Unconventional Monetary Policies and the European Central Bank's problematic democratic legitimacy

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Abstract Prior to the international financial crisis, the ECB's policies were shaped by the interpretation that its mandate was primarily to ensure low inflation. Since the outbreak of the sovereign debt crisis in early 2010, the ECB has adopted a range of policies which have pushed its role well beyond that interpretation. This article presents the argument that ECB policy-making since the start of 2010 undermines the democratic legitimacy of the ECB. The problems stem from three developments: the stretching - and arguably breach - of the ECB's mandate; the increasing politicization of the ECB's decisions and policies; and the extent to which the ECB's policies undermine the transparency of both its own monetary policy and national macroeconomic policies.

Zusammenfassung Die Beschlüsse der EZB wurden ihrem Mandat entsprechend bis zum Beginn der Finanzkrise primär unter dem Leitgedanken der Preisstabilität gefasst. Seit Beginn der Staatsschuldenkrise in 2010 hat die EZB eine Reihe von Entscheidungen gefällt, die weit über dieses Prinzip hinausgehen. Dieser Artikel argumentiert, dass die Organisation mit dieser Art von Beschlüssen seit 2010 ihre eigene demokratische Legitimität untergraben hat. Diese Probleme beruhen auf drei Entwicklungen: der Verwässerung - und möglicherweise dem Bruch - des Mandats der EZB; der zunehmenden Politisierung der Beschlüsse der EZB; und dem Grad in dem die Politik der EZB die Transparenz sowohl ihrer eigene Geldpolitik als auch die der nationalen makroökonomischen Politiken aushebelt.

Key words European Central Bank, European Union, Monetary Policy, Euro, Sovereign Debt Crisis, Legitimacy, Democracy, Transparency, Greece, Unconventional Monetary Policies, Troika.

Legal norms

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Maastricht Treaty
Statute establishing the European Central Bank and European System of Central Banks
Treaty on European Union (TEU)
Treaty on the functioning of the European Union (TFEU)

I. Introduction

Since the outbreak of the sovereign debt crisis in early 2010, the weak response of the EU's political institutions and the combined challenges of the sovereign debt crisis, banking crisis and economic stagnation/recession have pushed the ECB to adopt a range of policies which demonstrate a changed interpretation of its low inflation mandate established in the Treaty on European Union (Maastricht Treaty).[1] Whereas the ECB's role prior to 2010 was seen principally in terms of managing monetary policy to guarantee low inflation, its policies post-2010 demonstrate a greater focus upon other concerns - notably the stability of the euro area financial system and even the very survival of the euro area. This article presents the argument that ECB action since 2010 undermines the democratic legitimacy of the ECB (and the EMU project more generally) and demonstrates why linked claims about the transparency of ECB action are similarly problematic.

The next section summarizes the arguments that defend the democratic legitimacy of the European Union and, more specifically, the EMU project and the ECB's role. This section also sets out the main premises of our argument. In the following three sections, we discuss the three main problems faced by the ECB: the stretching of its mandate and - more importantly - the limits of its mandate; the increasing politicization of the ECB's decisions and policies; and the extent to which the ECB's policies undermine the transparency of both its own monetary policy and national macroeconomic policies. The article concludes by summarizing how most of the key arguments that can be used to defend the ECB's democratic legitimacy have been undermined by the unconventional monetary policies the ECB has adopted to tackle the euro area's sovereign debt crisis.

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[1] The Maastricht Treaty assigns the ECB the power to define its inflation target. In 1998, the ECB Governing Council agreed upon a target of 'below 2 per cent' year on year increase in the Harmonized Index of Consumer Prices (HICP). This definition was amended in 2003 to a target of inflation rates 'close to 2 percent' over the medium term. For more details, cf. *Howarth David/Loedel Peter,* The European Central Bank: The New European Leviathan? (2005).

II. Justifying the ECB's democratic legitimacy and accountability

In order to understand whether European monetary policy is managed in a democratic manner, one needs to have a concept of what it means to be democratic, as well as an understanding of the main criticisms of EU policy-making. 'Democracy' can have at least three different meanings that are of relevance in this context. First, 'democracy' can be defined as a political system where binding decisions are taken by actors whose legitimacy stems from elections.[2] Second, it can refer to democratically elected institutions as a means of taking decisions that serve the general good.[3] In the first definition the emphasis is placed on democratic *input* (input legitimacy), in the second on efficient and effective policy *output* (output legitimacy). *Schmidt* distinguishes a third type of legitimacy as being part of democracy: 'throughput legitimacy'.[4] This type of legitimacy focuses on the 'quality of EU policymaking processes, judged by their efficacy, accountability, transparency, and inclusiveness'.[5] Because this concept can be tied to the question of whether an institution operates the way it was intended to operate, it is particularly important for technocratic non-majoritarian institutions (including central banks and courts) that have less input legitimacy. In the context of these three concepts of democracy/ legitimacy, the democratic deficit is defined as 'the growing dissonance between the requirements of modern democratic rule and the actual conditions upon which the governance of the EU is based'.[6]

When compared to (ideal types of) democratic states, the main criticisms levelled at the EU refer to the inability of the European Parliament and national parliaments to control executives across the whole range of policy areas, the pro-integrationist bias of the European Court of Justice, the secretiveness surrounding decision-making in the Council of Ministers, the Commission and the European Central Bank and, generally, a tendency to delegate powers to executive agencies, parliamentary control over which is even more limited.[7] Overall, the EU is

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[2] Cf *Chryssochoou Dimitris*, Europe's Contested Democracy, in Cini Michelle/Perez-Solorzano Borragan Nieves (eds), European Union Politics[3] (2010) 377-389.

[3] Cf. *Scharpf Fritz*, Governing in Europe: Effective and Democratic? (2005).

[4] Cf. *Schmidt Vivien*, The Eurozone's Crisis of Democratic Legitimacy: Can the EU Rebuild Public Trust and Support for European Economic Integration, European Economy Discussion Paper, No 015, September 2015, available at <http://ec.europa.eu/economy_finance/publications/eedp/pdf/dp015_en.pdf> (04.12. 2015).

[5] Cf. *Schmidt* (Fn 4).

[6] Cf. *Chryssochoou* (Fn 2) 378.

[7] Cf. *Chryssochoou* (Fn 2); *Moravcsik Andrew*, In Defence of the 'Democratic Deficit: Reassessing Legitimacy in the European Union, Journal of Common Market Studies 40(4) (2002) 603; *Follesdal Andreas/Hix Simon*, Why There is a Democratic Deficit in the EU: A Response to Majone and Moravcsik, European Governance

criticized for its perceived remoteness from the ordinary citizen, its technocratic nature and the extensive role played by bureaucrats and executives in decision-making.[8]

These critiques have been countered by a number of authors who have come out in defense of the European Union's political system. Many of these counter-arguments are particularly relevant in the context of the operation of EU monetary policy. Already in the late 1990s, *Majone* argued that the democratic standards that should be applied to the EU depend largely on the nature of integration: If the European project is viewed as one that comprises both economic and political integration, the standards should come close to those of a parliamentary democracy.[9] If, by contrast, integration refers mainly to economic integration, then economics and politics should be 'kept as separate as possible'[10] and European policy-making should be depoliticized. In addition, whether non-majoritarian institutions are compatible with democracy or not depends on the tasks that are delegated to them and to the extent to which independence is reconciled with accountability.[11] In particular, 'as long as the tasks assigned to [the European level] are precisely and narrowly defined, non-majoritarian sources of legitimacy - expertise, procedural rationality, transparency, accountability by results - should be sufficient to justify the delegation of the necessary powers'.[12] Thus, *Majone* points out that the common criticisms of 'technocratic decision-making, lack of transparency, insufficient public participation, excessive use of administrative discretion, inadequate mechanisms of control and accountability' are also present in non-majoritarian institutions outside the EU, such as central banks and regulatory agencies.[13]

Papers, No C-05-02, 2005, available at < http://www.connex-network.org/eurogov/pdf/egp-connex-C-05-02.pdf> (09.06.2016).

[8] Cf. *Moravscik* (Fn 7).

[9] Cf. *Majone Giandomenico*, Europe's 'Democratic Deficit': The Question of Standards, European Law Journal 4(1) (1998) 5.

[10] Cf. *Majone* (Fn 9): 5.

[11] Cf. *Frazer Bernard William*, Central Bank Independence: What does it mean?, Reserve Bank of Australia Bulletin, December 2004; *Lastra Rosa Maria*, Central bank independence and financial stability, Revista de Estabilidad Financiera 18 (2012) 49.

[12] Cf. *Majone* (Fn 9): 28.

[13] Cf. *Majone* (Fn 9): 14-15. There also exists a well-established strand of economic and political science literature which explains why monetary policy in particular does not necessarily need to be subject to — or, indeed, should not be subject to — democratic (partisan) politics. Cf. *Bandura Romina/Mendoza Ronald/ Sidikou-Sow Balkissa*, Central Bank Independence and Accountability: A Literature Review', November 2006, available at <http://web.undp.org/developmentstudies/docs/central_bank_review_2006.pdf> (01.12.2015); *Blinder Alan,* Central Banking in Theory and Practice (1998); *Drazen Allan*, Central Bank Independence, Democracy, and Dollarization', Journal of Applied Economics V (2002) 1.

Majone mentions the ECB as a prime example of such a non-majoritarian institution. While the case is not discussed in detail, *Majone* generally contends that institutions such as the ECB can have legitimacy, if they adhere to certain standards. In particular, their authority and objectives need to be specified, their decision-making processes should be well-defined, their decisions need to be justified, the policy outcomes need to be sound and they need to have the necessary expertise and a willingness to protect diffuse interests. In the case of the ECB, *Majone* particularly appreciates its clear and measurable goal: low inflation. The ECB itself regularly reconciled its independence with democratic principles by way of its clear price stability mandate.[14] The unusually large degree of ECB independence is also considered necessary to overcome the diversity of national political views on monetary policy.[15] There is thus a strong assumption that the ECB is a body of experts that is taking decisions within narrowly defined goals and in a depoliticized manner.

The assumption that much of EU policy-making is technocratic and thus benefits from depoliticization is largely shared by *Moravcsik*.[16] He, too, argues that the EU is being held up to the wrong standards. Firstly, he claims that the EU is often compared to an ideal-type of a democratic state that 'real' states cannot live up to either. Secondly, he argues that EU policy-making is different from national politics. The EU's functions have often a lower electoral salience - for example, central banking, technical regulation of cross-border externalities, and economic diplomacy. He points out that many of those functions would in fact also be delegated by states to national central banks, courts or agencies, often in a deliberate attempt to 'insulate' them from politics. In addition, the EU's institutions are limited by narrow mandates and constrained by super-majoritarian decision-making, for example in the Council of Ministers. *Moravcsik* thus finds the relatively high degree of 'insulation' of EU policy-making acceptable,[17] insofar as:

1. Most EU policies are regulatory and economic. There are only limited (re)distributive policies. Most 'political' policies (for example, migration) remain largely intergovernmental and draw their legitimacy directly from elected national governments.
2. The EU lacks a range of more politicized competences, including fiscal priorities, social welfare provision and taxation.

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[14] Cf. *Issing Otmar*, Should we have faith in central banks?, London: Institute for Economic Affairs (2002); *Issing Otmar,* Central Banks – Paradise Lost, CFS Working Paper, No. 2012/06 (2012), available at <http://econstor.eu/bitstream/10419/71154/1/718692837.pdf> (15.12.2015).

[15] Cf. *Majone* (Fn 9): 5; Howarth/Loedel (Fn 1).

[16] Cf. *Moravcsik* (Fn 7).

[17] Cf. *Moravcsik* (Fn 7).

3. The political system with its multi-level structure, plural executive and distribution of power across several institutions is geared towards the protection of minorities.
4. Legitimacy stems from a variety of sources, such as elected national governments and the European Parliament.
5. Semi-autonomous judges and technocrats require insulation to produce policy outcomes in the general interest based on expertise. 'Most such insulated institutions arise out of the logic of commitment; that is, as efforts to enforce or embed the impartial implementation of prior bargains'.[18] *Moravcsik* also recognizes 'the need for greater attention, efficiency and expertise in areas where most citizens remain "rationally ignorant" or non-participatory'[19] - for policy areas where expert and informed decision-making is required, but difficult for the ordinary citizen to achieve. The impartiality of those institutions also protects minorities against majorities, but also majorities against powerful and vocal minority interests.

Overall, neither *Majone* nor *Moravcsik* see the role of the ECB in EU monetary policy as a problem, as they both recognize monetary policy as a policy area that should best be dealt with by experts in a depoliticized manner with powers delegated to them by elected governments. Even some of the academics who recognize the potential dangers of ECB independence, downplay the implications of independence for EU democracy. *Tallberg*, for example, contends that for many scholars, political control of the ECB is a 'non-issue', to the extent that the Bank has the same broad objective as its political Principals - namely, price stability.[20] As in the case of *Moravcsik* and *Majone*, output legitimacy alone alleviates those concerns, as long as the ECB fulfils its treaty objectives.

Even more remarkably, a number of authors who *are* concerned about the state of EU democracy and who find political participation desirable often only mention EMU in passing without problematizing the role of the ECB.[21] Indeed, the view that monetary policy can be depoliticized has been undermined by the euro area crisis, with *Bellamy* and *Weale*, for example, questioning the assumption of 'the normative value of the depoliticization of money'.[22]

[18] Cf. *Moravscik* (Fn 7): 613.

[19] Cf. *Moravscik* (Fn 7): 614.

[20] *Tallberg Jonas*, Executive Power and Accountability in the European Union, in Gustavsson Sverker/Karlsson Christer/ Persson Thomas (eds), The Illusion of Accountability in the European Union (2009) 111.

[21] Cf. *Follesdal/Hix* (Fn 7), *Chryssochoou* (Fn 2).

[22] Cf. *Bellamy Richard/Weale Albert,* Political Legitimacy and European Monetary Union: Contracts, Constitutionalism and the Normative Logic of Two-Level Games', Journal of European Public Policy 22(2) (2015) 257.

A common basis of the *Moravscik* and *Majone* positions on the democratic legitimacy of the EU is drawn from the insights of Principal-Agent analysis: with which we might also consider the democratic legitimacy of ECB action.[23] The Maastricht Treaty includes the terms of delegation established by the Principal (EU Member States) with regard to the powers and objectives of the ECB Agent. Here the Principal is collective: not only the twelve member states that agreed upon the Maastricht Treaty provisions but also, by extension, the other member states that joined the EU later and, specifically, the euro area, thus accepting the terms of the EMU project. In the context of a Principal-Agent analysis, ECB action can be seen to be democratically legitimate to the extent that the ECB follows the preferences of elected national governments as set out in the terms of delegation. Top ECB officials (and ECB supporters) have frequently defended the legitimacy of its policy making in these terms.[24] Member state preferences focused upon the following two elements (among others) outlined explicitly in the Maastricht Treaty and in the Statute establishing the European Central Bank and European System of Central Banks. First, the ECB must give primacy to the pursuit of low inflation, only after the achievement of which it can seek to pursue other goals, including economic growth. Second, the ECB cannot be a 'lender of last resort' for sovereigns (member state governments) - a prohibition established by provisions blocking the ECB from monetizing government debt (Article 101 TEU, Article 123 TFEU) and the 'no bail out' rule (Article 103 TEU, Article 125 TFEU). The aim of the prohibition of monetary financing was to ensure 'monetary dominance' and exclude the possibility of 'fiscal dominance' - that is, a situation where member state fiscal policy becomes so untenable that the ECB is forced into deficit financing.[25] These monetary policy preferences of member state governments reinforced broader macro-economic preferences also set in the Maastricht Treaty and notably through the convergence criteria and the need for governments to maintain sustainable national fiscal policies with public spending deficits at or below 3 per cent of GDP and debt levels at or below 60 per cent.

An additional argument about the democratic legitimacy of the ECB centers on transparency. Jones, for example, argues that by removing monetary policy from governments and removing

[23] Cf. *Elgie Robert*, The politics of the European Central Bank: principal-agent theory and the democratic deficit, Journal of European Public Policy 9(2) (2002) 186.

[24] For example, cf. *Trichet Jean-Claude*, Cérémonie de remise du Collier du Mérite Européen à M. Jean-Claude Trichet (Luxembourg, 6 mars 2013) – Transcription, March 2013, available at <http://www.cvce.eu/content/publication/2013/5/16/97f2cca1-b756-4092-a5a5-57602f9ddc23/publishable_fr.pdf> (12.09.2015).

[25] Cf. *Sargent Thomas J./Wallace Neil*, Some unpleasant monetarist arithmetic, Federal Reserve Bank of Minneapolis Quarterly Review 5(3) (1981) 1; *ECB (European Central Bank)*, Ten years of the stability and growth pact, ECB Monthly Bulletin, October 2008, 53.

the possibility of the deliberate pursuit of higher inflation for political reasons, EMU - and specifically independent ECB policy making - in effect strengthens democracy by focusing public and government attention upon other policy issues which have a greater impact upon redistribution in unequal societies.[26] Inflation can in effect confuse public perception as to inequality - by raising the minimum wage and making people feel wealthier, for a short while at least - and can better enable governments to forego difficult decisions that have greater redistributive effects in, for example, fiscal, wage, labour market and industrial policy. Currency devaluation is an ‘easy’ option for governments running high inflation; one that delays structural reforms, does not resolve underlying socio-economic problems and has further unequal implications for populations. Thus, ironically, by removing monetary policy from governments, Jones argues that EMU could actually be good for democracy. ECB policy-making thus was transparent and contributed to national macro-economic policy-making transparency by virtue of the primacy of the bank’s low inflation objective.

The ECB sought transparency in relation to financial markets through the establishment of its two-pillar monetary policy strategy and monetary policy map which demonstrated how it would meet its low inflation target.[27] The lack of transparency and accountability in day-to-day ECB policy-making in relation to EU institutions and member state governments was designed to shelter Governing Council members - mostly national central bank governors serving as independent experts - from national political pressures. The limited operational transparency of the ECB was thus officially justified in terms of effective technocratic policy making. However, in broader socio-economic terms, the clear prioritization of low inflation could be seen in terms of improving transparency in national macro-economic policy making and thus the democratic legitimacy of ECB action.

In the following sections, we demonstrate how the ECB’s unconventional monetary policies and other interventions since the outbreak of the euro area sovereign debt crisis have fundamentally undermined the validity of these arguments in favour of the democratic legitimacy of EMU and specifically ECB monetary policy. In particular, we argue that:

1. The assumption that the ECB’s objectives are narrowly circumscribed by the objective of price stability no longer holds true, as the ECB’s response to the euro area’s sovereign debt crisis has produced ‘slippage’.[28] In the context of the ECB’s new policies and of

[26] Cf. *Jones Erik*, The Politics of Economic and Monetary Union (2002).

[27] Cf. *Howarth/Loedel* (Fn 1).

[28] The term ‘slippage’ is drawn from Principal-Agent Theory and refers to the Agent acting on its own preferences and diverging from the preferences of the Principal.

the ECJ's interpretation of the ECB's competences, the precise nature of the central bank's powers and objectives is now much less clear.

2. The assumption that the ECB's decisions are depoliticized, technocratic and of low political salience - always a problematic assumption - has been rendered irrelevant by the increasingly obvious fiscal (policy) implications of ECB unconventional monetary policy.
3. The ECB's recent efforts to improve the transparency of its day-to-day operations disguise the dramatic extent to which the central bank has undermined the transparency of its monetary policy and, in turn, national macroeconomic policy making.

III. Mandate stretching

Through the lens of Principal-Agent theory, the terms of delegation have been undermined by unconventional monetary policy and the ECB Agent has in effect 'slipped' - that is, the ECB has operated in a manner that contradicts the preferences of the Principal (member states) as set out in the original terms of delegation.[29] First, the ECB potentially slipped by pursuing policies that may have undermined the central bank's pursuit of price stability - although this is of secondary importance, especially given that inflation since 2013 has been well below the ECB's target. Second, and more significantly, ECB policy has in effect had an indirect fiscal policy role, directly contradicting the Maastricht Treaty's prohibition of the monetization of member state debt and 'no bail-out' rules. In this section, we demonstrate that the ECB acted as a de facto lender of last resort without the quid pro quo of fiscal and macroeconomic policy constraint, thus undermining both the transparency of national fiscal and macroeconomic policy and the strength of national structural reform efforts.

The ECB's pursuit of low inflation was frequently criticized prior to, during and in the immediate aftermath of the financial crisis, especially in comparison to US Federal Reserve policy which gave equal weight to several policy making goals including price stability,

[29] An assumption is made in this article that the Principal's preferences have not changed over time and that conflicting preferences within the collective Principal are of secondary consideration to the original terms of delegation as set out in the Maastricht Treaty. Clearly, there were at the time of the EMU negotiations and since, conflicting member state government preferences on the ECB's low inflation mandate (cf. *Dyson Kenneth/ Featherstone Kevin*, The Road to Maastricht: Negotiating Economic and Monetary Union (1999)) and even on the Treaty provision banning the monetary financing of government debt and bail-outs. However, because the terms of the ECB's delegation are set in the Treaty and cannot be changed without the unanimous agreement of the member states, for the purposes of this article, the Principal's preferences are taken as the treaty provisions and the democratic legitimacy of Agent policy-making evaluated in terms of these provisions. For this reason, the issue of 'observational equivalence' - that is, when the actions of the Agent shift to respond to the shifting preferences of the Principal - is of secondary importance.

economic growth and job creation.[30] However, the pursuit of low inflation had legitimacy in that this policy goal was given primacy in the Maastricht Treaty. The German government pushed most actively for the prioritization of low inflation and full ECB independence to achieve this.[31] The other governments either concurred with German preferences or acquiesced to them.

A. Undermining the pursuit of low inflation

With the outbreak of the international financial and then sovereign debt crises, the inflationary effects of the ECB's unconventional monetary policies became the subject of intense disagreement among economists, euro area member state governments and even ECB Governing Council members (see section three). For 2008 and in 2011-12, euro area inflation remained well above the 2 per cent target. The ECB argued repeatedly that its medium term goal was consistently respected.[32] President *Jean-Claude Trichet* insisted that the ECB was far more successful in maintaining low inflation than the Bundesbank had been prior to 1999.[33] These claims, however, did not stop criticism of the potential inflationary implications of unconventional monetary policies from a range of credible observers.[34] We argue that the economic reality of the inflationary impact of the ECB's unconventional monetary policy mattered less than the perception of potential inflationary impact for the central bank's democratic (input and output) legitimacy.

Debates initially focused on the impact of the ECB's liquidity boosting measures (notably, the purchase of covered bank bonds) and the ECB's Securities Markets Programme (SMP) - specifically the purchase of sovereign debt on secondary markets of those euro area member

[30] Cf. *Howarth David*, Defending the euro: Unity and disunity among Europe's central bankers, in Hayward Jack/Würzel Rüdiger, European Disunion: Between Sovereignty and Solidarity (2012) 131.

[31] Cf. *Dyson/Featherstone* (Fn 29).

[32] Cf. *ECB (European Central Bank)*, Annual Report 2011 (2012), available at <https://www.ecb.europa.eu/pub/pdf/annrep/ar2011en.pdf> (15.12.2015). The ECB points out that: 'Data from Consensus Economics, the Euro Zone Barometer and the ECB Survey of Professional Forecasters show that survey-based long-term inflation expectations (five years ahead) were close to 2.0 [per cent]. Market-based indicators, such as break-even inflation rates derived from inflation-linked bonds and comparable rates extracted from inflation-linked swaps, were also fully consistent with the Governing Council's definition of price stability.'(*ibid*., 55)

[33] *Financial Times,* 8 September 2011.

[34] On German press, political and Bundesbank criticism, cf., for example, *Kaiser Stefan*, Bond-Buying Perils: ECB Risks Inflation and Loss of Independence', Spiegel online international 09.08.2011, available at <http://www.spiegel.de/international/europe/bond-buying-perils-ecb-risks-inflation-and-loss-of-independence-a-779183.html> (23.05.2016); *Atkins Ralph*, Bundesbank opposed ECB bond-buying, Financial Times 22.08.2011, available at < http://www.ft.com/intl/cms/s/0/d1cd36b4-ccc6-11e0-b923-00144feabdc0.html#axzz46DUwzF00> (23.05.2016).

states most at risk of default and facing high bond yields. In May 2010, ECB President *Jean-Claude Trichet* defended the SMP from accusations that that programme created inflation arguing that it 'should not be confused with quantitative easing. In simple words, we are not printing money. This confirms and underpins our commitment to price stability'.[35] The ECB consistently insisted that it could 'sterilise'[36] the purchase of Greek debt and that its monetary policy remained focused upon its core goal.[37] A number of economists argued that the amounts involved in the debt purchases were very small in relation to the ECB's overall operations.[38] Nonetheless, 'sterilisation' was an important political message to the German government, central bank and population that the bank's actions would not create inflation.[39] The political salience of low inflation was particularly significant in Germany given both the population's longstanding inflation aversion - and prioritsation of low inflation over other socio-economic goals - and the Christian Democratic Union Party's longstanding efforts to associate the EMU project with the pursuit and preservation of low inflation and broader macroeconomic policy stability.[40] Thus, the economic argument that the SMP did not in itself fundamentally undermine inflation was less important than the very real perception that it could do so - especially if widened to include the sovereign debt of additional member states. The diversion from the pursuit of low inflation thus, in itself, politicised ECB monetary policy for a large section of the German political class and public (see below).

The repeated inability of the ECB to neutralise fully the inflationary impact of its sovereign debt purchases through 'sterilization' was the subject of growing scrutiny and criticism. The ECB temporarily halted the SMP in October 2010 because of inflation concerns. By early 2011, the bank's measure of inflation (HICP) reached 2.4 per cent - the highest level for over two years - which prompted the ECB to announce at the end of January a second temporary halt to the programme.[41] By May 2011, the ECB announced that it had failed a fifth time (and twice

[35] Cf. *Trichet Jean-Claude*, Speech by Jean-Claude Trichet at the 38th Economic Conference of the Oesterreichische Nationalbank, May 2010, available at <http://www.ecb.int/press/key/date/2010/html/sp100531_2.en.html> (16.10.2015).

[36] Sterilisation' refers to the process of a central bank taking in fixed term deposits from banks of the same amount spent on the SMP purchases with the aim of neutralising the liquidity created by the bond purchases.

[37] *Financial Times*, 31 January 2011.

[38] Cf., for example, *Buiter Willem/Rahbari Ebhari* , Looking into the Deep Pockets of the ECB, Global Economics View, Citi Investment Research & Analysis 27.02.2012, available at http://blogs.ft.com/money-supply/files/2012/02/citi-Looking-into-the-Deep-Pockets-of-the-ECB.pdf, (23.05.2016).

[39] *Financial Times*, 3 May 2011.

[40] Cf. *Howarth David/Rommerskirchen Charlotte*, A Panacea for all Times? The German Stability Culture as Strategic Political Resource, West European Politics 36(4) (2012) 750.

[41] *Financial Times* (Fn 37).

in two weeks) to neutralise fully the inflationary impact of its debt purchases[42] — reflecting directly the tensions between the two ECB roles of ensuring financial and euro area stability and combating inflation — attracting criticism from the German Bundesbank among other interested parties. The extension of ECB sovereign debt purchases to Italy and Spain from August 2011 undermined further the thrust of the ECB's anti-inflation message and caused considerable frustration throughout the German political class (see below). The failure to 'sterilise' bond purchases continued into 2012 but came to assume less political significance as euro area inflation eased and then dropped below the 2 per cent target from late 2012. Later when inflation dropped well below target, the ECB justified Quantitative Easing (QE) as a mechanism to raise inflation [43] - and never in terms of supporting the purchase of sovereign debt which was its principal effect. The ECB's communications strategy was to place emphasis on its treaty-assigned primary goal and the legitimacy of its controversial unconventional monetary policy.

B. The ECB's legally problematic fiscal policy role

Four elements of ECB monetary policy since the outbreak of the sovereign debt crisis in 2010 can be seen as having had significant fiscal implications, indirectly contradicting the Maastricht Treaty's prohibition of the monetizing of member state debt and of 'bail-out'. These four elements are: the Securities Markets Programme (SMP), the Long Term Repurchase Operations (LTRO), the announced but yet to be activated Outright Monetary Transactions (OMT) Programme and, most recently, Quantitative Easing (QE). With the exception of the OMT Programme, both the transparency of national fiscal and macroeconomic policy and the strength of national structural reform efforts have been seriously undermined.

In response to rising sovereign debt yields in a number of countries and notably Greece, the ECB adopted the SMP (2010-2012). The logic behind the policy was that by purchasing the sovereign debt of specific euro periphery member states on secondary markets, the ECB would help bring down debt yields, thus enabling governments to fund themselves at lower rates. Economic studies[44] suggest a short term effect of the SMP, notably in terms lowering yields.

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[42] *Financial Times* (Fn 39).

[43] *Financial Times,* 22 January 2015.

[44] Cf. *Manganelli Simone*, The impact of the Securities Markets Programme', ECB Research Bulletin, 17, Winter 2012; *De Pooter Michiel/Martin R.F./Pruitt Seth*, The effects of special bond market intervention in Europe, US Federal Reserve Board of Governors, September 2012, available at: <http://www.efmaefm.org/0EFMAMEETINGS/EFMA%20ANNUAL%20MEETINGS/2013-

The ECB made clear publicly that it would hold these bonds to maturity - while the ECB refused to reveal the maturities of the debt that it held. Under the SMP, the ECB purchased approximately €220 billion worth of Greek, Irish, Portuguese, Italian and Spanish government bonds. The SMP was widely criticized for breaking the ban on the monetary financing of debt and transforming the ECB into, de facto, a 'lender of last resort'. The Bundesbank held firm in its opposition. *Jens Weidmann* publicly queried the legality of the ECB's 'monetary financing' of debt as contrary to EU Treaty provisions[45] and a well-known German economist brought a case against the ECB to the European Court of Justice.

In early August 2011, the ECB stepped up - considerably - its sovereign bond-buying programme, extending this to cover Italian and Spanish government debt. The shift was important because the SMP was extended to lower the bond yields not only of 'Programme countries' - that is, the three euro area member states that were subject to macro-economic policy programmes monitored by a 'troika' of the European Commission, the ECB and the International Monetary Fund - but also of two countries that were not subject to 'troika' monitoring. Thus, the ECB acted as de facto 'lender of last resort' without the quid pro quo of fiscal / macroeconomic policy constraint. *Jean-Claude Trichet* performed a delicate balancing act, insisting publicly that the ECB was not a 'lender of last resort' and that the SMP was not driven by the goal of maintaining government solvency but rather was a 'temporary and limited' measure adopted for monetary policy reasons and, specifically, the need to restore a better transmission of the bank's interest rate decisions - a claim made necessary for legal reasons.[46] The SMP was ended officially in September 2012 when the ECB announced its OMT programme.

The ECB engaged in Long-term Refinancing Operations (LTRO), at a very attractive 1 per cent fixed rate and full-allotment basis, meaning de facto that banks had unlimited access to central bank liquidity, on the basis of the provision of adequate collateral. Collateral requirements were in turn eased a number of times and, moreover, the maturity of LTROs - originally of only 3 months - was lengthened, introducing operations with maturity of, first, 6 months and then 1 year. Then the ECB engaged in two massive LTROs in December 2011 and February 2012 which amounted to approximately €1 trillion. The effect of the LTROs was that euro area banks

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Reading/papers/EFMA2013_0533_fullpaper.pdf> (23.05.2016); *Ghysels Eric et al*, A high frequency assessment of the ECB Securities Markets Programme', ECB Working Paper Series, No 1642, February 2012.

[45] *Financial Times,* 7 December 2011.

[46] Cf. *Trichet* (Fn 35); *Siekmann Helmut /Wieland Volker*, The European Central Bank's outright monetary transactions and the Federal Constitutional Court of Germany, Safe White Paper Series, No 4, (2013), available at <http://nbn-resolving.de/urn:nbn:de:hebis:30:3-315547> (21.09.2015).

- especially those in the periphery - borrowed funds to purchase sovereign debt with higher yields - notably that on the periphery. In addition to contributing very directly to the dangerous sovereign debt-bank doom loop, the ECB's LTRO operations effectively helped to lower sovereign debt yields by increasing demand, thus allowing the cheaper financing of governments.

On 26 July 2012, ECB President *Mario Draghi* announced that the ECB would do 'whatever it takes to preserve the euro', with the aim of tackling bond yield rises in a number of euro area countries. This was followed in September 2012, with the announcement of the OMT Programme which consists principally in a promise to conduct *unlimited* interventions in secondary sovereign debt markets to purchase the debt of a country on the condition that the member state government concerned accepted the conditions of a European Financial Stability Facility (EFSF) / European Stability Mechanism (ESM) programme. Officially, the ECB justified this policy in terms of safeguarding appropriate monetary policy transmission. In effect, OMT allowed the ECB to act potentially as a 'lender of last resort' in government bond markets.[47] *Draghi*'s July announcement and the subsequent launch of the OMT programme contributed significantly to restoring financial market confidence, even though no OMT was subsequently conducted (to April 2016). Officially, the ECB's decision to replace the SMP by the OMT demonstrated the adoption of a more aggressive approach to conditionality. The OMT undermined less forcefully the ECB's terms of delegation - notably the pursuit of low inflation - in that unlimited ECB purchase of sovereign debt could only come with (promises of) significant national structural reform designed to help governments meet their macro-economic commitments embedded in the Maastricht Treaty, notably on public spending deficits and debt levels. However, *Draghi*'s 26 July statement on unlimited ECB action had already worked to bring down euro periphery bond yields, thus, in effect, undermining conditionality. Moreover, the OMT amounted to a significant form of 'slippage' in terms of the potential fiscal policy powers that the ECB assigned itself - albeit via the EFSF / ESM - without any public or (likely) private consultation with any member state governments. Specifically, the ECB assigned itself the power to dictate fiscal and macroeconomic policy commitments to governments and monitor their progress in meeting these commitments.

On 22 January 2015, the ECB launched its QE programme with a promise to buy, from March, €60bn worth per month of mostly government bonds purchased on secondary markets until at

[47] Cf. *Winkler Adalbert*, The ECB as Lender of Last Resort: Banks versus Governments, LSE Financial Markets Group Special Paper, No 228, February 2014, available at <http://www.frankfurt-school.de/clicnetclm/fileDownload.do?goid=000000575799AB4> (04.12.2015).

least September 2016 - a total of €1.1 trillion. The programme was not completely new, in the sense that it included two existing programmes - the asset-backed securities purchase programme (ABSPP) and the covered bond purchase programme (CBPP3), which were both launched in late 2014. Officially, the ECB sought to stimulate euro area credit markets (bank lending) and economic growth. Officially, the ECB sought to diminish the risk of deflation and bring the inflation rate up closer to target, with the explicit aim of continuing the programme beyond September 2016, until the ECB saw 'a sustained adjustment in the path of inflation that is consistent with its aim of achieving inflation rates below, but close to, 2 [per cent] over the medium term'.[48] Yet again, the desired and real effect of ECB policy was to lower government bond yields - albeit this time throughout the euro area - although the impact on different government debt varied, with yields on bunds already at historic lows.

IV. The politicization of ECB policy-making

As the ECB's policies pushed against the boundaries of its mandate, they became increasingly political. Politicization took three main forms. First, dissent within the Governing Council became increasingly apparent - exposing deeper fundamental divisions in the euro area. Second, a number of governments moved to politicize monetary policy. Third, the public took a greater critical interest in ECB policy-making and national political debate intensified. The desirability of sheltering monetary policy from public and political scrutiny - never certain - became increasingly problematic in political terms.

First, the adoption of unconventional monetary policies resulted in, for the first time, public disagreement among ECB Governing Council members. Despite the *ad personam* rule assigned to Governing Council members, several 'Northern' European members expressed concerns with unconventional monetary policies that corresponded closely to those of their national governments, while euro periphery members expressed support. Although the full details cannot be known because of ECB secrecy, a growing number of unilateral public announcements by Executive Board members and NCB governors that criticized ECB policy can be seen as the clearest indication of discord.[49] These disagreements concerned, above all, the fiscal implications of ECB monetary policy. German members and Bundesbank officials were the loudest critiques of the impact of ECB policy on national reform efforts. The Germans

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[48] Cf. *ECB (European Central Bank)*, ECB announces expanded asset purchase programme, press release from 22.01.2015, available at <https://www.ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html> (23.05.2016).

[49] Cf. *Howarth* (Fn 30).

argued for further fiscal consolidation and structural reform in the besieged Southern European member states and criticised ECB action to reduce their bond yields. Bundesbank President *Axel Weber* publicly opposed ECB emergency bond buying from its start in May 2010 and was joined by up to four other Governing Council members who remained anonymous.[50] *Weber*'s opposition reflected widespread German concern over what the conservative newspaper *Frankfurter Allgemeine Zeitung* referred to as the 'Americanisation of monetary policy'.[51] In early April 2011, the Dutch central bank governor, *Nout Wellink* also went public with his concerns over bond purchasing and called for a reduction.[52] *Weber*'s resignation from the Bundesbank and *Jürgen Stark* - the ECB's head of economics - from the Executive Board demonstrated the intensity of internal discord. In February 2011, *Weber* announced his intended departure at the end of April. Widely regarded as the leading candidate to replace *Jean-Claude Trichet* as ECB President, *Weber* publicly explained his departure in terms of the impossibility of leading an organization in which his policy preferences placed him in a small minority.[53] From the outside, *Otmar Issing*, the former chief economist of the ECB and Executive Board member, repeatedly challenged the bank's purchase of Greek and other sovereign debt on the grounds that it took pressure off governments to engage in reform.[54]

Weber's successor as Bundesbank President, *Jens Weidmann*, went public with his opposition to the OMT programme.[55] In a public statement, *Weidmann* noted that he regarded such bond purchases 'as being tantamount to financing governments by printing banknotes' and that the announced interventions carried 'the additional danger that the central bank may ultimately redistribute considerable risks among various countries' taxpayers'.[56] Effectively, *Weidmann* was arguing that ECB action would have non-transparent distributive effects - the exact opposite of what the surrender of national monetary policy and the adoption of an explicit low inflation goal in EMU were meant to achieve. *Weidmann* feared that the OMT programme, like

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[50] *Financial Times*, 12 May 2010.

[51] FAZ, 10 May 2010.

[52] *Central Banking.com*, 4 April 2011.

[53] *Financial Times* 13, 16 and 21 February 2011.

[54] *Bloomberg.com*, 3 September 2011.

[55] *Financial Times* (Fn 33); *Weidmann Jens*, Eingangserklärung anlässlich der mündlichen Verhandlung im Hauptsacheverfahren ESM/EZB, Opening Statement at the Oral Hearing in the ESM/ECB Principal Proceedings 11.06.2013, available at <http://www.bundesbank.de/Redaktion/DE/Kurzmeldungen/Stellungnahmen/2013_06_11_esm_ezb.html> (14.12.2015).

[56] *Financial Times* (Fn 33).

the SMP before it, would fundamentally undermine willingness of euro area member states to implement reforms to achieve fiscal consolidation - despite the conditionality imposed.[57]

There was speculation that the Bundesbank sought to undermine ECB action on reducing bond yield differentials by casting doubt on its willingness to defend this action.[58] *Weidmann* publicly argued that Italy could ‘handle even an interest rate that remains over 7 per cent for a while’[59]: its bond yield would lower in time following what *Weidmann* saw as long-overdue structural reform. These views were not just about desirable monetary and macroeconomic policy. They were also - crucially for the purpose of this analysis - focused on agency slippage and the failure of the ECB to respect the narrow price stability terms of its delegation.

Second, there was longstanding government criticism of ECB monetary policy. Thus, politicization was not new. From senior French politicians - including the President - there were regular criticisms of the low inflation-focus of the ECB when the euro was perceived to be too strong in relation to the dollar and other major international currencies, which had a perceived negative impact on exports.[60] Government criticism of ECB policy-making following the outbreak of the sovereign debt crisis was arguably far greater and owed to both unconventional monetary policies and the ECB’s role in the Troika.[61] The criticism of unconventional monetary policies was greatest from the German government, starting with the SMP, rising with the extension of sovereign debt purchases to Italy and Spain, and again with the introduction of QE. In April 2016, the German government engaged in a full frontal assault on unconventional monetary policy and the record low interest rates that resulted. The German finance minister, *Wolfgang Schäuble*, and a number of other senior German politicians, called for the end of the QE programme and the policy of low interest rates.[62] He specifically accused the ECB’s unconventional monetary policies (notably QE) as contributing significantly to the rise of the German populist right-wing party (AfD) - 50 per cent of the responsibility to be precise![63] For

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[57] Cf. *Weidmann* (Fn 55).

[58] *Financial Times,* 29 November 2011.

[59] *Financial Times* (Fn 58).

[60] Cf. *Howarth David*, Bank of France: The challenge of escaping politicization, in Dyson Kenneth/Marcussen Martin (eds), Central Banks in the Age of the Euro: Europeanization, Convergence, and Power (2009) 111; *Howarth David*, France in the Euro-Zone: the management of paradoxical interests, in Ken Dyson (ed.) The Euro at Ten (2008) 111.

[61] A full analysis of the degree to which Government criticism of ECB policy making increased following the outbreak of the international financial and then sovereign debt crisis - and the implications of this criticism - is beyond the scope of this paper.

[62] *Le Monde*, 11 April 2016; *Financial Times*, 10 April 2016.

[63] *Financial Times* (Fn 62).

Schäuble 'excessive liquidity [was] more a cause than a solution to the problem'.[64] For the German federal transport minister, *Alexander Dobrindt*, 'the disappearance of interest rates [created] a gaping hole in citizens' old age preparations',[65] a particularly sensitive topic in a country with a rapidly ageing population.

The German government critique of QE also owed to the reality of negative interest rates undermining the core business models of German pension funds, life insurers and a large section of the German banking system - specifically small savings banks and cooperatives - which were legally required to guarantee a fixed rate of return.[66] German savings banks (*Sparkassen*) and cooperatives - the principal lenders to the German *Mittelstand* (Small and Medium Size Enterprises) - relied disproportionately on interest on loans and attracting savings for the bulk of their business;[67] while the insurance industry relied on the average return on bonds held to be higher than the guaranteed rate they paid out.[68] According to the International Monetary Fund,[69] the pre-tax profits of German banks were amongst the most detrimentally affected in the world by negative interest rates.[70]

Politicization in Germany thus stemmed directly from the perceived threat of ECB unconventional monetary policy to a core element of the German economic model. ECB President *Mario Draghi* fought back against the criticisms arguing that the German government had to assume responsibility for the difficulties facing its savings and cooperative banks, while the ECB's legal obligation was to bring inflation closer to target.[71] Interestingly, despite being a long-standing critic of ECB unconventional monetary policies and despite his criticism of the ECB's strategy of dealing with falling prices, Bundesbank President *Weidmann* defended the ECB's QE policy with specific reference to the need to increase inflation.[72] The irony then was that politicization in this case did not stem from ECB slippage but rather from the economic implications of ECB policy designed to meet its inflation target.

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64 *Financial Times* (Fn 62

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66 *Financial Times*, 17 April 2016; 21 April 2016.

67 *Financial Times*, 18 September 2015.

68 *Financial Times*, 8 March 2015.

69 Cf. *IMF (International Monetary Fund)*, Global Financial Stability Report, April 2016, available at <http://www.imf.org/external/pubs/ft/gfsr/2016/01/pdf/c1_v3.pdf> (23.05.2016).

70 *Financial Times*, 17 April 2016.

71 *Financial Times*, 21 April 2016.

72 *Financial Times*, 12 April 2016.

Third, European national publics and parliamentarians became increasingly aware of the importance and significance of ECB policy-making and public debate and criticism intensified. Public awareness of the ECB rose from 71 per cent in the autumn of 2007 to 85 per cent in the spring of 2015. In the meantime, public trust in the ECB - almost always marginally lower than trust in the Commission and significantly lower than trust in the European Parliament - declined from a high of 53 per cent in the Spring of 2007 to a low of 31 per cent in the Spring of 2014.[73] The trust-distrust ratio for the ECB was consistently negative, reaching a high of 10 percentage points in the spring of 2015 - when the trust-distrust ratio for the Commission was no longer negative. In Germany, trust in the ECB (in the spring of 2015) reached 32 per cent while distrust reached 54 per cent for a record differential of 22 percentage points - the highest of any euro area member state with the notable exceptions of Greece, Spain and Cyprus. Public demonstrations against the ECB were limited, taking place above all in the programme countries (notably Greece and Portugal) and focusing principally upon the ECB's role as part of the the 'troika'.[74] However, the violent demonstrations directed at the ECB in Frankfurt at the opening of its new headquarters in March 2015 provided the most mediatized evidence to date of public mistrust in the ECB and the politicization of its role.[75]

Furthermore, parliamentary interest in ECB policy-making increased markedly from the outbreak of the international financial crisis. One of several possible measures of parliamentary interest, MEP written questions to the ECB president rose significantly following the onset of the sovereign debt crisis. In the first year and a half of the European Parliament's eighth term (to the end of 2015) there were 195 written questions to the ECB - significantly more than the number of questions during all of the seventh term (149 from 2009-2014) and more than three times the level of the sixth term (62 from 2004-2009).[76] In 2015, MEPs wrote 159 questions to the ECB. During the 2009-2015 period, 31 per cent of MEPs questions to the ECB focused on monetary policy, 9 per cent on 'economic governance and surveillance', and 21 per cent on the 'troika'.[77]

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[73] Cf. *Eurobarometer*, Public opinion in the European Union', Standard Eurobarometer 83, Spring 2015.

[74] *Financial Times*, 1 May 2015.

[75] *Financial Times* 18 March 2015; 23 April 2015.

[76] Figures from *Giovannini Alessandro/Jahning, Malte/ Salines Marion*, The Evolution of the ECB's Accountability in Light of the Euro Area Crisis, paper presented to the ECPR Joint Sessions, April 2016, on file with the authors.

[77] Figures from *Giovannini/Jahring/Salines* (Fn 76).

While many national and European parliamentarians praised the ECB's unconventional monetary policies, there were strong voices of opposition and concern as to their distorting effects. In a resolution on the ECB's 2011 Annual Report, the European Parliament (2013a) warned 'that in the absence of proper conditionality, non-standard measures such as three year LTROs may fall short of producing the desired effects'. In a resolution on the 2012 Annual Report, the European Parliament stressed that LTROs 'did not provide a fundamental solution to the crisis', expressed concern 'about the transfer of risks from struggling banks and governments onto the ECB's balance sheet as a result of the ECB's decision to buy "unlimited" amounts of short-term government debt' through the OMT programme and the impact of very low interest rates which 'may cause distortions in the business sector and harm private savings and pension plans'.[78] The European Parliament also actively criticized the ECB's role in the 'troika' for lacking democratic accountability and called for the role of the ECB to be downgraded to that of 'silent observer'.[79]

A. On emergency liquidity and democracy

The provision of emergency liquidity assistance (ELA) to euro area countries unable to access bond markets gave the ECB considerable power to interfere directly in member state macro-economic policy making. The ECB's intervention in Ireland is a good example of the significant power that the central bank could wield in relation to euro area member state governments in need of emergency funding. Letters released four years later confirmed widespread views in Ireland that the ECB President at the time, *Jean-Claude Trichet*, agreed to provide emergency liquidity assistance to Irish financial institutions only if the Irish government sought a bailout from euro area member states in November 2010 - which it did shortly afterwards with a €67 billion package funded by the IMF, the European Commission and the ECB.[80] In addition to the requirement that the Irish government apply for a bailout, the ECB demanded that it agree to fiscal consolidation and structural reform, that it recapitalize and restructure Irish banks, and guarantee the repayment of the ELA. While the demands presented in the letter were

[78] *European Parliament*, European Central Bank Annual report for 2012, 2013/2076(INI), November 2013, available at <http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2013/2076%28INI%29> (04.12.2015).

[79] *European Parliament*, European Parliament resolution of 17 April 2013 on 2011 Annual Report of the European Central Bank', 2012/2304(INI), April 2013, available at <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2013-0176&language=EN> (04.12.2015).

[80] *Cardiff Kevin,* Recap: Inside Ireland's Financial Crisis (2016); *Financial Times*, 6 November 2014.

unprecedented in late 2010, they became more frequent as the sovereign debt crisis worsened in 2011 and were also sent to non-programme member state governments. In August 2011, *Trichet* sent similar letters to the Italian Prime Minister, *Silvio Berlusconi* and to the Spanish Prime Minister, *José Zapatero*, demanding economic reform as a condition of ECB purchase of their sovereign debt on secondary markets. A similar demand was made of the Cypriot president, *Nicos Anastasaiades*, in March 2013.

The ECB's decision to limit the level of emergency liquidity to Greek banks in June 2015 - forcing the Greek government to close banks and impose capital controls- put into the spotlight both the power of the ECB but also its exposed position as an non majoritarian body with such power.[81] The ECB Governing Council took the decision - without warning at an emergency meeting on a Sunday - and a week prior to the Greek referendum on bail-out terms. An unelected technocratic institution such as a central bank cannot make a democratically legitimate choice in such circumstances, regardless how scientifically accurate it attempts to be. The choice itself is quintessentially political.

V. Non transparent monetary policy

In the course of the crisis - as the ECB's actions gained political salience - the ECB undertook a number of measures to improve its process legitimacy. Most notably, the ECB moved to improve transparency through the publication of summaries of its meetings from 2015 onwards. However, beyond this attempt to enhance procedural transparency, unconventional monetary policy arguably had the effect of creating less transparency on the ground. ECB unconventional monetary policy undermined structural reform efforts in member states, thus directly contradicting stated ECB preferences on structural reform and the explicit objective of the Maastricht Treaty of avoiding the possibility of 'fiscal dominance'. Furthermore, ECB monetary policy undermined the transparency-inducing effects of EMU at the national level that *Jones* vaunted.[82]

The imposition of the convergence criteria, and notably the 3 per cent criterion, forced national governments to lower their public spending deficits in order to participate in the single currency (Stage III of the EMU project). The launch of the euro in 1999, however, effectively undermined national structural reform efforts. The elimination of the threat of currency speculation, devaluation and a significant drop in sovereign debt bond yields in euro periphery member states, effectively gave national governments more breathing space on fiscal

[81] *Wall Street Journal*, 28 June 2015.

[82] Cf. *Jones* (Fn 26).

consolidation. Markets failed to punish deficit or debt levels above the Maastricht criteria and, despite the Treaty's 'no bail-out' clause, markets did not assign credit risk to sovereign debt. The majority of member state governments repeatedly broke the fiscal rules of the Maastricht Treaty and the Stability and Growth Pact with no sanctions imposed to date.[83] National divergence in macro-economic policy and position persisted or increased on a range of measures.[84] Thus, even prior to the sovereign debt crisis, the reform-boosting effects of EMU - emphasized by both proponents and opponents of the project - were overrated.

From its creation, the ECB performed the role of critic of inadequate government structural reform and this continued throughout the sovereign debt crisis.[85] Despite fundamental disagreements on the ECB's unconventional monetary policies, ECB Governing Council members embraced a uniform position on the fiscal policies to be pursued by member state governments, notably those most at risk of default. The ECB also took a strong position on the operation of the EFSF (that it not be allowed to purchase debt directly from the markets) and the use of ESM funds (that their use be subject to strict conditionality of structural reform). The ECB also strongly and publicly opposed the move by member states and the IMF to push for a compulsory 'selective' default (haircut) on Greek sovereign debt - arguing that this would undermine investor confidence in the euro area.[86]

However, the ECB's unconventional monetary policy during the sovereign debt crisis worked to *undermine* national reform efforts, notably by lowering sovereign debt bond yields - especially in the euro periphery - and lowering the bond yield differential with Germany. One ECB working paper finds that the OMT announcement alone lowered Italian and Spanish two-year government bond yields by approximately two percentage points, while leaving unchanged the German and French bond yields of the same maturity.[87] This ECB study also concludes that this drop in bond yields could be associated with a 'significant increase in real activity, credit, and prices in Italy and Spain' but 'with relatively muted spillovers in France and Germany'. The distributive implications of the OMT (and other unconventional monetary policies) become

[83] Cf. *Howarth David*, Making and Breaking the Rules: French Policy on EU Economic Governance, Journal of European Public Policy 14(7) (2007) 1061.

[84] Cf. *ECB (European Central Bank),* Real convergence in the euro area: evidence, theory and policy implications, ECB Economic Bulletin, Issue 5, May 2015, 30, available at <https://www.ecb.europa.eu/pub/pdf/other/eb201505_article01.en.pdf> (12.11.2015).

[85] For an overview of ECB interventions during its first half decade, cf. *Howarth/Loedel* (Fn 1).

[86] *Financial Times*, 14 October 2011.

[87] Cf. *Altavilla Carlo/Giannone Domenico/Lenza Michele*, The Financial and Macroeconomic Effects of OMT Announcements, ECB Working Paper Series, no. 1707, August 2014, available at <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1707.pdf > (23.05.2016).

clear: much lower interest rates in the euro periphery and only moderately lower rates in Germany and other member states. As explained in the previous section, in German political and media circles, the very low ECB interest rates from the outbreak of the sovereign debt crisis were widely blamed on ECB unconventional monetary policy. Low rates angered German savers - a powerful constituency in the country - and their political representatives. It was argued that the redistributive effects of these rates had implications which fundamentally undermined the German financial system.[88]

The ECB, under President *Draghi*, engaged in a number of direct interventions in national macroeconomic policy. However, these interventions were not all in the direction of fiscal consolidation and structural reforms. Noteworthy is Mario *Draghi*'s speech at a central banking conference in *Jackson Hole*, Wyoming in August 2014 in which he pressed Berlin for looser fiscal policy to stimulate the economy. The speech was widely reported in the media and resulted in a direct German riposte by Bundesbank President *Weidmann*, Chancellor *Angela Merkel* and a number of other senior German politicians.[89]

VI. Conclusion

Over the course of the sovereign debt crisis, the ECB's unconventional monetary policies blurred the boundaries of the central bank's mandate and undermined the transparency of both its own monetary policy and the implications of this monetary policy for national macro-economic policy. As a result of these changes, many arguments that had been used to support the democratic legitimacy of the ECB's policies became less obviously valid. Notably, *Moravscik*'s five claims in favour of the democratic legitimacy of EU policies that are regulatory and economic can be shown to apply less obviously with regard to ECB policy-making. By way of conclusion, we take each of these claims in turn.

1. Most EU policies are regulatory and economic. There are few (re)distributive policies. Most 'political' policies (for example, migration) remain largely intergovernmental and draw their legitimacy directly from elected national governments.

The ECB is a supranational institution with complete operational independence and considerable goal-setting independence - in the context of broad goals set out in the Maastricht Treaty. The Treaty provisions on the primacy assigned to low inflation and the ban on the monetary financing and bail-out of governments clearly defined and delimited the ECB's redistributive role. From the outbreak of the sovereign debt crisis, unconventional policy making

[88] *Financial Times* (Fn 66).

[89] *Financial Times*, 23 January 2015.

involved ‘distribution’ to euro periphery countries - by lowering unsustainably high bond yields - albeit with no certain ‘redistribution' from other member states. However, the negative impact of low and then negative interest rates upon the German financial system and German savers created the widespread perception of a de facto redistribution. ECB action during the crisis had potentially massive distributive implications among member state central banks (and thus member states) - which was contained within the Target II system. But this is a secondary consideration.

2. The EU lacks a range of more politicized competences, including fiscal priorities, social welfare provision and taxation.

On the one hand, ECB unconventional monetary policies had clear fiscal policy implications, notably by enabling euro area periphery countries to maintain levels of public spending (or to diminish these levels less they would have had to) which had implications on social welfare provision, taxation and the pursuit of other structural reforms. On the other hand, the bulk of ECB communication on macroeconomic policy almost always pushed in favour of structural reform.

3. The political system with its multi-level structure, plural executive and distribution of power across several institutions is geared towards the protection of minorities.

The involvement of other institutions in euro area monetary policy was negligible. It is far from clear how ECB monetary policy protected minorities - the definition of which is unclear in the case of monetary policy.

4. Legitimacy stems from a variety of sources, such as elected national governments and the European Parliament.

Prior to the sovereign debt crisis, ECB legitimacy had relied on respecting terms of delegation set by elected national governments (input legitimacy) - specifically its focus upon low inflation (the principal source of output legitimacy). In the Maastricht Treaty, member states carefully defined and delimited the fiscal implications of ECB monetary policy. These implications shifted and expanded during the sovereign debt crisis. While the extent to which ‘monetary dominance’ has ceded to ‘fiscal dominance’ must be left to economists to debate, the significant fiscal implications of ECB unconventional monetary policy are undeniable.

5. Semi-autonomous judges and technocrats require insulation to produce policy outcomes in the general interest based on expertise. Moravscik claims ‘the need for greater attention, *efficiency and expertise in areas where most citizens remain "rationally ignorant" or non-participatory'*.[90]

The legitimacy of both the ECB's indirect fiscal policy role - through its unconventional monetary policies - and direct fiscal / macro-economic policy role - through its participation in the 'troika' - were challenged by ECB Governing Council members themselves, member state governments, national and European parliaments, 'credible' and controversial academic economists and legal scholars, and a number of other technocratic institutions - including the IMF. While euro area (notably euro periphery) citizens remained 'ignorant' about most elements of ECB monetary policy, it is clear that ECB policy-making had become highly politicized.

Schmidt, among several observers, claims that the ECB, in defense of its unconventional monetary policies, shifted its discourse from a previous focus on input legitimacy (its price stability mandate) and 'throughput legitimacy' (that is, respect for the rules and procedures) to output legitimacy, notably in terms of easing the sovereign debt crisis.[91] The ECB changed its throughput processes, moving from 'non-standard' to 'unorthodox' and 'unconventional' monetary policy, and consistently claimed 'in its public discourse to be following the rules as it reinterpreted their meaning'.[92] The findings of our analysis support those of Schmidt who also argues that:

> whether we see the ECB as a hero or as an ogre, the ECB's reinterpretation of the rules 'by stealth', that is, by not admitting that it was in fact changing the rules, nor making the case that this was necessary and appropriate, limited not only what it did but also made it more difficult for it to legitimate what it had to do over time.[93]

The European Central Bank is at a crossroads. Its original mandate was to be an independent technocratic institution, the legitimacy and credibility of which was set in terms of its price stability mandate. However, from the outbreak of the sovereign debt crisis, ECB unconventional monetary policies had significant impact upon the direction of macro-economic policy in euro area member states - and in a manner that contradicted the terms of the central bank's delegation as outlined in the Maastricht Treaty. In light of the political salience of these policies and their impact, it is questionable whether the independence of the ECB remains democratically viable. ECB policy-making has become problematically controversial and politicized.

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[90] Cf. *Moravscik* (Fn 7): 614.

[91] Cf. *Schmidt* (Fn 4).

[92] Cf. *Schmidt* (Fn 4): 31.

[93] Cf. *Schmidt* (Fn 4): 32.

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