The European Central Bank FREE

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https://doi.org/10.1093/acrefore/9780190228637.013.254
Published online: 30 April 2020

Summary

The European Central Bank (ECB) has been in existence for almost 20 years and more if one considers its immediate predecessor the European Monetary Institute (1994–1997). During these two decades the ECB has become an established institution. It secures price stability and further increased its reputation as a lender of last resort during the financial crisis and its aftermath. In the 2010s, in response to the global financial crisis and the sovereign debt crisis, the ECB has also taken on the role of supervisor of the financial system and monitors developments in the Euro Area financial sector.

Political science literature on the ECB can be subdivided into different strands. One strand looks at the ECB as just another central bank and hence examines its role as a central bank with the usual instruments. Another strand of literature examines the role of the ECB as an institution that is insufficiently embedded into democratic checks and balances. This perennial criticism of the ECB was born when the European System of Central Banks (ESCB) was created to be independent from political influence. A third strand of the literature is newer and examines the unorthodox steps that the ECB (and other central banks) took, and have taken, to offset the financial crisis and the ensuing economic crisis. An analysis of European integration and the political economy of the Euro Area can contribute to a better understanding of why the ECB has taken a proactive role. The political science research of the ECB is discussed here as well as the various dimensions of research conducted on the ECB.

Keywords: accountability, central banks, democratic deficit, euro, European Union politics, European Central Bank, financial crisis, legitimacy, monetary policy, sovereign debt crisis

Introduction

The European Central Bank (ECB) is a recent innovation that is closely connected to the creation of the euro. Earlier plans had been made in the early 1970s to create an economic and monetary union (EMU), but those plans failed (Commission of the European Communities, 1977; Tsoukalis, 1977). When the so-called Delors Report (1989) was written, which proposed a three- stage approach to create an economic and monetary union in the EU, the goal was to fix irrevocably the exchange rates and, ideally, to set up a single currency (De Cecco & Giovannini, 1989; Gros & Thygesen, 1992). A new supranational institution, a European-level central bank, would be necessary, and it would set a single monetary policy. “Supranational” meant that such a body could potentially overrule interests of individual member states in favor of the interests of the whole (Kitzinger, 1963; Stone Sweet & Sandholtz, 1997). The plan to create such a system was proposed by central bank representatives of the central bank governors of the then 12 member states in a committee presided by Jacques Delors (Verdun, 1999). The ensuing three-stage plan of the Delors Report (in many ways similar to what the 1970 Werner Report had proposed) was later incorporated into the Maastricht Treaty. Its second stage envisaged the set-up of the predecessor of the ECB: the European Monetary Institute (EMI). It would be created to prepare the establishment and functioning of the ECB in the third stage.

The central bank that was dominant before the creation of the ECB was the German Bundesbank (Kennedy, 1991; Marsh, 1992). Thus, seeing that this new supranational institution would replace it, leaders agreed that the ECB would need to have a mandate similar to that of the Bundesbank (Smits, 1997; Dyson & Featherstone, 1999; Heisenberg, 1999). The reason was that many of the central banks had gradually been starting to follow German monetary policies (Kaelberer, 1997; Loedel, 1999; Verdun, 2000) even though there had been stark differences in monetary policy traditions in earlier decades (Goodman, 1992). Thus, rather than inventing a new mandate, member state leaders approved that the ECB would have this same mandate: It would focus first and foremost on safeguarding price stability. Without prejudice to this objective, the ECB would also "support the general economic policies within the Union" (which were, among other things, "full employment" and "balanced growth") (Howarth & Loedel, 2005). The ECB was to be a supranational institution embedded in a larger European System of Central Banks (ESCB)—which consists of the ECB plus the national central banks of all the EU member states. The smaller set of national central banks, those in the countries that have adopted the euro, is referred to as the "Eurosystem." National central bank governors of the Eurosystem serve as members of the ECB Governing Council, which together with six members of the executive board make up the ECB's main decision-making body of the ECB. Its responsibilities are "to ensure the performance of the tasks entrusted to the ECB and the Eurosystem." It also formulates monetary policy for the Euro Area. Finally, most recently, it has been laden with new responsibilities around banking supervision. The Governing Council adopts the decisions proposed by the Supervisory Board (ECB, 2018). Similar to what is expected from the European Commission, the members of the ECB Governing Council as a collective are expected to serve the Euro Area as a whole (rather than advocating merely for member states' own national interests). The European System of Central Banks is made up of the ECB and the national central banks (NCBs) of all EU countries. The Eurosystem is a smaller entity as it consists of the ECB and the NCBs of the Euro Area member states once they have substituted their national currencies for the euro. In early years critics pointed out that there might be a democratic deficit of EMU (Verdun, 1998; Buiter, 1999). The ECB responded as best it could within the context of the EU treaty and the ESCB statutes. These stipulate that the ECB is accountable to the European Parliament (EP), but it also has to report to the Council of the EU. This is operationalized as follows: The ECB president reports back to the EP in quarterly hearings, as do other Executive Board members. The ECB has also experimented with other ways to be accountable to the public. The ECB president and vice president hold press conferences after each Governing Council monetary policy meeting and allow journalists to ask pointed questions. The criticism of the ECB is not only about whether the public and experts can assess the decisions of the Governing Council. One should not confuse general democratic accountability issues related to the asymmetry of EMU (a supranational monetary authority and decentralized fiscal authorities; see Verdun, 1996) with the phenomenon of central bank independence (Jones, 2002a, 2002b).

In its early years the ECB was criticized for being insufficiently tough on inflation. With every member state that became a member of the Euro Area, there were complaints that the transition from the national currency to the euro led to rising prices in the country that was witnessing the changeover. In response, national central banks and the ECB would provide studies indicating that these perceived increases were valid when it came to various types of expenses but were not statistically valid over the medium run nor if one considered the full range of the basket of goods that make up the inflation indicators (Ehrmann, 2006, 2011). Another early criticism was that the ECB was only targeting low inflation (self-defined as close to [but not more than] 2%) but that other macro-economic targets (full employment, economic growth, the ensuing European model of society and so on) were not properly considered by the ECB (Patomäki, 1997; Crouch, 2000; Dyson, 2000; Magnusson & Stråth, 2001). The treaty stipulated that the ECB had to ensure "price stability"—the definition of it not having been operationalized therein. Over time the ECB has provided its working definition of it in various steps, most recently as: "Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%." The Governing Council stated in 2003 that the goal of achieving this level of price stability of "below but close to 2%" would be measured over the medium term.

This article examines the way the ECB has been researched in the field of political science. Some references to economists and lawyers are mentioned in passing, but it concentrates on how the ECB has been studied by scholars in political science. The themes that are recurring are the role of the ECB in EMU; accountability, democracy, and legitimacy issues related to the ECB; and the ECB and the crisis. The final section draws some overall conclusions.

The Role of the ECB in EMU

With the creation of EMU in 1999 and the introduction of banknotes and coins in 12 member states in 2002, the ECB became the central bank of the Euro Area. Its primary role was to ensure price stability. Scholars examined various themes that included the way in which the ECB set its monetary policies. Who was effectively governing the ECB (Zilioli & Selmayr, 2001)? Although the members of the ECB Governing Council were all supposed to be setting monetary policy based on their personal assessment, with a view to what was in the best interest of the Euro Area as a whole, were they all doing so? Were some members of the Governing Council more influential than others? After all, the ECB Governing Council consists of the governors of the national central banks as well as the six executive board members. Each of the governors has one vote, and if voting occurs it happens by simple majority. But not all member states are equal in economic and political weight, so it raises the issue of the politics of the ECB (Howarth & Loedel, 2003, 2005). Giving each voting member equal weight has been a key value. Recently, however, ever since the Euro Area has grown to 19 members, to keep the size of the voting group manageable, a rotation system has come into place in which in any given month some members would not have a vote.[1] Typically decisions in the Governing Council are taken by consensus, but during the euro crisis, it was increasingly necessary to vote (Henning, 2017, p. 46). Apart from these details of voting, researchers have studied whether the ECB was colored by national preferences. They examine whether monetary experts develop common ideas. Some have emphasized that central bankers have similar ideas and increasingly move to learn from one another and gradually converge (McNamara, 1998; Verdun, 1999; Marcussen, 1998a, 1998b, 2005; Dyson & Marcussen, 2009). More recent research emphasizes the differences among members of the ECB Governing Council due to their national beliefs but also how contestation develops over time now that agreement on some of the basic ideas has become engrained (McNamara, 2006; de Jong, 2017; Schulz, 2017). Furthermore, researchers asked whether the monetary policy of the ECB was effective. Various scholars argued that the ECB policies had a procyclical effect on the periphery of the Euro Area (Micossi, 2015).

Another key area of research into the role of the ECB in EMU was the extent to which EMU could function with only one authority involved in monetary policy and the other component of the monetary-fiscal policy mix being left to coordination rather than having macroeconomic and fiscal policies transferred to a supranational authority (ECB, 2003, 2008). Various scholars examined the different national perspectives on whether there should be an economic government to flank the ECB or even whether a more "French" perspective on the ECB should be taken—that favors an institutional architecture whereby more instruction could be given to the ECB (Verdun, 2003; Howarth, 2007). The way economic policy coordination took place was initially via the so-called Stability and Growth Pact (Heipertz & Verdun, 2010). Once the crisis took hold of Europe, an extended role was given to the European Commission through the Macroeconomic Imbalance Procedure (Hodson, 2018) and the European Semester (Zeitlin & Vanhercke, 2018 Verdun & Zeitlin, 2018, see also the section on "The ECB and the Sovereign Debt Crisis") so it could be more firmly involved in macroeconomic surveillance of national economic policies.

These issues raised the question of the role of the ECB as an independent actor responsible for price stability and by extension economic growth and employment. In other nations throughout the globe, a central bank sets monetary policy while other government bodies deal with adjacent policies (taxing and spending), and collectively the economy is governed. To have made the ECB and all the EU national central banks of those in the Euro Area independent was a way to ensure the credibility of monetary policy and thus increase the effectiveness of securing price stability. In this way the government cannot be pressured into an inflationary spiral as the responsibility over monetary policy has been delegated to the independent central bank that does not take instructions from the government. It cannot be pressured by governments to decrease or increase interest rates. The concern by some was whether the ECB was perhaps more independent than any other central bank in the world (Smits, 1997; Jones, 2002b; Dyson & Marcussen, 2009). Furthermore, given that there was no other authority at that same supranational level to take action, was there perhaps an error in the institutional design of EMU in that the ensuring policies might not deliver the results many wished for (Martin & Ross, 2004)? Over the past decades, however, central banks all across the globe have moved to inflation targeting, and 90% of all central banks have become independent (Marcussen, 2005). Furthermore, the so-called Maastricht consensus (a commitment to sound public finances) remained the cornerstone of the EMU edifice during the first 10 years of EMU (Winkler, 2006) even if not undisputed (Tamborini, 2006). Reflecting on 10 years, the commission's own assessment report on EMU identified a need for EU member-state ministers of economic and financial affairs (ecofin) to have a better dialogue with the ECB (European Commission, 2008, pp. 290–291). The ECB from the outset also played a role in providing advice on matters to do with economic policy coordination. Even though it had no responsibility, the ECB was asked for advice. This would also be the case when a member state sought to join the Euro Area (convergence reports). Some authors have indicated that in these early years there was something of a tug of war between monetary and fiscal authorities over who was dominating. It seems that for the most part the monetary authorities had the upper hand (Henning, 2016).

Finally, as is discussed in the section "The ECB and the Sovereign Debt Crisis," with the onset of the crisis it quickly became clear that many of the supervisory roles that had been left to the national central banks needed to be done at the EU level. In the past, the ECB has seen a rapid expansion of its involvement in various other areas of financial supervision.

Democracy and Legitimacy Issues Related to the ECB

One of the early criticisms of the ECB was the criticism of independence (and the fact that no one could give the ECB instructions). As mentioned earlier, the concern raised about independence was not only that the ECB was the most independent central bank in the world, but also that there was no clear counterbalancing actor. In most nation-states, there would be a "government" at the same level as the central bank with considerable authority. The concern expressed by some was simply that the central bank was independent, but others worried that the asymmetrical design of EMU (Verdun, 1996) meant there was no other authority at the same level given that EMU was characterized by a centralized monetary author and decentralized fiscal authorities. Some worried that the choice to concentrate first and foremost on price stability and forcing the fiscal authorities to stick to the budgetary deficit rules—of no more than 3% and a public debt of 60%—would cause procyclical policies during times of recession or sluggish economic growth. Even though, strictly speaking, the ECB would in these cases not be able to do anything about it, given its mandate, the lack of an EU-level authority to pursue fiscal policies, and the weak mechanisms of economic policy coordination among member states, could mean sluggish growth in the Euro Area. Indeed in the first 10 years of EMU there was much criticism around whether the Euro Area was unnecessarily depressed and whether ECB monetary policy or its institutional design was causing it (Winkler, 2006)

Those who made the step toward the democratic deficit were seeking to sort out many of these issues. Comparing the situation to the status quo, before introducing the euro and setting up the ECB, one of the concerns was that it was not clear which body was to be held accountable if the results of EMU were suboptimal (Verdun, 1998). Some pointed to the fact that there was no other institutional arrangement in the world where a central bank was so far removed from politics (Teivainen, 1997; Berman & McNamara, 1999). Furthermore, the societal acceptance of the new institutional framework was not firmed up. Scholars identified the need to ensure this framework was perceived as being legitimate by making sure it is fully supported by the population at large (Patomäki, 1997; Verdun & Christiansen, 2000). Some proposed the introduction of more accountability to the European Parliament to deal with this issue (Elgie, 2002). Then there were concerns about the amount of freedom the ECB has to determine its own parameters and the ensuring weak overall accountability (de Haan &

Eijffinger, 2000; Taylor, 2000). An example that illustrates this concern is that the ECB was given the right to set its own operational definition of price stability, for instance, which it set at below (but close to) 2% over the medium run.

But the matter was complicated by the question of whether one thinks that price stability (inflation at close to 2%) is good for voters (Fontan, Claveau, & Dietsch, 2016), and for the economy and thus whether it would make sense to delegate this task to a central bank at all. On the assumption that many countries have decided that they want their central banks to be targeting inflation and that many national parliaments have made national central banks independent—so that they will not be tempted by governments with a shorter time horizon, as well as that central bank policies are difficult for the average person to understand—there is sense in delegating to the ECB the task of securing price stability and without prejudice to that goal seeking to ensure growth and employment objectives (Jones, 2002b).

Yet not all were in agreement. Some concentrated on the idea that the Euro Area was not an Optimal Currency Area (Mundell, 1961; McKinnon, 1963; Kenen, 1969). Therefore monetary policies of the ECB were bound to be producing imperfect effects for some member states even if being part of the monetary union may lead to quicker convergence (Frankel & Rose, 1998). Normally in federal states there would be some compensation (transfer payments or automatic stabilizers) that would offset the suboptimal distributive outcomes. Thus, they argue that without these mechanisms the Euro Area could end up being politically unstable (Mabbett & Schelkle, 2015). Schelkle (2017) instead concentrated on risk sharing as being perhaps a more important element of EMU rather than worrying about whether more fiscal union was necessary (see also Praet, 2017). The argument of those who argued for more fiscal federalism was that numerous EU economies needed to catch up further or risk political instability (Patomäki, 1997; Demertzis & Wolff, 2019). Others who were worried that the fiscal authorities were faced with strict rules on budgetary deficits and public debts would reduce public expenditure. Such a reduction could mean a downward trend in terms of investment in social policies, the welfare states, and other public goods (Crouch, 2000) with little to no flexibility to use a larger budgetary deficit to offset public choices. Yet others also identified that the decline in welfare state spending in the EU member states preceded the advent of EMU (Leander & Guzzini, 1997; Verdun, 2000). Various scholars pointed to how EMU and deeper integration would be part of the next steps in European integration, also to ensure that the EU would remain a region with commitment to social goals (Jones, 2002a). The focus on the question of ECB legitimacy changed completely as the financial crisis hit the EU (Torres, 2013; Visconti, 2014) when the ECB hit its teenage years (Enderlein & Verdun, 2009).

The ECB and the Sovereign Debt Crisis

Previously we discussed the expected role of a central bank in a currency union and discussed some of the concerns with the institutional design and the role of the ECB in good times. The first 10 years of EMU were generally judged to be a success, although there was a sense that the financial crisis was about to change matters (Enderlein & Verdun, 2009, 2010). The financial crisis was caused by a combination of loose monetary policy in the United States, boom and bust in the U.S. housing market, new financial instruments that concealed bad mortgages, and financial turmoil in the United States that spread to other countries (Sorkin, 2009). The policy responses also have aggravated the crisis in that monetary policy was too loose in 2007 in response to the first (and worst) part of the financial crisis, and it was unclear why some financial institutions were saved whereas others, notably Lehman Brothers, were allowed to go bankrupt (Taylor, 2009).

In August 2007 the ECB was among the first of the major central banks to make liquidity readily available to the banking system when the interbank market was severely disrupted on August 9 and 10. In the aftermath, the major central banks of the world kept in close contact and exchanged views on what would be the next steps. Central banks collaborated regularly through the Bank for International Settlements (BIS) and emphasized the importance of strengthening global governance so that more nations were part of global governance initiatives (Trichet, 2010; Drezner, 2014). One of the instruments that the central bank uses to impact the price level is the interest rate. Central banks exchanged views on interest rate policies and instruments that could be used. Eventually, with the financial markets not working properly (due to the crisis) and historically low interest rates, the ECB eventually (as other central banks also did) reverted to non-standard measures (ECB, 2013).

The financial crisis morphed into an economic crisis and eventually led to a sovereign debt crisis in the EU due to a combination of macroeconomic, financial, and fiscal vulnerabilities (De Grauwe, 2006a, 2006b, 2011, 2012; De Grauwe & Yi, 2012). These were caused by a domestic credit boom Euro Area periphery, which in turn led to current account imbalances, and the admittance of serious fiscal deficits in Greece in Autumn 2009 proved to be the catalyst (Featherstone, 2011). As EMU had not installed EU-level mechanisms to deal with these kinds of crises, the EU leaders first had to agree that they would assist a member state in need (Yiangou, O’Keeffe, & Glöckler, 2013). It took them several months to come to that conclusion (Jones, 2010). Subsequently, they had to create new institutional structures to provide needy member states with funding. First they created ad hoc institutions, but gradually they were integrated into the EU framework (Drudi, Durré, & Mongelli, 2012; Gocaj & Meunier, 2013; Howarth & Quaglia, 2013; 2016; De Rynck, 2015; Verdun, 2015). Eventually the sovereign debt crisis affected the EU for a number of years with the crisis more or less simmering down rather than abruptly ending (Lane, 2012; Jones, 2014; Seabrooke & Tsingou, 2019; D’Erman & Verdun, 2018).

The sovereign debt crisis dramatically changed the role of the ECB in EU governance. It became part of the so-called Troika (ECB, European Commission, and International Monetary Fund [IMF]) that assisted member states that had difficulties in refinancing their debt (Henning, 2017). The ECB also ended up becoming the actor that ultimately stood up to defend the euro. The ECB backed member states by allowing banks to borrow at very low rates, whereas it was buying public bonds at higher rates (Wyplosz, 2012; Sinn, 2015). Most notable was the impact of ECB President, Mario Draghi, who in a speech on July 26, 2012, declared: “Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough” (Draghi, 2012; *Der Spiegel*, 2012; *Financial Times*, 2016). Shortly after he provided the details of the scheme known as the Outright Monetary Transactions (or OMT). This strong leadership of the ECB has been assessed as having made an important contribution to fighting the crisis (Verdun, 2017; Schoeller, 2019). Although the OMT did not actually get used, the very existence of this scheme, together with the quantitative easing program that was in place since March 2015 and ended in 2018, was restarted again in the dying days of President Draghi. This instrument has had the effect of bringing down the interest rates on government debt (Kang, Ligthart, & Mody, 2015; Lombardi & Moschella, 2016). It also seems to be the last remaining instrument of central banks in an environment of very low or even negative interest.

The banking crisis and sovereign debt crisis have taught us that the asymmetrical EMU needed to be addressed. European Council President Herman van Rompuy presided over a report written by the presidents of four EU institutions, which set out steps to deepen integration and provide EU-level regulatory framework that would enhance EMU (Van Rompuy, Barroso, Juncker, & Draghi, 2012). It provided steps to improve fiscal governance (which included regulations such as the six-pack, the fiscal compact, and the two-pack) and economic policy reforms, as well as to establish a single supervisory mechanism as an initial part of the banking union, a deposit guarantee framework, a European Stability Mechanism (to refinance banks), and a Single Resolution Mechanism and Fund (to deal with banking resolution and or to provide financial backstop). The crisis had indicated that fiscal policy needed more coordination. Through the so-called fiscal compact—an intergovernmental treaty signed at the outset by all member states, except the United Kingdom and the Czech Republic—each member state would commit itself to include in its national laws or constitution the fiscal rule that the general government budget be in balance or in surplus. Member states were able to create such rules, even outside the EU framework, as long as there was a critical mass of members interested in taking steps together. Those where no consensus were found on were moved to the future (Chang, 2016).

Many of the action points of the Four Presidents' Report were completed by the time a second such report was drawn up, the Five Presidents' Report, to which the European Parliament president was added, presided over by Commission President Juncker (Juncker, Tusk, Dijsselbloem, Draghi, & Schulz, 2015). This report built on these developments but added a few more ambitious goals such as creating what it called a "genuine Economic union," a "Financial Union," a "Fiscal Union," and a "Political Union."

The ECB presidents have played a major role in enhancing the ECB in order to more effectively deal with the financial crisis and the sovereign debt crises. The ECB president has played a crucial role in the contents of both the Four Presidents' Report and the Five Presidents' Report. One could easily identify the ECB has having taken a major political leadership role (Verdun, 2017) to offset the crisis.

Conclusion

The process of economic and monetary integration was asymmetrical from the outset. EMU was created with a clear monetary component (including a supranational European Central Bank) whereas macroeconomic, fiscal, and financial governance was kept on the national level and subject to rules. The process of integration was clearly incomplete and needed deepening. The financial, economic, and sovereign debt crisis highlighted this asymmetry.

The European Central Bank has had two distinct experiences since 1999. The first 10 years were characterized by a period of institutional build-up. The ECB was seeking to stand its ground, secure its mandate, and shrug off any pressures to influence it. The second 10 years included the global financial crisis and its aftermath and offered the ECB an opportunity to push its mandate to the limit and show everyone what it was capable of doing. Being the only supranational institution that could act swiftly, it often took action when politicians were unable to. It exercised political leadership to find solutions that were necessary to avoid a further worsening of the crisis. In so doing, it took chances, as did the EU as a whole, which implicitly approved this behavior.

The crisis emphasized the need to further expand the supranational regulatory framework of the EU in the economic, fiscal, and financial domain. The ECB now houses new institutions that participate in deeper regulation of the EU. Future research will concentrate on obtaining a better understanding of how the ECB assists in shaping European integration through its ideas, institutional structure, and the politics at play.

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Notes

1. There are two groups, and each share a limited number of votes. The way voting rights are subsequently organized is as follows: The group of the five larger countries in turn each have one month that they do not have a vote; the members in the group of smaller member states each in turn do not have voting rights during a period of three months. All votes carry the same weight. See ECB *<https://www.ecb.europa.eu/ecb/orga/decisions/govc/html/votingrights.en.html>*.

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