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FORUM

The European Central Bank in the International Political Economy

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Central banks lie at the interface between domestic and international political economy. Powerful technocracies tasked with domestic and international macroeconomic governance functions are responsible for monetary policy, sometimes banking supervision, and to contribute to overall financial stability. On occasion, they supervise a variety of non-banking financial services and other functions, such as anti-money laundering. During economic and financial turmoil, central banks can be crisis managers of last resort, or actually crisis managers of first resort. Today, many central banks often enjoy independence from the political authorities. They are important actors in the international monetary and financial systems acting separately from government actors. Central banks contribute to shaping these systems, and are, in turn, affected by them. Major geopolitical developments pose significant challenges to central banks and thus to the scholars studying them. This forum takes stock of current academic and policy debates on the European Central Bank (ECB) and the euro. Individual contributions explore key aspects of the ECB and the euro: the ECB as an overstretched multi-tasking technocracy, struggling with multiple goals; the distributive effects of ECB's policies; the ECB as a global normative and policy entrepreneur in combating climate change; and the geopolitics of the euro, in particular, the failed promise of the euro as a leading international currency. Together, these contributions tackle fundamental questions about the past, present, and future of the euro and the ECB; offer contending perspectives on the success (or otherwise) of this experiment; and point out what features would warrant further study.

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We reflect on how these analyses feed into the broader literature on central banks and international organizations in the global political economy more generally.

Los bancos centrales se encuentran en medio de la interrelación entre la economía política nacional e internacional. Las poderosas tecnocracias, que se encargan de las funciones a nivel de gobernanza macroeconómica nacional e internacional, son las responsables de la política monetaria, a veces, incluso, de la supervisión bancaria, y de contribuir a la estabilidad financiera general. En ocasiones, también ejercen la supervisión de una variedad de servicios financieros no bancarios, así como otras funciones, tales como la lucha contra el blanqueo de dinero. Durante las turbulencias económicas y financieras, los bancos centrales pueden llegar a ser gestores de crisis de último recurso, o, de hecho, gestores de crisis de primer recurso. Hoy en día, es frecuente que muchos bancos centrales gocen de independencia con respecto a las autoridades políticas. Son actores importantes en los sistemas monetarios y financieros internacionales que actúan al margen de los actores gubernamentales. Los bancos centrales contribuyen a dar forma a estos sistemas y, a su vez, se ven afectados por ellos. Los grandes acontecimientos geopolíticos plantean importantes desafíos a los bancos centrales y, por lo tanto, también a los académicos que se encargan de estudiarlos. Este foro hace un balance de los debates académicos y políticos actuales con relación al BCE y al euro. Las contribuciones individuales exploran aspectos clave del BCE y del euro: el BCE como una tecnocracia multitarea sobrecargada, que lucha contra múltiples objetivos, los efectos distributivos de las políticas del BCE, el BCE como empresario normativo y político mundial en la lucha contra el cambio climático, la geopolítica del euro, en particular, la promesa incumplida de que el euro sería la moneda líder a nivel internacional. En conjunto, estas contribuciones abordan cuestiones fundamentales sobre el pasado, el presente y el futuro del euro y del BCE. Además, ofrecen perspectivas contradictorias sobre el éxito (o no) de este experimento e indican qué rasgos justificarían un estudio más profundo. Reflexionamos sobre cómo estos análisis alimentan la literatura más amplia en materia de bancos centrales y organizaciones internacionales en la economía política global en general.

Les banques centrales se situent au point de rencontre entre l'économie politique nationale et internationale. Les puissantes technocraties dotées de fonctions de gouvernance macroéconomique nationale et internationale sont responsables de la politique monétaire, parfois de la supervision du système bancaire, et doivent contribuer à la stabilité financière globale. À l'occasion, elles supervisent divers services financiers non bancaires et d'autres fonctions, comme la lutte contre le blanchiment d'argent. Lors de crises économiques et financières, les banques centrales peuvent s'occuper de leur gestion en dernier recours, ou en premier recours. Aujourd'hui, nombre de banques centrales jouissent souvent d'une certaine indépendance par rapport aux autorités politiques. Il s'agit d'acteurs importants au sein des systèmes monétaires et financiers internationaux, qui agissent indépendamment des acteurs gouvernementaux. Les banques centrales participent au façonnement de ces systèmes, dont elles, à leur tour, subissent les conséquences. Les événements importants en géopolitique représentent un défi conséquent pour les banques centrales, et donc pour les chercheurs qui les étudient. Ce forum propose un état des lieux des débats politiques et académiques actuels au sujet de la BCE et de l'euro. Chaque contribution s'intéresse à des aspects clés de la BCE et de l'euro: la BCE, une technocratie polyvalente et surmenée, en difficulté vis-à-vis de maints objectifs; les effets distributifs des politiques de la BCE; la BCE, un entrepreneur normatif et politique mondial dans la lutte contre le changement climatique; la géopolitique de l'euro, et

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notamment la promesse non tenue d'une monnaie qui aurait dû devenir une devise internationale de premier plan. Ensemble, ces contributions traitent de questions fondamentales quant au passé, présent et futur de l'euro et de la BCE; proposent des perspectives opposées sur la réussite (ou non) de cette expérience; et indiquent les caractéristiques qui mériteraient une étude plus approfondie. Nous réfléchissons à l'insertion de ces analyses dans la littérature plus vaste sur les banques centrales et les organisations internationales dans l'économie politique mondiale.

Keywords: euro, European Central Bank, geopolitics, green politics, independence, international political economy, legitimacy
Palabras clave: bancos centrales, Banco Central Europeo, política monetaria
Mots clés: banques centrales, Banque centrale européenne, politique monétaire

Introduction

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Central banks are important subjects of academic inquiry as they lie at the interface between domestic and international political economy (IPE). They are powerful technocracies tasked with domestic and international macroeconomic governance functions. Central banks are responsible for monetary policy, and, in some countries, they are also responsible for banking supervision and for contributing to overall financial stability. They are sometimes tasked with the supervision of a variety of non-banking financial services and other functions, such as anti-money laundering. In times of economic and financial turmoil, central banks tend to be crisis managers of last resort. Given the speed with which they can act, they are actually often crisis managers of *last* resort acting *first*. Modern-day central banks are bureaucracies that enjoy some degree of independence from the political authorities. They are important actors in the international monetary and financial systems acting separately from government. They contribute to shaping these systems, and are, in turn, affected by them. Major geoeconomics developments pose significant challenges to central banks and thus to the scholars studying them.

The establishment of the European Central Bank (ECB), to support the introduction of the euro, represents a novelty in the world of central banking. The euro and the ECB were created from scratch by the Treaty on European Union (EU), signed and ratified by the—at the time twelve—member states. The EU has twenty-seven member states, and the euro is the currency of twenty of them (euro area). The ECB is a supranational central bank that builds on the institutional arrangements, operational cultures, and epistemic views of the national central banks (see, inter alia, McNamara 1998; Verdun 2000; Quaglia 2008). Together, these national central banks and the ECB comprise the Eurosystem. The ECB is the most independent central bank in the world (Bernhard et al. 2003). Unlike national central banks, it has no equivalent political counterpart at the EU level (Jones 2002; Howarth and Loedel 2005). Over time, it has undergone a significant institutional and policy evolution and has substantially expanded its competences, either of its own initiative or

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after being prompted to do so. Since its establishment, the ECB has navigated good times and bad times. The time seems ripe to reflect on what we know (and do not know) about the ECB.

This forum takes stock of current academic and policy debates on the ECB and the euro. It contributes to these debates and discusses the main challenges ahead in a period of profound geoeconomic changes as well as monetary and financial instability. These changes include more rivalry among blocks, less cooperation among transatlantic partners in some areas, and a movement toward a multipolar world. Central banks are confronted with seeking to bridge these divides where possible and desirable. Individual contributions explore key aspects of the ECB and the euro, namely: the ECB as an overstretched multi-tasking technocracy, struggling with multiple goals (Verdun and Quaglia); the distributive effects of ECB's policies (Jones); the ECB as a global normative and policy entrepreneur in combating climate change (Helleiner); and the geoeconomics of the euro, in particular, the failed promise of the euro as a leading international currency (Cohen), which has given the United States a longer period of hegemony vis-à-vis the EU. Taken together, these contributions tackle fundamental questions about the past, present, and future of the euro and the ECB; offer contending perspectives on the success (or otherwise) of this real-life experimentation with a monetary union that has a single currency for twenty sovereign states used as legal tender by 347 million citizens. We also reflect on how these analyses feed into the broader literature on central banks and international organizations in the global political economy more generally and point out what features would warrant further study.

Some key findings emerge from the articles in this forum. The ECB, and central banks more generally, has been front and center in the national and international responses to the economic and financial instability that characterized the last decade and a half. Overall, their response to crises was adequate (relatively quick and sizeable), but laid the groundwork for future problems, notably, mission-creep, over-stretching, politicization, and legitimation of technocracies. Since the start of the twenty-first century, central banks, especially the ECB, have first had to deal with a low inflation environment (even, deflation), followed by relatively high inflation (Moschella 2024). The ECB has been confronted with the great financial crisis and the sovereign debt crisis and developed policies to rescue the euro. The ECB's toolkit has evolved in tandem with the evolution of economic thinking in the profession, albeit after laborious soul-searching exercises by the ECB and other main central banks. This change is important to appreciate. When independent central banks were set up to try to secure price stability, it was thought this goal would always benefit society. As one takes stock of a quarter of a century of monetary policy at the ECB, one realizes that one needs to obtain a better understanding of having these semi-independent technocratic institutions involved in a variety of policies that have distributional implications after all, and thus increasingly put central bankers into the political limelight.

The ECB has become an important international actor, although trailing at some distance the US Federal Reserve, which is the undisputed lead institution in the realm of central banking (Helleiner 2014; Epstein 2019). With other central banks, the ECB has made credit lines available to stabilize the financial system during periods of economic and financial turmoil (Henning 2017; Spielberger 2023). It has promoted the greening of monetary policy and has supported policies that were instrumental in combating climate change (Helleiner this issue). Finally, the ECB and the other central banks of the Group of Seven economies and the EU have been enlisted for monetary and financial warfare, following the recent geoeconomic turn in world politics (Quaglia and Verdun 2023b). These actions have made international cooperation potentially more difficult, bringing to the fore the danger of fragmentation of the international financial system. Further research could explore the consequences of raising geoeconomic tensions for international cooperation

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among central banks, but also for the international organizations involved in the governance of the world economy.

Despite the success of the ECB, the introduction of the euro has not given rise to the creation of a fully fledged state-like polity in the international state system. The institutional architecture of Economic and Monetary Union (EMU) is asymmetric in that it features a single monetary policy, run by the ECB, whereas fiscal and budgetary policies have stayed at the level of national member states, with the EU in the role of soft coordinator (Verdun 1996). The result is that the euro has yet to reach its potential. The past 25 years have shown that a new supranational currency can gain international recognition and be widely used throughout the globe (the second most-used international reserve currency). Yet, the absence of a supranational fiscal or political authority at the EU (or euro area) level, which can speak with one voice for the union (or the euro area), has remained a weakness (see Cohen, this issue). Future research could investigate how important the incomplete integration process is for the success of the ECB and euro as an international currency.

The European Central Bank: An Overstretched Multi-Tasking Central Bank

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The ECB—the central bank of EU member states whose currency is the euro—was set up in 1999, as envisaged by the Treaty on EU (or "Maastricht treaty") signed in 1992. After concisely reviewing the main bodies of works on the politics and political economy of central banks in general, this contribution engages in a stocktaking, forward-looking exercise, thereby teasing out the main features of the ECB's institutional, policy, and ideational evolution. We highlight the main blind spots in the literature, thereby providing interesting venues for further academic inquiry.

Taking Stock of the Political Science Literature on the Political Economy of Central Banking

The vast literature on the political economy of central banking had first been dominated by economists who focused on central bank independence (CBI), assessing its effects on policy performances, notably, the level of inflation and economic growth. Often referred to as positive political economy, using models and experiments, these scholars review the work of central banks, in particular how institutional differences lead to different economic and political outcomes depending on the system (inter alia Epstein 2019; Romelli 2022).

Various definitions and measures of CBI have been devised (see, e.g., Cukierman 1992; Alesina and Summers 1993), and case studies of CBI have been investigated (e.g., Goodman 1992; Maxfield 1997; more recently, Johnston 2016).[1] In various rankings of CBI, the ECB has systematically come to the top. Yet, in fairness, the notion of CBI has also been criticized as a "zombie" idea (Qanas and Sawyer 2023, 577) that even if disproven does not go away. Christopher Adolph's comparative public policy study finds that individuals who work for a central bank across a range of countries may still be influenced by partisan politics, depending on incentives, despite the legal framework suggesting there is little room for maneuvre (Adolph 2013). Moreover, scholars have used game theory to examine the interac-

[1] Garriga (2016) ranks central banks from 182 countries (1970–2012) (but not the ECB), and finds that the national central banks of the euro area score high on CBI considering a multidimensional index.

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tions between the monetary authorities (the central banks) and the fiscal authorities (the political authorities), which can engage in cooperative or uncooperative games (Goodhart 1994). The ECB's interactions with the national fiscal authorities have initially been characterized as an uncooperative game, but in the second part of the sovereign debt crisis in the euro area, there has been a shift toward more cooperation (Debrun et al. 2021).

In the remainder, we concentrate on political science literature of central banking. Political scientists have examined central banks as part of a broader set of regulatory agencies (i.e., technocracies composed of unelected officials) and international organizations to which certain tasks have been delegated by elected officials (i.e., politicians) (Pauly 1997; Pollack 2003). This body of scholarly work has often used a principal–agent framework to examine the relations between elected officials (governments and parliaments) and unelected officials (bureaucrats in regulatory agencies), discussing issues concerning the effectiveness and legitimacy of the delegation of certain tasks, notably, monetary policy and, sometimes, banking supervision in the case of central banks (Elgie 2002; Pollack 1997). More recently, scholarly works have examined the involvement of central banks, including the ECB, in policy areas, ranging from the adoption of financial sanctions (Quaglia and Verdun 2023b) to climate change (Helleiner, this issue), which are somewhat removed from the "traditional" lines of business of monetary policy. It has also led to questioning the current central bank mandate that focuses on inflation.

A third stream of academic work has examined, often using various forms of content analysis, the communication policies of central banks toward the markets, the political authorities, and public opinion (Blinder et al. 2008; Ferrara 2020; Moschella 2024).[2] This debate has taken a particular twist in the EU because the ECB is a central bank in a polity in the making and thus lacks a political counterpart equivalent to a national treasury ministry or national government (Verdun 1996) and faces a variety of national *demoi* to speak to. These aspects are important as the ECB has over time considerably expanded its competences as explained below.

A final body of scholarly works has examined the external relations of central banks and their interactions in the international monetary and financial systems. This literature analyzes inter alia the cooperation (or lack thereof) among central banks (Spielberger 2023) that enjoy varying degrees of independence from their respective national governments. These technocracies can constitute a potential epistemic community of like-minded officials (Verdun 1999), often sharing similar educational backgrounds, professional training, and epistemic outlooks. The findings of these studies feed into the broader literature on international organizations as international actors and transgovernmental networks of domestic regulators that cooperate across borders. The international dimension of the ECB is of particular interest because it is the second most influential central bank in the world, after the Federal Reserve in the United States. The euro, in turn, is the second leading international currency (Cohen 2011 and Cohen, this issue).

The ECB: Independent and Lonely (No More?)

The ECB is a supranational central bank, whose independence from the political authorities is guaranteed by an international treaty. The initial institutional design of the ECB, its objectives, instruments, and epistemic outlook (discussed below) were significantly informed by those of the German central bank, the Bundesbank, which had been the most powerful central bank in Europe (Brunnermeier et al. 2016). It had consolidated credibility for being an inflation averse and fiercely independent

[2]Note here the important work of some economists many of them working at central banks (see Blinder et al. 2008; Hansen et al. 2019).

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of the political authorities (Quaglia and Verdun 2025). In the first decade since its inception, the ECB kept politicians at arms' length and refused to engage in cooperation between monetary policy and fiscal policy. Occasionally, the relationships between the bank and national governments in the euro area resembled a tug of war (Howarth and Loedel 2005; Jones 2021).

On the one hand, the ECB succeeded in consolidating its independence. On the other hand, at times, that became what Padoa-Schioppa and others worried about, namely "loneliness" (Bini-Smaghi 2011; see also Mabbett and Schelkle 2019), especially in times of crisis. Rather than having a single (unified) political counterpart at the EU level that the ECB could engage with, there were a multitude of national governments that had different priorities embedded in domestic politics (Sadeh and Verdun 2009). Moreover, the political authorities were unwilling and unable to respond in an effective manner to the successive economic and financial crises that hit the EU and the world economy from the Great Financial Crisis to the COVID-19 pandemic. Thus, it was left to the ECB to act as a crisis manager, exerting political leadership at crucial times (Verdun 2017) and expanding de jure and de facto its competences (Schmidt 2016).

During the COVID-19 crisis, the ECB acted quickly by substantially expanding its unconventional monetary policy tools (negative interest rates, forward guidance, asset purchases, and longer-term refinancing operations [LTROs]—developed dealing with the twin financial and the sovereign debt crises in the euro area). Political authorities in the EU adopted a variety of financial funding instruments (Recovery and Resilience Facility [RRF]), providing loans and grants to EU member states in need. This situation was, in fact, a cooperative game between fiscal policy and monetary policy. Having firmly established its independence in previous decades, the ECB was willing openly to speak of cooperation between monetary and fiscal authorities. Thus, the ECB was lonely during the sovereign debt crisis, not anymore in the COVID-19 crisis (Quaglia and Verdun 2023a).

Critics point out that the unconventional monetary policy measures adopted by the ECB in responding to crises and the expansion of its competences have brought to the fore the risk of the ECB's *de facto* involvement in fiscal policy as well as fiscal and financial dominance in the euro area (Schlosser 2019). In a regime of fiscal dominance, fiscal policy drives inflation, while monetary policy accommodates the fiscal stance by keeping interest rates low so as to stabilize the public debt, impairing the central bank's ability to safeguard price stability. In a regime of financial dominance, a central bank is reluctant to tighten monetary policy if that could threaten the stability of the financial system. These themes add to the existing literature on the politics of CBI by pointing out the (at times difficult) interactions between central banks, elected officials, public opinion, and financial markets in a multi-level polity, such as the EU, all matters that would warrant further research.

Evolution of Economic Thinking and Multi-Tasking of the ECB

The ECB's institutional and policy evolution discussed above was accompanied by an ideational shift (Ferrara 2020; Mugnai 2024). The EU Treaty gave the ECB the primary objective to safeguard price stability and some under-specified secondary objectives (van 't Klooster and de Boer 2023). Given that, when the ECB was set up, its epistemic outlook was strongly informed by that of the Bundesbank, the ECB spent its first decade preaching "sound money, sound public finance," i.e., relatively tight monetary and fiscal policies (Howarth and Loedel 2005; Quaglia 2008). The turnover of senior officials as well as the new challenges that the ECB had to confront, notably, a succession of economic and financial crises, fostered the development of new economic thinking within the Bank (Quaglia and Verdun 2025). The initial objective of monetary stability was flanked by other objectives, namely, financial stability as well as the survival of the euro (Quaglia and Verdun 2023a)

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leading to experimentation with unconventional monetary policy tools (Moschella 2024). Thus, the ECB has undergone a significant ideational change away from the monetary "orthodoxy" of the Bundesbank.

There has been a considerable expansion of the ECB's tasks. Initially, the ECB was solely responsible for monetary policy and, partly, exchange rate policy, whereas its function as a lender of last resort was less clear. Although this function is generally performed by central banks, in the case of the ECB, it initially remained an open question as to which institution would be responsible for providing liquidity to financial institutions in periods of financial turmoil. In its early years, the ECB maintained deliberate ambiguity as to how it would behave in case of crises (Quaglia 2008). Yet, it acted fast as a lender of last resort during the twin financial and sovereign debt crises. During these episodes of economic and financial turmoil, the ECB was a crisis manager of last resort acting first (i.e., before other EU institutions or collection of member states) because it was able and willing to act quickly, unlike the political authorities. Thus, it filled a "void" and bought time for national governments to agree on response measures at the EU level, often after prolonged and bitter negotiations (Schoeller 2020).

The ECB proved to be a capable crisis manager, expanding its policy space, moving away from its initial narrow focus on price stability, and exploring unconventional monetary policy. It added new tools (including "big bazookas") to its toolkit. Moreover, the ECB took responsibility for market stabilization whilst safeguarding financial stability. After Banking Union was agreed to in 2012, the ECB also became responsible for banking supervision in the euro area and for contributing to financial stability (Howarth and Quaglia 2016). This significant increase in ECB's competences had been resisted by some member states when the institutional design of the ECB was negotiated in the run-up to the Maastricht Treaty (Dyson and Featherstone 1999).

The considerable expansion of ECB's competences raises important issues. First, as expected by theories of delegation and bureaucratic politics, the ECB has engaged in "mission creep" by extending its original goals and tasks. Thus, there is a need to improve ECB's accountability in parallel with its increased competences (Torres 2013). Second, the multi-tasking of the ECB and the (over)stretching of its mandate result in potentially conflicting goals as well as an insufficient number of tools to pursue those goals. Called "Tinbergen's dilemma," in economics, it refers to a situation in which policymakers who seek to pursue multiple policy goals need to have control over at least one policy tool for each goal. Third, unlike monetary policy, which has indirect, hard-to-grasp distributional effects, other tasks of the ECB have clear distributional consequences, involving political choices (Jones, this issue). Central bank operations have an impact on collateral markets. During the euro area sovereign debt crisis, the loosening of eligibility criteria had a material impact on private market participants (BIS 2015). Therefore, they entail the risk of politicizing the ECB (Tortola 2020), notably, through politicians' interference in ECB's policy decisions, bringing the ECB into the political limelight, and making it a target for political contestation (Moschella and Pinto 2018).

The ECB and the Euro in the International Financial System

The ECB is an important player in the international financial and monetary systems. The conduct of exchange rate policy of the euro is conducted by the ECB without the involvement of EU political authorities. The ECB has operationalized the conduct of exchange rate policy as one left to the markets as it does not target a particular exchange rate outcome. Initially, the ECB, privileged the objective of price stability for monetary policy, adopting a non-interventionist approach concerning the management of the exchange rate of the euro (Henning 2017). From the Great Financial Crisis onward, the ECB's concern about financial stability, while

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dealing with successive economic crises, meant that the exchange rate policy of the ECB was not interventionist, i.e., it was a consequence of the ECB's unconventional monetary policy. The ECB, as the Bundesbank before it, was initially reluctant to promote the euro as an international reserve currency—preferring to leave the matter to market forces—because of the responsibilities that come with this role, which could impinge upon the conduct of monetary policy. The concern was that focusing on the international role might at times come into conflict with the primary mandate of price stability.

The ECB has partly reversed its initial stance on this matter. Already in response to the Great Financial Crisis, the ECB contributed to protecting international financial stability by establishing joint swap lines with the other main central banks (notably, the Federal Reserve and the Bank of England) and repo lines with other ECBs not in the Eurosystem (Spielberger 2023).[3] The Federal Reserve was the international lender of last resort during the Great Financial Crisis, but, during the pandemic, the ECB partly did so, also to underpin the status of the euro as a global international currency (something that was not yet in the minds of leaders in 2008). Still in this period, the ECB did not target an exchange rate outcome. Furthermore, following the geoeconomic turn in international relations, the ECB and European Commission began to promote the euro as a leading international currency even if not considering its actual exchange rate. Yet, as other central banks, the ECB was enlisted for monetary and financial warfare in the adoption of financial sanctions against Russia, including freezing the foreign reserves of the Russian central bank (Quaglia and Verdun 2023b). All this has resulted in the weaponization of finance and the potential fragmentation of the international monetary and financial system into rival blocks. Finally, the ECB has also begun to play a leading role internationally in promoting the greening of monetary policy (Helleiner, this issue).

Conclusions

The ECB's swift and effective response to the pandemic represented the "coming of age" of the Bank, which has become a more mature central bank and a more self-assured institution, not afraid of engaging with the fiscal authorities. The ECB has gradually moved away from its Bundesbank heritage and has increasingly compared itself to the Federal Reserve Bank, becoming one of the leading institutions in the EU to push integration forward. Traditional integration scholars had pointed to supranational institutions to be the motor of integration but typically looked to the European Commission or the Court of Justice of the EU. In this case, the ECB jumped into the leadership void, speaking to issues raised in the literature on the role of international organizations and showing that the latter are able and adapt to lead.

The ECB was set up as an institution that was to have a simple mandate, but when the crises emerged, it was able to assist by taking on board new tasks. Future research could investigate how the ECB is seeking to rebalance its primary, secondary, and tertiary objectives, and with what consequences. It would be worth examining the many new roles that central banks have acquired recently and discussing the economic and political implications of these developments. Finally, the ECB has increasingly promoted the euro as an international currency, also for geoeconomic purposes, and has become a much more proactive central bank internationally. This forum discusses this matter with reference to green policies (Helleiner, this issue). Going forward, it will be interesting to see whether the ECB will seek to take more of a leading role in the community of central bankers. It will be stimulating

[3] During 2008, there was no major conflict between price stability and financial stability; the challenge was whether the ECB could act as lender in light of the no-bailout clause.

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to investigate the implications of the geopolitical tensions for the activities of and cooperation among central banks.

Confronting the Democratic Legitimacy of Crisis Policymaking at the European Central Bank

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European University Institute

The global economic and financial crisis changed the ECB in ways that its founders could never have anticipated. That change is permanent. Hence, it is worth asking whether any act of delegation that took place when Europe's leaders drew up the plans for the ECB in the early 1990s or launched the institution later that decade could legitimate that institution's political independence today (Elgie 2002; Torres 2013). The answer to such a question may not lead to a reform of the ECB's founding documents—which is a remote prospect—but could suggest the need for some political recognition that the institution today is very different from when it was founded (Demetriades 2019).

To recognize that change, it is necessary to wade through technical jargon to set out the policies the ECB has adopted and how those policies have impacted the markets. The goal is to highlight discretionary distributive decision-making—meaning decisions that pick obvious winners and losers from the way monetary policy instruments are used. As Lucia Quaglia and Amy Verdun make clear in their introduction, politically independent central banks are not supposed to make overtly political decisions. There is nothing more political than picking winners and losers (Tucker 2018). Understanding how the ECB got into that business is therefore important.

This essay looks at the transformation of the ECB in three stages. The first focuses on instruments, discretion, and distributive consequences. The second explores implications and path dependence. The third argues that some political acknowledgment of this transformation is going to be necessary for the ECB to retain its legitimacy as a politically independent institution.

Instruments, Discretion, and Distributive Consequences

The ECB's Governing Council (hereafter, the "Governing Council") is where decision-making takes place for the ECB and the national central banks of the EU member states that have adopted the euro—the "Eurosystem." That body had to respond to the global economic and financial crisis creatively. It started by using existing instruments in unconventional ways. It lengthened the very short-term loans it made to banks into LTROs that started at 90 days and eventually extended to 3 years. It loosened the rules governing acceptable collateral and began providing waivers on specific assets to ensure banks had enough collateral to borrow. It started buying assets to stabilize secondary markets in specific instruments until it eventually embarked on a large-scale asset purchase program. It dropped its policy rates until the rate it paid out on bank deposits fell below zero (and so became a tax!).

This use of existing monetary policy instruments in unconventional ways was transformational: not only did it create "winners" and "losers" but it also gave the ECB Governing Council discretion over who won and who lost (Jones and Matthijs 2019). The creation of 3-year long-term refinancing operations in December 2011 is a good illustration. The purpose of those loans was to ensure that banks could borrow the money they needed at concessionary rates. The effects went even further. The banks that took up those 3-year LTROs pledged sovereign debt (public borrowing by government) as collateral. Then those same banks used the money they borrowed to purchase more sovereign debt that they could use as collateral

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for the next round of lending. This cycle of events not only increased demand for sovereign debt—because adding demand into the market put upward pressure on prices—but also provided profits for the banks since the assets they purchased offered a yield to maturity (and often a coupon) greater than the cost of the loan.

The distributive consequences of these LTROs were obvious both for the governments who saw the price of their bonds rise in the markets and for shareholders in banks who could see the benefits in the quarterly statements (Jones 2019; Mabbett and Schelkle 2019). Those consequences were obvious to the Governing Council as well. The instrument was nevertheless too powerful in propping up both financial stability and economic activity to surrender. So, the Governing Council transformed the instrument into a form of "targeted" long-term refinancing operation (TLTRO). By implication, the Governing Council decided—in very broad terms—who should benefit from these 3-year concessionary loans both among the banks and among their clients. There was a monetary policy justification for the new instrument. The targeted loans could be used to create incentives for banks to provide credit to businesses or households, for example, and so foster economic activity and put upward pressure on prices. Since price inflation was below the ECB's target, such upward pressure was consistent with its mandate. However, the use of such instruments could not have been imagined in the 1990s.

A similar point could be made with respect to market stabilization. The Governing Council began making outright asset purchases via a "securities markets programme" to dampen market volatility. Such purchases were not "new" as all central banks have assets that they purchase outright for investment reasons (e.g., staff pensions) and for use (e.g., buildings and the art that decorates them). The innovation was to make those purchases for market stabilization (Mabbett and Schelkle 2019). In this early period, the creation of additional central bank liquidity was an expected and yet unintended consequence. In August 2011, ECB Executive Board Member Jürgen Stark resigned his position in protest over the introduction of this policy.

That securities markets programme gave the ECB Governing Council the ability to determine which markets and assets to stabilize and which to experience volatility. Such discretion could be even more focused than the discretion exercised with respect to the TLTROs because the conditionality could be tailored for specific institutions. This logic was behind the letters that ECB President Jean-Claude Trichet sent under the joint signature of the respective national central bank governors to the governments of Italy and Spain on August 5, 2011 (Heldt and Mueller 2021). Those letters underscored that any support from the ECB via the securities markets programme would be contingent upon the governments pursuing specific policies to strengthen economic performance and stabilize public sector finances.

The Trichet letters were not an isolated instance. The ECB Governing Council ended the securities markets programme soon after ECB President Mario Draghi promised to do "whatever it takes" to stabilize European sovereign debt markets. The replacement was a commitment to purchase unlimited assets with a residual maturity of 3 years or less issued by governments that requested assistance in the form of "outright monetary transactions." Those governments that received support had to remain in the markets and agree to go into some kind of conditional emergency lending program. Even then, the ECB Governing Council had a choice about whether to act (Torres 2013). The same could be said for the "transmission protection instrument," which is a commitment by the ECB Governing Council to support sovereign debt markets subject to excessive volatility. That policy gives the ECB Governing Council discretion in determining the conditions, timing, and recipients of support.

The exercise of discretion extends to the eligibility requirements for collateral waivers and participation in large-scale asset purchases. There is a clear monetary justification for such conditionality. Central banks should not take unnecessary risks

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onto their balance sheets and should not engage in the monetary financing of governments (particularly when they are insolvent). All central banks have rules governing the eligibility of collateral. What is new is the transparent exercise of discretion in the application of such rules.

Consider two examples related to the way Greece was affected by ECB decisions:

> First, the Governing Council pulled the waiver on Greek sovereign debt after the at the time radical left-wing political party Syriza came to power in 2015. The point is not that such action was unjustified; the official explanation was that the incoming government had promised to withdraw from its emergency credit programme. Nevertheless, the timing of the decision was discretionary. It is no surprise that Syriza's finance minister, Yannis Varoufakis, complained that the ECB had sabotaged his economic policy before it started (Varoufakis 2018).
> Second, the Governing Council excluded Greek government bonds from the large-scale asset purchase programme—which was the ECB equivalent to quantitative easing the United States and the United Kingdom. To balance concerns for monetary financing and unnecessary balance sheet risks, that programme included provisions to ensure that governments qualified for inclusion. Greece fell outside those conditions.

There were more general acts of discretion as well. The Governing Council changed the formula for risk sharing across central banks, for example. Normally, the asset purchases across the euro area should be proportional to the size of the economy where they are issued—as measured by the "capital key," which represents the relative contributions each country makes to the capital requirements of the ECB. This way, no government benefits disproportionately from the policy. In addition, national central banks should use the capital key to share the risks related to assets they purchase for the Eurosystem as a whole—so that losses are also proportionate. When it came to the purchase of government bonds, however, the Governing Council decided that central banks can only be required to purchase government bonds issued by their own country. It also decided that those risks would not be shared, and so each national central bank carried the risks of its own government's sovereign debt. The presumption was that central banks from low-risk countries would "win," in relative terms, and central banks from high-risk countries would "lose," in the event that one of the high-risk governments were to default on its obligations.

A further innovation lay in the use of negative interest rates and the interaction between policy rates and LTROs. Immediately prior to the start of its large-scale asset purchase program, the ECB Governing Council decided to move the rate on its deposit facility below zero—effectively taxing the deposits made by commercial banks in the Eurosystem. The initial goal of the policy was to encourage banks to lend to the real economy. That goal changed once the start of the large-scale asset purchase program began to swell the supply of bank deposits at central banks. The ECB Governing Council moved the deposit rate even lower (increasing the tax) to ensure that banks lent into the real economy, but it also introduced a tiering system where the tax applied only to deposits well above reserve requirements to encourage commercial banks to redistribute central bank liquidity across institutions.

The innovation came at the start of the pandemic when the ECB Governing Council changed the rules on its third series of TLTROs to make the interest rate charged on those loans negative as well (Jones 2020). The ECB Governing Council set the interest rate on loans to the banks below the negative rate on the deposits held by banks with central banks. This way the ECB Governing Council created a subsidy for banks that chose to borrow money even greater than the tax it charged those same banks for holding central bank deposits. Again, there were conditions

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attached in terms of requirements for lending into the real economy. Moreover, the policy was successful in promoting economic activity at a time when price inflation was well below the ECB's definition for price stability. Hence, the ECB Governing Council could justify its actions as part of an effort to do whatever it takes to respond to the pandemic. In doing so, however, the ECB Governing Council exercised discretion with clear distributive consequences—benefitting banks at the cost of taxpayers.

Implications and Path Dependence

This sequence of policy innovations has had lasting implications, many of which were unexpected. Some of these implications were transitional, while others were more permanent (Verdun 2017; Heldt and Mueller 2021). Consider the decision not to share the risks associated with the purchase of sovereign debt obligations across the Eurosystem. The justification was to avoid having central banks in low-risk countries being forced to purchase sovereign debt instruments from countries at higher risk of default. This way, the low-risk central banks could be insulated from potential losses. By the time the ECB Governing Council brought an end to net purchases and the reinvestment of maturing principal on the public sector purchase program, no government that participated in the program suffered from a default.

That absence of default does not mean, however, that the decision not to share risks across central banks succeeded in insulating the central banks in low-risk countries from losses. On the contrary, those central banks were uniquely exposed to the risks associated with buying their own government's sovereign debt. Because those governments were at a low risk of default, that debt traded at a premium (in terms of the price of the bonds) over the debt of higher-risk countries. Given that the deposit rate was negative, that premium often brought the price of the bond so far above par that the yield to maturity on those instruments was also negative. Here, it is worth noting that the yield to maturity is a function of both the coupon (or any regular interest payment) on the debt and the difference between the price of the bond and its par value, or the price at which the debt is redeemed at maturity. The central banks in low-risk countries suffered significant capital losses as those debt instruments matured because the price fell down to par at maturity, even as the central banks in high-risk countries benefited from capital gains because the price they paid was below par and so rose to par at maturity. The policy had exactly the opposite effect from what was intended.

The consequence of LTROs was different. Those loans provided ample, cheap liquidity to banks that took them up. Where the banks could use the proceeds to invest in higher-yield sovereign debt instruments, they gained a further advantage. Nevertheless, the existence of such loans meant that the market for interbank lending never recovered from the crisis. To meet their liquidity requirements, banks needed access to LTROs and TLTROs, which became clear in early 2019 as the second round of TLTROs was winding up.

The ECB Governing Council reluctantly agreed to launch a third round of the program to avoid extracting too much liquidity from financial markets at a time when inflation was still well below target. That third round almost created a similar trap for banks in the Eurosystem when those loans came due in 2022 and 2023. The ECB Governing Council was able to avoid that fate only because of the huge volume of central bank liquidity in circulation due to the large-scale and pandemic emergency purchase programs. Even then, the ECB Governing Council had to announce well in advance that it would not provide another round of TLTROs, so banks could prepare for repayment.

Efforts to tighten monetary policy instruments and shrink the Eurosystem collective balance sheet revealed other unanticipated implications. For example, any rise in the policy rates pushes down bond prices—as the yield on those bonds rises

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to match the change in policy rates—thereby threatening to impose even greater losses on central banks should they try to sell their assets before they mature. Once the ECB Governing Council lifted the deposit rate back above zero, the national central banks had to start remunerating the banks on their holdings of central bank liquidity—creating another redistribution from taxpayers (who would benefit from any surplus on the central bank's accounts and who would have to cover any losses) to private banks (Jones 2023).

It is unclear whether the ECB Governing Council will be able to move back to a monetary policy framework that relies on the rate for main refinancing operations as opposed to the remuneration of deposits. This is a form of path dependence resulting from the extensive use of central bank liquidity rather than interbank markets to ensure commercial banks meet their regulatory liquidity requirements. Interbank markets simply never recovered from the crisis. Without adequately functioning interbank markets, it may not be possible for the Eurosystem to shrink its balance sheet beyond the size necessary to ensure adequate provision of liquidity across the Eurosystem: as a result, the ECB will have to continue to purchase assets outright. As of July 2024, the new operational framework is still in development. What is clear is that the ECB Governing Council will be exercising discretion that creates both winners and losers even with the crisis long gone. The open question then becomes what kind of assets the ECB Governing Council will choose to purchase.

Conclusion: (Re-)Legitimating the ECB

The ECB Governing Council now exercises more discretion than it did before the global economic and financial crisis. In making its decisions, the ECB Governing Council also creates clear winners and losers. This situation is very different from the simple setting of monetary policy interest rates (Torres 2013; Mabbett and Schelke 2019). The world is not neatly divided into creditors and debtors the way we can identify whose assets are purchased and whose are not. The same sharp division arises in terms of how quickly the pandemic emergency purchase program is wound up, who receives support from the transmission protection instrument, and who benefits from (the promise of) outright monetary transactions. The distributive consequences associated with the level and remuneration of reserve requirements are also transparent, as is any ECB decision regarding which of the EU's economic objectives to support.

None of this is meant as a criticism of the Governing Council, the ECB, or the delegation of political independence to the most important institution in Europe's EMU. Rather, it is meant to underscore just how much the ECB has been transformed by the decisions taken during the crisis (Verdun 2017). Europe's policymakers must recognize this new reality if they are to sustain the ECB's political independence (Jones 2019; Jones and Matthijs 2019). The ECB Governing Council can provide reasons for how its decisions connect to its price stability mandate, but what Europeans believe about the legitimacy and possible distributional effects of those decisions may be more important for the continued political support of the ECB's political independence.

The European Central Bank's Green Shift and Its New International Environmental Role

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What explains the ECB's recent interest in climate change and environmental issues? What are the consequences of this green shift for the institution's interna-

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tional role? Recent scholarship has addressed the first question quite thoroughly. Building upon this literature, I question the idea that the ECB's green turn is an example of temporary "mission creep," arguing that it has more complicated roots and is likely to prove more durable. The second question has received much less scholarly attention to date. Outlining a new research agenda on this topic, I suggest that the ECB is emerging as an important actor in global environmental politics (GEP) in a number of ways that deserve much more scrutiny from scholars of both the ECB itself and international relations more generally.

Explaining the ECB's Green Shift

The ECB's green shift has been rapid. According to an analysis of ECB speeches by Jérôme Deyris (2023, 717), climate change was "barely present before 2018." By 2021, however, it was being mentioned "at a level comparable to inflation in ECB public speeches." In that latter year, the ECB's Governing Council unanimously endorsed a 4-year climate action plan as part of its strategic monetary policy review. Since that time, its climate work has proceeded, and its environmental focus has widened to include other issues such as biodiversity loss.

Deyris (2023) highlights how the ECB's green shift was initially encouraged by the idea that climate change might be generating systemic financial risks. As Stine Quorning (2023) has shown, this idea emerged from some outside professionals working at the intersection of finance and climate science who promoted it as early as 2011. As governments committed to tighter international climate agreements, these professionals warned of an impending "carbon bubble" caused by fossil fuel reserves that could never be used and whose value was thus overstated. Their arguments were reinforced by a high-profile 2015 speech by Bank of England governor Mark Carney (2015), who highlighted not just the "transition" risks emphasized in the "carbon bubble" argument but also various "liability" and "physical" risks arising from climate change for financial actors. This framing of climate change as a financial risk resonated with many central bankers who had become more interested in systemic financial risks in the wake of the 2008 financial crisis, including those in Euro Area institutions such as the French and Dutch central banks, which engaged with it a few years earlier than the ECB (Quorning 2023; Siderius 2023). It was also critically important in explaining the ECB's growing interest in climate change issues from 2018 onward.

But ECB officials have also increasingly discussed the implications of climate change for other aspects of their work as well, such as monetary policymaking and macroeconomic forecasting. Both the ECB's initial green shift and this wider focus were encouraged by personnel and leadership changes in 2019–2020 within the institution (Deyris 2023). Half of the Executive Board was replaced in this period, bringing in figures such as Frank Elderson and Isabel Schnabel, who emerged as strong champions of the green shift and who spoke about it as more than just a financial risk issue. The same was true of Christine Lagarde, who was appointed ECB president in late 2019 and who emphasized at the time her "personal view" that "any institution has to actually have climate change risk and protection of the environment at the core of their understanding of their mission" (quoted in Hale 2019).

Deyris (2023, 714) highlights how the ECB's green policies initially focused heavily on a "risk-based *prudential* approach," encouraging disclosure of climate-related risks and tightening bank supervision relating to the management of those risks. The latter included the launching of bank stress tests in 2022 and even the application of additional capital requirements on some banks with poor environmental risk management (ECB 2022). More recently, the ECB's discussion of environmental risks has widened to include biodiversity risks, with its research showing that three-quarters of euro area bank loans are exposed to the latter. Elderson has drawn

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the following conclusion from this work: "Destroy nature and you destroy the economy. This is not some kind of a flower power, tree-hugging exercise . . . this is core economics" (quoted in Arnold 2023).

In 2022, the ECB also announced its intention to embrace what Deyris (2023, 714) calls more "proactive policies aimed at facilitating the low-carbon transition," notably the application of climate-related criteria to its collateral and corporate asset purchase policies. The decision to move from its previous policy of "market neutrality" to a green "tilt" in its asset purchases was deemed by ECB officials such as Schnabel (2021, 55) to be more compatible with a principle of "market efficiency that more fully incorporates the risks and societal costs associated with climate change" (see also van 't Klooster and Fontan 2020; Thiemann, Büttner, and Kessler 2023). In keeping with these more proactive policy goals, Lagarde and others have signaled their interest in using the ECB's existing TLTRO program to offer preferential interest rates for banks that lend green (Deyris 2023; for the TLTRO program, see Jones, this issue).

Deyris (2023) notes that these more proactive goals have been controversial within Euro Area central banking circles. Conservative voices have also argued more generally that the ECB's new green focus risks straying too far from its primary mandate of protecting price stability, thus undermining the ECB's legitimacy and independence. Rising inflation in 2021–2022 encouraged these criticisms, with some arguing that the ECB's environmental activities had distracted the institution from its core responsibility. These criticisms raise the question of whether the ECB's green shift is an example of what Amy Verdun and Lucia Quaglia (this issue) call temporary "mission creep" that might trigger growing resistance and a legitimacy crisis for the institution. Might those trends soon prompt the ECB to abandon its environmental focus and return to its more conservative "Bundesbank heritage"?

There are two reasons to question that scenario. First, the ECB's leadership has forcefully challenged the idea that they are straying from their mandates. One line of defense has been to invoke the ECB's "secondary mandate," which requires it to support (without prejudice to price stability) "the general economic policies of the Union" with a view to contributing to the achievement of wider objectives of the EU that include "a high level of protection and improvement of the quality of the environment" (quoted in van 't Klooster and de Boer 2022, 733). ECB officials have also emphasized the links between the ECB's environmental activities and its primary mandate to protect price stability. This line of argument was first advanced officially by Lagarde in 2020, who noted that climate change would affect monetary policy if natural disasters made inflation more volatile or carbon taxes influenced relative prices. She concluded: "bringing climate change more fundamentally into our analysis and strategy is not 'mission creep': climate change is also a price stability risk" (Lagarde 2020). Other ECB officials have subsequently highlighted in more detail how environmental risks are related to their institution's price stability mandate (e.g., Faccia et al. 2021; Ciccarelli et al. 2023). In the post-2020 more inflationary context, officials such as Schnabel (2022) have also pointed to Europe's fossil fuel dependency as a cause of rising prices as well as the risks of "greenflation" arising from supply bottlenecks for materials associated with the green transition.

Second, a number of scholars have shown that the ECB's green shift has been caused not just by the agency of internal advocates but also by external political pressures coming from European civil society groups and politicians, including members of the European Parliament (MEPs), who pressed for both the ECB's initial environmental focus in 2018 and the more proactive policies it has launched more recently (Deyris 2023; DiLeo et al. 2023; Bondeel et al. 2024; Moschella 2024). Although the ECB is formally independent, these scholars highlight how the institution remains deeply concerned about its reputation in its wider political environment. In the context of this external pressure, they argue that the ECB's environmental work has been partly an initiative to *boost* its legitimacy rather than a

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move that undermines it. External political pressures have also been used by internal "green" advocates to strengthen their agenda and have prompted the ECB to deepen its research on environmental issues in order to respond—as it must do—to MEP questions (Deyris 2023).

These external political pressures on the ECB are likely to endure as climate change intensifies. To be sure, the results of the 2024 European Parliament elections may lessen the intensity of some of these pressures coming from that body. But even there, support for the ECB's general green shift is very wide; for example, a 2023 resolution in the Parliament highlighting the ECB's secondary mandate, including with respect to environmental issues, was approved with a very large majority (376 in favor, 96 against, and 35 abstentions) (Costa 2023). Calls for the ECB to embrace more ambitious green policies also continue to come from prominent European politicians, including French president Emmanuel Macron, who called in April 2024 for the ECB's goals to be widened to include decarbonization (Lee 2024b).

The ECB's New International Environmental Role

If the ECB's green shift is likely to be more than temporary, what are its consequences for the institution's international role? This issue has received much less scholarly attention than the causes of its green shift. But it is important to recognize a number of ways in which the ECB is emerging as a new actor in GEP. To begin with, the ECB has been a key supporter of a new international institution called the Network for Greening the Financial System (NGFS). This body was created in December 2017 by eight central banks and financial supervisors in order to "help to strengthen the global response required to meet the goals of the Paris Agreement" on climate change as well as "to enhance the role of the financial system to manage risks and to mobilize capital for green and low-carbon investments in the broader context of environmentally sustainable development" (NGFS 2017, 1). As of mid-2024, its membership has grown to include 138 central banks and financial supervisors from across the globe, and it has become the key international body promoting green central banking (Helleiner et al. 2024).

Despite the dramatic growth and new importance of the NGFS, international relations scholars have been slow to analyze this institution. Evidence suggests, however, that it has already been quite influential in encouraging many central banks around the world to embrace a green shift (DiLeo et al. 2023; Thiemann, Büttner, and Kessler 2023; Blondeel et al. 2024). It is also clear that Euro Area central bankers have played a leading role in the body from the start. The Banque de France (BdF), the De Nederlandsche Bank (DNB), and the Bundesbank are made up of eight of its founding members (the others came from China, Mexico, Singapore, Sweden, and the United Kingdom). The BdF's role was particularly important, first proposing the NGFS' creation in 2017 and then housing its secretariat ever since. The DNB also provided the NGFS with its first Chair, Elderson, who served two terms in the role until 2022 (when he was succeeded by Singapore's Ravi Menon). Bundesbank officials have also been deeply involved in the network from its early days, including Sabine Mauderer, who was also appointed as its Chair in 2024.

What about the ECB's role in the network? Although it was not one of the founding members, the ECB was one of four central banks that became the first institutions admitted to the new body in early 2018 (the others came from Austria, Morocco, and Spain). When the NGFS' charter was updated for the first time in July 2020, the ECB was also chosen as the only institution to be added as a permanent member of the body's powerful Steering Committee (which included institutions from the eight founding member countries and Morocco). When Elderson joined the ECB's Executive Board in December 2020, the ECB's connections to the NGFS deepened, given his role as the latter's chair. Although the ECB and other Euro

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Area central banks have thus clearly played an important role in the NFGS, the specific ways in which they have supported the body's global role is a subject that needs more research.

In addition to supporting the NGFS, the ECB has also been promoting green central banking internationally through the influential Basel Committee on Banking Supervision (BCBS). Since the 1980s, this body has played a key role in the development of international standards for banking regulation and supervision, standards that have considerable impact in steering global flows of private capital in one direction or another. As European members of the BCBS became more interested in climate-related financial risks, they started to press the standard-setting body to address the issue. Initially, however, they encountered some resistance, a development that served as one of the prompts for the creation of the NGFS. As the head of the NGFS secretariat, Morgan Deprés, later put it, "our primary objective when we kicked off the NGFS was to encourage the Basel Committee and the other bodies to step in and do their job" (quoted in Thiruchelvam 2020). This strategy was successful. Two months after the NGFS (2019) produced its first major report in April 2019, titled "A Call for Action," the BCBS discussed its content and decided to join the body as an observer. In February 2020, the BCBS then created a new Task Force on Climate-Related Financial Risks, with Elderson as its co-chair (along with Kevin Stiroh of the Federal Reserve Bank of New York). The Task Force has already prompted changes, including the incorporation of climate-related risks within the BCBS' *Core Principles for Effective Bank Supervision*, a move that was approved in April 2024 by over 200 central bankers and supervisors representing over ninety jurisdictions (Lee 2024a).

As in the case of the NGFS, the causes and consequences of the gradual greening of the BCBS have not yet been analyzed by international relations scholars. But the ECB has clearly played a key role within its Task Force on Climate-Related Financial Risks, given Elderson's position as a co-chair of the body. What explains ECB's interest in reforming Basel standards in a green direction? Elderson (2023) himself has emphasized that the Task Force's initiatives are designed to foster not just effective international management of climate-related financial risks but also "an international level playing field" in this area. The latter comment recalls how the creation and updating of the Basel standards in the past were often driven by central banks seeking to avoid international competitive problems for their local banking sector that might arise from their unilateral initiatives to tighten regulation and supervision (Helleiner 2014). To what extent is the ECB's interest in updating BCBS standards today driven by similar competitive considerations arising from its green supervisory and regulatory initiatives? And if the Task Force is unable to forge consensus for a level playing field, will green issues be a trigger for international financial fragmentation?

Verdun and Quaglia (this issue) note that the ECB has become a "much more proactive central bank internationally" in recent years. Its roles within the NGFS and BCBS reinforce this point in the realm of green central banking. Even when it is not promoting green issues in these formal international settings, the ECB has become an important actor in GEP. For example, because of the Euro Area's importance within the world economy, the ECB's "domestic" green activities will have global environmental implications. Those activities may also serve as a model for central banks elsewhere to follow. Although central banks such as the People's Bank of China have often gone further than the ECB in this policy space (Larsen 2023), the ECB's initiatives have been important in highlighting how a Western independent central bank with a strict price stability mandate can move in a green direction.

Of course, the ECB could be assuming a larger international environmental role. For example, the ECB has not followed the lead of the Swedish central bank, which sold its holdings of sovereign bonds issued by Alberta, Queensland, and Western Australia in 2019 because these jurisdictions were, in the words of its deputy gover-

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nor, "not known for good climate work" (quoted in Gluyas 2019). Environmentalists also highlight the limitations of the ECB's green activities within the Euro Area, criticizing the institution for not embracing a more ambitious green tilt in its corporate asset holdings and collateral policies (Dafermos et al. 2023) or for not promoting the green transition more aggressively through its TLTRO program or other direct credit allocation mechanisms (e.g., van 't Klooster 2022; Kedward et al. 2024). Despite these criticisms, it is important to recognize how quickly the ECB has already become an important actor in GEP.

Conclusion

That new international role is likely to endure. For that reason, scholars of international relations need to devote more attention to the ECB's green shift. This may require some of them to move somewhat outside their scholarly comfort zone. Specialists in GEP will have to become more familiar with an institution they rarely discuss as well as with subjects beyond their usual expertise, such as the dynamics of central banking and the politics of transgovernmental financial networks such as the NGFS and BCBS. Scholars of IPE are much more familiar with the ECB and these broader monetary and financial subjects, but they, too, will need to expand their research focus to understand the broader environmental issues with which the institution is now engaged. In short, if the greening of the ECB and its international consequences are to be better understood, both GEP and IPE scholars need to engage with, and learn more from, each other as well as from the European specialists who have pioneered the study of this topic to date.

Failed Promise: Geopolitics and the Euro

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Why has the euro failed to live up to its promise as an international currency? Expectations went awry for two reasons—first, because of the dollar's advantage as an already entrenched leader; and second, because of Europe's relative impotence in global politics. Owing to the high cost of switching from one currency to another, it is difficult for a new money to challenge an incumbent rival; and the task is made even harder when the new money lacks the backing of a single, powerful geopolitical actor. Neither factor was sufficiently appreciated at the time the euro was born. The joint currency's failure to live up to expectations has been due, above all, to Europe's inability to match the enduring power of the United States in world affairs.

A quarter of a century ago, when Europe's joint money first arrived on the scene, its future seemed bright. In short order, many predicted that the newborn euro would achieve parity with the United States greenback as a global currency or possibly even surpass it. Typical was Nobel Prize laureate Robert Mundell, often hailed as the father of the euro, who boldly asserted that Europe's money "will challenge the status of the dollar and alter the power configuration of the system" (Mundell 2000, 57). The old era of unilateral dollar hegemony was about to end. A new era of currency competition was about to begin. Only a few skeptics, myself included (Cohen 2011), begged to differ.

As matters have turned out, it would appear that a certain amount of skepticism was justified. In many respects, the euro is undoubtedly a monumental achievement. The national currencies of twenty countries have been successfully merged, and the ECB has emerged as one of the world's most respected monetary institutions (with an ever-expanding portfolio of goals and responsibilities) (Verdun and Quaglia, this issue; Jones, this issue). As an international currency, however, the euro's story is sad—a tale of failed promise. Europe's money today languishes far

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behind the dollar in almost every category of cross-border use and shows no sign of catching up. The greenback's dominance at the peak of the global currency hierarchy remains unchallenged. In the words of *The New York Times* (Sommer 2023): "The dollar still has plenty of swagger." If any currency is thought to be a threat to the dollar in years to come, it is China's renminbi, not the euro.

What went wrong for the euro? In this essay, I argue that expectations went awry for two reasons—first, because of the dollar's advantage as an already entrenched leader; and second, because of Europe's relative impotence in global politics. Owing to the high cost of switching from one currency to another, it is difficult for a new money to challenge an incumbent rival; and the task is made even harder when the new money lacks the backing of a single, powerful geopolitical actor. Neither factor was sufficiently appreciated at the time the euro was born. The joint currency's failure to live up to expectations has been due, above all, to Europe's inability to match the enduring power of the United States in world affairs.

Dollar–Euro Rivalry

I begin with a few facts. In two recent papers (Cohen and Benney 2014; Benney and Cohen 2022), a colleague, Tabitha Benney, and I concluded that despite persistent challenges, the dollar remains as dominant as ever in global currency competition. Its biggest rival, the euro, trails far behind, firmly ensconced in distant second place. For most purposes, the dollar outranks Europe's money by as much as 3:1. The greenback may not enjoy absolute unipolarity at the international level. But neither has the world moved toward a shared duopoly, as some observers have suggested (Auboin2012). It is more accurate to describe today's currency structure as akin to something in between—a "one-and-a-half currency system" (Cohen 2011, ch. 8). In both of the papers co-authored with Benney, our analysis stretched back to 1989, when systematic data for international currency use first started to become publicly available. Tests relying on concentration ratios and Herfindahl–Hirschman indices confirm that the competitive structure of the global currency hierarchy has not changed significantly in over 30 years.

Not everyone concurs. Representative is an authoritative study of the currency composition of international reserves by the renowned economist Barry Eichengreen and two associates (Arslanalp et al. 2022), which comes to a very different conclusion. The dollar, the authors argue, is in decline and has been losing market share for at least two decades. In their words, "The dollar has not become more dominant. It has not even maintained the dominance of prior years" (Arslanalp et al. 2022, 5). Instead, the greenback's hegemony is undergoing "stealth erosion." The currency system is becoming ever more competitive. Many other sources have written in a similar vein, including both the European Commission (2018) and the ECB (2023).

The stealth-erosion view, however, is seriously misleading for two reasons. First is the choice of baseline. In the work of Arslanalp et al. (2022) and others (ECB 2023; Møller 2023), reserve composition today is contrasted with data beginning in 1999, the year when the euro was born. By that standard, the dollar's share appears to have drifted downward by as many as 12 percentage points since the turn of the century—a significant loss of standing. In reality, though, the change is far less dramatic than suggested. Reserve statistics at the turn of the century were distorted by the formal start of Europe's monetary union, which eliminated trading among the euro's constituent currencies. From 1999 onward, transactions among members of the euro area became effectively "domestic" and thus were no longer treated as part of the foreign-exchange market. That, in turn, caused an apparent sharp dip in the recorded share of the euro (calculated prior to 1999 as the sum of the shares of the old Deutsche mark, French franc, and other so-called "legacy" currencies). Correspondingly, the dollar's recorded share was artificially inflated for a time,

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spiking to above 70 percent in 2001 before dropping down again in subsequent years. Over the most recent decade, the greenback's share seems to have stabilized in the neighborhood of 60 percent, about where it was throughout most of the 1990s. The dollar's alleged erosion turns out to be a little more than an accounting fluke.

The second reason has to do with the diverse roles that an international currency may play. That currency internationalization involves a multiplicity of roles has long been acknowledged in the formal literature (Cohen 1971). Conventionally, analysts distinguish among the three familiar functions of money—medium of exchange, unit of account, and store of value—at two levels of analysis: the private market and official policy, adding up to six roles in all. At the private level, sources speak of a currency's use as a *vehicle* for foreign-exchange trading (medium of exchange); as an instrument for trade *invoicing* (unit of account), and as a means to facilitate cross-border *investment* (store of value). At the official level, we speak of a money's use as an *intervention* currency (medium of exchange), an exchange-rate *anchor* (unit of account), and as a *reserve* asset for central banks (store of value). Market shares for individual currencies may vary widely depending on which role we are talking about.

Remarkably, most scholars, including Arslanalp et al. (2022), seem to want to talk mostly about just one of these roles: the reserve role. Most likely this focus is because central bank holdings are the easiest of all currency roles to research empirically. But can the reserve role serve adequately as a proxy for a money's overall international standing? In fact, the approach builds in a bias against the greenback, especially if analysis is limited to the period since 1999 when the dollar's share of foreign exchange reserves seemed (for artificial reasons) to be sinking. In every other category of currency use since the turn of the century, empirical studies show that the greenback's position has held steady or actually improved substantially relative to the euro as well as to most other international currencies (Benney and Cohen 2022). A recent Federal Reserve paper, calculating an index combining several international currency roles, confirms that the dollar's cross-border usage is "basically unchanged" in recent years (Bertaut et al. 2023). That hardly seems to be a story of erosion, stealth, or otherwise.

Does the Euro's Failed Promise Matter?

But does any of this matter? The euro's failed promise does not matter much at all if the mainstream economics literature is to be believed. Most economists, by and large, are uncomfortable addressing the political aspects of something like currency competition. It is so much easier simply to ignore the role of geopolitics or else cavalierly dismiss it as much ado about nothing. Typical is Paul Krugman, another Nobel Prize laureate, who recently remarked that "the importance of controlling the world's reserve currency is greatly overrated . . .. You have to actually work with the numbers to appreciate how little is really at stake" (Krugman 2023). Overrated? Underappreciated would seem more accurate.

In fact, much is at stake. Currency competition actually has profound political implications. Widespread use of a money adds greatly to the issuer's material capabilities, thus playing a critical role in shaping the distribution of power among states. As a practical matter, currency competition is unavoidably associated with state rivalry in broad terms.

An international currency adds to capabilities in two ways: direct or indirect (Cohen 2019, ch. 5). On the one hand, the money *itself* may provide an effective instrument of state power, available for direct use as a means to achieve selected foreign-policy goals. To make use of a term that has lately become popular, the currency can be "weaponized." Political objectives can be promoted by putting the money to work variously as either carrot or stick—sometimes making it available as a

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form of reward or encouragement; at other times, withholding access to it as a form of punishment or disapproval. On the other hand, the role of the currency may be more indirect, reinforcing power by enhancing the utility of *other* policy weapons. Widespread overseas acceptance of a currency enables the issuer to finance expenditures abroad with its own money or by cheap borrowing, thus removing a payment constraint on government spending around the world. The nation can run "deficits without tears"—what Charles De Gaulle many years ago referred to enviously as the United States' "exorbitant privilege."

De Gaulle had a point. For as long as it has reigned supreme in monetary affairs, the greenback has been counted as an important part of the nation's foreign policy arsenal. Washington decision-makers have not hesitated to exploit US currency power, both direct and indirect, when national security seemed at stake. Examples are easy to cite (Cohen 2019). When the euro was born, many in Europe hoped that now they also would be in a position to exploit the benefits of currency power. Why should Europeans not also be able to weaponize their money? Why should they not also enjoy an exorbitant privilege? For many Europeans, that was the true "hidden agenda" of the European monetary union.

Explanations

So what went wrong? Why did the euro fail to live up to its promise? Two considerations have been decisive. One was the *incumbency* of the dollar, which heightened the competitive challenge facing Europe's currency in its infancy. The other is the *impotence* of the monetary union as a political actor, which has persistently limited the euro's appeal as an alternative to the dollar.

Incumbency

The salience of the dollar's incumbency was unmistakable. International currency use is highly path-dependent. The playing field is by no means a *tabula rasa*. At any given moment, market actors and governments are already locked into established patterns of behavior. A newcomer such as the euro, therefore, starts at a distinct competitive disadvantage that may be difficult to overcome. As the economist Ronald McKinnon once noted, "there is a tremendous first-mover advantage to the national currency already ensconced as international money" (McKinnon 2013, 6).

In fact, currency choice is notoriously subject to inertia owing to the often-high cost of switching from one money to another. At issue are what economists call "network externalities" or, simply, the network value of money. Network externalities may be understood as a form of interdependence in which the practices of any one actor depend strategically on the practices adopted by others in the same network of agents. By heightening switching costs, network externalities sustain the use of a first mover and retard the rise of other currencies. Why would market actors go to the trouble of adapting financial practice to a new money unless they can be sure that others will make use of that money, too? A challenger—the newborn euro—must not just match at least some of the qualities of an incumbent currency—the dollar. It must somehow also offer additional advantages sufficient to persuade agents to risk making a potentially costly change. The euro's difficulty in rising to that challenge came as a surprise to many.

Impotence

Beyond incumbency is political impotence—the simple but undeniable fact that the euro, as the offspring of a monetary accord among sovereign states, lacks the backing of a single supranational actor capable of projecting power in global affairs. It is surely not insignificant that in every instance throughout history—going as far back as ancient Athens, with its widely popular drachma—an international currency's issuer, at least at the start, was always also a major political power. Each

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issuer, in its day, was a highly ranked if not dominant player in the great game of geopolitics. It was undoubtedly that recurrent pattern that Mundell (1993) had in mind when, many years ago, he coined his famous aphorism: "Great powers have great currencies."

Geopolitics influences the appeal of a national currency in two ways. First, great powers can be expected to have extensive *foreign policy ties*, which in turn are especially likely to influence the currency preferences of governments. In an uncertain world, geopolitical leadership can exercise a form of gravitational pull, encouraging use of the leader's currency. Links to a geopolitical leader may take many forms, ranging from traditional patron–client relationships to linkages based more on cultural, linguistic, or historical affinities. Ties may also be more or less institutionalized. The deeper the relationship, the more likely it is that friends and allies will feel comfortable using the leader's money as an anchor or reserve asset. In monetary matters, familiarity breeds not contempt but confidence, encouraging a currency's acceptance and making its use come to seem part of the natural order of things. Should we be surprised that a recent Federal Reserve study (Weiss 2022) found that as much as three-quarters of dollar-denominated assets held by foreign governments are in the hands of countries with strong geopolitical relations with the United States?

Second, geopolitics can be expected to magnify a great power's *military reach*—the security dimension of international relations, which is often neglected in discussions of currency internationalization. For nervous investors, a militarily powerful nation can provide an appealing "safe haven." A strong defense structure ensures a more benign climate for storing wealth. Similarly, currency preferences of governments may be influenced by security guarantees in one form or another. A leading country's ability to project power abroad will exercise yet more gravitational pull—though only so long as the issuer is seen as a guardian of peace and stability. The opposite effect is more likely if the issuer is seen as a destabilizer or aggressor. Eichengreen et al. (2017) estimate that a formal military alliance will boost the share of a currency in a partner's foreign reserves by as much as 30 percentage points.

In both respects, the euro is obviously at a disadvantage relative to the dollar. The EU does not lack for friends and allies beyond its borders. But most are located in the immediate vicinity of the EU itself or in former colonial domains in Africa—collectively, what has sometimes been called the European time zone. As compared with the United States, Europe can be described as no more than a regional power at best. Similarly, the European nations do not lack for military strength. But for the most part, their security forces are subordinated to the United States through the institutions of the North Atlantic Treaty Organization. Politicians such as French President Emmanuel Macron like to speak of the goal of "strategic autonomy" for Europe. In practical terms, however, the idea remains little more than a seductive daydream.

As a result, the euro was handicapped from the start. As is often said, Europe may be an economic giant, but it is a political dwarf. Any gravitational pull its currency might have been able to exert was eclipsed by the even stronger force of the well-established greenback.

Conclusion

Can anything be done to reverse the euro's sad tale of failed promise? In a development parallel to the ECB's growing interest in environmental issues—what Eric Helleiner (this issue) calls the central bank's "green shift"—interest in boosting the euro's international status seems to have increased considerably in recent years. The latest edition of the EU's annual review of the euro's international role forcefully celebrates the currency's "resilience" in the face of an increasingly fragmented

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world economy (ECB 2023). Christine Lagarde, the ECB's president, now openly declares that "An international euro is a force for stability" (quoted in *The Economist* 2023). Is there hope yet for Europe's money?

In principle, proactive initiatives are surely possible. The dollar's incumbency advantage could be narrowed by measures designed to make international use of the euro more attractive. For investors, this might mean steps to consolidate European banking and capital markets, which today are still regrettably segmented. For central banks, it might mean easily accessible swap facilities or perhaps even exchange-rate guarantees. Equally, Europe's relative impotence in global politics, as compared with the United States, could be eased by measures to move more rapidly toward a "more pFuerfect union," as long promised in every EU treaty: a powerful European federation. In practice, however, the political impediments to such ambitious steps are obvious. The necessary political will is lacking—and without the necessary will, the euro is most likely to remain no more than a junior partner to the still dominant greenback.

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