

Expert, Stakeholder or Just Politician? New Roles of European Central Bank

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The financial crisis has put many of the European actors in situations where they have been able or even forced to take new roles. The constitutional issues involved have mostly been tackled at a relatively superficial level if at all and only by experts. Most of the actions that have created new roles have been based on more or less ad hoc decisions. It is already visible that while many of these decisions have not resulted in their intended consequences they have had a broad list of unintended and unforeseen consequences. In this paper, I will concentrate on the European Central Bank (hereafter ECB when referring to either the ECB or the ESCB as it is the decision-making body for both). It is naturally only part of the complex financial and institutional set-up involved in the financial crisis. However, it is also one of the clearest examples of the constitutional drift in roles and also a potentially unfortunate example of the unintended constitutional and other consequences of these ad hoc decisions. I will first discuss the original intended constitutional position of the ECB as defined by the constitutional principles of the economic and monetary union. Second, I will discuss the three potential roles of administrative bodies: expert, stakeholder and politician. I devote some special attention to the demarcation lines between the roles before turning to the new roles of the ECB. Finally, I will discuss these new roles from the constitutional law and control perspectives. It should not come as a surprise that constitutional control mechanisms envisaged for a limited expert role are hardly sufficient for the roles of a stakeholder or a politician. This also has implications for the democratic legitimacy of the institutions involved, the issue with which I will end my paper. In order to avoid misunderstandings, I am not proposing some specific model for the common central bank nor am I claiming that the current model is value free and based on purely scientific rationales. It clearly is not. However, discussions of the economic and political rationales and merits of various central banking models are totally outside the scope of this paper. I am simply taking the constitutionally stipulated model as given and trying to assess what kind of roles it equipped the central bank with from the point of view of constitutional control and legitimacy. To the extent that these roles are not deemed sufficient, the main route to remedy the situation should be Treaty changes.

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I. Constitutional boundaries of the ECB

The constitutional boundaries for the common monetary policy and the ECB can be derived mostly from the legal provisions of the Maastricht Treaty that was signed in 1992. The Treaty changes thereafter have not touched upon the legal or institutional set-up of the common monetary policy. However, the legal provisions need to be complemented by other relevant material in order to become understandable as a functional whole, a consistent set of constitutional principles. These materials include the general economic constitution and economic constitutionalism, the influence of the German Bundesbank as a model for the common central bank and the consensus on monetary economics that started to emerge from the late 1970s onwards until the finalisation of the Maastricht Treaty in the early 1990s. However, a thorough analysis of the underlying economic, historical and political issues shaping the ECB's constitutional position is not the purpose of this paper. I will limit myself to explaining the basic legal material and direct interested readers to my earlier work on the subject.¹ On the basis of an 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 the key constitutional principles covering monetary policy and central banking in the EMU.

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 (TFEU)”, but still in the new Treaty on European Union (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 full employment and social progress. This prominent role of price stability is closer to the fundamental ordoliberal 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 stipulates that “the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both

¹ For example, in Tuori 2013.

of which shall be to maintain price stability”. Hence both the exchange-rate policy of EU Council (Ecofin) and the monetary policy of the ECB are supposed to have price stability as the primary objective. Furthermore, all economic and monetary policy activities “shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments.”(Article 119.3).

Concerning monetary policy and the ECB in particular, it is made very clear in Article 127 of the 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.² It therefore also 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 the result of a German demand based on their more fundamental anti-inflationary background.³ 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 less fundamental role for price stability.

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

² Smits 1997, 180–181. The Committee of Governors was an EU organ composed of central bank governors that prepared the draft statute for the proposed EU central banking system.

³ For a thorough description of the discussions, see James 2012, chapter 6–8.

Bank or national central banks of debt instruments.” This is further elaborated in the ECB’s statute in article 21. Defining when to apply Article 123 was made by Council regulation,⁴ 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”.

The background for the prohibition is very clear. The history of central banking is full of examples where monetising, that is, financing government with the issuance of paper money, has led to the collapse of the currency or at least excessive inflation.⁵ Hence, the most important reason from the monetary policy perspective is to protect price stability, that is, achieving the primary objective.⁶ This need for protection could be seen directly by 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.⁷ In this regard, the provision also aims at imposing market discipline on Member States, so 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 the 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

4 Regulation 3603/93.

5 Issing 1998, 54–55.

6 Committee of Governors (Document 1669/1670), 25, according to Smits 1997, 289.

7 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.”

circumvented via purchases from the secondary markets. Hence, the ECB should not have any role in financing Member States.

Independence of the central bank

The independence of the ECB (and also the ESCB) is one of the key elements of the common monetary policy framework. In the Treaty, this 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 Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body.” 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 ECB Statute contain a number of provisions that are meant to safeguard independence. These include provisions for a 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 policymaking 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 policymakers, monetary policy was already “lost” even before it was transferred to the EU level.

Advancing and respecting the principle of an open market economy with free competition

Article 119.1 TFEU on economic and monetary policy emphasizes 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 the phrase “favouring

an efficient allocation of resources”, which is then repeated in Article 2 of the statute on the objectives of the ESCB.

This 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.⁸ 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 decisions 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.⁹ 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 not fundamentally 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 that they be fully remunerated. Somewhat paradoxically, this 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.¹⁰

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.¹¹

A key element of this 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 the 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 an adequate pricing of risk. Indeed, the fact that the ECB does not in principle take any margin on its regular lending activities

8 Smits (1997, 190–91) reached the same conclusion.

9 This is also stressed by the ECB in *The monetary policy of the ECB*. Frankfurt: The European Central Bank, 2004, 72.

10 Issing 2008, 120–122.

11 For example, in Issing (2008, 122–130) there is a good description of the decisions and early evolution of the ECB operational framework

makes it clear that lending should be as safe as possible. 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, this lending is to credit institutions that are supervised by national authorities and secondly 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.

A 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 any 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 always made it 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 for redistributive elements in ECB policy, which has also occasionally been acknowledged by the ECB.¹² This is obvious from the limited budgetary resources

¹² Speech by Trichet 2009.

given to the ECB, but more fundamentally it stems from lack of a mechanism to make political value-based decisions.

Defined strategy and operational targets

It might be considered somewhat surprising to find 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 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 probably created the perception that the Bundesbank was primarily accountable to the people of Germany rather than to the government. This was achieved by announcing its strategy and targets in advance and providing explanations afterwards if and when they were not achieved.¹³ Price stability has a fundamental role not only for the ECB and the Eurosystem but for the EU's economic policy framework as a whole. There was no discretion left in the formulation of the primary objective, which shows how stable prices are a fundamental part of the economic and social systemic choice rather than just a question of economic optimisation based on narrow theoretical and empirical research. Hence, there are no situations where the ECB could compromise the primary objective or balance it with other objectives.

III. The main roles of the administrative organs (economic-political institutions)

In the following, I will explain the three main theoretical concepts I intend to use in order to analyse activities of central banks. These are the roles of an expert,

¹³ The Bundesbank had so-called monetary targets, that is, 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.

stakeholder and politician. They are hardly exclusive to central banking or even economic governance more generally. The theoretical concepts have a direct link to general governance theories at the national and transnational level. Hence the present legal study could draw on the legitimacy theories developed on those broader and more advanced areas of scientific inquiry.¹⁴ The term role is here meant to include a relatively wide set of elements, for example, the type of processes and information that are used, formal position as well as control and accountability techniques.

Expert

In economic constitutional thinking, the concept of an independent expert is very important and the role of an independent expert is pivotal in a number of key areas concerning the actual conduct of the economic constitution. There is hence a crucial difference between an expert, a stakeholder and a politician, respectively.

At the general level, the role of an independent expert has two pre-conditions. First of all, there needs to be a strong belief that an expert is best suited to perform a given task in a society. Normally the type of function performed by an expert requires a specific kind of knowledge that is cumulative in an organisation. The elementary, main substance of the function also needs to involve applying scientific or quasi-scientific tools and information to specific cases. As is clear, modern societies are full of expert functions that are performed by publicly funded or organised organisations. As a rule, these functions are organised under ministries or in separate bodies with at minimum some top-level political control. The second, and more specific, pre-condition is the requirement to perform the task independently from outside influences, particularly political influences. In practice, an expert can often be and is expected to be independent. An expert does not need to or is not assumed to take into account issues outside his/her given field of responsibility. The input information is solely defined by the “scientific” needs of the process. However, the practical independence of an expert should not be mixed with the intentional or even formal independence of an expert. In the latter case, there is a perceived possibility or risk of political intervention, which is seen as harmful. Hence, a truly independent expert organisation should not take orders or even receive advice from, for example, political organs. In this regard, a formally and intentionally independent organisation is always an exception and hence needs strong specific reasoning to argue for its position.

The purest examples of independent expert bodies include courts and competition authorities. In the case of the courts, the fact that they were given a constitutionally protected independent position is a surprisingly recent development.¹⁵ However,

¹⁴ See, for example, Losada 2012 or Habermas 1961.

¹⁵ See, for example, Hayek 1960, 168–173

nowadays it is obviously one of the elementary principles of the *Rechtsstaat* that legislative, executive and judicial powers are separated. And even the much debated blurring between the roles of the executive and the legislative in the EU context has kept the independent expert position of the courts intact.

To assign competition authorities the role of an independent expert is an even more recent phenomenon. It is a particularly European or more precisely German *ordo-liberal* notion that the function of a competition authority is of elementary importance in maintaining the proper functioning of the economic system and ultimately a liberal society.¹⁶ In order for the competition authority to perform this important function it needs both a high level of expert knowledge and full independence. Without expert knowledge it is not able to apply its very specific rules to varying type of situations in a coherent manner. Independence must be guaranteed as the economic interest involved could be such that they would risk taking over the political system with harmful consequences for the economic system but more fundamentally also for the political system.¹⁷

The means to safeguard the independence of an expert are mostly legal and even constitutional. The most straightforward means to create a protected field of operation is to stipulate it in a written constitution. However, it is by no means the only one. Societies with longer tradition can have unwritten constitutional norms (England is the prime example). In addition, a protected independent expert position can also be achieved with the popular support of the people as was the case with the German Bundesbank, the notoriously independent German central bank. In the same vein, if an organ does not gain public support for its role and actions, its independent position will increasingly become more difficult to maintain in the longer term, even if it is formally protected in the constitution.

Hand in hand with an independent expert role is the constitutional control of the agent acting in that role, and the accountability of the independent institution. The control mechanisms for independent experts need to be designed in a specific way. On the one hand, control mechanisms should be such that they do not effectively remove the independence of the expert. On the other hand, they should make sure that the expert does not misuse the discretion he/she has been given. There needs to be effective juridical control of these activities, which is considerably more complex to organise than would appear at first sight. Actions must be such that they can be exposed to judicial scrutiny, which also demands that the underlying issues are such that there is a possibility to make straight-forward and rule-based judgements on them. In addition, there needs to be effective possibility and even responsibility to start legal proceedings against an independent organisation if there is any serious chance of it failing or exceeding its mandate.

16 Of course, one should not underestimate the importance of the US tradition that facilitated the implementation of a German competition authority after the war.

17 This refers to the *ordo-liberal* nightmare of an interest group society that is well described, for example, in Eucken 1950/52.

In addition to judicial control, the second and possibly the most important means of control is accountability through the transparency and publicity of its activities. This again has more to it than would first appear. Actions need to be taken in forms that allow for effective transparency, not full publicity as such.¹⁸ Indeed, many of the functions that are assigned to independent experts are of such a nature that it is deemed that full publicity would not serve the best interests of the society, but that should not be misused to prevent the transparency of the institutions' activities. It simply puts additional pressure on the institution to find effective ways to be accountable. Transparency is often deemed necessary for an institution to achieve its aims. It both facilitates public support for its activities and helps to guide the activities of the institutions' addressees in the desired direction without recourse to more coercive means.

Stakeholder

There is a hint of arbitrariness in making a strong distinction between the roles of an expert and stakeholder. However, for the purpose of my analysis, the distinction is very important, because it is used to describe how influences other than "science"-based information force their way into the decision-making process of the independent expert. A stakeholder is commonly defined as a party that is affected by the outcome of decisions or events, and hence has something at stake in the process. Generally speaking this is not perceived as good or bad as such. An elementary part is that the driving forces of stakeholders are such that they have a vested interest in a given outcome. Indeed. A stakeholder's influence can be seen as complementary to democratic legitimacy particularly in some areas of economic governance.¹⁹

A stakeholder is different from the owner of the process. Broadly defined an owner is the core beneficiary of or responsible body for the process. For example, the ECB is the owner of issue of price stability in the euro area. In addition, price stability has a number of other owners as it has been assigned as an objective for EU economic policy. Furthermore, price stability has a broad list of stakeholders as public support by the people and companies in Europe is considered fundamental for price stability to uphold its position and to be achieved at a low social cost.

Stakeholder-analysis is commonly looked at the owners or initiators perspective. The aim of the analysis is to reveal what important parties could and would be needed to be engaged in the project. It can also be used to define strategies or shorter term tactics on how to increase the likelihood of getting key actors behind

18 Issing 2005, 65–83.

19 Losada 2012, 4–5.

a desired action or outcome. Taken from a completely different field,²⁰ the matrix below is a simplified representation of how to classify potential parties by using two variables: the power of the stakeholder and the level of interest of the stakeholder. Obviously, a more accurate real life matrix would have more dimensions and more options within the dimensions with a loss of graphical simplicity.

Table 1. Stakeholder Matrix

<i>Level of Power</i>	Keep Satisfied	Key Players
	Minimum Effort	Keep Informed
	<i>Level of Interest</i>	

An independent expert is normally not a stakeholder in a process. He/she is the owner of his/her own process, where he/she obviously needs to keep all the relevant stakeholders onboard. Using the table above for competition authorities, he/she needs to keep high-level political powers satisfied and the broad public involved with the provision of information about his/her activities and their positive impacts. In the case of the ECB, one could argue that it needs the support of the other economic agents in order to be able to perform its duties and hence needs to keep them satisfied to some extent. It also needs to keep the man on the street informed about its aims and also about the success it has had in achieving these aims. The Bundesbank has been considered particularly skilful in this respect, as it managed to convince the German public that monetary stability and the post-war *wirtschaftswunder* were linked to and facilitated by a strong and independent central bank.

For the purpose of this analysis, the issue is whether the owners of some other processes have been able to engage the ECB as a stakeholder in their processes. There are at least two main suspects that I will discuss in the next section: (a) has the ECB become a stakeholder in the financial stability of the euro area banking system or even in the profitability of individual institutions and (b) has the ECB's deep involvement and also financial exposure to single Member States deprived it of its ability to act as an independent expert vis-à-vis a Member State's fiscal situation? In other words, has the independent expert role of the ECB become questioned by the potential roles of stakeholder in either euro area banking sector solvency or in Member States' public finances or in both?

²⁰ For example, the State Services Commissioner of New Zealand (see <www.ssc.govt.nz> and also the Department of Sustainability and Environment in Australia (see <www.dse.vic.gov.au>) use this matrix to design Engagement Plans for their projects.

Politician

The role of politician refers to an actor that makes political decisions, which for the purpose of this analysis have a few crucial features. First of all, political decisions contain value judgements. They are decisions that shape societies and give expression to their views on a broad range of issues that by definition do not have a “scientifically” proven correct single alternative. In a democratic society, delegating value judgements to administrative organs, let alone independent authorities is highly problematic. Administrative organs obviously give physical appearance to those value decisions in individual cases, but should have only limited discretion in the actual formulation of such decisions concerning values.

Second, at the core of political decision-making is determining how the tax burden is shared and how the proceedings are spent. For example, the German constitutional court has emphasised that parliament’s budgetary power is a core element of Germany’s self-representation.²¹ The contrary argument should make it clear. If we assume that any group of people was subjected to unlimited financial liabilities without any say on the issue, we would use words like slavery or dictatorship rather than democracy. Indeed, in a modern liberal society, the majority of the self-representation of a nation takes the form of deciding about public expenditure and the allocation of the financing burden of the aggregate expenditure. That also includes the allocation of financing burdens between generations. The link between democracy and taxation is also reflected in the classical “no taxation without representation” slogan initially used by the Thirteen Colonies’ spokesmen.

Thirdly, the role of politician includes an assumption that there is some kind of process to decide between conflicting views in an organised and, hopefully, open manner. The conflicting views should represent those of the people and the decision-making process should have some direct or indirect input from the people at best on equal terms. Here one elementary feature is that the process does not necessarily anticipate or have preconditions for the type of issues that can be tackled.

One could obviously start from a different perspective by taking political decision making as the basis for all public decision making and see them as acts of self-representation of a given population or a state. Then all the deviations from the political role should be seen as exceptions to the rule that would require specific reasons. However, it is quite unlikely that we would have very different results if the procedure was reversed. For the purpose of my analysis, I find it more fruitful to focus on the core elements of the political role in order to find as much undisputed ground as possible.

The constitutional requirements for the political process are manifold and depend on the specifics of a given system. Without being exhaustive, I could mention that it needs to have continuous input from the people, and if that takes

²¹ *BVerfG*, 2 *BvR* 987/10, 7 September 2011

place via representative democracy, the mandates need to be renewed at relatively constant intervals. Obviously, for the EU there is the vast number of theories assuming various democratic input mechanisms, either through the EU parliament or through the Member States' own democratic processes.

IV. The new roles of the ECB

I have discussed the actual measures taken by the ECB elsewhere more thoroughly.²² In order to focus on the major substantive constitutional issues, I will only describe the stylised facts of the most interesting new type of actions by the ECB. They can be put into two groups according to the main concern of the action: actions concerning financial market crises and actions over fiscal crises. It is somewhat arbitrary to draw a line between these two types of actions, as many of the measures by the ECB since early 2010 could be explained by either form of crisis, which furthermore have become increasingly interlinked.

The broad list of action during the peak of the financial market crisis circled around means to resist the falling liquidity of the banking sector. Firstly, with the extensive expansion of the list of eligible collateral and the resulting variability in asset quality, the ECB has potentially become more exposed to the profitability variation of the banking sector. Obviously, this is also demonstrated by the fact that the ECB's total exposure towards the banking sector has increased from appr. 200 bln in mid-2000, and from 480 bln in mid-2007 to more than 1,400 bln as of the end of September 2012. While all this expansion, with the exception of the so-called Emergency liquidity assistance (ELA) by some national central banks, has nominally been simply liquidity provision and has as of now resulted in very marginal actual credit losses, it cannot be denied that the ECB has become a major stakeholder in the euro area banking system. This was further expanded with the creation of the European Systemic Risk Board under the organisation of the ECB,²³ which made the explicit distinction between monetary policy and supervisory policy responsibilities less clear and opened the door for further involvement of the ECB in the support operations of the financial sector, which are currently discussed under the heading of banking union.

The case with the link between the banking sector and the central bank is generally not very simple and straightforward. Modern central banks have always had close ties with the banking sector.²⁴ Banking sector is the main channel through

²² Tuori 2012.

²³ Regulation (EU) No 1092/2010 of the European Parliament and of the Council 24/11/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (the 'ESRB Regulation'), and Council Regulation (EU) No 1096/2010 of 17/11/2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board.

²⁴ The US Federal Reserve was even initially founded to support banking sector liquidity.

which central banks try to influence the supply of money and the liquidity condition of the financial system more generally. In the case of the ECB, the banking sector was intentionally made to be a debtor towards the ECB. This was guaranteed by the minimum reserve system, which forced banks to make minimum reserve deposits at their national central banks.²⁵

Notwithstanding, or even because of, these close and substantial ties between banks and central banks of the ESCB, there was supposed to be a very clear distinction between the banking sector and the ECB. In real terms, the ECB was not supposed in any event to be involved in the provision of solvency support to the banks (i.e. capital support). Hence all the lending was to take place only against sufficient collateral and have short term maturity as a rule. The demarcation line between allowed liquidity support and prohibited solvency support is somewhat unclear en ante. And even ex post, it is possible that fully justified liquidity support results in credit losses and hence actual solvency support, and vice versa. This notwithstanding, the principle is very clear. No such situation should arise, where the ECB needs to concern itself with the fact that its monetary policy action might result in its own capital being eroded through losses incurred by banks. If however that did occur, the ECB would have become a stakeholder in banking sector profitability, which would be directly against the constitutional principles mentioned earlier.

The main actions of the ECB with regard to the fiscal crisis could be summarised in three groups. The first group consists of verbal interventions and other involvement in drafting the rescue plans of the Member States facing fiscal challenges and also in controlling the implementation of those plans. The involvement has exceeded the more traditional practice of commenting on the fiscal policy stance and even more often on fiscal sustainability, which was also part of the ECB's approach from the start. Before the Greek situation, the ECB refrained from commenting on individual Member States and made sure that it did not get involved in the actual fiscal policy discussions of individual countries. However, as the Greek fiscal situation became worse and the country was being excluded from credit markets, the ECB became heavily involved in the rescue operations of Greece and of some Member States. The governor of the ECB Mr Trichet was also insisting that Greece was not allowed to default on its debts.

Second, the ECB changed its collateral policy for Greece and most likely engaged in large scale liquidity creation at abnormally long maturities to encourage market participants to invest in higher-yielding government bonds. Third, and most controversially, the ECB started its Securities Market Programme (SMP), that is, it purchased the government bonds of the countries facing fiscal hardships. The programme has been justified by monetary transmission arguments, which,

²⁵ See, for example, Monetary policy transmission in the euro area, a decade after the introduction of the euro. *ECB Monthly Bulletin* article, May 2010, and also *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.

however, have raised more questions than provided convincing explanations.²⁶ The claim is that there has been some sort of renationalisation of money and capital markets in the euro area with the result that monetary transmission differs between areas of the euro area. Most crucially, this differentiation could be fought by purchasing the government bonds of the troubled Member States. The programme was activated in May 2010 and closed by the end of Autumn 2012 with a total exposure of somewhat more than 200 bln euros. It has been replaced by the Outright Monetary Transactions programme that was announced in August 2012, which is similar to a large extent but makes conditionality and the link to adjustment programmes conducted by the euro area Member States by the EFSF/ESM a more explicit part of the programme.

How should these new ECB roles be assessed? It could be claimed that the safeguards that were designed for the ECB in the Treaty and also carefully respected in its initial operational framework have been eroded by its own decisions during the crisis. In the Treaty context two threats of this kind were tackled. First of all, the new central banking system was not to become a stakeholder in government finances and, secondly, it was designed to distance itself from the banking sector's potential problems. In both of these regards, the ECB(ESCB) is unlike other central banks working in the nation-state setting, but is somewhat similar to the actual conduct of the Deutsche Bundesbank.

It is at the heart of the monetary policy part of the European economic constitution that the EU central bank was not supposed to have any responsibility for government finances at any level (municipal, Member State, or EU). This was safeguarded by the prohibition of central bank financing of governments, etc., by the requirement that all lending of the central bank should be based on adequate collateral. In addition, the central bank was assigned an extensive degree of independence: long fixed term assignments for management, its own primary objective that was also supposed to be respected by others, and a prohibition on seeking or taking advice from external sources.

The above-mentioned central banking stipulations of the public finances part of the European economic constitution were one side of the coin with the other side being the Member State's responsibility for its own public finances. The latter obviously consisted, *inter alia*, of a no-bail-out clause and an excessive deficit procedure of the SGP. The central banking part was distancing the central bank from public finances at the Member State level and the other part was protecting the common monetary policy from the negative spill-over effects of reckless public finances. The ECB was not involved in the operational part of the SGP or any other disciplinary mechanism, because it would have made it a stakeholder in the public finances.

²⁶ See, for example, the ECB press conference of May 2010 and press release on 10 May 2010, The ECB decides on measures to address severe tensions in the financial markets.

I have already made the point that there is a major risk that the ECB has been made a stakeholder in the euro area banking sector. With the massive increase in lending exposure and a simultaneous decline in collateral quality, the ECB would face potentially unbearable losses, if a large number of banks defaulted on their debts. As the ECB possesses two main elements of banking sector profitability, the provision of liquidity and setting the level of short-term interest rates, it is not irrelevant whether it can consider the financial difficulties of individual banks – primarily, private sector problems and, secondarily, a Member State’s problems – or whether it is in the front line being hit by those difficulties. My assessment would be that there is no longer a certainty that the ECB can function purely as an independent monetary expert, because of its stakeholder position vis-à-vis the banking sector.

The same analysis would seem to apply to the Greek and some other Member State’s fiscal problems. The ECB has clearly been made a stakeholder in those situations, as it has been involved in the actual rescue operations. Obviously, there is an increasing link between the banking sector’s problems and fiscal problems as the local banks have been “forced” to buy local government bonds with helpful funding from the ECB. However, it could also be claimed that the ECB has actually taken a political role in the fiscal crisis. The massive increase in indirect and even direct lending to Member States is effectively government financing, which is fully analogous to spending tax payers’ money. For example, the SMP programme and even more the OMT programme could, from the debtors perspective, have been exactly the same as funding Member States. This is further emphasised by the fact that the ECB has started to act like a creditor towards the countries in question. The letters sent to both the Italian and Spanish governments are a case in point.

V. ECB constitutional controls and democratic legitimacy with new roles?

The constitutional structure for central banking in the euro area relied heavily on the model of apolitical expert function that could in the European economic constitution be assigned to an independent central bank. There are at least three crucial elements in that delegation of powers. First, the tasks assigned are deemed to be such that their operation can be controlled with dual means of juridical control and accountability, mainly through the transparency of actions. Second, functions and decisions containing value judgements could be excluded or at least be defined in a rule-based form that can then be assigned to an expert.²⁷ Thirdly, and related to the previous two elements, the functions that are delegated to an independent expert body must be such that they can be defined ex ante relatively precisely. This means that the delegated process is well known and the outcomes of given

²⁷ Obviously this has been a contested perception of central banking.

actions are known with a relatively high level of certainty, which would be in line with the technocratic model presented by Habermas. Obviously, there must be some ability to confirm *ex ante* democratically that the process description and objectives are preferred by the polity, preferably with a large majority. In particular, if the legitimacy discourse is primarily based on the liberal tradition, the role of the broad consent of the people would be highly supportive for the legitimacy of the independent guardian of monetary stability.

The demand for the above mentioned conditions are stricter if the delegation is made at a higher level, that is, if the position of the independent expert is constitutionally protected rather than a result of administrative action or normal laws. In the same vein, the more independent the expert function is, the more closely the delegation should follow the preconditions. Against this background, the demands for the delegation in a nation-state setting are looser than they are in a Treaty-based constitutional set-up such as the EU (or the euro area).

In the case of the ECB, I would argue that the delegated function largely fulfilled the criteria set above although with some arguably very demanding assumptions. The most crucial assumption was that the role of money and monetary policy was seen in a monetarist or in a German *ordo-liberal* perspective. There is also an interesting issue linked to Scharpf's division of legitimacy discourses into liberal and republican, respectively. Namely, in the German *ordo-liberal* discourse with its narrow central banking model with the sole objective of ensuring monetary stability, the central bank could be seen as one main guarantor of the systemic choice for a free market economy and ultimately a free society.²⁸ As a result, the euro area monetary environment was closer to an enhanced gold standard than a field of activist monetary policy. However, it would seem questionable whether all Member States realised this or subscribed to it, even if this is the way it was very clearly written in the Treaty of Maastricht.

Concerning the narrow role of the central bank, one could argue that constitutional control mechanisms met at least some minimum criteria. However, a lot was left to the new institution to meet the requirements of transparency and accountability and also to exercise considerable self-restraint with regard to its actions in border-line cases of its mandate. I have argued that this was well understood by the ECB when designing its monetary policy strategy and also during its first decade of operation.

These constitutional control mechanisms seem to be struggling with its new stakeholder or politician roles. Transparency and accountability only work if the institution reveals all its influences and aims, and does not try to mislead the public. The main risk in this respect is that the institution continues to describe its actions according to the independent expert function although the substance of the actions is that of a stakeholder or a politician. That would effectively prevent those actions

28 This is particularly well described in Eucken 1952 in which monetary stability is the first of the constituent principles of the economic order.

from becoming exposed to public scrutiny. They would require even more than the pure expert functions due to their inherent value judgements.

In the unfortunate situation in which accountability through transparency of actions has become void, we are left with judicial control mechanisms. In the case of the ECB this is still mostly untested territory. However, I would think it highly unlikely that in the middle of the crisis, the European Court of Justice (ECJ) would, for example, order the ECB to narrow down its collateral list and to sell all the government bonds in its possession that it cannot justify on the ground of controlling short-term liquidity. In a recent *Pringle* case, the ECJ even failed to find any means in the Treaty to define monetary policy and showed quite a limited willingness or ability to engage in argumentation concerning monetary policy related issues.²⁹ More generally, juridical control and contested macro-economic policy choices make a poor match as the famous decision on the Stability and Growth Pact has also shown.

Hence, if we assume that the envisaged constitutional control mechanisms are not sufficient to correct the situation, we have to come back to the old question of democratic legitimacy and a given model of administration or governance. The complexity starts with the varying perceptions of legitimacy itself. Following Lord (2012) on the subject, there is, first of all, the empirical notion that relies on the acceptability of the use of political power. Without qualifying the concept of acceptability with some moral criteria, it is fundamentally a nihilistic (or even Schmittian) description.³⁰ Indeed, often some notion of moral justification is added to the definition³¹ with a potentially detrimental impact on the preciseness and testability of the concept. The relatively easy and not necessarily uncomfortable way out would be to hold as a starting point that private persons are autonomous subjects that can judge for themselves what is acceptable and justified, and this becomes manifested in processes where these people can participate on an equal footing. This also justifies some form of coercive actions towards people as long as these actions and their rationales have been deemed justified by the same people acting as a polity.³² Obviously, this is no more than to say that democratic processes are the least controversial ways to find acceptable and justified, that is, legitimate forms of governance.

If we define the criteria of legitimacy as something whereby people consider justified even decisions or administrative actions to which they are opposed, it is easy to see that some link to democratic decision making is close to essential. This would seem to hold even in cases where direct democratic mechanisms are not preferred due to time-inconsistency and prisoners dilemma type of situations,

29 Case C-370/12 on the Council Decision 2011/199/EU.

30 Lord 2012,11 with a reference to both Beetham 1991 and Grafstein 2002.

31 For example, Buchanan 2002.

32 Habermas 1996, 67.

which are obviously also at the heart of delegating public power to independent experts. The same argumentation has been used to legitimise the whole approach of constitutionalising the main framework for economic action, namely, the economic constitution.³³

With regard to the EU, there are two additional issues involved in the legitimacy discussion. The first is question of legitimacy to whom, governments or the people of the EU. It seems clear that at least legitimacy in the eyes of or consent of the governments of the Member States is necessary. Without the consent of the governments (and national courts of justice), the decisions of the EU could not be implemented.³⁴ A more difficult question is whether the EU needs to be perceived as legitimate by the people of the EU. Another issue concerning the EU and legitimacy comes from the fact that it is still founded by and based on international treaties. Hence original commitments of the Member States, their consent to the powers of the EU, have a far bigger role than in national political processes. Hence the “the notion of ‘no legitimacy without consent’ does seem to have a special significance for the European Union.”³⁵

Much has been written about the democratic legitimacy of the ECB or the lack of it.³⁶ It is clear that in the ECB’s conduct of monetary policy, there is no mechanism for democratic inputs to influence its action. Quite the contrary, as explained before, the ECB has been carefully protected from democratic inputs in the same manner as it has been from other undue influences. To conclude that the ECB has never been democratically legitimised, is not correct in my view. Here the reference to courts or competition authorities should be useful if not conclusive. Hardly anyone would consider the legal system lacking legitimacy on the basis that court decisions are not based on a democratic process but on expert knowledge and a protected independent reasoning.

The ECB’s relationship with legitimacy is based on a few elements. First of all, the most important democratic legitimatisation takes place at the time the system is decided upon. In the case of the ECB, its position is defined by the European economic constitution that was decided upon in the Maastricht Treaty concerning the supra-nationalisation of monetary policy. In the democratic processes of the Member States, the monetary order was constitutionalised to contain a certain type of objectives and institutional set-up. The second, and slightly more problematic form of legitimacy, comes from so-called output legitimacy. The system is considered legitimate as long as it provides the people of the euro area with the prosperity and economic stability it has promised.

33 Among the earliest proponents of the economic constitution, ordo-liberals, there was considerable variation in the emphasis of the democratic basis of the systemic choice.

34 Scharpf 2007, 7.

35 Lord 2012, 21.

36 The vast literature can hardly be summarized here. Some well-known examples include: Verdun 1999; Scharpf 1997; Moravcsik 2002; Majone 2001; and De Haan and Eijffinger 2000.

Both the systemic choice and output legitimacy deserve a fresh look after the series of events we have witnessed in the course of the last five years. In particular, the pre-conditions for an independent expert organisation need to be continuously met. If that was not the case, the constitutional control mechanisms would hardly be sufficient. Using the constitutional controls of an independent expert on political decision-making would not make any sense. There are simply no mechanisms to make value-based political decisions in a legitimate manner. In conclusion, if my fears are substantiated, the lack of democratic legitimacy of the ECB has also become a problem from the point of view of the European economic constitution due to the new roles of the ECB. By questioning underlying fundamental principles, this goes to the heart of the whole monetary order.

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