policy part seems to be highly ordo-liberal.

What this means in practice is that the ECB should cross-check its decision and objectives with the principles of a free competition based market economy. This is particularly important with regard to the operational framework of the ECB. It should be designed in a way that has a minimal effect on the functioning of the free market economy[51]. There were indeed a number of elements in the design of the ECB operational framework that could be partially explained by strict adherence to market principles. For example, the minimum reserve system is fundamentally not a market based system as it is based on obligating market participants to make minimum reserve deposits in central banks. In the case of the ECB, it was decided that minimum reserve proportions should be kept relatively low and more importantly they were fully remunerated. Somewhat paradoxically, reliance on minimum reserves came directly from the Bundesbank template but the ECB decided to be more market-oriented than the Bundesbank by having low, uniform and remunerated minimum reserves[52].

Quite similarly, the main tool for implementing ECB monetary policy is the weekly auction. As soon as it was deemed possible, these weekly auctions were made as short as possible and with variable rate tenders instead of fixed rate tenders in order to have limited impact on the market mechanism[53].

A key element of the conformity of actions with free market principles is the provision that ECB lending should be based on adequate collateral. For an institution that by nature thrives on being in a position to lend to the banking sector, it is of utmost importance that lending is safe. This is even more so because ECB lending aims at controlling liquidity conditions in the banking sector rather than at a commercial profit through adequate pricing of risk. Indeed, the fact that the ECB does not in principle take any margin on its regular lending activities makes it clear that lending should be considerably safe. Otherwise lending would be a subsidy to the receiving bank and hence against free market principles. In the operational framework as defined by the ECB, the safety of lending is based on two principles. Firstly, lending takes place to credit institutions that are supervised by national authorities and lending is based on adequate collateral. In order for losses to occur, both the receiving bank must fail and the collateral must lose at least something of its value.

[50] Rene Smits (1997) reached the same conclusion. p. 190-91.
[51] This is also stressed by the ECB in The monetary policy of the ECB. Frankfurt 2004. P. 72.
[52] Issing (2008).p. 120-122.
[53] For example, in Issing (2008) there is a good description of the decisions and early evolution of the ECB operational framework. p. 122-130.

III.4 Role limited to achieving pre-defined objectives and excluding areas needing political value judgements

The Treaty is very clear in allocating objectives and related tasks and mandates to the ECB (and Eurosystem). Apart from the primary objective and tasks enumerated in the Treaty (and repeated in the statute), the ECB is given very little leeway for expanding its role even with the consent of the Council. The most telling example relates to prudential supervision, which has often been part of the central bank mandate. Firstly, all explicit deviations or additions to the tasks of the ECB have been made very difficult. For example, conferring special tasks in the field of financial supervision of credit institutions requires a unanimous decision by the Council, and consultation with both the European Parliament and the ECB (Article 127.6 of TFEU). Even this procedure does not allow similar tasks with regard to insurance undertakings. This shows that there are very strict barriers to expanding the tasks (and hence the mandate) of the ECB.

Secondly, it could be argued that the European economic constitution, in particular in its ordo-liberal reading, would limit the role of independent administrative bodies to pre-defined tasks that can also be controlled by judicial means. If it is seen that a given function is best organised as a non-democratic expert function, then it can be allocated to an independent expert organisation. As argued earlier, the assumption that monetary policy is such a function is indeed a key assumption behind the role of the ECB. Without taking a stance on whether that assumption is correct, it should be clear that it does not allow for any tasks to be transferred to an undemocratic body if that body does not fulfil the same assumption. Furthermore, it could be argued that original ordo-liberal thinking would also avoid concentration of power, be that public or private: hence the preference for independent expert organisations with very clear tasks and mandates. In the case of the Bundesbank, it was also seen as part of the institutional arrangement that its tasks and objectives were relatively limited. That made it always clear what the primary task of the Bundesbank was.

Another corollary of the limited role of the ECB is that it clearly excludes any role of redistributive elements in ECB policy, which has also occasionally been acknowledged by the ECB[54]. This is obvious from the limited budgetary resources given to the ECB, but more fundamentally it stems from lack of a mechanism to make political value-based decisions.

III.5 Defined strategy and operational targets

It could be somewhat surprising that a predefined strategy and operational targets could be seen as a constitutional principle. The enhanced importance of a pre-defined strategy in the case of the ECB stems from two sources. First, a defined strategy has an elementary role in the accountability of the ECB. With very limited means of controlling and making the ECB accountable, forcing the central

[54] Speech by Trichet 2009.

bank to announce strategy beforehand gives some kind of point of reference. If there were no strategy or intermediate targets, it would be very difficult to say whether the ECB had performed according to its objectives and tasks or not. Public ex post hearing in the EU Parliament would easily become formalities and more direct accountability toward the people of the euro areas would be absent.

Second, the Bundesbank was the first major central bank that started to define its strategy and (monetary) targets. A pre-announced strategy and intermediate targets played a very important part in the institutional set-up of the Bundesbank, as it facilitated the de facto independent role of the institution as well as public respect. Indeed, it most likely enforced the perception that the Bundesbank was primarily accountable to the people of Germany rather than to government. This was achieved by pre-announcement of the strategy and targets and ex post explanation if and when they were not achieved[55].

IV Constitutional analysis of ECB actions in the economic crises

This section aims at combining the key constitutional principles presented in the previous section with the actual actions that the ECB (and Eurosystem) has taken in the course of the crises. Rather than aiming at the impossible task of being exhaustive, I will concentrate on some actions that could be particularly informative of the ECB's role in the economic crises and useful in applying constitutional analysis. The actions under scrutiny will be expansion of the collateral pool, measures to increase and manage liquidity in the financial sector, involvement in designing and implementing the Greek rescue package and the purchase of government bonds (SMP programme). However, I will start with a short description of the ECB monetary policy framework with some notes on how this could be assessed from the standpoint of constitutional principles. If not stated otherwise, all factual material is obtained from the ECB (website and other publications).

IV.1 Short description of the ECB monetary policy framework

In order to follow the line of thought of this analysis, it would be helpful if the reader was slightly familiar with the way the ECB conducts monetary policy for the people of the euro area[56]. Three different concepts should be clarified in order to understand the role and actions of the central bank: monetary policy strategy, the monetary policy transmission mechanism and the operational framework.

[55] The Bundesbank had so called monetary targets, i.e. targets for the growth rate of some monetary aggregates. For the credibility of the institution, it seemed to be less important to achieve the targets than to have them in the first place. Accountability is enhanced by the aim of achieving targets and by the need to explain why they were not achieved.

[56] For a more thorough description, the reader is advised to look for example at Monetary Policy on the ECB website and also Issing et al. (2001), Monetary Policy in the Euro Area – Strategy and Decision-Making at the European Central Bank, which are used as a main source for this description.

Monetary policy strategy

Monetary policy strategy refers to the general principles of conducting monetary policy including the intellectual framework for making decisions on the appropriate level of short-term interest rates. According to the ECB, monetary policy strategy comprises a quantitative definition of price stability, and a two-pillar approach to analysis of risks to price stability.

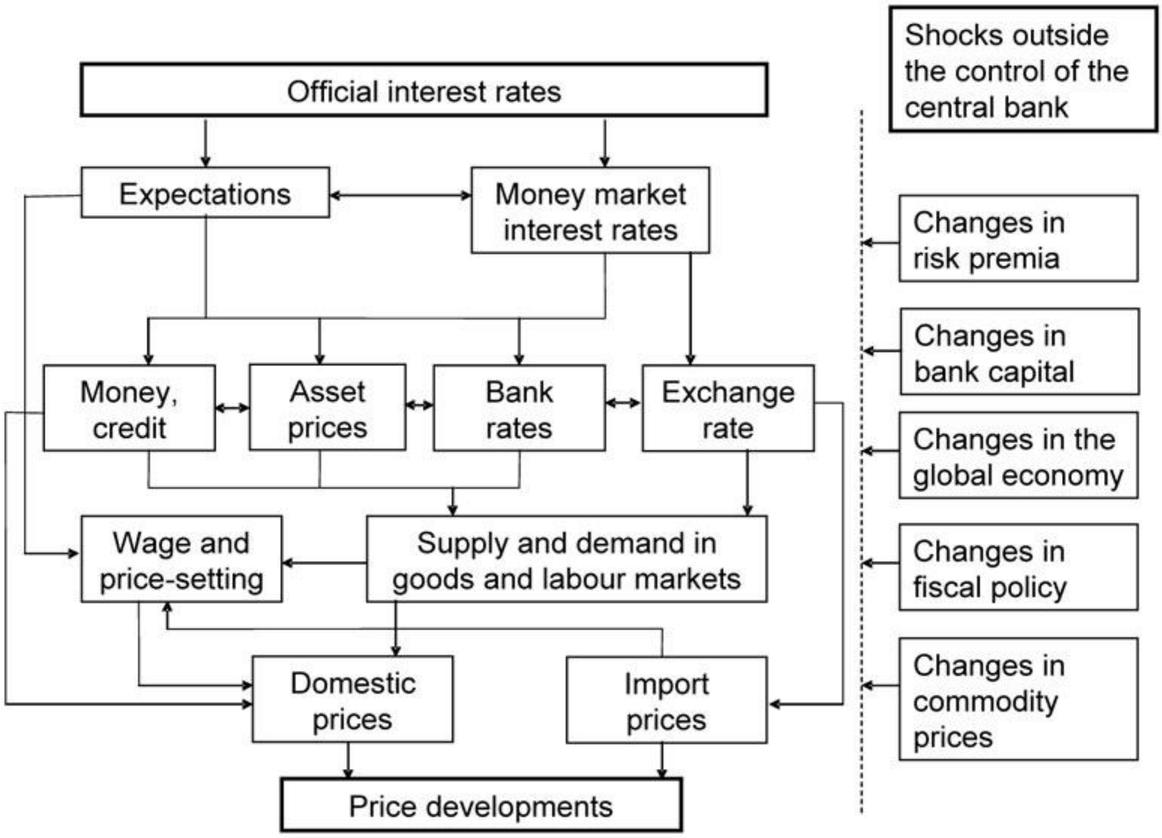
A quantitative definition of price stability refers to the ECB Governing Council's definition of price stability as a year-on-year increase in consumer prices (HICP) for the euro area of below but close to 2% over the medium term. The main arguments provided for this selection are adequate margin to avoid the risk of deflation, the possibility of measured inflation slightly overstating true inflation, and a sufficient margin to take into account inflation differentials in the euro area.

The two-pillar approach refers to thorough analysis of economic developments based on two analytical perspectives: economic analysis and monetary analysis. These form the basis for the Governing Council's overall assessment of risks to price stability and its monetary policy decisions. It other words, the ECB did not adopt the more purist monetarist approach of the Bundesbank but still maintains a major role for monetary analysis including a reference value for the growth rate of the broad monetary aggregate.

In addition, communication is a major element of the strategy. Explaining monetary policy decisions to the public in a clear and transparent manner would help the central bank to carry out its mandate more effectively, but also to ensure accountability to the public. The ECB has acknowledged that political independence needs to be balanced with accountability. According to the ECB it is the legal and political obligation of the ECB to explain and justify its decisions to the people of the euro area and their elected representatives. This is enhanced by transparency, i.e. by providing the public with information on ECB strategy, assessments and policy decisions as well as on its procedures in an open, clear and timely manner. The main reasons for transparency as a means of effective conduct of monetary policy are: (1) when monetary policy is understood and a central bank is perceived as able and willing to achieve its policy mandate, price expectations are better anchored, (2) facilitating public scrutiny of monetary policy actions is a strong incentive for decision-making bodies to fulfil their mandates, and (3) market participants can better understand and anticipate the direction of monetary policy over the medium term, which could shorten the transmission process and make monetary policy more effective.

Transmission mechanism

A transmission mechanism is a key economic concept in monetary theory. It is the assumed process through which monetary policy decisions affect the economy and price levels in particular. It is surrounded by great uncertainty with regard to the importance of various elements and time lags. It has been claimed that these uncertainties are particularly large in the case of the euro area[57]. A sketch of a standard transmission mechanism is provided by the ECB website:



Operational framework

To achieve its primary objective, the Eurosystem uses a set of monetary policy instruments and procedures which it calls the operational framework. The operational framework is used to affect the transmission mechanism to achieve ECB objectives. The main elements of the operational framework are the minimum reserve system, which affects the monetary base directly, and official interest rates (the main refinancing rate and interest rates on standing facilities), which affect money market rates. The amounts allocated and interest rates applied in the main refinancing operations and other auctions affect the liquidity situation in the banking sector. Furthermore, as a result of the crises, the operational framework has been supplemented by a number of ad hoc measures aimed at correcting specific problems and malfunctions.

The Eurosystem is the sole issuer of banknotes and bank reserves in the euro area. This makes it the monopoly supplier of the monetary base, which consists of currency in circulation as well as reserves

[57] Issing et al. (2005). Imperfect Knowledge and Monetary policy. Cambridge University Press and also Monetary policy transmission in the euro area, a decade after the introduction of the euro. ECB Monthly Bulletin article. May 2010.

and deposits bank held with the Eurosystem. Through this monopoly, the Eurosystem is able to manage the liquidity situation in the money market and influence money market interest rates.

The most important part of the operational framework is open market operations. These are used to steer interest rates, manage the liquidity situation in the market and signal the monetary policy stance. Five types of instruments can currently be used. The most important instruments are reverse transactions, which are applicable on the basis of repurchase agreements or collateralised loans. The ECB can also make outright transactions, issue debt certificates, conduct foreign exchange swaps and collect fixed-term deposits.

Four types of open market operations can be differentiated according to aim, regularity and procedure:

1. Main refinancing operations are regular liquidity-providing reverse transactions with a frequency and maturity of one week. They use standard tenders and a pre-specified calendar. They normally provide the bulk of refinancing to the financial sector.
2. Longer-term refinancing operations are similar to the main refi-operations. They are regularly conducted with a monthly frequency and a maturity of three months. Other longer-term operations are conducted at irregular intervals and with other maturities. These operations aim to provide additional longer-term refinancing rather than signalling monetary policy stance.
3. Fine-tuning operations can be executed on an ad hoc basis to manage the liquidity situation in the market and to steer interest rates. Fine-tuning operations are primarily executed as reverse transactions.
4. Structural operations will be executed whenever the ECB wishes to adjust the structural position of the Eurosystem vis-à-vis the financial sector (on a regular or non-regular basis).

The aim of these operations is to signal monetary policy stance, to ensure proper functioning of the money market and to help credit institutions meet their liquidity needs in a smooth manner. In addition to open market operation, the Eurosystem also has standing facilities to support the above mentioned aims. With standing facilities, banks can make overnight deposits and get overnight loans against full collateral. As a rule, the deposit rate is below and the loan rate is above the prevailing market interest rate.

A crucial element of the operational framework is ECB collateral policy. Collateral is the assets that are pledged to the Eurosystem as security for its credit operations. To be accepted as collateral, these assets must fulfil certain criteria, i.e. be "eligible". Collateral policy is communicated in the regularly up-dated document “The implementation of monetary policy in the euro area: General Documentation on Eurosystem monetary policy instruments and procedures”[58]. The specific features of ECB

[58] The latest version is the Guideline of the ECB of 20 September 2011 on monetary policy instruments and procedures of the Eurosystem (recast) (ECB/2011/14) OJ L 331, 14.12.2011.

collateral policy are the very large number of counterparties (banks), a broad list of eligible collateral and a de-centralised procedure through the Eurosystem central banks.

The Eurosystem started with a relatively diversified collateral policy and hence collateral pool that took into account national practices in the run-up to the single currency. This was a temporary solution, as national differences were not to be a permanent part of the system. Hence from the start of 2007, the Eurosystem moved to a single and uniform collateral framework.

Constitutional assessment of the ECB monetary policy framework before the crises

It could be assessed that the ECB monetary policy framework was designed and implemented broadly in line with key constitutional principles. First, monetary policy strategy respects the primacy of price stability. It also aims at providing the people of the euro area with a genuine strategy and operational targets that could provide a basis for accountability. This is enhanced with relatively transparent communication. On the positive side, reporting to the EU Parliament, regular press conferences with questions and answer sessions and availability to the press of senior management have increased accountability and transparency. On the negative side, the deliberations of the ECB Governing Council are kept secret for 16 years, which renders them useless for the purpose of accountability. It could also be claimed that judicial control of ECB actions has remained unsatisfactory from the point view of accountability of this highly independent organisation[59]. The Pringle case, although discussing the actions of the ECB only indirectly, would rather have added to the confusion.

Second, the operational framework was designed according to constitutional principles. It respected free market economy principles to a very large extent. It was also based on uniform principles and there was a limited role for pre-selection of counterparties, for example. With regard to collateral policy, there were some issues of concern. It started of with two lists, national and system-wide, which was unsatisfactory and contained some (although transitory) elements of favouritism. Collateral policy could be seen as favouring government bonds beyond what could be explained by their properties, for example initially with no haircuts in collateral value and later very limited haircuts. Indeed, taking into account the prohibition of public finances principle, a more prudent collateral policy concerning government bonds would have been warranted.

III.2 Measures during the first phase of the financial crisis

The first larger scale indications of the upcoming financial crisis became apparent in the latter half of 2007[60]. As late as in June 2007, the ECB raised interest rates and hence it was clear that an upcoming

[59] The only proper case at the ECJ has been OLAF Case C-11/00 Commission of the European Communities v. the European Central Bank, where the Commission challenged the validity of ECB Decision 1999/726/EC of 7 October 1999 on fraud prevention (ECB/1999/5), which was institutionally important but remained at the periphery concerning the ECB's actual role in the EU economy.

[60] One of the key events was the disclosure by Bear Stearns, a major US investment bank, of major losses of value of two hedge funds investing in so called sub-prime loans. These events started the more familiar story of

financial crisis was not foreseen. When the first major implications of the crisis became apparent, the ECB responded with a series of measures that were mainly intended to ease the liquidity situation in the banking sector and thus ensure market funding for (solvent) banks. What complicates analysis of the initial response to the financial crisis is that the transition to the first single collateral framework and later Target2-securities system took place in parallel[61]. With that in mind, I will briefly describe the ad hoc measures taken by the ECB and draw some stylised facts on them. These will then be placed under some constitutional scrutiny.

Ad hoc measures and unusual use of standard measures started in August 2007. After the regular meeting on 2 August, the ECB had indicated that it would provide liquidity needed for markets to perform[62]. This began a long series of general announcements on liquidity policy that were accompanied by fine-tuning operations both of which were aimed at addressing short-term nervousness in the money market. The general theme appeared to be that the ECB was trying to convince the markets that it would provide more than the necessary liquidity needs and that allotments in weekly tenders would be such that the variable interest rate would be close to the refinancing rate (policy rate).

However, as these measures were considered insufficient, the ECB engaged in a series of ad hoc or supplementary measures concerning longer term financing to the banking sector[63] aimed at normalising conditions in the money market. These tenders were all variable rate and to a large extent 3-months long. Tenders reached a total outstanding amount of first 120 bln EUR and later 150 bln EUR.

Another ad hoc type of measure was the provision of US dollar liquidity in connection with the US Federal Reserve Term Auction Facility[64]. The main aim of this operation was to provide non-US

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surprise losses by investment bank-led hedge funds related primarily to the US real estate markets. These surprise losses subsequently led to a realisation that many risks were heavily underestimated and hence undercapitalised (probably the worst of all, counterparty risks). As a natural consequence, banks' ability to trust one another was at times heavily questioned and led to malfunction of the interbank market, which had become a major source of funding for the banking sector.

[61] On 8 March the GC of the ECB decided that it was feasible to go ahead with TARGET2-Securities, and a list of measures were taken which also affected collateral policy. The TARGET2-securities project was officially launched on 17 July 2008.

[62] This was followed by a full allotment in the following weekly tender, i.e. banks received all the financing they asked for and a statement by governor Trichet on 14th August mainly to calm down markets.

[63] On 27 August a supplementary liquidity-providing longer-term refinancing operation with a maturity of three months for an amount of EUR 40 billion; on 6 September a supplementary liquidity-providing longer-term refinancing operation with a maturity of three months carried out as a variable rate tender, with no preset allotment amount (EUR 75 bln). These were followed on 8 November by a decision to renew them with two new supplementary LTROs carried out through variable rate tenders, each with a preset amount of EUR 60 billion. These supplementary operations were renewed with somewhat different amounts and lengths on 7 February, 28 March and 31 July 2008.

[64] The first case took place in 12 December 2007, when the ECB jointly with Bank of Canada, Bank of England, the Federal Reserve, and the Swiss National Bank announced co-ordinated measures to address pressures in short-term funding markets. The ECB decided to offer US dollar funding to Eurosystem banks with two US

banks active in the US dollar market with US dollar liquidity by using collateral domiciled (and denominated) in those non-US jurisdictions. It was an external part of the US Federal Reserve programme to guarantee funding to the banking sector.

Key stylised facts

First, the ECB operated broadly in line with its pre-announced operational framework. The main part of the exceptional liquidity provision was conducted by weekly main refinancing operations. The operational mode and structure was maintained. Also the ad hoc measures were part of the operational framework, as structural longer term operations formed part of those operations. In this regard, the only truly ad hoc measure was acting as agent for the US Fed by using Eurosystem collateral and hence with Eurosystem risk.

Second, and related to the first point, there was a serious attempt to maintain the market conformity of operations. All refinancing operations were conducted as variable rate tenders without a guarantee of full allotment, even though there was occasionally strong communication stating that the rate would be close to the refinancing rate. More importantly, longer-term operations were with truly variable rates and with fixed allotments. Hence ECB influence on the financial market price mechanism increased but remained under check.

Third, although the underlying risk of the ECB over the euro area banking sector increased even substantially, there was no serious doubt that the reason would be anything other than liquidity provision in order to maintain the functioning of the interbank market. The ECB explicitly remained outside discussions over banking sector solvency support[65], which also helped to maintain ECB institutional independence. Liquidity support was not mixed with indirect solvency support or, even worse, indirect public financing. Against this background, it was not seriously questioned that the ECB maintained focus on its primary objective.

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dollar operations. The US dollars would be provided by the Federal Reserve. The actual operations were conducted on 14 and 19 December with a fixed rate defined by the Fed. These were then renewed in January for the same total amount of up to 20 bln USD. In March the total amount was somewhat increased. More fundamentally on 2 May, again as part of a joint effort, the ECB announced a regular bi-weekly provision of dollar monthly liquidity of 25 bln USD, raising the outstanding amount to 50 bln USD with provision of currency and fixed coming continuously from the Fed.

[65] In the case of a German bank failing over US subprime liabilities, Trichet stated in a press briefing on 2 August 2007 “I will not add anything to what has been said by the German entities concerned themselves, by the authorities and by Axel Weber.”, making it very clear that the ECB had nothing to do with a bank failure in a euro area country.” And even more explicitly on responsibility concerning Fortis Bank at a press conference on 2 October 2008 “And in a period when it appears that the situation calls for government responsibility, I confirm that we judge it appropriate that governments take up their responsibilities. I think they did well in the case you mentioned, they did well in other cases, including in this country: I confirm that I think the government did well in Germany.”

IV.3 Measures taken in the escalation of the financial crises

The financial crisis took a turn for the worse on 15 October 2008 with the collapse of Lehman Brothers (the US investment bank) after somewhat chaotic attempts to sell or rescue it. At the time, it was the fourth largest US investment bank and very active in most financial market sectors, for example one of the largest derivatives counterparties. The collapse of Lehman was a shock to market confidence in general and the interbank market in particular. The fact that a bank of Lehman's size was allowed to fall to bankruptcy proceedings rather than being rescued with public sector involvement came as a surprise[66]. Lehman's large exposure to most main markets and counterparties even made it likely that another bank could face unbearable losses, when Lehman failed to fulfil its liabilities. Hence banks' ability to trust one another was eroded to an extent unforeseen in the short history of modern banking. With large-scale exposure to the US market and US banks, the European banking sector was in the middle of the crisis. For central banks, the main problem to be solved was the functioning of the interbank markets. When banks could not trust each other, they could not borrow or lend in the interbank market. The lack of interbank funding was leading to large-scale reductions or even withdrawals of lending, fire-sale of assets and other forced measures that could transform a liquidity crisis into a solvency crisis. Along with other central banks, the ECB was forced to react very quickly in order to avoid malfunctioning of the economy.

Measures on collateral policy

On 4 September 2008, just a few days before the outbreak of the Lehman collapse, the ECB decided on changes concerning Eurosystem collateral policy. The changes were labelled as a regular review taking place every second year. Three changes were implemented. A uniform haircut of 12% was set for asset-backed securities (ABSs), which in practice made rules slightly stricter. On bank bonds a haircut add-on of 5% to unsecured bank bonds was applied. In addition, higher rating disclosure standards were introduced. It is not totally clear why the ECB introduced those changes at that point in time. However, there were indications that the quality of ECB collateral was seen to have weakened, and the rules were feared to have supported that weakening. For example, in the press conference, a question was asked whether unsecured bank bonds had increased their role in collateral[67].

The main deviation with regard to previous collateral policy took place on 15 October[68]. The ECB decided temporarily to expand the list of eligible collateral in Eurosystem credit operations until the

[66] This surprise was probably made bigger by the fact that Bear Stearns was rescued only six months earlier through a sale to JPMorgan Chase that was facilitated by financial assistance from the NY Federal Reserve.
[67] ECB Press conference: Introductory statement with Q&A Jean-Claude Trichet, President of the ECB, Frankfurt am Main, 4 September 2008. Transcript provided by the ECB website.
[68] The decision was quickly made in the form of ECB Regulation (ECB/2008/11), because it amended albeit temporarily ECB Guideline ECB/2000/7, and needed to have direct applicability throughout the Eurosystem and soon after adopted the respective ECB Guideline on temporary changes to the rules relating to eligibility of collateral (ECB/2008/18).

end of 2009. The main additions to the list of collateral included marketable debt instruments denominated in other currencies, syndicated euro-denominated loans governed by UK law, debt instruments issued by credit institutions traded on accepted non-regulated markets (CDs) and subordinated debt instruments with an acceptable guarantee. In addition to this major expansion of the collateral list, the ECB lowered the credit threshold for marketable and non-marketable assets from A- to BBB-.

Clearly the attempt was to broaden the collateral framework considerably and very quickly[69]. Excessive funding needs by the euro area banking sector caused by malfunctioning interbank markets had rendered available collateral a potential constraint for sufficient liquidity creation.

A more minor change was implemented a year later on 20 November 2009 when the ECB amended rating requirements for ABSs. Now at least two ratings from rating agencies were required and the "second-best" rule would apply. This had the announced aim of ensuring that the Eurosystem's requirement of high credit standards for collateral was met.

The next major change in collateral policy took place on 8 April 2010 when the ECB introduced graduated valuation haircuts for lower-rated assets, while keeping the minimum credit threshold at investment-grade level (i.e. BBB-/Baa3)[70]. The graduated haircut schedule based on differences across maturities, liquidity categories and the credit quality of the assets concerned replaced the uniform haircut add-on of 5% that was previously applied. The lowest haircuts applied to the most liquid assets with the shortest maturities, while the highest haircuts applied to the least liquid assets with the longest maturities. The change was clearly intended to reduce the exposure of the ECB to lower quality collateral. More importantly, it was also confirmed that the major temporary expansion introduced in October 2008 and once prolonged in May 2009, would end as from 1 January 2011[71]. However, somewhat illogically no changes were introduced to the haircut schedule for central government debt instruments, and the ECB was criticised for bending the system for Greece[72].

ECB standard and ad hoc measures

In addition to the changes in collateral policy, the ECB was very active with other features of its standard and ad hoc measures of the operational framework. The ad hoc measures that were started in the first phase of the financial crisis were continued and given a more permanent status. Firstly,

[69] A telling example was the fact that syndicated UK loans were excluded from the ECB Guideline formalising the decision only 11 days later, which indicates extreme urgency in designing the expanded list.
[70] The actual new hair-cut schedule was published 28 July 2010.
[71] So marketable debt instruments denominated in currencies, debt instruments issued by credit institutions, traded on the accepted non-regulated markets; and subordinated debt instruments protected by an acceptable guarantee would not be accepted from 2011 onwards.
[72] See for example, the heated discussion at a Press Conference on 8 April 2010. The issue will be discussed more in the next part on fiscal policy measures.

provision of dollar liquidity was made a permanent (even weekly) feature of ECB operations[73], which reflected the importance of the dollar in the global financial system and the relevance of dollar funding for the euro area banks. Provision of dollar liquidity was deemed so important that it was provided using the ECB collateral system and hence at the ECB's credit risk[74]. Secondly, special and longer-term refinancing operations became regular and the maturity of operations was increased. All longer-term refinancing operations were also carried out through a fixed rate tender procedure with full allotment, which was a major shift from the first phase of the financial crisis[75].

As a sign of crisis assessment, the ECB changed its normal tender procedure and the standing facilities corridor on 8 October 2008. The weekly main refinancing operations were carried out through a fixed rate tender procedure with full allotment at the interest rate of the main refinancing operation. The corridor of standing facilities was reduced from 200 basis points to 100 basis points. Although these measures, which effectively eliminated a major part of the market mechanism from the euro area money markets, were deemed temporary, there was no pre-set expiry date.

A new type of measure was introduced on 7 May 2009, namely a covered bond programme[76]. The programme amounted to EUR 60 billion and was carried out by means of direct purchases in both the primary and the secondary markets. A minimum rating of AA was set and purchases were directed at relatively large issues. This outright purchase programme was a major shift in policy. It could also be recalled that in October 2007 the ECB had decided to remove the option of employing outright transactions for fine-tuning operations, although retained the option of using outright transactions for structural operations.

The aim of the programme was to support a "specific financial market segment that is important for the funding of banks and that had been particularly affected by the financial crisis." In more concrete terms, the programme was set up to facilitate some countries' financial markets, where bank funding was effectively based on covered bonds. In this regard, it could be seen as symmetrical to longer term auctions in those countries where direct bank lending was the primary source for loans. The ECB used the programme in full already in the course of 2009. In 2010 it was announced to be completed with the information that central banks intended to keep the covered bonds until maturity[77].

The market situation appeared to calm down towards the end of 2009 and early 2010. Hence, on 4 March 2010 the ECB decided to continue the gradual phasing-out of its non-standard operational

[73] The first in the series of decisions was taken on 26 September 2008 and was a coordinated measure with other central banks.
[74] On 13 October, these weekly dollar auctions were conducted on a fixed rate full allotment basis.
[75] For example on 7 May 2009 the ECB announced for the first time a schedule of one-year auctions with fixed rate and full allotment, so a considerable lengthening of maturity.
[76] Officially the decision was made on 2 July 2009 on implementation of the covered bond purchase programme (ECB/2009/16)
[77] This has been the case and another covered bond programme was later announced but fully implemented.

measures with the announcement of a likely ending of conducting its main refinancing operations (MROs) as fixed rate tender procedures with full allotment in the latter half of 2010 should that be deemed appropriate. As part of the normalisation, the ECB also decided to return to variable rate tender procedures in regular longer-term refinancing operations in April 2010, while still keeping amounts so that no major difference in policy rate and tender rates would take place. However, these decisions were not fully kept in the situation of emerging Greek problems.

Stylised facts on and constitutional assessment of ECB measures

The measures taken in the course of the financial crisis form a pattern and need to be seen as part of the ECB total reaction to an unforeseen and rapidly evolving situation. The main aim of the measures was to maintain the functioning of the European interbank market which was seriously hampered by the Lehman episode, but even more fundamentally by the losses that had occurred and that were expected to occur in various markets and instruments. Obviously, the fact that banks could not trust each other also reflected distrust of financial supervision in Europe[78].

In order to provide the banking sector with liquidity in times of a non-functioning interbank market, the ECB increasingly replaced the money market with its operational framework. The ECB guaranteed unlimited funding to banks as long as they had collateral, which was helped by expansion of the list of eligible collateral. And when that was not deemed enough, the ECB even started direct purchase of covered bonds. The increased role of the ECB (Eurosystem) in the euro area banking market is visible in the evolution of its balance sheet. Eurosystem consolidated loans to and securities by euro area residents were slightly more than 320 bln in July 2003, 560 bln in July 2007, 1080 bln in July 2009 and reached 1780 bln EUR in March 2012. Hence the Eurosystem’s exposure to euro area financial markets increased more than threefold since 2007.

For analysis of these measures, a number of issues could be brought up. On collateral policy, we can analyse the policy both in static and in dynamic terms. In static terms, the main issue is whether relaxation of collateral policy went to the point where the term “adequate collateral” could no longer be used to describe it (Article 18.1 ECB Statute). There is no clear cut definition of adequate collateral, but it should be kept in mind that ECB lending and collateral policy does not allow for risk to be flexibly taken into account in pricing. Indeed, the safety requirement should be more extensive than with the case of private banks, because there is no compensation for risk in the lending rate (margin).

[78] Without going into too much detail, it was clear that some supervisory solutions like the transition of potentially problematic assets including some government bonds from application of the mark-to-market accounting principle to hold to the maturity principle of the banking book were elementary in increasing distrust in the system.

In more dynamic terms, the question is whether collateral policy led to a reduction of market discipline and to a potential increase in systemic risk. For example, the inclusion in the collateral list of debt instruments issued by credit institutions traded in the non-regulated marketplace could be seen against the decision only one and half months earlier to try to curb the use of bank bonds via increased haircuts. Indeed, just before the outbreak of the Lehman crisis, it was well understood that the possibility of using bank-created assets as collateral could lead to an unwelcome loss of market discipline and worsening of collateral quality. So expansion of the use of bank-created assets as collateral was potentially questionable or at least showed a very deep trust in Member States' ability to supervise and (as need be) save banks from collapsing.

Against this background, the expansion of collateral further in the direction of bank-created assets potentially exposed the ECB to a major moral hazard or gamble for resurrection. When banks know that the ECB would have incentives to rescue them, they could actually increase risk-taking (moral hazard). In addition, banks that are facing probable bankruptcy could engage in reckless risk-taking with hopes of gambling their way out of problems. A very small number of banks could via coordinated action replace their market financing and hence market discipline by issuing CDs to one another. As banking theory would indicate, this kind of option in the hands of banks could in adverse circumstances lead to an increase in risks even to the level of systemic risks. In practical terms, this could have exposed the Eurosystem to replace market funding with central bank money in a country that was expected by markets to face major financial strains. This type of exposure could also be seen as a risk to the ECB's independence and hence its ability to focus on its primary objective of price stability in all situations, which would be exactly the moral hazard consideration voiced by the Bundesbank people in preparation for the EMU.

With regard to liquidity provision via standard auctions and special auctions, the main question is to what extent replacing the market mechanism by ECB actions could be seen to be in conformity with the principle of market economy.

IV.4 ECB measures and action during the fiscal crisis

It is obviously somewhat arbitrary to draw a line between actions that relate to the financial crisis on the one hand and to the fiscal crisis on the other hand. Naturally, many of the measures by the ECB since early 2010 could be explained by either of these crises. I use mainly the simple chronological line of deviation. By and large the financial crisis was losing steam and markets were normalising during the first months of 2010, which was also reflected in the ECB communication as explained earlier. Similarly, there is little evidence that the fiscal crisis was the leading concern in the financial market before the end of 2009.

The events concerning the Greek debt crisis could be timed with the help of the interest rate on Greek government debt. The rate started to edge higher towards the end of 2009, when more serious fears about the sustainability of Greek public finances made their way into the centre of financial market discussions, for example, in the form of a rating downgrade by Fitch[79]. Thereafter, fears escalated quickly. The three-year budgetary plan of the Greek government lacked credibility and further ratings downgrades eventually led to junk bond status and forced a joint rescue package by euro area Member States and the IMF. From late November 2009 to early May 2010, the interest rate on Greek 10-year government debt increased from less than 5% to above 12%. Since then, the interest rate has increased more or less continuously to reach more than 35% in early 2012[80].

The main actions of the ECB with regard to the fiscal crisis could be summarised in four groups. First, verbal interventions both towards Member States facing fiscal challenges and financial markets. Second, the ECB became heavily involved in drafting rescue plans and following their implementation. Third, the ECB changed its collateral policy for Greece and most likely engaged in large scale medium-term liquidity creation to encourage the market to invest in higher-yielding government bonds. Fourth, and most controversially, the ECB started its Securities Market Programme, i.e. outright purchase of government bonds.

Verbal interventions

Verbal interventions outside the scope of normal commenting on the fiscal stance of the euro area needs some further clarification. It is common for central banks to comment on fiscal policy as part of their analysis of the economic situation. The ECB has not been an exception to this practice. There has hardly been a press conference or communication of monetary policy decisions without mentioning fiscal policy either from a structural or a cyclical point of view. However, although this communication has been scarce on positive evaluations, it was as a rule kept at a general level. The ECB did not want to engage in discussing individual Member States' fiscal policy more than it welcomed Member States discussing its own monetary policy stance or structural elements of conducting monetary policy. This policy started to change during the escalation of the Greek situation, when the ECB demanded Greece and other countries "to fully respect the Stability and Growth Pact, and fully respect the excessive deficit procedure"[81].

A clear change in policy took place in March 2010, when the ECB issued a special statement on Greek government fiscal consolidation measures. It could be assessed that the statement was meant to convince financial markets of the adjustment measures, although with very limited success. Another potential reason could have been to convince the Greek people of the necessity of consolidation. The

[79] See for example *Financial Times* Interactive timeline: Greek debt crisis by Emily Cadman, Rob Minto and Steve Bernard at http://www.ft.com/intl/cms/s/0/003cbb92-4e2d-11df-b48d-00144feab49a
[80] http://www.bloomberg.com/quote/GGGB10YR:IND/chart/
[81] Introductory statement with Q&A Trichet. Frankfurt am Main, 4 February 2010.

ECB makes its deliberations public only after 16 years, so until that time the reasons remain secret. The ECB statement was followed by Trichet's support for the decision of Heads of State or Government that "euro area Member States will take determined and coordinated action if needed to safeguard financial stability in the euro area as a whole". He also caused some surprise by stating that "I do not believe that it would be appropriate to introduce the IMF as a supplier of help through stand-by arrangements or through any such kind of help." He thus explicitly disregarded the only bail-out mechanism that was deemed appropriate and available. Hence, Trichet implicitly advocated bail-out mechanisms within the EU.

The verbal interventions by Trichet on Greek default were surprisingly strong. When asked "can you, in your position, as of now categorically rule out a Greek default?", he replied: "I would say that based on all the information that I have, default is not an issue for Greece."[82] In the same vein, Trichet replied in the name of the ECB that "we are firmly of the view that Greece will not default."[83] Naturally, these interventions could be explained by attempts to calm down fears in the financial markets, although their limited success also in that regard speaks loudly against that interpretation. They could also be compared to Trichet's earlier comments on bank defaults, where he skilfully distanced the ECB from that type of responsibility.

ECB involvement in rescue plans

A broad range of measures and packages were planned and designed during the Greek fiscal crisis. It was somewhat unclear what the role of the ECB should be in these processes. The first package was drawn up by the euro area governments and the IMF. The Plan involved a EUR 30 bln loan from governments and an additional EUR 15 bln loan from the IMF to cover financing needs for the remainder of 2010. The package was activated by the Greek government in late April. Concerning the first package, it was decided that the ECB would be involved in deciding whether Greece had used all other options and needed rescue funding.

The first package was quickly replaced by a new three year plan after activation of the package caused or at least was unable to prevent Greek government bonds being downgraded to below investment grade status (junk bonds). In the new package the same parties, namely the euro area governments and the IMF, agreed on rescue funding of a total amount of EUR 110 bln. From here on, the involvement of the ECB became more formalised. It was part of the Troika concluding negotiations with the Greek

[82] Introductory statement with Q&A Trichet. Frankfurt am Main, 8 April 2010.
[83] Introductory statement with Q&A Trichet. Frankfurt am Main, 6 May 2010.

government[84]. In addition, it was asked "whether or not it was appropriate for them (euro area Member States) to activate the bilateral loans that they envisaged"[85]

Another element of ECB involvement in fiscal adjustment processes was in particular Trichet's activity in communicating with finance ministers and heads of government. While this communication has remained mainly secret, it has affected the ECB's role *vis-à-vis* governments. The most telling examples are the letters from Trichet to prime ministers Berlusconi and Zapatero in August 2011[86]. In a published letter, Trichet (and his successor Mario Draghi) were demanding large-scale reforms in Italy and even had a view on the legal form of these measures[87].

Changes in collateral policy and liquidity measures

As explained earlier, the collateral policy changes in April 2010 were already accused of being primarily made for the purpose of facilitating acceptance of Greek government bonds as collateral. However, that discussion was soon silenced by the explicit decision by the ECB to suspend application of the minimum credit rating threshold in the case of debt issued or guaranteed by the Greek government. This took place only one day after the Troika and the ECB as part of it had concluded negotiations with Greece. The justification was that the ECB had assessed the Greek adjustment programme and considered it to be appropriate also from the risk management perspective. The suspension applied to all outstanding and new marketable debt instruments issued or guaranteed by the Greek government[88].

The ECB further elaborated this violation of its own collateral policy by arguing that its position in the negotiations and as part of the team in Greece gave it sufficient information and confidence in Greek government finances: "We had to be consistent with this judgement as regards the eligibility of the Greek government bonds"[89]. Collateral policy relaxation with regard to Member State governments continued first with Ireland in March 2011[90] and then with Portugal in July 2011[91].

As explained earlier, the ECB had started to unwind its extraordinary liquidity-creating measures just before the escalation of the Greek situation. However, these plans were postponed. There is a difference between creating liquidity for the purpose of keeping the interbank market functioning and

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84 The actual term used for the Troika was: the European Commission, in liaison with the ECB, and the International Monetary Fund. See for example ECB Press Release 2 May 2010 on approval of Greek adjustment programme.

85 Introductory statement with Q&A Trichet. Frankfurt am Main, 6 May 2010.

86 *Corriere della Sera*, 6 th August 2010.

87 It was also claimed that the ECB was demanding the resignation of Berlusconi as a condition for its support.

88 Decision of the ECB of 6 May 2010 on temporary measures relating to the eligibility of marketable debt instruments issued or guaranteed by the Greek Government (ECB/2010/3).

89 Introductory statement with Q&A Trichet. Frankfurt am Main, 6 May 2010.

90 31 March 2011 **-** ECB announces the suspension of the rating threshold for debt instruments of the Irish government.

91 7 July 2011 **-** ECB announces change in eligibility of debt instruments issued or guaranteed by the Portuguese government. This suspension will be maintained until further notice.

for the purpose of creating incentives for banks and other investors to invest in government bonds. There are some indications of the latter being increasingly the driving force for exceptional liquidity measures. However, to make matters less clear, a link exists between interbank market liquidity and government bonds as banks are major investors in government bonds in some countries. If government bonds become illiquid or lose their value, it could seriously hamper banks' ability to perform their normal functions.

With this in mind, I would limit myself in drawing attention to the very long term auctions announced by the ECB towards the end of 2011 as part of the measures to support bank lending and money market activity. The ECB decided to conduct two longer-term refinancing operations with an unforeseen maturity of 3 years[92]. The operations were conducted as fixed rate auctions with full allotment, and totalled nearly EUR 1015 bln. With the scale and length of these two operations, they could also be seen as giving large incentives to banks to buy government bonds and other relatively liquid medium term instruments particularly if they were eligible as collateral.

Purchase of government bonds alias Securities Market Programme

Probably the most controversial of the ECB's actions was the outright purchase of government bonds it called the Securities Market Programme (SMP). This was announced on 10 May 2010 as part of a larger package to address severe tensions in financial markets[93]. The SMP contained "interventions in the euro area public and private debt securities markets to ensure depth and liquidity in those market segments which are dysfunctional. The objective of the programme is to address the malfunctioning of securities markets and restore an appropriate monetary policy transmission mechanism."[94] It was soon made clear that the programme was solely aimed at buying government bonds of the troubled Member States, first Greece, Ireland and Portugal and later also Spain and Italy. The programme was to be sterilised to ensure that the monetary policy stance was not affected.

The programme was a surprise as only two working days earlier Trichet had denied that the Governing Council would even have discussed such a measure. In the meanwhile, the EU Council had adopted a European Stabilisation Mechanism to preserve financial stability in Europe during its weekend crisis meeting where also governor Trichet had been highly vocal stressing the need for a European based rescue solution. The exceptional nature of events was added by some Eurosystem central banks apparently leaking information and questioning the foundations of the decision on

[92] 8 December 2011 - ECB announces measures to support bank lending and money market activity. In addition the ECB halved the reserve ratio from 2% to 1% and also relaxed collateral availability further by including for example bank loans on the list.
[93] Formally the SMP was established by a Decision of the ECB on 14 May 2010. (ECB/2010/5),(2010/281/EU).
[94] Press Release 10 May 2010 - ECB decides on measures to address severe tensions in financial markets.

SMP[95]. Trichet explained the quick change in heart by the acute malfunctioning of some segments of the euro area bond markets.

The ECB did not give any indication of the total volume it expected to use in buying government bonds, but it provided weekly information on the amounts it sterilised. The programme started off immediately after the decision, and during the first two weeks the ECB bought EUR 16.5 bln and 10 bln. The programme was more or less paused in July 2010, and reactivated with large-scale purchases from August 2011 onwards. On 16 March 2012, the amount totalled just short of EUR 218 bln. Later the ECB revealed the composition of SMP purchases. The largest holdings were in Italian (101 bln), Spanish (44 bln) and Greek (34 bln) government bonds[96].

Constitutional assessment

Measures to combat the fiscal crisis raise the most obvious questions concerning key constitutional principles guarding the ECB. First of all, the ECB's involvement in fiscal rescue packages is hardly based on any task assigned to it by the Treaties. With a positive interpretation, it could be seen in the light of Article 127.1 of TFEU as Eurosystem support of general economic policies in the Union. However, even that is addressed to the Eurosystem, not the ECB, and furthermore it does not cover Member States' intergovernmental and bilateral actions.

More fundamentally, the large scale involvement could be seen as questioning the key constitutional principle of independence. For example, being part of the Troika and negotiating with Member States on adjustment packages could impose constraints on the actions of the ECB in other fields such as collateral policy. There is also a dynamic aspect in the involvement that could hamper ECB independence. Should the ECB engage in practices of demanding some measures from Member State governments, this could weaken its position against Member States advice or demands. It is also very unclear as to what the constitutional grounds are for the ECB to demand certain actions from Member States particularly when these actions are outside the central banking area. Obviously, no legal measures were available for the ECB to activate against the Member States in question, but at that point in time it had other means to make its demands effective. Countries were dependent on the ECB's support, both verbally and through the SMP programme.

Second, we need to assess whether verbal interventions by the ECB could be challenged from a constitutional point of view. In this context, verbal interventions could be defined as mainly Trichet's interventions that could have created justified expectations among people and market participants. In

95 In an interview with *Börsen Zeitung* the next day, Bundesbank governor Weber stated: "Der Ankauf von Staatsanleihen birgt erhebliche stabilitätspolitische Risiken" and he also made known that he had opposed the decision. Apparently some other unnamed senior level bankers from the Bundesbank even raised the suspicion that Trichet was simply trying to save French banks from incurring large losses on Greek government debt (*Spiegel* Online 31st May 2010: German Central Bankers Suspect French Intrigue).

96 ECB Press release 21.2.2013.

some cases these interventions could also have led to confusion about institutional balance and responsibilities. Against this background, it could be claimed that Trichet's insistence that Greece would not default and also a negative view on the leadership of the IMF in rescue operations led to an expectation that the non-bail out clause would not be respected and also that the ECB would stand ready to act to effectively prevent default by Greece.

Third, changes in collateral policy and liquidity measures for the fiscal crisis could be assessed first by the market economy principle. Accepting Member State government bonds that were deemed unsafe by the financial markets and the rating agencies can hardly be considered compliant either with the market economy principle or with the requirement of adequate collateral. More fundamentally, it could be considered as both indirect public financing and as a subsidy to the holders of those bonds and governments issuing them. However, and perhaps surprisingly, the largest questions relate to the independence of the ECB. As the ECB becomes a large lender to the Member States' financial sector, and as that lending is conducted by using government bonds as collateral, the ECB cannot necessarily afford a default of the country or countries concerned. It is to be expected that the role which Eurosystem financing plays in some Member State banking sectors and the proportion of that financing that is based on local banking collateral or government bonds is such that it questions the ECB's operational independence and even its ability to concentrate on its primary objective. Obviously, the large-scale and medium-term auctions conducted by the ECB could also be seen from this perspective.

Fourth, the Securities Market Programme suffers from many of the risks to the key constitutional principles mentioned above. However, it is even more explicit in many ways. There are significant differences between holding government bonds as collateral and holding them directly. Collateral is problematic in the sense that exposure is not controlled by the ECB, even though the ECB can influence the collateral it receives by haircut requirements and eligibility criteria. However, with collateral the ECB incurs losses only when both collateral and debtor fail. In the case of direct purchases, the ECB incurs losses as soon as the value of the bond declines. Also, as holder of a government bond, the ECB is in the role of creditor to a Member State. I would argue that being in the role of creditor is problematic for the constitutional independence of the ECB. It raises both problems mentioned earlier: the ECB steps outside its role of a central bank for the people of the euro area and it also becomes a stakeholder in the fiscal problems of Member States.

Obviously, the SMP programme could be questioned purely on the basis of prohibition of public financing. It should be clear that the reference to prohibition of direct purchase of government bonds needs to be read in the proper context. And the context is that a central bank may have a legitimate need to use government bonds in its operations as they are generally the largest and most liquid instruments in most countries. However, the Treaty and the constitutional principles mentioned in section 3 are very clear that in the EU context the central bank should not finance governments and should not be in the position of a real creditor to governments. The argumentation that the SMP is part of monetary policy and designed to correct malfunctions of the transmission mechanism deserves a fair assessment, which could only be performed against economic theory and monetary policy practices. While I have doubts whether it will pass even that test, I would hold the position that regardless of that outcome, the case against SMP on other constitutional grounds is too strong.

V Conclusions

Legal analysis of modern central banks is a complicated task that does not easily yield straightforward conclusions. Only an analysis of a supranational central bank would promise less fruitful and more inconclusive answers. One should be (and has been) advised against it. However, the economic importance of central banks has lately been growing to unforeseen proportions as was shown to be the case with the ECB. Assuming that this could have happened in a legal vacuum would be highly unsatisfactory.

The ECB is an EU institution designed to define and conduct monetary policy for the benefit of people in the euro area. Its objectives and tasks were enumerated in the Maastricht Treaty. These objectives and tasks should define the mandate, the borders for the role and actions of the ECB. However, they need to be interpreted in their correct context. That context, I claim, is a combination of requirements arising from the European economic constitution, the German Bundesbank as a template for the common central bank system and (quasi)-consensus of the economics profession particularly at the time of the Treaty. When the Treaty provisions are assessed with the help of these three legal sources, we can derive a number of key constitutional principles that should safeguard the role and actions of the ECB.

The most difficult of the legal sources is the European economic constitution. The concept has been developed and defined in the context of the four market freedoms, competition policy and state aid regulations. From the economic point of view these are micro-economic and mostly structural issues. Monetary policy has been perceived as a macro-economic issue; policy aimed at steering the economy toward smaller cyclical fluctuations and higher employment. The dilemma is how to combine fundamentally micro-economic and regulatory elements of current European economic constitutionalism with macro-economic elements of monetary policy to form a consistent and coherent new broad economic constitution.

The answer is surprisingly simple if economic constitutionalism is analysed in its original context. In the ordo-liberal economic constitution monetary policy has always played a prominent role. However, the prominent role has not meant active cyclical fine-tuning, but a role in constructing a stable monetary framework for the economy to function to its full potential and also in safeguarding the systemic choice of competition-based market economy. Price stability is the best contribution that monetary policy can make to people. Achieving price stability is a task for economic experts that does not contain political value decisions. However, the monetary policy maker needs to understand and take into account value-decisions by other actors and also communicate its views and reactions.

The template of the Bundesbank already contained many elements of the ordo-liberal economic constitution. In many institutional and technical questions the argumentation behind the decisions taken in the case of the Bundesbank could also add clarity in the case of the ECB. However, the ECB is not the Bundesbank. Even targeting the same outcome might often require different solutions. The most apparent examples are price stability and independence. Both of these were deeply anchored in the Bundesbank through its reputation and trust among the German people. In the case of the ECB, starting with no reputation or limited trust, price stability and independence need to be explicitly anchored at constitutional law level.

The main development of interest in economic theory and central banking practices took place in the fields of inflation and institutional theory. The assumption that there is a trade-off between inflation and employment that could be used in the design of economic policy was invalidated. The negative experience of parallel increase in inflation and unemployment on the 1970s led to a major reconsideration in economic policy. At the same time, economic theory could explain the development by rationally behaving households and companies, and advocated institutional choices such as central bank independence as a cure.

The key constitutional principles that could be derived from the crossing of three roads mentioned above in the design of a common monetary policy framework are as follows.

Price stability plays a fundamental role not only for the ECB and Eurosystem but for the EU economic policy framework as a whole. There was no discretion left in the formulation of the primary objective, which shows how stable prices are part of the economic and social systemic choice rather than only a question of economic optimisation and empirical research. There are hence no situations where the ECB could compromise the primary objective or balance it with other objectives.

Prohibition of public financing is a protection principle. Primarily it safeguards the primary objective. In the EU context, the prohibition also protects Member States from an accumulation of liabilities by the ECB, which could indirectly lead to loss of national budgetary control. It also protects the non-bail out clause of the Treaty. Against this background, it is clear that the necessary leeway given to the ECB in using government bonds in its operations should be interpreted with extreme caution. A creditor role for the ECB towards Member State governments would also be against the institutional balance.

Independence of the central bank is another key element that is safeguarded in a number of ways and that comes from all the three legal sources. Indeed, acceptance of strong argumentation for central bank independence was one of the reasons facilitating EMU. Only if central bank independence is an elementary part of monetary policy can it be transferred to the EU level.

Advancing and respecting the principle of an open market economy with free competition links common monetary policy directly to the objectives of the European economic constitution. The ECB has to obey a market economy-based economic rationale in its own actions and should assess the impact of its decisions and objectives on the principles of a free competition-based market economy.

Role is limited to achieving pre-defined objectives and excluding areas needing political value judgements. The ECB is given very limited discretion to expand its role even with the consent of the EU Council. Designed as an independent organisation with limited or no democratic control, the ECB is a typical European economic constitution institution. Hence, its role should be limited to pre-defined tasks that can also be controlled by judicial means. A corollary of the limited role and lack of democratic control is that it excludes any redistributive elements in ECB policy as it is not given power to make political value-based decisions.

Defined strategy and operational targets are less obvious parts of constitutional principles. A pre-defined strategy is needed to facilitate the accountability of the ECB in particular towards the people of the euro area. In addition, a pre-announced strategy and intermediate targets were an important part in the institutional set-up of the Bundesbank facilitating its de facto independent role and public respect.

Constitutional analysis of ECB action in the economic crises

Constitutional analysis of the ECB is conducted by combining the key constitutional principles with the actual actions that the ECB (and Eurosystem) has taken in the course of the crises. The actions under scrutiny would be expansion of the collateral pool, measures to increase and manage liquidity in the financial sector, involvement in the design and implementation of the Greek rescue package, and purchase of government bonds (SMP programme).

First, it is concluded that the ECB monetary policy framework was designed and implemented broadly in line with key constitutional principles. *Monetary policy strategy* respects the primacy of price stability and aims at providing the people with a genuine strategy and operational targets that could provide the basis for accountability. This is enhanced by a relatively transparent communication, though with the main caveat of the extensive secrecy of the deliberations of the ECB Governing Council, which could hamper judicial control of ECB actions. *The operational framework* was designed even with the deliberate aim of following constitutional principles. It respected free market economy principles to a very large extent (uniform and transparent principles). However, collateral policy raised some issues of concern with regard to prohibition of the public finances principle. Even from the beginning it might have favoured government bonds beyond what could be explained by their properties.

Second, during the initial phase of the financial crisis the ECB operated broadly in line with its pre-announced operational framework, while its ad hoc measures were also part of the operational framework. There was a serious attempt to maintain the market conformity of operations. All the refinancing and longer-term operations were conducted as variable rate tenders without a guarantee of full allotment. ECB influence over the financial market price mechanism increased but remained under check. Although the risks of the ECB towards the banking sector increased, even substantially, liquidity support was not mixed with indirect solvency support or, even worse, indirect public financing and it was credibly communicated. The ECB explicitly remained outside discussions over banking sector solvency support, which also helped to maintain institutional independence. Against this background, it was not seriously questioned that the ECB maintained focus on its primary objective.

Third, the measures taken in the course of escalation of the financial crisis aimed at maintaining the functioning of the European interbank market. In order to provide the banking sector with liquidity in times of a non-functioning interbank market, the ECB increasingly replaced the money market with its operational framework. The ECB guaranteed unlimited funding to banks as long as they had collateral, which was helped by expansion of the list of eligible collateral. And when that was not deemed enough, the ECB even started direct purchase of covered bonds. What remains unclear is the ultimate cause of banks' inability to trust one other. Obviously the Lehman episode was a major single shock. However, I would claim that the distrust originated fundamentally from the losses banks had suffered and more importantly that they were expected to suffer. Hence it was ultimately also a solvency crisis that was worsened by distrust of national financial supervision. It was suspected that supervisors would not force banks to show all their losses and recapitalise if need be.

On a number of aspects constitutional analysis is more difficult than in the first phase of the crisis. The relaxation of collateral policy could have gone beyond the point of the term "adequate collateral". More importantly, it most likely led to a reduction of market discipline and even to a potential increase in systemic risk through use of bank-created assets as collateral. In practical terms, this could have exposed the Eurosystem to the risk of replacing market financing with central bank money in countries that were already facing a banking solvency crisis. The measures during the financial crisis could have been questionable on the grounds of advancing market economy principles, if the ECB was removing market principles in its own operations and its operations were replacing the market mechanism at least in the euro area money markets. Furthermore, the exposure of the ECB to potentially insolvent banks could be seen as factually a redistributive function and at least a risk to the ECB's independence. The ECB could have become a stakeholder in Member State banking sectors and hence its ability to focus on its primary objective of price stability might have been jeopardised. However, should there have been no major concern over the solvency of banks or Member States' ability and willingness to recapitalise the banks when needed, these constitutional worries would have been far less prominent.

Fourth, measures to combat the fiscal crisis raise the most obvious questions concerning the constitutional principles safeguarding the ECB. ECB involvement in designing and implementing fiscal rescue packages is hardly based on any task assigned to it by the Treaties. More fundamentally, the large scale involvement of the ECB could be seen as questioning the key constitutional principle of independence as it could impose constraints on the actions of the ECB in other fields. The verbal interventions could also have led to confusion on the institutional balance and responsibilities. For example insisting that Greece would not default could have created expectations that the ECB would stand ready to act to effectively prevent default by Greece.

Changes in collateral policy and liquidity measures during the fiscal crisis were problematic both for the market economy principle and also indirectly for both prohibition of public financing and the redistributive role. However, the main constitutional issues relate to the independence of the ECB. When the ECB becomes a major lender to a Member State's financial sector, and as that lending is conducted using government bonds as collateral, the ECB cannot necessarily afford a default by that country. As a consequence, the ECB's operational independence and even ability to concentrate on its primary objective could be at risk. The large-scale and medium-term auctions conducted by the ECB are a case in point.

Finally, the Securities Market Programme suffers from many of the risks to the key constitutional principles mentioned above. However, it is even more explicit in many regards. Holding government bonds as collateral is different from holding them directly. With collateral the ECB incurs losses only when both collateral and debtor fail. In the case of direct purchases, the ECB incurs losses as soon as the value of the bond declines. Additionally, as holder of government bonds the ECB is in the role of creditor to a Member State. I would argue that being in the role of creditor is problematic for the constitutional independence of the ECB. Obviously, the SMP programme could be questioned purely on the basis of prohibition of public financing. The reference to prohibition of direct purchase of government bonds needs to be read in the proper context: central banks may have legitimate needs to use government bonds in operations, but in the EU context, the central bank should not finance governments. The argumentation that the SMP is part of monetary policy and designed to correct malfunctions of the transmission mechanism deserves a fair assessment, which could only be performed against economic theory and monetary policy practices. While I have doubts whether it will pass even that test, I would hold the position that regardless of that outcome, the case against the SMP on other constitutional grounds is too strong to validate it.

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