The Making of the Statute of the European System of Central Banks

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The Making of the Statute of the European System of Central Banks

An Application of Checks and Balances

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‘L ‘Europe se fera par la monnaie, ou ne se fera pas’
(Jacques Rueff, *Synthèses*, 1950, p.267)

Preface

This study explores the genesis of the most important parts of the Statute of the European System of Central Banks (ESCB). This genesis and a comparison with the national central bank laws at the time of the drafting of the ESCB Statute can contribute to a better interpretation of the ESCB Statute and therefore a better understanding of the functioning of the ESCB. This is a first study covering in full detail the genesis of the ESCB Statute.
The study also shows the significant influence which the governors of the central banks have had on the design and formulation of the statute by comparing the texts of the Delors Report (April 1989) up till the final outcome of the Intergovernmental Conference (IGC) in December 1991. The governors' text went almost unscathed through the IGC process, especially because the governors had appreciated from the beginning the importance of incorporating checks and balances in the draft ESCB Statute. The governors knew the European central bank had to be both independent and accountable. This study shows independence and accountability are not opposites, but they are complementary to make for a balanced system of checks and balances. In this sense the study purports to contribute to the increasing amount of literature on central bank independence.
The governors were also careful in designing a balanced internal structure, i.e. they opted for a federal system within which neither the new European Central Bank nor the existing national central banks would be dominant.

To be more specific the study is, like Gaul, divided into three parts: the first covering the ESCB's external relations, the second covering the intra-system relations between the ECB and the NCBs, and the third covering the internal relations within the Governing Council (i.e. between the Executive Board and the national central bank governors).

The study is based on publicly available documents. Some new material has been made available for research purposes, including the draft versions of the Delors Report. The study is basically an intertextual and chronological comparative analysis. Comparisons with the Federal Reserve System are also included, as the FRS is also a federally structured central bank system and because the Federal Reserve Act is full of checks and balances.

When I came back to the Nederlandsche Bank in 1989 after having lived a few years in the United States I found that important developments had taken place in Europe. For instance the Delors Report had been written and the Heads of State had decided to embark on a road which would possibly lead to Monetary Union. I was fortunate enough to get involved in the further process leading to the conclusion of the Treaty of Maastricht in December 1991. I was closely involved in preparing the discussions held in the Committee of Governors of the Central Banks of the Member States of the European Communities on the draft ESCB Statute. In those days Wim Duisenberg was president of the Nederlandsche Bank and André Szász, board member for international affairs, was his Alternate. Subsequently I attended most of the Intergovernmental Conference meetings at the deputy level as a member of the Dutch delegation as well as most meetings of the EMU Working Group, which was a drafting working group reporting for the deputies.

This study would not have been possible without Dr André Szász, who made available for research purposes all draft versions of the article of the Statute (and Treaty where relevant),

starting from the draft versions of (and discussions leading up to) the Delors Report. Special thanks are due to him, and also to Jacques Delors for welcoming the purpose of this study.
A hindrance for the writer could have been his close involvement in the issue being studied. This hindrance was overcome by relying on the subsequent draft versions of the Delors Report and the articles of the ESCB Statute, which are 'neutral' documents, and by cross-checking possibly personally tainted experiences with other sources and publicly available material.

This book would never have been realized without the never-ending support of Rodetta Noordwijk, who typed the several revisions, corrected the lay-out and gave me the idea that this large manuscript was manageable. I also relied much on the continuous and expedient assistance of persons working in the archives and library of the Nederlandsche Bank, of whom I want to mention especially Joop van Bakel. My indebtedness also extends to those colleagues of the national central banks (and some of them in the meantime of the European Central Bank) with whom I discussed parts of this work and who encouraged me.
Special mention deserves the support of my promotor, Age Bakker, discussions with whom in the period 2000-2003 helped improve the structure of the book, and the guidance of my co-promotor, Hans Visser, whose immense knowledge of economic literature was of large value to me.
Inexpressible gratitude goes to Nynke, my wife, and Mees, my son, who had to suffer, if not physical than at least mental absence during the last two years when work became intensive.

September 2004 Carel C.A. van den Berg

Preface to commercial edition

This book is the commercial version of the dissertation defended and approved at the Economics faculty of the Free University of Amsterdam on 29 October 2004.
After the dissertation was distributed on a limited scale, it appeared there was wider interest for the book from practitioners (economists, economic historians and legal experts) and those in academic circles. Therefore, I decided to issue a commercial version. The difference between the dissertation and commercial version is limited to some minor revisions and corrections. The conclusions I draw are mine.

Amsterdam
November 2004 Carel C.A. van den Berg

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Readers' guide:

In this publication the articles of the EC Treaty which are referred to correspond to the numbers used in Title II of the Treaty of Maastricht (signed 1992). The articles have since been renumbered in accordance with Article 12 of the Treaty of Amsterdam (signed 1997) – see Annex 5.

Articles referred to as Art. 103-*EC* refer to the Treaty establishing the **E**uropean **C**ommunity (as agreed at Maastricht). Articles referred to as Art. 102-*EEC* refer to the older Treaty of the **E**uropean **E**conomic **C**ommunity (one of two so-called Treaties of Rome) – see also chapter 3. At Maastricht the EEC Treaty was amended and the term 'European Economic Community' was replaced by the term European Community. Articles referred to as Art. 7-*ESCB* refer to the Protocol on the Statute of the **E**uropean **S**ystem of **C**entral **B**anks and of the European Central Bank, which was annexed to the Treaty of Maastricht.

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CHAPTER 1: INTRODUCTORY CHAPTER

Zur Thematik

The creation of the Economic and Monetary Union (EMU) is one of the most profound steps in the monetary history of Europe, which has significance not only for professionals, politicians and academics, but also for everyday life. Among the accomplishments that stand out are the establishment of a federally structured European System of Central Banks (ESCB)[1] and the introduction of a single currency. The opinions and decisions of the European Central Bank (ECB)[2] are almost daily topics for the national newspapers, discussions on its accountability (or perceived lack thereof) are recurrent topics in the European Parliament and political and academic circles. In short, the ECB has become a reality for almost everyone within a couple of years since its establishment. Technically it has been successful: the transition from national currencies to a single currency, the euro, has been a remarkably smooth process despite the gigantic scale of the operation. Though it is too early to evaluate how effective the ECB is in implementing its mandate, for the Monetary Union as a whole inflation rates are lower than they were during a large part of the nineties.

The legal underpinnings of the System and its independence have been extensively studied, see e.g. Stadler (1996), Smits (1997) and also Endler (1998). Also, from a political angle, the degree in which the negotiations leading up to the signing of the so-called Treaty of Maastricht in February 1992 could be characterized as a success for the German or for the French negotiators has been analyzed, e.g. by Viebig (1999) and Dyson/Featherstone (1999). In many respects these authors have concluded that it was a German success. However, the ESCB is not a copy of an existing central bank, not even the Bundesbank. It has been established on the basis of a unique Statute.[3] This Statute will guide the ECB, also in the future. But like many texts, the Statute is sometimes ambiguous. For a right interpretation of the texts it is important to know their genesis. Sometimes wording was copied from existing other texts, sometimes texts are a delicate compromise, sometimes texts have a difficult technical history.
What distinguishes this study from these other studies is that these studies analyzed the ESCB from only one perspective, i.e. either from a legal, political or economic point of view. This study aims to show how political, economic and institutional considerations were combined and have found their way into the (legal) wording of the ESCB Statute. To this end I focus on each article, describing the economic rationale behind it as well as its genesis, systematically using historical sources which until now have not been used for these purposes. The perspective I take in order to interpret, analyse and assess the Statute of the ESCB is that of checks and balances. We will identify and study the 'checks and balances' which have been

[1] The European System of Central Banks encompasses the (newly established) European Central Bank and the (already existing) central banks of the Member States of the European Community. The ESCB was established on 1 June 1998. It became responsible for monetary policy as of 1 January 1999.
[2] Decisions and opinions are the preserve of the Governing Council of the ECB, which consists of the Executive Board members and the governors of the euro area national central banks. The Executive Board manages the ECB and the governors are heading the managing boards of their central banks. In many instances ECB will used as a short-hand for the Governing Council of the ECB.
[3] Officially called the Statute of the European System of Central Banks and of the European Central Bank.

introduced in the Statute of the ESCB. 'Checks and balances' are an important characteristic of any federally designed system. They are part of the 'rules of the game', which have to be taken into account by the components of the system, which rules should ensure the system's stability and effectiveness. For instance, 'checks and balances' prevent the possibility of 'winner takes all', because this would mean the end of the federal character. A clear normative framework for checks and balances for federal central bank systems is not available, though there are general notions which any workable system of checks and balances has to accord with. Therefore, we will develop a framework to describe the checks and balances in central bank systems.

The concept of checks and counterchecks also played a role when the American central bank system (the Federal Reserve System, FRS) was designed. A nice description can be found in P.M. Warburg in his book 'The Federal Reserve System, Its Origins and Growth' (1930), p. 166: 'The position of the Reserve Board, as designed in the Act, was bound to prove exasperatingly difficult and trying. The office was burdened with the handicap, commonly imposed upon so many branches of administration in a democracy, of a system of checks and counter-checks – a paralyzing system which gives powers with one hand and takes them away with the other. […] Success or failure in such cases generally depends on the wisdom with which the balancing of the checks and counter-checks in a legislative act is handled, and on the intelligence with which, later on, the act is administered.' And *ibidem* p. 170: '[….] many attempts were made to find a satisfactory answer to the tantalizing puzzle of how to safeguard the autonomy of the reserve banks while giving, at the same time, adequate coordinating and directing powers to the Reserve Board.' From our study it appears that these considerations were still relevant for the conception of the European central bank.

Organization of the book

This book is organized as follows. In **Chapter 2** we will deal in more detail with the concept of 'checks and balances'. This concept is predominantly of American origin, the American Constitution being a prime example of the application of checks and balances. Another example is the Federal Reserve Act, which is also full of checks and balances. And, to complete the cycle, the Americans introduced checks and balances in the design of the post-war German central bank system, based as it was on State central banks, while its successor, i.e. the Bundesbank,[4] has been a model for the ESCB. We analyze the concept of checks and balances and derive some notions which are applicable to federally designed central banking systems.

After this more theoretical chapter we turn to a description of the genesis of the articles of the ESCB Statute, which forms an important part of this study (**Chapters 3 to 11**).
For analytical purposes we distinguish three clusters, which are defined as follows: (1) articles dealing with the relations between the ESCB and the political authorities (*inter alia* independence, mandate, competences, accountability), (2) articles describing the relation between the ECB and the NCBs (how centralized or decentralized is the system?), and (3) articles relating to the balance of power within the Governing Council, i.e. the relation between the Executive Board and the governors of the NCBs (voting power of the governors,

[4] See appendix 3 at the end of cluster III.

role of the Executive Board). This distinction also reflects the discussion in the Committee of Governors, which drafted the draft ESCB Statute.[5] Each of these three clusters is characterized by specific checks and balances. In each of the three areas delicate compromises were necessary. In the first area this was necessary, because the Member States (and their NCBs) had different traditions as regards the (need for) independence of the central bank. In the second area, because a number of NCBs (most prominent among them the Banque de France) were strongly of the opinion that the System should be based as much as possible on the principle of subsidiarity. They wanted to centralize decision-making, but not its implementation. This conflicted with the priority of the Bundesbank to ensure (in a legal and operational sense) that in Stage Three monetary policy would be one and indivisible.[6] In a situation where decentralized implementation could conflict with this, they (the Bundesbank) wanted to be sure that priority would be given to indivisibility, and not to the principle of subsidiarity. The Bundesbank wanted to ensure that the system was strong and would act decisively, it being afraid of national politicizing. In the third area, which relates to the decision-making powers within the Governing Council, difficult checks and balance-issues concerned the relative strength of the Executive Board vis-à-vis the governors in a number of policy and operational areas.

Each of the three clusters will be set up as follows: a first chapter with a general introduction, a second chapter with the genesis of selected articles [7] (including per article a comparison with the Federal Reserve System (FRS)) and a third chapter with conclusions (including suggestions for possible improvements in the checks and balances of that cluster) – these are to be found in **Chapters 5, 8 and 11**. In the text generous reference is made to draft versions of the articles, starting with the wording used in the Delors Report and through the draft versions discussed by the Committee of Governors to the drafts discussed at the IGC. These references serve two purposes: first, to contribute - where necessary - to a fuller understanding of the history of the article; and second, to serve as source for future references.

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[5] When he informed the ministers on the progress the governors were making in designing a draft Statute during the Ecofin Council of 11 June 1990, Bundesbankpresident Pöhl, in his capacity of chairman of the Committee of Governors, singled out three areas of problems which still had to be resolved by his Committee: (1) the division of tasks between the ECB and the NCBs, (2) the division of tasks between the governors and the Executive Board and (3) the relation between the ECB and the other Community institutions. (Report on the Ecofin Council meeting of 11 June 1990 by the Representative Office of the Netherlands in Brussels (bre 2886, 12 June 1990).)

[6] Pöhl (Bundesbankpresident) and Tietmeyer (as of 1 January 1990 vice-president of the Bundesbank) were very adamant on this. One of the factors behind this might have been earlier proposals by the Banque de France for a gradual transfer of monetary policy decision-making, for instance only in the field of the management of exchange rates and foreign reserve assets. See the proposal of the Banque de France for the creation of a European Reserve Fund (paper by de Larosière (1988) submitted to the Delors Committee, see annex to the Delors Report (1989); see also paragraph 53 of the Delors Report).

[7] The descriptions are given per article. The study covers all articles of the Statute which are relevant for the external and internal checks and balances for the eurosystem. Articles not selected here are more of a technical or very specific legal nature. For sake of reference we show in Annex 1 how we divided the articles over the three clusters and which articles we selected for further treatment. Article 109 of the EC Treaty on exchange rate policy will also be dealt with in this study because of its relevance for the autonomy of the ECB as well as Art. 109b and 109c(2) which are relevant for the relations of the System with the traditional EU institutions. An article of the ESCB Statute will be denoted as 'Article X-ESCB', while an article of the EC Treaty will be denoted as 'Article Y-EC'.

In the final chapter (**Chapter 12**) we will present some general observations based on the chapters describing the genesis of most of the articles of the Statute and we will assess the system of checks and balances in the ESCB Statute against the theoretical framework developed in chapter 2: did the drafters of the Statute create a stable framework or does the framework need to be enhanced? We will also arrive at a recommendation as to which elements, usually checks and balances, contained in the Statute or that part of the EC Treaty relating to EMU should be seen as having constitutional status and should deserve a place in a possible European Constitution.

I will conclude this Introductory Chapter with a description of the main actors (committees, persons) and documents in the run up to Maastricht, which will also serve to describe the historical setting. This will allow me to work with short-hand references in the remainder of the study.

Methodology and sources

Since Maastricht, where the Treaty was signed on 7 February 1992, many documents relating to the negotiations have been published and many inside stories have been told. A new element this study will bring along is a thorough study of almost all draft versions of the articles of the Statute (and Treaty where relevant), starting from the draft versions of (and discussions leading to) the Delors Report. It will appear that many texts of the statutes can be retraced directly to the wording used in the Delors Report. Another source of information are the discussions held in the Committee of Governors and the committee of their Alternates on the design of the draft ESCB Statute, in the run up to the Intergovernmental Conference (IGC), in which possible Treaty amendments were negotiated between Member States. The IGC meetings themselves are another important source of information. Many of the negotiations took place at the level of the representatives (deputies) of the ministers of finance, who were formally responsible for the IGC on EMU. As mentioned in the preface most of these documents were available to the author. Therefore, a rich source of information has been used to write a genesis (coming close to an exegesis)[8] of important parts of the ESCB Statute.
Where useful, comparisons with the design of the Federal Reserve System (FRS) will be made. These comparisons are integrated in the chapters describing the genesis of the articles. This allows us - where necessary - to go into detail as regards specific aspects of the FRS. The Fed is taken as comparison, and not the Bundesbank, because the main purpose of the comparison is not to find similarities (of which one would expect to find more with the Bundesbank), but to find dissimilarities - which are usually more insightful than similarities.

Description of the main documents, committees and historical setting

In 1969 a study was commissioned by the Conference of the Heads of State or Government, which had met in December 1969 at the Hague at the initiative of France, to look into the

[8] Exegeses are more common in theological studies. See for instance the work of C.J. den Heyer, Dutch theologian. He has been active in showing that the formal exegesis by the protestant church of the New Testament (the Heidelberg catechism) could be partly contested by just looking at the source and origins of the texts. Most theologians however only succeed in creating more uncertainty. The purpose here is to build a basis for the interpretation of the articles which is as factual as possible.

various aspects of the realization by stages of economic and monetary union in the Community. The study was conducted by a group chaired by Pierre Werner and resulted in the so-called Werner Report (1970). (The deputy of Schöllhorn, the German member of the group, was no one else than Hans Tietmeyer, who would play an important role in the IGC on EMU.) However, by the mid-70s the momentum for further integration had been lost and the Report was no longer a driving force in Community developments. (For a critical assessment of the Werner Report, see the contribution of Baer and Padoa-Schioppa in the Annex to the Delors Report.) For our study it is important to note that the Werner Report was not specific on the design, mandate and institutional position of the envisaged 'Community system for the central banks'. This makes the Werner Report less relevant as a starting point for our study into the genesis of the articles of the ESCB Statute.

The oldest document which had an important influence on the content and the actual wording of the ESCB Statute is the 'Report on Economic and Monetary Union in the European Community', the so-called *Delors Report*, [9] named after its chairman Jacques Delors, then president of the European Commission (see Box 1 below for an overview of the main committees). This report was written in response to the mandate of the European Council meeting in Hanover on June 1988 'to study and propose concrete stages leading towards economic and monetary union'.

A good description of the run-up to and the motives for such a study can be found in André Szász (1999, pp. 85-109) and Dyson and Featherstone (1999, pp. 151-187 and 313-343).[10] Delors, who had been actively involved in promoting the completion of the Internal Market ('1992'-project), had been keen on furthering European integration for many years and he knew further monetary integration would not succeed without the assent of the Bundesbank. He had learned that the 'M-word' (monetary union) was a very sensitive issue in Germany[11] and that the independence of the Bundesbank was almost of a constitutional nature. [12] Early 1988 the German Minister of Foreign Affairs, Hans-Dietrich Genscher, surprised the Bundesbank and the Finance Ministry by publishing a personal memorandum, calling for a 'Gremium von Sachverständigen (Rat der Weisen), das den Auftrag hat, Grundsätze für die Schaffung eines europäisches Währungsraums und ein Statut für die Errichtung einer Europäischen Zentralbank sowie ein Konzept für die während der Übergangszeit zu treffende Maßnahmen vorzulegen.' The German Chancellor Helmut Kohl sided with Genscher, especially because he considered it necessary to show his European credentials in view of the acceleration of developments in East-Germany. Kohl had always considered the unification of East- and West-Germany to be possible only in the context of further European integration.[13]

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[9] Committee for the Study of Economic and Monetary Union (Delors Committee), 'Report on economic and monetary union in the European Community', Office for Official Publications of the European Communities, April 1989.

[10] See also Thatcher (1993), pp. 691 and 706-8, who was firmly set against this development. For another British view, see Lawson (1992), chapters 71 and 72.

[11] See for instance Dyson/Featherstone (1999), p. 317.

[12] Vide Bundesbankpresident Pöhl in interview with Wirtschaftswoche, printed in Deutsche Bundesbank, Auszüge aus Presseartiklen Nr. 69, 30 July 1982: "Die Unabhängigkeit der Bundesbank hat nach meiner Überzeugung den Rang einer Verfassungsnorm gewonnen und wäre deshalb durch eine Gesetzänderung mit einfacher Mehrheit wohl kaum zu beseitigen."

[13] When Kohl became chancellor in 1982 the European integration process was at a low point. Kohl and Mitterrand decided to intensify the German-French relations. (Helmut Kohl (1996), p. 27). Kohl believed in the importance of *Westbindung* to create trust among its western allies. (Dyson/Featherstone (1999), p. 270.) Section

Delors and Kohl planned secretly to make Delors chairman of this committee, which should consist further of the governors of the national central banks (and a few expert members). The inclusion of the central bankers themselves - who were seen by politicians as at best cynical to the idea of monetary union - was a clever move. The aim was to bind in the 'Bundesbank'. Bundesbankpresident Pöhl was enraged, but he acquiesced.[14] Delors first defined the most important conceptual issues, on which the members of the committee submitted papers.[15] Then the rapporteurs[16] of the committee started drafting various draft versions of the report for discussion by the committee. The final report was agreed unanimously[17] and would form an important guiding light for the future draft ESCB Statute and the negotiations during the Intergovernmental Conference.
The Delors report contained proposals for establishing EMU in three distinct stages. At the proposal of Duisenberg, and supported by Pöhl and Delors, the Delors report ended with the suggestion that 'The competent Community bodies should be invited [by the European Council] to make concrete proposals on the basis of this Report concerning the second and the final stages, to be embodied in a revised Treaty.' This was taken up by the European Council summit of Madrid in June 1989, which considered that the report fulfilled the mandate given at Hanover. The European Council 'asked the competent bodies (The Ecofin and General Affairs Councils, the Commission, the Committee of Governors and the Monetary Committee) to adopt the provisions necessary for the launch of the first stage on 1 July 1990, [and] to carry out the preparatory work for the organization of an intergovernmental conference to lay down the subsequent stages; that conference would meet once the first stage had begun and the preparatory work was sufficiently advanced and would be preceded by full and adequate preparation.' The European Council did not set a date for the IGC. Only the European Council summit of Strasbourg in December 1989 would set a date for the start of the IGC, i.e. 'before the end of 1990'.

During the April 1990 meeting of the *Committee of Governors* chairman Pöhl proposed to draft the statutes for the future European central bank system covering matters such as the objective, the organization, functions, instruments and voting rights. Pöhl said governors should not enter into negotiations, because that would last a very long time, but could present to the IGC a text with alternatives, enabling the governments to be aware of the consequences of transferring powers to a central institution. This approach was welcomed by Commissioner Christophersen of the European Commission, who attended the meeting. During their May meeting the Committee decided to aim for a short, precise, legal text by October. The

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IIA of the genesis of Article 7 (dealt with in chapter 4 below) contains a further description of the important role played by Kohl, Mitterrand and Delors.

[14] Pöhl described this as one of the worst episodes in his professional life. See the Brook Lappings production for BBC2 (in cooperation with Arte TV) on the history of the single currency (March 1998): The European Monetary Union. Pöhl was appeased - among others - by Wim Duisenberg (Dyson/Featherstone (1999), p. 714).

[15] The Committee later decided to annex these papers to the report.

[16] Tommaso Padoa-Schioppa (Deputy Director-General of the Banca d'Italia, former Director-General DG2 Economic Affairs and described as a Delors' intellectual intimus on EMU (Dyson/Featherstone (1999), p.714) and Günter Baer (BIS).

[17] The report still contained a minority position of the Banque de France, which had advocated the creation of a European Reserve Fund in Stage One (paragraphs 53-54). The report also pointed to some difficult, unresolved issues, for instance the concept of a gradual transfer of monetary decision-making in Stage Two. Later Pöhl would state that the reference to Stage Two had been a mistake, as there could be no gradual transfer in this area (Source: discussion in the Committee of Governors, 10 April 1990).

Committee of Alternates (chaired by Jean-Jacques Rey of the Belgian central bank) was asked to prepare this document. The Committee of Alternates discussed many drafts, which were compiled by the secretariat of the Committee of Governors (chaired by Gunter Baer) under the guidance of Rey. A first draft dates from June 1990.[18] During their monthly meetings the governors would discuss successive drafts. On 27 November 1990 a nearly complete draft was sent to the IGC. In April 1991 a complete draft was transmitted to the IGC.[19] The author of this study had access to the discussions both in the Delors Committee and the Committee of Governors, which present a valuable source of insight into the genesis of the articles.

The *Intergovernmental Conference* (IGC) on Economic and Monetary Union was opened in December 1990. IGCs are conducted outside the normal Community framework: the negotiations are conducted between the member states without a formal role for the Commission, though the Commission was always invited to sit at the negotiation table. The Committee of Governors was allowed to send an observer to the IGC meetings. IGCs are normally in the hands of the foreign affairs ministers - an exception was made for the IGC on EMU, which fell under the aegis of the ministers of finance. IGCs end in a meeting of the heads of state or government (usually they have to negotiate on the last remaining points), after which the unanimously approved Treaty amendments need to be ratified by all the Member States in accordance with their respective constitutional requirements (in some countries involving a referendum), before the amendments can take effect. Chairmanship of the IGC rotates according to the schedule for the rotating presidency of the Council of Ministers. The negotiations started in January 1991 under Luxembourg's presidency (first half of 1991) and were finalised under Dutch presidency (second half). Before the start of the conference the Committee of Governors had sent in their draft Statute including an Introductory Report and a commentary. The Commission sent in a working document containing a comprehensive draft Treaty amendment. The Commission supported the line taken by the Governors that the ESCB Statute would be annexed to the Treaty, thus giving it 'Treaty status', while at the same time the constitutionally important elements of the ESCB were captured in specific Treaty articles. In some important respects the Commission draft deviated from the Governors' text (for instance it had named the new system 'EuroFed' and it proposed to transfer the ownership of foreign reserves to the Community). The French delegation submitted its own draft on 25 January 1991, while the Germans followed suit on 25 February 1991. The German draft was short on Monetary Union, as Germany fully backed the draft Statute of the Committee of Governors. During the IGC meeting of deputies of the ministers of finance on 12 March, the German deputy Horst Köhler strongly demanded that this draft Statute should not be altered. He added that, even though the German government did not agree with the Statute in all detail, it did accept the Statute as the outcome of sensitive negotiations - after which the French deputy Trichet retorted the governors had not negotiated on behalf of their governments. The UK had also submitted a proposal, based on its earlier idea of introducing a parallel currency, the so-called hard Ecu. The UK (and a similar Spanish) proposal had hardly any impact on the negotiations, as a parallel currency was regarded as detracting from, or at best a detour towards, monetary union.[20] Other countries

[18] A very first, skeleton-like draft dates from 11 June 1990, the first comprehensive draft dates from 22 June 1990.

[19] Also containing chapters VI – IX on financial, general and transitional provisions.

[20] The idea of a parallel currency had already been rejected by the Delors Committee - see par. 47 of the Delors Report and Duisenberg's contribution to the Delors Committee, printed in the Report's annex.

restricted themselves to submitting draft texts on specific articles or chapters. The Luxembourg presidency wrapped up discussions by continuously issuing so-called Non-papers, which were not agreed documents, but only reflected 'the prevailing drift' emerging from the discussions. Luxembourg ended its presidency by issuing on 18 June 1991 a Reference document containing 'a consolidated text of the Treaty on the Union based on the prevailing drift to emerge from the work of the two Conferences (on EMU and Political Union)'. The Dutch presidency would often work with 'chairman's papers', which could either be Issues Papers or working documents. By October 1991 most articles had been discussed, either on the basis of the Reference Document of the Luxembourg presidency or on the basis of alternative draft proposals or issue notes by the Dutch presidency. On 28 October the Dutch presidency published a first consolidated draft Treaty text, followed by a new one on 22 November, on 28 November and 5 December.[21]
The final text was agreed at a meeting of the Heads of State in Maastricht on 10 December. The text went through the usual process of legal and linguistic nettoyage (sometimes called toilletage) and was officially signed on 7 February 1992. During the Luxembourg presidency a limited number of amendments had been made in the ESCB Statute. Under the Dutch presidency some of these amendments were reversed and new ones were introduced.

Box 1: Main committees, their chairmen and main output

Period	committee	chairman	main output
July 1988 - April 1989	Delors Committee	Delors	Delors Report
April 1990 - April 1991	Committee of Governors	Pöhl	ESCB Statute
	Alternates Committee	*Rey*	*preparatory work*
Dec. 1990	start IGC		
January - June 1991	Luxembourg presidency	Juncker	Reference Document of 18 June 1991
	deputies IGC	*Mersch*	*preparatory work*
July - Dec. 1991	Dutch presidency	Kok	Maastricht Treaty (10 December 1991, signed February 1992)
	deputies IGC	*Maas*	*preparatory work*
Oct. and Nov. 1991	*EMU Working Group*	*ter Haar*	*preparatory work*

[21] Annex 2 contains some further information on the documentation.

The *Monetary Committee* [22] brought together the highest Treasury officials and board members of the central banks. The Committee was not a decision-making body (its formal task being to prepare discussions and decisions by the ECOFIN Council[23]), which contributed to an open and informal atmosphere within the committee. It continued to meet in parallel to the IGC. Its most comprehensive document in the area of EMU is the report 'Economic and Monetary Union beyond Stage 1'.[24] The report dealt inter alia with the issue of budgetary discipline, the organization of the ESCB, the responsibility for exchange rate policy and touched upon the issue of phasing (i.e. the conditions for the passage to stage 2 and 3 of EMU). The Monetary Committee stayed close to the Delors Report by supporting an independent European Central Bank System with price stability as its primary objective. In some respects it went into more detail, for instance by expressing a general preference for the principle of 'one person, one vote' in the governing Council of the System.
The document was not tabled in the IGC. It helped though to forge insight in each other's preferences. This was helpful, because the representatives of the ministers (their 'deputies'), who did a lot of the negotiating, were the same persons as the representatives of the ministers on the Monetary Committee.

[22] As of the start of the third stage the Monetary Committee is replaced by the Economic and Financial Committee (see Article 109c(2)-EC) with basically the same composition.
[23] See Art. 109b(1)-EC.
[24] Full title: 'Economic and Monetary Union beyond Stage 1 - Orientations for the preparation of the IGC' 19 July 1990, published in HWWA (1993), pp. 169 ff.

CHAPTER 2: INTEGRATION THEORY, FEDERALISM AND CHECKS AND BALANCES

Integration and transfer of power

Economic and political integration has been studied by a number of European authors. These studies related to the desirability for *economic* integration (a.o. Tinbergen)[1] and to ways to achieve *political* integration, on a worldwide scale or a regional scale (Mitrany, Haas).[2] And there were 'practioners' (Monnet and Schuman). As to the academic writers occupied with questions relating to political integration, they were especially concerned with the issue of the optimal form of international organizations – intergovernmental or supranational. The proponents of supranational forms have won, be it of course dependent on the areas to be covered. Specific attention for the institutional aspects of integration (e.g. which powers to transfer, which decision-making procedures) is usually reserved for writers specialized in law, especially those specialized in European law (Lenaerts, Kapteyn and VerLoren van Themaat and more typically Dutch scholars like Barents and Brinkhorst)[3] or American constitutionalism (Vile, Boon).[4] But usually their emphasis is describing and explaining how the institutions actually work (and possibly recommending improvements) rather than putting down an overall framework for the institutional arrangement of those institutions – probably also because many institutions are seen as *sui generis* or otherwise historically determined. Below we will touch upon relevant elements of the work of those who have written in this area and this will lead us to a description of the concept of checks and balances, which will enable us to develop a framework to assess the role of checks and balances in the framework of the European central bank.

Above we have mentioned Tinbergen. In his book *International Economic Integration* (1965) Tinbergen argues that a central agent is primarily needed where one government may adversely or favourably affect the interests of other nations. However, he does not deal with the institutional aspects of this agent. Other writers were more focused on the issue of political integration. In *Beyond the Nation-State* (1968) Ernst Haas deals with the questions such as 'what kind of international organization is required in order to maximize a process of international integration' (defined as a process of growing mutual deference and institutional mingling[5]). To answer this question Haas turns to study the dynamics of *intergovernmental*

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[1] J. Tinbergen (1965), International Economic Integration.

[2] D. Mitrany (1946), *A Working Peace System* (Royal Institute of Int'l Affairs); E. Haas (1958), *The Uniting of Europe: Political, Social and Economic Forces*, 1950-1957; and E. Haas (1968), *Beyond the Nation-State – Functionalism and International Organization*. See also Elazar and Greilsammer (1986), 'Federal Democracy: The U.S.A. and Europe Compared – A Political Science Perspective', in: *Integration Through Law*, Volume 1 (ed. by Cappelletti a.o.), containing inter alia an overview of theoretical approaches to European integration in the period after World War II (pp. 79-85).

[3] K. Lenaerts (1991), 'Some Reflections on the Separation of Powers in the European Community', *C.M.L. Rev.* 11; K. Lenaerts (1998), 'Federalism: Essential Concepts in Evolution – the Case of the European Union', *Fordham International Law Review*, Vol. 21; P.J.G. Kapteyn and P. VerLoren van Themaat (1998*), Introduction to the Law of the European Communities*; R. Barents and L.J. Brinkhorst (1994), *Grondlijnen van het Europees Recht.*

[4] M.J.C. Vile (1967), *Constitutionalism and the Separation of Powers*; P.J. Boon (2001), *Amerikaans staatsrecht*.

[5] Haas (1968), p. vii.

types of organizations. Intergovernmental organizations, which can only act on behalf of their members and on behalf of themselves, had been recommended by Mitrany, the founder of the functionalist school, as a way to propagate international integration. According to Haas, intergovernmental organizations are only successful, as long as there is mutual trust between the participants, for the delegates remain representatives of their respective governments. Haas applies this approach to the International Labor Organization (ILO), which confirms him in his view that a process of international integration will only have a chance of succeeding when the central organizations are supranational, as opposed to international, in character - the crucial difference being that the supranational organ would be autonomous, having independent rather than intergovernmental powers within its own domain and would have the capacity and desire (or better: a natural propensity) to expand its activity into adjacent sectors.[6]

Seen from our perspective, it is important to realize that Haas' neo-functionalism is a theory concerned with the *dynamics* of regional integration.[7] The supranational ESCB might be seen as part of such integration, but the neo-functionalist theory does not provide a framework for assessing the design of the ESCB. More in general, the so-called 'Monnet method' for achieving European integration, i.e. making small steps at a time, exemplified by the establishment of the European Coal and Steel Community in 1951, could be seen as an example of both the functionalist and the neo-functionalist method. However, there are important ideological differences, as the founder of the functionalist method Mitrany was opposed to the project of European regional integration, because he feared European nationalism would replace 'national' nationalism. The European debate between 'economists' and 'monetarists' can also be put in this perspective. The 'monetarists' wanted to give priority to integration in the monetary sphere. Once achieved, monetary integration was expected to 'spill over' and force integration in other domains. According to the 'economists' monetary integration had to follow economic and political integration, as money was seen as an

[6] Haas also referred to other commentators on the functioning of international organizations, among whom Gunnar Myrdal, former Executive Secretary of the United Nations Economic Commission for Europe. Myrdal ventilated sobering remarks on international intergovernmental bureaucracies. They may be occasionally successful, but in such organizations voting does not resolve conflicts of a substantive nature, only procedural issues, and they do not arise above a minimum common denominator of interests. (Haas (1968), p. 98 and 119.)

[7] Another difference with the functionalist school of thought, apart from the emphasis on supranational organizations, is that the neo-functionalists rejected the functionalists' rigid distinction between socio-economic (labelled non-controversial) and political functions. The functionalist school had advocated integration in the non-controversial or 'technical' sectors through the creation of a myriad of international agencies performing collective welfare tasks, with extensive powers in their own limited spheres. This would prepare the mind of the peoples for future cooperation at the political level. The neo-functionalists considered the socio-economic and political spheres as a continuum. According to Haas once the process of the shift in popular attention from national to supranational government has started on instigation of the national governments, it will become more or less automatic, because of technical spill-overs (cooperation in one sector would spill over into cooperation in other sectors). (This was criticized by Stanley Hoffmann (1966), who distinguished between issues of 'low politics' and 'high politics', over which national governments would want to maintain tight control.) However, Haas also argued that there was no 'dependable, cumulative process of precedent formation leading to ever more community-oriented organizational behaviour, unless the task assigned to the institutions is *inherently expansive*, thus capable of *overcoming the built-in autonomy of functional contexts* and of surviving changes in the policy aims of member states.' (Quoted in L. Cram (2001), in J. Richardson (ed.) (2001), European Union, p. 59 – emphasis by Cram). This expansive element is a tenet of the European Community, see the first recital of the Treaty of Rome establishing the EEC (1957): 'Determined to lay the foundations of an ever closer union among the peoples of Europe'. Note that the emphasis is on uniting peoples, and not states.

attribute of sovereignty, and introducing a single currency was likened to member states giving each other a blank cheque.[8]
Another post-war school on integration was the Social Communications School, founded by Karl Deutsch in the early fifties.[9] Deutsch perceived integration at the international level as a process of strengthening the cohesion of transnational groups (with the same socio-economic characteristics and the same problems or values). Increased cooperation among these groups would lead to an increasing mutual dependence among political actors, thus promoting a process of integration among them. However, as late as 1967 Deutsch concluded that in Europe the forces to increase the independence of the nation-states were stronger than the forces strengthening the cohesion of transnational groups.[10]

The relaunch of the Community, with the Single European Act (1986) and subsequently the Maastricht and Amsterdam Treaties, has given rise to studies trying to explain the driving forces behind this form of supranational integration. See for an overview Cram (2001).[11] In this process governmental preferences are accorded an important role. According to some these preferences are endogenized, i.e. the participation in lighter forms of integration, like the EEC and the EMS, alter the perceptions held by the national elites of their own interests and lead to the development of shared identity and norms. Others, e.g. Wolf (1997), applied the existing theories to explain the establishment of EMU. Wolf found that both Intergovern-mentalism and Neo-Functionalism had explanatory value when applied to EMU.[12] Finally some authors hold the view that no single theory can explain EU governance at all levels of analysis.[13] More recent research follows and promotes an eclectic approach, i.e. borrowing concepts of different strands of integration theories in order to understand the process (or better said: certain episodes) of European integration. One example, the theory of multilevel governance, deserves special mentioning, because an attempt has been made to describe the ECB in terms of this theory.[14] This particular integration theory acknowledges the continued importance of individual states and intergovernmental bargains, but also recognizes the shifts in decisional authority away from individual member-state control towards institutions at the (in this case) European level. However, we find the attempt does not convince, as the influence of national interests in the ECB is artificially exaggerated in order to introduce a '<u>multi</u>-level'. To be more precise, both the influence of the national executive elites and the

[8] See André Szász (1999), *The Road to Monetary Union*, p. 9-10.
[9] Deutsch and Haas are seen as the founders of (post-war) integration theory.
[10] Elazar and Greilsammer (1986), pp. 83-84.
[11] L. Cram (2001), 'Integration theory and the study of the European policy process: towards a synthesis of approaches', in J. Richardson (ed.) (2001), *European Union – Power and policy-making*.
[12] Intergovernmentalism, as defined by Wolf, explains integration through a process of converging interests and preferences, while (neo)functionalism explains integration through functional spill-over, 'forcing' ever more integration. Wolf points out that liberal (intentional) intergovernmentalism views the EC as an instrument of national governments; in their view the EC is 'kein eigenständiger Akteur' (is not one of the negotiating parties), but its institutions improve the 'Kooperationsbedingungen' (conditions for cooperation), for example they can improve the commitment credibility of the Member States by assuming certain functions. (Wolf (1997), *Integrationstheorien im Vergleich – Funktionalistische und intergouvernementalistische Erklärung für die Europäische Wirtschafts- und Währungsunion im Vertrag von Maastricht*, pp. 14, 62 and 273-274.
[13] View held by Peterson (1995), mentioned in Cram (2001), p. 65.
[14] P. Loedel (2002), 'Multilevel Governance and the Independence of the ECB', in A. Verdun (2002), '*The Euro - European Integration Theory and Economic and Monetary Union*'.

eurogroup (Ecofin-12) is exaggerated and the NCB governors are - misleadingly – seen as representing an 'intergovernmental voice to ECB deliberations'.

There are also authors who assess the actual European institutional structure, or details thereof, in terms of legitimacy and accountability.[15] They look for possible improvements in these areas, but do not provide criteria for an optimal design of a supranational organization with distinctive federal characteristics. More recently, the issue of optimal institutional rules for federations has received some attention from the economic profession as well. An interesting example is the study of Alesina, Angeloni and Etro[16] on the organization of federations in which the members decide together on the provision of public goods. The authors find among others that federal mandates in which both the state and federal levels are involved in providing public goods are typically superior to complete centralization and are politically feasible. Furthermore, they find a qualified majority voting rule in a centralized system can be a useful device to correct a bias towards 'excessive' union level activism. However, this study seems less applicable in the sense that the authors allow for differences in the provision of public goods due to local differences. In the central bank system the input may be different (i.e. local circumstances and preferences may differ), but the outcome is one (and the same) interest rate. Of course, in other areas, like payment systems, local differences are allowed to exist.

Supranationality implies transfer of sovereign power to a higher level of government. Based on the literature studied I distinguish four degrees of power transfer:

1. Reversible power sharing
2. Reversible power sharing subject to the settlement of conflicts by procedures of arbitration
3. Non-reversible but non-absolute power transfer
4. Absolute power transfer.

The first form is close to intergovernmentalism; an example is the transfer of power, while allowing for an opt-out or the possibility to invoke the requirement of unanimity for a certain decision. The second form would introduce the possibility for a majority of the members to put a unilateral decision of one member to opt-out or to invoke the unanimity requirement before an arbitration committee, which takes a binding decision. The third form is one which does not allow to block a current decision, but allows for influencing the outcome of similar decisions in the future. An example is the right of a government to appoint new members of the Supreme Court or of the central bank's executive board, possibly with a political thinking more in line with that of the appointing government. The last form of power transfer would on the face of it seem to be the most permanent of the forms, but in the end this is most likely not to be true, because it is not adaptable. That is to say, it is too rigid a form to be able to adapt to changes in the environment. In this respect we quote from the study by Elazar and Greilsammer: 'It is commonly said that the U.S. Constitution has survived until now, because it is a fundamental charter and is far from being a narrow legalistic code. The strength of the

[15] E.g. Everson (1995), 'Independent Agencies: Hierarchy Beaters?', *European Law Journal*, Vol. 1; Cappelletti a.o. (ed.) (1986), *Integration Through Law*, Vol. 1; but see also Kapteyn and VerLoren van Themaat (1998), Chapter IX.3, sections E and F and Epilogue, section 4 (as regards EMU topics).

[16] Alesina, Angeloni and Etro (2001), 'Institutional Rules for Federations', *NBER Working Paper* 8646.

Constitution – unlike the French Constitutions, for example – has been its ability to adapt itself to changing circumstances.' It would seem that the ESCB is an example of non-reversible but non-absolute transfer of power (type 3).

Federalism

This brings us to the concept of federalism. There is no universal definition which captures every aspect, so we turn to a description. We borrow a description from Elazar and Greilsammer, which captures a number of aspects relevant for our study:[17]
'In strictly governmental terms, federalism is a form of political organization which unites separate polities within an overarching political system, enabling all to maintain their fundamental political integrity, and distributing power among general and constituent governments so that they all share in the system's decision-making and executing processes. …. [F]ederalism has to do first and foremost with a *relationship* among entities – and then with the structure which embodies that relationship and provides the means for sustaining it.'

This description expresses that federalism is more than transferring power to a higher level, but it is also more than just power *sharing* – the American system can best be described in terms of 'powers that co-exist'. There is no hierarchy between the States and the Federal Government, the only difference being that the power of the Federal Government extends to a larger area than that of an individual state.[18] Behind this is the strong American allergy for too large concentrations of power. In practice, it is difficult to define what is exclusively in the federal sphere of competence, or in the state sphere, or in the local sphere. Inherent to such a system, in which the division of power is not very precise nor detailed, is the need to have checks and counterchecks, which guarantee one own's rights and which limit the powers of the others. This brings us to the question of 'checks and balances'.

Checks and balances

The phrase 'checks and balances' is most known for its use as a description of the American system of government. The essential feature is that the departments (branches) of government are not just separate from each other (i.e. having their own functional jurisdiction and the absence of personal unions)[19], but also exert limited control over each other, to the extent necessary for preventing departments (branches) from assuming authority in areas for which other branches are responsible. This philosophy was based on the experience that especially the legislature if left to itself could expand its powers in the field of the executive and in extreme cases even taking on judicial powers. Such an extreme case had been the Long Parliament, which governed England for a period of twenty years (1640-1660) following the Civil War by appointing a host of committees dealing with all the affairs of state, confiscating

[17] Elazar and Greilsammer (1986), p. 90.
[18] Uniformity in interpretation and application of federal law is assured through the appellate jurisdiction of the Supreme Court. See K. Lenaerts (1990), 'Constitutionalism and the Many Faces of Federalism', *The American Journal of Comparative Law*, Vol. 38, p. 252-262, and Boon (2001), chapter 5.3, also for a comparison with the European Court of Justice.
[19] This is the so-called concept of the separation of powers, which aims at preventing a too large concentration of governmental power in one hand. (See S.E. Zijlstra (1996), *Zelfstandige Bestuursorganen in een Democratische Rechtsstaat*, p, 152.) One could say the motto of this concept is: 'division of power by separation of functions'.

property, summoning people before them, and dealing with them in a summary fashion. A similar, though less extreme development took place in the early years of the United States (1776-1787), when the States established constitutions based on the concept of the separation of powers, but where in fact the State legislatures soon meddled in every type of government business, including those normally reserved to the judiciary. This explains why the Constitution of the United States of 1787 is based on a combination of the ideas of the separation of powers and checks and balances.[20]
Checks and balances presuppose one is able to distinguish several functional powers,[21] which can be separated without creating deadlock. These checks can take different forms. Examples (taken from the American Constitution) are: the president has a veto power over Congressional legislation (though he can be overruled),[22] Congress has the power of impeachment,[23] the president nominates (e.g. Judges of the Supreme Court, Ambassadors, important officials) but needs the assent of the Senate,[24] the Supreme Court may invalidate legislation.[25] Some define the bicameral character of Congress, consisting of a House of Representatives and a Senate, as another (internal) check and balance, as both chambers have to agree with legislation.

In the framework of the European Communities, the functional separation of powers is less clear: e.g. the Commission is both legislator and executive, the Council of Ministers has legislative power, but its members are, back home, part of the executive branch. On the other hand, the European system is characterized by many control mechanisms: Community legislation requires input or approval from two (sometimes three) 'branches' (the Commission, the Council of Ministers, the European Parliament - sometimes advice, sometimes approval), the appointment of the Commission members by the Heads of State is subject by the European Parliament,[26] the Commission can be dismissed by the European

[20] Vile (1967), p. 43, 143 and 145-147.
[21] The most famous distinction is the Trias Politica, developed by Montesquieu (1689-1755). Montesquieu did not want to rely upon a concept of negative checks to the exercise of power, i.e. checks dependent upon the mere existence of potentially antagonistic agencies, charged with different functions of government - he went further, and advocated placing positive checks by placing powers of control over the other branches in the hands of each of them. In his writings the judiciary was not given powers of control over the other branches. At the same time, the judiciary's independence in trying individual cases was to be absolute, i.e. not subject to control by the other branches, directly nor indirectly. (Vile (1967, p. 87ff.)
[22] Constitution of the United States, Art. I, section 7, paragraph 2. The president does not have a line item veto. A line item veto is considered unconstitutional by the Supreme Court (Clinton v. City of New York (1998))
[23] Constitution of the United States, Art. I, section 2, par. 5; Art. I, section 3, par. 6 and 7; Art. II, section 4. The House impeaches, the Senate tries the impeachment. The impeachment procedure relates to the president, vice-president and all civil Officers of the United States, which includes federal judges (see Boon (2001), p. 103-104). It is a typical feature of the American system that the president (Administration) cannot be dismissed by Congress (indeed, impeachment has not to do with policy, but with 'treason, bribery or other high crimes and misdemeanours'); likewise the president cannot dissolve Congress and call for elections.
[24] Constitution of the United States, Art. II, section 2, paragraph 2 ('by and with the Advice and Consent of the Senate').
[25] The Supreme Court has the power to assess the constitutionality of State laws (Art. VI, section 2 Constitution) and of Federal laws (Marbury v. Madison (1803)). This deviates from Montesquieu (see above). In other words, the Court sees itself as guardian of the system of checks and balances. It should be noted however that the Court does not have the means to enforce its opinion (see Boon (2001), p. 118).
[26] This is only the case after the Treaty of Nice of December 2000, which became effective in February 2003. Approval of the European Parliament is not required for the appointment by the Heads of State of the Judges of the Court of Justice.

Parliament, the legality of decisions by the Council of Ministers is subject to review by the Court of Justice.[27]

Separation of powers does not only exist between the branches, but also within branches. Again, this is the case in the United States, where I refer especially to the establishment by Congress of independent regulatory commissions, like the Interstate Commerce Commission (1887) and the Securities and Exchange Commission (1934).[28] The increased role of government in modern society and the increased complexity of this role in general have led to a reduced role of the legislative branch and – in the European context - an increased role of the government as regulator, while the implementation (i.e. decisions to be taken in individual cases) is also in the hands of the government (civil service). This could create two temptations: first, the temptation to change regulation ad hoc, at short notice and in an opportunistic way, with the argument that he who sets the rules, can at least also change them; second, and in fact going one step further, the temptation to dispense with regulation altogether. This could lead to arbitrariness, abuse of regulatory power for political reasons and unequal treatment and could constitute in itself a very valid reason to set these regulatory tasks at a distance of the Minister by creating *independent* bodies for applying the rules to individual cases.[29] The case of a central bank is related to this, in the sense that a government could, under circumstances, be tempted to intervene in central bank's monetary policy decision-making. However, this would affect the credibility of the central bank's monetary policy, and therefore its effectiveness. Thus, there are good reasons to grant the central bank independence, i.e. independence from the executive and the legislator. In the case of the ECB the independence is directed to the European governmental branches. Another threat to the effectiveness of the ESCB could come not so much from a direct instruction (or political pressure), but from uncontrolled fiscal behaviour. Monetary Union makes free rider behaviour more likely, as neither ballooning current account deficits nor exchange rate pressures can exert discipline anymore once the national currency has been replaced by a single currency.[30]

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[27] Kapteyn and VerLoren van Themaat (1998), p. 187.

[28] See R.E. Cushman (1941), *The Independent Regulatory Commissions*. Cushman also places the Federal Reserve Board on his list of independent agencies. These agencies may perform quasi-legislative and quasi-judicial and/or executive-type functions. Because they do not fit in one branch (or better said: in more than one) the independent commissions are sometimes likened to a 'fourth' branch. Because of the characteristics of the commissions (among which limited mandate and, essentially, respect for the due process of law doctrine) the legislative act of creating such agencies itself has never been judged by the Supreme Court as incompatible with the constitutional separation of powers doctrine, though the Supreme Court might rule negatively on individual decisions by these commissions. (The word 'regulatory' is a bit misleading, as what these commissions basically do is exercising control and discipline over private conduct.)

[29] Such bodies are called in Dutch *zelfstandige bestuursorganen* (ZBOs, autonomous public bodies), a difference being that in the Dutch case autonomous public bodies with national competence are as a rule created by the Minister, i.e. the executive branch with approval from the legislator, while in the US the independent regulatory commissions devolve from Congress, though the members of the federal commission are always appointed by the US President (Cushman (1941), p. 743). In the Dutch context the Commission-Scheltema concluded in 1993 that the use of ZBOs would improve the system of checks and balances in the Dutch system of public law, because it creates more distance between the rule-makers (in modern society many rules are made not by the legislator, but by the executive branch) and those who apply the rules to individual cases – mentioned in S. E. Zijlstra (1996), p. 157.

[30] At the same time the central bank of the anchor country loses its capacity to discipline the fiscal authorities of its country, because in EMU monetary policy is set for the euro area as a whole. A less disciplined fiscal authority might also imply less disciplined trade unions, because they might hope that a less disciplined

Indeed, a major threat to price stability (the ESCB's primary objective) could come from derailed *national* budgetary positions (which are more relevant than the small budget of the European Commission), for which reason the 3 per cent of GDP limit for national government deficits can be seen as an important check, *in casu* on the behaviour of national governments. This risk emanating from the fiscal side was already clearly described by the Delors Committee,[31] and this led to the rule for a limit on the deficit and the debt. Failing budgetary policies together with high unemployment will make the ECB vulnerable: inflation which is too high in some countries (eating away purchasing power) and too low in other countries (deflationary) will lead to attacks on its monetary policy and, in the end, on its independence. This is why the ECB has every reason to be openly critical on any deviations from agreed budgetary rules, which rules are part of its constitutional checks and balances. We will make some critical remarks on the economic part of EMU in chapter 12, seen from the perspective of checks and balances.

The ESCB, being set up as a federally designed system of central banks, is, however, also characterized by the relationship between its constituent elements. More specifically, a natural partnership, but also tension, could arise between the ECB and the national central banks (NCBs), both in the operational area as well as in the highest decision-making body, the Governing Council, in which are represented the members of the Executive Board and the presidents of the NCBs – a tension the drafters of the ESCB Statute were well aware of. In the end a form has been found which gives the upper hand neither to the centre nor to the periphery. Also here the concept of checks and counterchecks applies.

Checks and balances can be framed with different time horizons. For instance, the examples of checks and balances in the American Constitution listed above can be divided into two groups: checks which work immediately (e.g. veto, assent) and checks which work over time (appointments). Checks that work over time probably take away tensions which would otherwise be fought out in a different way, possibly leading to a break-up of the system. In other words, the presence of such checks and balances adds a desired flexibility to the system. It means the system or - within its mandate – a regulatory body can adjust over time to external circumstances, though at the same time it introduces certain continuity over time.

A definition of '**a system of checks and balances**' which covers both external and (in case of a federally designed organization also) internal aspects could thus be formulated as follows:
"a rule-governed system for two or more public bodies with rules which prevent the concentration of too much power in one public body (or a part of that public body), basically by separation of functions, [32] but combined with rules which *protect* each public body's

government is more willing to correct for any negative employment effects of too high wage demands. This points to an increased need for fiscal rules in EMU, as compared to before EMU.

[31] The Delors Report (section 30, third paragraph) defined unbalanced fiscal positions as a direct threat to price stability: 'In particular, uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community.'

[32] Usually a distinction is made between executive, legislative and judicial functions. A separate category are independent (regulatory) commissions/independent public agencies or organs established by or pursuant to public law and invested with any public authority. Such organs usually have a hybrid character (combining some regulatory and executive power). In these cases it is important to allow for enough distance between rule-making and the application of policy to individual cases.

power, which allow for *influence* by and over the other public bodies, which *stimulate co-operation* among these public bodies and which *prevent the dominance* of personal interest over public interest, among others through public control mechanisms." [33]

On top of this, these rules of the game should allow for some *intertemporal flexibility* (to prevent the need to overhaul the framework, which could put several valuable characteristics of the institution at risk). Intertemporal flexibility will serve the longevity of the system, because it allows for different degrees of power concentration, which could serve possible changing circumstances. [34] This element is especially relevant for the relation of the ESCB vis-à-vis the political authorities.

Normative aspects

This definition will help us identify checks and balances in the ESCB Statute. Together they form a system, the sustainability of which would depend on a certain degree of flexibility. However, the system should also be acceptable from a normative point of view. As a starting point for formulating elements of a possible normative framework we will take the fact that the organizations we study are part of modern Western society, which can be characterized as a liberal democratic society based on the rule of law. This implies that some *basic notions* apply, like the liberal notion that infringements by the State into the rights of citizens should be as limited as possible, the democratic notion that any law, regulation or decision based thereupon should have a democratic basis (i.e. should be based on a decision by general representative (elected) bodies), that 'government' should be accountable to the 'democratic complex'[35] and that concentration of large powers should be prevented both in one branch/public body and/or in one part of a public body (separation of powers doctrine). The notion of the rule of law refers to the concept of due process and the fact that public administration should be subject to judicial control. Apart from this, general notions should apply like the notion that public administration should be effective and efficient (no squandering of public money). These notions have been derived from Zijlstra (1996, pp. 43-51, 232-233 and 480-481). Cushman (1941, pp. 11-13 and 759) likewise emphasizes the notions of democracy, responsibility (i.e. vis-à-vis the three governmental branches), separation of powers, efficiency and effectiveness.

[33] The checks and balances determine the rules of the game. These rules undoubtedly leave room for strategic behaviour of the parties involved. However, we do not look into this, as we look into the rules of the game themselves, which should ensure that powers do not become concentrated into the hands of one party.

[34] The importance of institutions being adaptable is also made by Douglass North, i.e. especially in complex environments characterized by non-efficient markets and incomplete information. Rigid institutional structures are not equated with success. (D. North (1994), Economic Performance Through Time, *AER* Vol. 84, Issue 3, p. 359-368.)

[35] For a definition see S.E. Zijlstra (1996), p. 481.

We translate these notions into the following list of *basic norms*, with which a system of checks and balances of a federal central bank system should comply:

1. The regulatory powers of the central bank system should be circumscribed.
2. It should be accountable to the 'democratic complex'. [36]
3. There should be as little infringement as possible into the rights of citizens.
4. The doctrine of separation of powers should apply.
5. It should be efficient.
6. It should be effective.
7. The rule of law should apply.
8. It should be democratically based.

A categorization of checks and balances

The separation of powers doctrine aims at preventing one branch or one part of the system from attaining too much power.[37] This doctrine is sometimes referred to by the notion of 'balance of power', which itself is a mixture of 'delineation of powers', 'independence', 'interdependence' and the 'need to cooperate'. Based on this we distinguish *prima facie* four categories of checks and balances:

a. those which **protect** a body's independence and competences;.[38]
b. **controlling** (or blocking) mechanisms (which give a branch the power to prevent the build-up of uncontrolled power by one of the other branches);[39]
c. **consultation** mechanisms (either voluntary (i.e. at one's own initiative) or obligatory, i.e. when prior consultation is required);[40]
d. **accountability** mechanisms.

We add a fifth category to capture the notion of some desirable flexibility over time:

e. some **flexibility** over time.

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[36] This relates to the issue of democratic control and presupposes sufficient transparency.

[37] This could hardly be better expressed than by quoting from *Federalist* paper no. 47 written by James Madison: "From these [historical] facts by which Montesquieu was guided it may clearly be inferred, that in saying 'There can be no liberty where the legislative and executive powers are united in the same person, or body of magistrates,' or 'if the power of judging be not separated from the legislative and executive powers,' he did not mean that these departments ought to have no *partial agency* in, or no *control,* over the acts of each other." Here Madison expressed the core of the American system of checks and balances, i.e. not a simple separation of powers, but mechanisms to prevent the accumulation of too much power in one institution or one governmental branch. ('*The Federalist'* papers, which initially took the form of brilliantly written essays published in the New York press under the pseudonym of Publius over the period October 1787 – May 1788, were written by Hamilton, Madison and Jay with the aim to convince the people of the State of New York to vote in favor of the Constitution of the United States of America ('We the People ...'), which had been drafted during the Constitutional Convention held in Philadelphia in 1787 and which was meant to replace the earlier Articles of Confederation (1777); see Michael Kammen (1986), *The Origins of the American Constitution*, p. 125)

[38] This is a wide category covering inter alia the endowment of exclusive competences and mechanisms that shield from political pressure.

[39] Examples are the right of the US president to veto budget proposals by Congress and the requirement of Senate consent for the presidential appointment of new members of, for example, the Supreme Court and the Board of Governors. Such mechanisms ensure that no power can fulfil its tasks in an efficient way without at least the assistance of one of the other powers, thus controlling the use which the first power makes of its authority – see Lenaerts (1991), p. 11.

[40] A difference between consultation and accountability is that consultation takes place *ex ante* and accountability *ex post*.

In this study we use this categorization as a model for recognizing and evaluating checks and balances in federal structures. In the remainder of the study we apply this model at three levels:

1. the checks and balances between the Treaty-based institutions in the area of monetary policy (i.e. between the ESCB and the public authorities)
2. the checks and balances between the components of the federally structured European System of Central Banks (ECB, NCBs)
3. the checks and balances between the members of the ECB's Governing Council (i.e. the Executive Board and the governors)

At the end of each cluster we group the checks and balances found according to these five categories. One would expect all categories to be represented, in a balanced way – where this is not the case, there have to be special reasons for it, or it might point to potential weaknesses in the design. The categorization should assist in finding deficiencies and imperfections, from which will follow suggestions for improvements. These suggestions will be presented in each cluster's final section.

While accountability as such is part of the normative framework, the accountability mechanisms themselves are part of the checks and balances. They help control powers in an indirect way. The accountable party is forced to be transparent, while the 'receiving' party is likewise bound to the pre-defined accountability mechanisms, i.e. the legal framework lends the accountable party some institutional privacy. In the American Constitution there is less emphasis on accountability, as the Constitution's checks and balances work mostly directly (cf. the examples given). In line with this there are limits to each branch's powers over the other branches (the president cannot dissolve Congress, Congress cannot dismiss the president, but only impeach him/her). Indeed, the executive and legislative branches are only 'responsible' to the electorate.[41] In the case of the Federal Reserve, however, accountability does play a role, i.e. in its relationship with Congress (which established the Fed) and with the Administration (which appoints the members of the Board of Governors). In all cases public opinion matters, as the public constitutes the electorate.

There are not many studies taking a similar approach. Some studies look into the optimal allocation of power between accountable and non-accountable branches of government, e.g. Maskin and Tirole (2004). In their study they conclude that highly technical decisions, of which the feedback on the quality thereof is slow may be best allocated to appointed (unaccountable) officials (called 'judges') rather than to elected (re-electable) officials (called 'politicians'), though 'judges' should be given less discretion than 'politicians'. When important minority interests are at stake independent 'judges' could create a better outcome

[41] This is different in the European countries, where parliaments may force governments to step down, when a majority of parliament lost confidence in the government, and where governments may call for new elections. The 'control' function of US Congress as regards actions by the Executive takes the form of its right to approve the Administration's appropriations (expenditures, taxes) and its right to be informed by the Administration's Departments in the form of reports or hearings and its right of investigation. (Leibbrandt (1968), *Economen in dienst van politici*, dissertation Vrije Universiteit Amsterdam.) In fact, the States created a federal government with many internal checks and balances to prevent one branch from becoming dominant, with accountability not directed to them (the States), but directly to the people. But it should also be recalled that the States placed the federal government not over them, but next to them. See our paragraph on Federalism above.

for society than majority rule. Eggertsson and Le Borgne (2003) also come close to some aspects of what we are doing. They study why, and under what circumstances, a politician gives up rent and delegates complex policy tasks to an independent agency, which crucially has a longer time-horizon. (We refer to the last pages of chapter 3 for a critical remark on their approach.)

Based on the above we conclude that an important condition for the durability of the ESCB is that the legal framework defining its external[42] and internal relations contains in all relevant aspects of its institutional set-up adequate checks and balances. In the final chapter of this study we will, inter alia, try to answer the following questions:

- Does the Statute, as one would expect from a federally designed central banking system, contain an adequate measure of checks and balances?
- Is it assured that none of the parties/actors involved can assume all power at the cost of the other?
- Does the system display an efficient degree of flexibility over time to adjust/adopt to changing circumstances?
- Does the system of checks and balances comply with the basic norms one would expect to hold for such system?

In describing the genesis of the articles we will also try to gauge the influence the central bank governors had on the formulation of the articles of the ESCB Statute.

[42] This relationship is usually framed in terms of the opposition between independence and accountability. However, we will take a much broader look.

CLUSTER I

CHECKS AND BALANCES BETWEEN THE ESCB AND THE PUBLIC AUTHORITIES
(the *political* relations of the ESCB)

CHAPTER 3: INTRODUCTION TO CLUSTER I

The ESCB, consisting of the ECB and the national central banks of the Member States, has been inserted, as a new institution *sui generis*, among the existing Community institutions.[1] We note there was no attempt to amend or change the existing institutions to the new EMU environment, e.g. there was no attempt to create an independent 'gouvernement économique' (an idea alluded to in the Werner Report), which would have taken away responsibilities assumed by the Ecofin Council and could have led to a reduced involvement of national parliaments, as Member States were reluctant to hand economic powers to the Community. [2] The relations of the ESCB with these other institutions will develop over time, but they will always have to be based on the Protocol on the Statute of the European System of Central Banks and of the European Central Bank and a number of relevant EC Treaty articles.[3] In this and the following two chapters we will select and study those articles of the Protocol and of the Treaty, which constitute the framework for the ESCB's relations with the other branches of government.

First we will take back a few steps and ask ourselves a few seemingly elementary questions, such as 'what is the basic Community structure' and 'what makes the ESCB different from the existing Community institutions'? Their treatment will constitute a useful general background for chapter 4, where we reconstitute the genesis of the wording of the most important articles governing the external relations of the ESCB. Because of the relative importance of the concepts of independence and accountability for the System's external

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[1] Article 4.1 of the EEC Treaty (see also next footnote) originally mentioned four institutions (which are usually referred to as Community institutions): a European Parliament, a Council of Ministers, a Commission and a Court of Justice. In 1977 Article 4.3 was added, which mentioned a fifth institution: the Court of Auditors. The Treaty of Maastricht moved the Court of Auditors to Article 4.1.

[2] We do not delve into these issues. Here we only note that in the end - apart from the establishment of the ESCB - only a few aspects of the Community framework were adapted to the new situation. We will come back to this in the paragraph below on the 'Basic Community structure'.

[3] The Treaty of Maastricht (signed on 7 February 1992 and, after being ratified by all Member States, effective as of 1 November 1993) created the European Union (EU). The official name of that Treaty is the Treaty on European Union (TEU). The Union (Articles A-F of the Treaty of Maastricht) is founded on the European Communities, supplemented by a *second* and *third* pillar (a common foreign and security policy and cooperation in the fields of justice and home affairs) (Articles J and K of the Maastricht Treaty). The European Communities encompass the European Economic Community (which was rebaptised by the Treaty of Maastricht into the **E**uropean **C**ommunity (EC)), the European Atomic Energy Community (Euratom), like the EEC established in 1957, and the **E**uropean **C**oal and **S**teel **C**ommunity. (The ECSC Treaty was concluded in 1951 for fifty years and has expired.) The EMU provisions are part of the EC (i.e former EEC) Treaty, while the Protocol on the Statute of the ESCB and of the ECB is attached to the EC Treaty. Sometimes reference will be made to the Treaty of Maastricht, where what is actually meant is a reference to the EC Treaty as established and amended by Maastricht.

checks and balances we pay some attention to them as well by referring to the existing literature on these topics. We do not develop new frameworks, as we focus on the concept of checks and balances, of which they constitute a part, though a familiar part. Part of our contribution will be that we do not look at them as antitheses, but as somehow complementary in terms of checks and balances. In chapter 4 and following reference will be made to US Federal Reserve System, i.e. where this might help us understand, and assess, better the solutions found for the ESCB.

Basic Community structure

The **basic Community structure** has developed out of the structure of the European Coal and Steel Community (ECSC), established in 1951 on the basis of the ideas of Jean Monnet.[4] The ECSC was managed by the High Authority, which had executive, but also regulatory powers. However, important decisions needed political backing in the form of approval by a Council of Ministers.[5] A Court of Justice was established to ensure lawful application and interpretation of the Treaty (and the regulations). An Assembly with representatives of the Member States was established (which met once a year) with consultative powers. The structure of the European Economic Community and Euratom, each established in 1957 by a Treaty of Rome, resembled this institutional design: a Council of Ministers which decides, but which can only do so on the basis of a proposal or recommendation of the Commission.[6] The Commission has the important right of initiative and forms the executive branch of the Community structure. The roles of the Court of Justice and the Assembly [7] were the same as under the ECSC.[8] The Single European Act (1986) introduced some important changes: the

[4] See Francois Duchêne's biography of Jean Monnet: *Jean Monnet, The First Statesman of Interdependence* (1994).

[5] See also van Bergeijk c.s. (2000), *The Economics of the Euro Area*, p. 155.

[6] The Treaty does not distinguish different Councils of Ministers, in other words in institutional terms the Council of Ministers of Transport is the same as the Council of Ministers of Economic Affairs, though indeed the composition in terms of persons depends on the subject matter. The most visible Councils are the General Council (the Council of Foreign Affair Ministers) and ECOFIN (the Council of Economic and Finance Ministers). It is standard practice that Council decisions relating to economic and monetary union are taken by ECOFIN (as confirmed by Declaration 3 of the Treaty of Maastricht). In exceptional cases the Council can meet in the composition of Heads of State or Government (Article 109J-2) and 109K(2)-EC (relating to the assessment whether a Member State fulfils the necessary conditions for the adoption of the single currency). This differs from the European Council, which is composed of the Heads of State or Government and the president of the Commission. The European Council is a political body and 'provides the Union with the necessary impetus for its development and shall define the general political guidelines thereof' (Article D of the EU Treaty). These guidelines take the form of Conclusions issued after their meetings (at least twice yearly). In exceptional cases decisions are taken 'by common accord of the governments of the Member States at the level of Heads of State or Government'. Examples are the appointment of the members of the Executive Board of the ECB (Article 109a(2b)-EC) and the decision to abrogate a derogation of a Member State not yet participating in the euro area (Article 109k(2)-EC). In case of weighted voting, the votes of the members of the Council of Ministers are weighted according to a key, reflecting more or less the size of the Member State the minister is representing (Article 148(2)-EC). The Council cannot act without either a Commission proposal or recommendation. However, it may 'request' the Commission to make a recommendation or proposal in specific fields. See Article 109d-EC. Within the Council unanimity is required to amend a Commission proposal (a Commission recommendation can be amended by the same majority as needed for the decision itself).

[7] Since 1976 members of the Assembly (European Parliament) are elected by direct universal suffrage (whereas before they were chosen by the national parliaments), with a fixed number of elected representatives for each Member State (depending more or less on the size of its population) - see Article 138-EC.

[8] The ECSC, EEC and Euratom shared these two institutions (see Convention on Certain Institutions Common to the European Communities, 1957). In 1967 the High Authority and the Commission were merged too, as well as

Assembly was renamed into European Parliament and most decisions in the area of the internal market could as of then be taken by a qualified majority in the Council and in co-operation with the European Parliament (instead of requiring unanimity among the ministers and only consultation of the Assembly).[9]

The Treaty of Maastricht has changed the situation considerably, by introducing new areas of competence and decision-making procedures for the European *Union*. However, within the classical *first pillar,* encompassing the EEC (renamed European Community), the ECSC (expired in 2002) and Euratom the basic structure has remained relatively unchanged, important changes within this structure being the introduction of a co-decision procedure between the Council and the European Parliament, increasing the role of the latter, and the introduction of a right of initiative for the ECB (shared with the Commission) for some Council decisions.[10] This shared right of initiative is less of an infringement on the exclusive right of initiative of the Commission than it seems at first hand, as until then the Commission had no competence whatsoever in the monetary area. A few **special characteristics** of the four Community institutions (Parliament, Council, Commission and Court of Justice) will be mentioned here, because they help to understand the special position of the ESCB. The four traditional Community institutions operate as specific arms of the Community: they do not have legal personality and they operate always on behalf of the Community (the Community itself has legal personality).[11] Their task is not confined to one area (for instance transport or economic policy), but they have to carry out 'the tasks entrusted to the Community'.[12] 'Each institution shall act within the limits of the powers conferred upon it by this Treaty.' [13] The tasks of the Community are mentioned in Article 2 of the Treaty (we quote the tasks as amended by the Maastricht Treaty): 'to promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.'

What makes the **ESCB** special compared to these institutions is its narrow objective, that is to guard the stable value of money. This is not only clear from Article 105-EC, but also from Article 3a(2)-EC, which clearly mentions that the primary objective of both the single monetary policy and the exchange-rate policy is to maintain price stability. By contrast, the activities of the Community (and therefore of its institutions), which activities are mentioned

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the special Council of the ECSC, the Council of the EEC and the Council of Euratom (see Treaty establishing a Single Council and a Single Commission of the European Communities, the so-called Merger Treaty, 1967). Since then the Council is called the Council of the European Communities (plural).

[9] As reflected in Article 100A of the amended EEC Treaty.

[10] The so-called second and third pillar are basically intergovernmental structures, with no role for the Commission in the decision-making structure nor an executive role and no jurisdiction for the Court of Justice except in respect of one article on home affairs. These pillars relate to provisions on a common foreign and security policy and on cooperation in the fields of justice and home affairs.

[11] Article 210-EEC. See also the genesis of Article 1-ESCB *infra*.

[12] Article 4.1-EEC: 'The tasks entrusted to the Community shall be carried out by the following institutions: etc.'

[13] Idem Article 4.1.

in Article 3 and 3a(1), are directed towards fulfilling the purposes mentioned in Article 2. Does this imply the ESCB is not part of the Community, but a partner? [14]
This question relates to the difference between the concept of the Community as a political idea (closely related to the concept of a European Union) and the concept of the Community as a legal entity expressly related to the common market and *derived* objectives (such as a balanced development of economic activities, high levels of employment, economic convergence and social protection).[15] Indeed, it is probably better to say that monetary sovereignty has been surrendered to the Community *level* than to the Community as such. If we say that the ESCB is a Community institution *sui generis*, the emphasis is on *sui generis*. We would not concur with those who would describe the ESCB as an organ or body of the Community, because it does not do justice to the special position of the ESCB, as it suggests the ESCB could fall under the general political guidance of the European Council[16] - though we do agree the ESCB and the ECB are part of the Community framework.

Independence
Concurrent with the foregoing, the ESCB has been endowed with a high degree of **independence**. This was a *sine qua non* for Germany, based on its historical experience, supported by economic arguments (see genesis of Article 7-ESCB). Most authors distinguish institutional, personal, functional and financial independence (see Smits (1997), Endler (1998, p. 405) and also the Committee of Governors' Introductory Report on the draft ESCB Statute of November 1990, p. 5, par. (d)). For a further treatment of these elements of independence, see under Art. 7, section I.1. The ESCB is not goal-independent. In the words of Issing: 'the goal [is] set out by the legislature on behalf of the ultimate sovereign: the wider public, the people we serve.' [17] Others contest this; in their view the ECB still has too much goal independence, as it can define 'price stability'.[18] However, what we want to stress here is that the feature of independence as such is not unique for the ESCB.
For instance, the independence of the Commission is based on almost exactly the same wording as used for the ESCB. (In fact, the wording used for the Commission was copy-pasted by the drafters of the ESCB Statute.)[19] Another (and maybe better[20]) example might

[14] In this respect Smits (1997, p.93, ft 330) refers to a publication by Dunnett, who draws from the wording and order of the provisions establishing the Community institutions, the ESCB and the European Investment Bank (EIB) 'a sign of an intention to confer comparable legal status on the Community, the ESCB and the EIB.'
[15] A striking difference with the American Constitution is that the Constitution's declaratory opening words ('We the people of the United States, in Order to form a more perfect Union, establish Justice, [….], promote general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America.') are clearly directed to its citizens, and not to member states or policy makers.
[16] Smits (1997, p.93) prefers to call the ESCB an organ of the Community.
[17] Interview with Issing, executive board member of the ECB responsible for the directorate monetary policy, economic developments and research, in *Central Banking*, Vol XI, 2001, p.32.
[18] Begg and Green (1998). We do not concur with them: pre-defining price stability, e.g. as a point target, would take away all flexibility for the central bank, or risk bringing it under control of the political authorities when they would have to approve the use of escape clauses. For us, the essential point of the ESCB not being goal independent is that the ESCB is not free to switch its goal from price stability to, for instance, exchange rate stability, while neglecting price stability. Moreover, political authorities are more likely to change the goal for electoral reasons than central banks.
[19] See genesis of Article 7-ESCB.
[20] In real life, pressure of governments on 'their Commissioners' is an existing phenomenon. For an example of political pressures on Commissioners, see Endler (1998), p.433, ft 89.

be that of the Court of Justice. The judges and advocates-general of the Court of Justice have to take an oath that they will perform their duties impartially and conscientiously. (Protocol on the Statute of the Court of Justice, Artt. 2 and 8). The judges and advocates-general are appointed for terms of six years by common accord by the governments of the Member States and cannot be dismissed by the political authorities. It could be said that the ESCB has a degree of independence quite similar to that of the Court of Justice.[21]

But even the Court of Justice is not completely independent. For instance, the judges do not appoint their successors. Complete independence does not exist (and should not exist in a democracy). In a democracy there are only degrees of independence. Complete independence is even not supported by the literature: according to Rogoff's famous model (1985) the appointment of a completely independent and very conservative central banker will lead to a suboptimal outcome for society (read: it suboptimally raises output variability when supply shocks are large). He does plead for a central banker who places a large, but finite, weight on inflation rate stabilization. Of course, this is not the same as saying that the optimal solution is that in extreme situations the central banker can be overruled by the government (as recommended by Lohmann (1992)), because a government will more often see 'extreme situations' than the central banker, which risks upsetting the balance of power between the central bank and the political authorities.

This leads us to the important issue of 'checks and balances' between the different elements of government (defined in a broad sense).[22] Independence and accountability have a place within the framework of 'check and balances', which can be understood easily if one realizes that both concepts relate to other parts of the government: independence from whom? And accountable to whom? Checks and balances were also a recurring theme – though mostly implicitly - during the negotiations on and drafting of the articles of the ESCB Statute, which will be dealt with in chapter 4. It appeared to the author that the central banks were ahead of the academics, for instance as regards the importance of independence for maintaining price stability and the ways in which independence could be designed. The first studies that specifically deal with the importance and measurability of central bank independence date from the late eighties and especially the early nineties. [23] A lonely predecessor in this respect was Donald Fair (1980), who compared the relations between governments and central banks for twenty OECD countries. He emphasized that no country has been prepared to grant complete independence and none is likely to. The relative success of the best known independent central banks, i.e. those of Germany and Switzerland, are ascribed by Fair to the

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[21] This strong independence might be defended by using the following analogy: 'Just as the law is to be guarded by an independent authority, the judiciary, so is the stable value of money to be guarded by an independent institution, the central bank.' Analogy used by J. Zijlstra, former governor of the Dutch central bank and quoted by De Beaufort Wijnholds (1992, pp.14 and 18).

[22] For instance, when the Federal Reserve is described as 'independent *within* the government', the word 'government' not only refers to the Administration, but also to Congress (see Chapter 4 under Article 7-ESCB, section I).

[23] For instance, Alberto Alesina ('Macroeconomics and politics', in Stanley Fischer (ed.) NBER Macroeconomics Annual, 1988), Alex Cukierman ('Central Bank Strategy, Credibility, and Independence: Theory and Evidence', 1992), Alberto Alesina and Lawrence Summers ('Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence', *Journal of Money, Credit, and Banking*, 25 (1993) and Sylvester Eijffinger and Eric Schaling ('Central bank Independence: Criteria and Indices', *Beihefte zu Kredit und Kapital* 13 (1993b).

communis opinio in these countries over the main economic policy objectives.[24] Bade and Parkin should also be mentioned for their seminal paper, first presented in 1977 at a conference in Victoria, Australia, and available over the years as updated unpublished mimeo and as a Working Paper in 1988.

Finally, we do not share Neumann's approach which is to dismiss the issue of democratic accountability by saying a central bank only makes 'technical' decisions.[25] According to Neumann, democratic accountability is only necessary in cases where institutions make political decisions, i.e. face a trade-off with respect to conflicting objectives, whereas an independent central bank is only committed to one objective. This is too simple: in practice there are many moments when a central bank has to decide whether or not to move interest rates and how fast on the basis of imprecise and often conflicting information, with important consequences for general macro-economic and financial developments. The point in favour of independence is that political authorities have a shorter time horizon and will probably consistently lean towards easier money, as the time lags between monetary easing and inflation are relatively long, which behaviour is not conducive to price stability. (The occasions that ministers have called for tighter monetary policy are very rare indeed.) The behaviour of the government is at the same time understandable, but also self-defeating. This is captured by the time-inconsistency (or 'dynamic inconsistency') concept. This concept was formulated by Kydland and Prescott (1977) and later developed by Barro and Gordon (1983).[26] Basically, their analysis shows that, if the appointed monetary authority shares the government's incentive to expand output above its equilibrium level, discretionary policy has an inflationary bias. The temptation for the government comes from the desire to achieve growth higher than potential growth, or an unemployment rate below the natural rate, by surprise monetary stimulation, which however will lead to a shift of the Phillips curve to the right, leading to an equilibrium with unchanged output and higher inflation. (See also Blinder (1998), *Central Banking in Theory and Practice*, pp. 36-50.) The 'solution' is to appoint a relatively conservative central banker.[27] One of the earliest references to the impact of reputation of the central bank governor on the outcome of monetary policy is to be found in a study by Kenneth Rogoff in 1985 and Alex Cukierman in 1986.[28]

Accountability [29]

Accountability (like independence) is an elusive concept. One commonly used definition among academics is based on the Oxford English Dictionary, which defines accountable as "obliged to give a reckoning or explanation for one's action; responsible".[30] We also think

[24] D. Fair (1980), "Relationships between central banks and government in the determination of monetary policy - with special reference to the United Kingdom", SUERF Series 31A.
[25] Neumann (1991), p.109.
[26] Kydland and Prescott (1977), 'Rules Rather Than Discretion: The Inconsistency of Optimal Plans', *Journal of Political Economy* 85 (June 1977), pp. 437-492; Barro and Gordon (1983), 'A Positive Theory of Monetary Policy in a Natural-Rate Model', *Journal of Political Economy* 91 (August 1983, pp. 589-610).
[27] See also section I.1 of Article 2, treated in chapter 4.
[28] Rogoff (1985); Alex Cukierman (1986).
[29] See also Amtenbrink (1999), *The Democratic Accountability of Central Banks – A comparative study of the European Cental Banks,* esp. p. 377
[30] The first ones to use this approach were Briault, Haldane and King (1996) in the *Bank of England Working Paper Series* No 49 (p. 11). For them "the natural context in which to consider accountability is within a principal-agent relationship. And, in a monetary context, these roles are typically taken by the government - as

accountability should extend to the *way in which* a central bank has achieved its objective (in other words, accountability should not be confined to explaining failures). Indeed, in certain circumstances it might be better to overshoot the target than to achieve it at extremely high costs - which in itself pleads against using contracts between government and central bank governor setting ceilings to inflation, with the possible exception for countries coming from a situation with very high inflation or a low reputation for the central bank. Or to put it differently, would the performance of the Bundesbank have improved if it had been under a contract; and what would have happened with the contract in the extreme event of the unification when inflation went up? It is hard to imagine anything but reduced credibility for the Bundesbank and thus reduced discipline in the other sectors of the economy. Briault c.s. (1996, p. 21) say as much by pointing out the Bundesbank model with so much independence and so little accountability would not have survived without the social acceptance of sound monetary policy. Their argument seems to imply that imposing a contract on the central bank presupposes support for sound monetary policy is lacking, possibly especially among those who impose the contract, which would indicate the contract is meant to bind the hands of the government and not so much of the central bank.[31]

Accountability nor independence are the main topic of this study. However, they are relevant concepts in the context of checks and balances. We will come back to accountability and independence in chapters 5.2.2 and 5.3. We will see that more accountability does not necessarily mean less independence. Accountability can make the independence *de facto* more acceptable to others. In an unbalanced system, eliciting jealousy and irritation among the political authorities, even independence-engraved-in-stone is at risk. So the essential point is that central bankers are not served by minimizing accountability. [32]

Before describing some of the outcomes in terms of checks and balances, first a short observation on the **democratic deficit**. This expression is normally used by authors who put the emphasis on the negative aspects of a too high degree of independence (which is usually equated with a lack of accountability towards democratically elected politicians).[33] For the central bankers the fact that the Statute would become part of the Treaty (in the form of a

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principal - and the central bank - as agent." We think a central bank could also be accountable to parliament directly (the American system) or indirectly through the public (like was the case in Germany), and not so much directly to the government. We come back to this issue when discussing Art. 10.4-ESCB on the confidentiality of the proceedings of the meetings of the ECB's Governing Council.

[31] The relative lack of political pressure by the government on the Bundesbank is shown in a study by Maier, Sturm and de Haan (2002), who use the number of news reports in which politicians argued in favor of a change in monetary policy. ('Political Pressure on the Bundesbank: An Empirical Investigation Using the Havrilesky Approach', in *Journal of Macroeconomics*.) As shown by Maier and Knaap (2003), to the extent pressure was applied it did not critically influence the Bundesbank's monetary policy. (See also Maier (2002).)

[32] A similar approach is now being taken by some academic writers, see de Haan and Amtenbrink, who for instance conclude specific institutional features 'may at the same time support the independence of the central bank as well as its accountability.' (De Haan/Amtenbrink (2000), 'Democratic Accountability and Central Bank Independence: A Response to Elgie', *West European Politics*, Vol.23, No.23 (July 2000), pp. 179-190.)

[33] See inter alia Gormley/de Haan (1996), 'The Democratic Deficit of the European Central Bank'; Elgie (1998), 'Democratic Accountability and Central Bank Independence'; Stiglitz (1998), Central Banking in a Democratic Society; and W. Buiter (1999), 'Alice in Euroland'. For an eloquent reply to Buiter, see Issing (1999), 'Willem in Euroland'. For a comment on their debate, see de Haan and Eijffinger (September 2000a). In their paper on 'Independence and Accountability' Briault c.s. (1996, p. 43) conclude there is an inverse relationship between accountability and goal independence.

protocol) implied that the Statute would be endowed with the highest form of democratic approval.[34] For them a democratic deficit was not apparent. Nonetheless, some authors (Gormley/de Haan, Stiglitz) are of the opinion that 'monetary policy ultimately should be controlled by democratically elected politicians' (Gormley/de Haan (1996), p. 112). In addition to this 'normative-legal' argument, these authors also refer to economic academic writings, according to which a conservative central banker can be 'too independent'; in such a case the government will try to effectuate less independence (or a less conservative governor) in order to minimize their own loss function depending on its own preference for output stabilisation.[35]

The first argument (the 'normative-legal' one) has been dealt with adequately by a number of constitutional courts in Europe. The German constitutional court (Karlsruhe) has given a verdict to the contrary in a well-known case initiated by a group of citizens who wanted to block the ratification of the Maastricht Treaty. The Karlsruhe court decided that the modification in the 'Demokratieprinzip', implied by the Treaty of Maastricht (i.e. a deviation from the principle that important policy decisions should be taken by elected persons) was acceptable, because it considered 'an independent central bank would be better able to ensure price stability (thus providing an economic foundation for economic decisions by the official and private sector) than bodies which might benefit from higher inflation and which rely on political support with a short-term focus.' [36] [37]

In France parliament approved a constitutional amendment which the French Constitutional Court had deemed to be necessary - thereby clearing any constitutional obstacles and clearing the way for ratification of the Treaty of Maastricht.[38] If the Union were ever to develop statehood capacities, it will have to be decided whether to expressly vest all monetary powers

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[34] It also ensured that the Statute could not be amended lightly.

[35] See S. Lohmann (1992); S. Fischer (1994b), 'How Independent Should the Central Bank be?', *American Economic Review*, Vol. 85, no. 2, pp.201-6; and Eijffinger and Hoeberichts (1998).

[36] Endler (1998), p. 567-578. A full quote reads: '[weil] eine unabhängige Zentralbank den Geldwert und damit die allgemeine ökonomische Grundlage für die staatliche Haushaltspolitik und für die private Plannungen und Dispositionen bei der Wahrnehmung wirtschaftlicher Freiheitsrechte eher sichert als Hoheitsorgane, die ihrerseits in ihren Handlungsmöglichkeiten und Handlungsmitteln wesentlich von Geldmenge und Geldwert abhängen und auf die kurzfristige Zustimmung politischer Kräfte angewiesen sind.'

[37] In Germany the independence of the Bundesbank, established in 1957, had been debated before by specialists in constitutional law. Those supporting the Verfassungszulässigkeit (constitutional acceptability) of independence of the Bundesbank had argued that (1) only an independent central bank can guarantee price stability (with the need for price stability being based on the constitutional obligation of the government to aim for a 'gesamtwirtschaftlichen Gleichgewichts') and (2) the government has some room to delegate powers, provided certain conditions are met. They argued that in this case such conditions had been met, because the Bundesbank was required to inform and consult with the government, because the government had a dominant say in the appointment of the directors (and because the government is accountable to parliament, the influence of parliament was ensured), and finally because the legislator could change the law. The opponents had argued that the character of monetary policy is 'high politics', because of its influence on the economy, and can therefore not be out the control of the executive. In these days it never came to a case before the Constitutional Court. (Endler (1998), p. 265-271.) By the way, Issing (1982) reduced this argument of 'high politics', with which he obviously did not agree, to the postulate that 'governments should have the possibility to print money, when the election approaches'. Thát, he said, can hardly be called a strengthening of the democracy. Or as put by A. Moravcsik in 'Democracy and Constitutionalism in the European Union' (ECSA Review (13:2), Spring 2000, pp. 2-7): 'non-majoriarian decision-making [= by non-elected independent government agencies - cvdb] is justified in democratic theory not simply because it may be efficient, but because, ironically, it may better represent the long-term interest of the median voter than does a more participatory system.'

[38] See Szász (1999), p. 167.

in one of the branches, e.g. the legislative branch[39], or in the Union as such, for instance using the formulation of the German constitution: 'Der Bund errichtet eine Währungs- und Notenbank als Bundesbank' (Article 88 Grundgesetz *ante* Maastricht).
One could describe the democratic process as follows: first, elected politicians subscribe to the importance of price stability; second, they choose a credible method for achieving this – one proven method being to place the central bank outside the direct control of themselves, giving up the possibility of using monetary policy for electoral purposes. This supports the logic of instrumental independence, not per se of goal independence. However, allowing a government to change the central bank's goal in the run-up to elections makes monetary policy less predictable, the pre-commitment of the central bank to price stability less credible and the inflation expectations less subdued.[40]
While the 'normative-legal' argument against an independent central bank is thus less convincing, the economic-electoral argument against a too independent or too conservative central banker[41] seems to hold better. Being experienced central bankers, many of them serving for many years and a number of them having served before in the administration of their country, the governors knew that an organization which creates the suspicion it is aiming for uncontrolled 'power' will come under much more indirect and even direct political pressure, with the ultimate threat of a change in their legal base.[42] The importance they thus attached to 'an institutional balance of power' led to a situation, in which the ESCB is indeed less than completely independent. [43] Our purpose is not to try to evaluate whether the ECB is too independent or not. This is a too narrow view. It would seem beforehand that different degrees of independence are possible, provided it is embedded in an appropriate structure of

[39] Copying the American situation where all monetary powers are vested in Congress, see chapter 4 under Article 7, section I. Congress delegated these powers to the Fed. The alternative is to vest the monetary powers constitutionally directly in the central bank, putting it at the same level as the Court of Justice.
[40] This is not true, at least not to the same extent, for policies like tax policy. Though one could imagine that tax policy-without-any-short-term electoral motives would be better than with such motives, it is clear that tax policy is directly affecting the income distribution, and therefore has a high political and electoral content, which is thus less easily delegated to an independent institution. Also tax policy does not lend itself for defining a narrow objective, which makes delegation more difficult. Moreover as regards monetary policy, in the case of the Bundesbank its independence was inherited partly from its predecessor, the Bank deutscher Laender (see appendix 3) and partly based on the experience of hyperinflation. This led to a successful low inflation policy of the independent Bundesbank, which was exported to the other EC countries. In case of the Fed, the delegating party was Congress (and not government), which was not able to run monetary policy itself. When after a period without a central bank it was decided to establish one, a compromise had to be found between those favouring government influence on the central bank and those fearing government influence. Therefore, there was no explicit choice for a single 'elected politician' to delegate monetary policy or not. This is a different approach to the problem of delegation than is taken by Eggertsson and Le Borgne (IMF WP 03/144), who develop a theory for why an elected politician should himself be willing to delegate tasks.
[41] Independence and conservatism can be distinguished. See Berger, de Haan and Eijffinger (2001, p. 4 ff.).
[42] Compare Briault c.s. (1996, p. 40) who mention that according to a purely political explanation of accountability 'independence and accountability should run in parallel – or else a widening democratic deficit would force change on the existing institutional set-up.'
[43] To use the words of Endler (1998, p. 568): 'In der Verfassung eines States soll der unkontrollierte Machtsausübung regelmäßig durch die aus dem Rechtstaatsprinzip fließende Teilung der Gewalten entgegen gewirkt werden.' Endler continues: 'Nun läßt sich das schon national nur schwer zu fassende Gewaltenteilungsprinzip nicht einfach auf die Europäische Union übernehmen, da diese gerade keinen Staat darstellt. Der EuGH (European Court of Justice) spricht immerhin näherungsweise von dem Erfordernis eines 'institutionellen Gleichgewichts der Organe.' This concept of 'institutional balance' might be suitably applied also to the ESCB, though we do not consider the ESCB (or the ECB) as a Community organ.

checks and balances. For instance it would be hard to imagine that a political body which cannot be sent away by a parliament would be allowed to define price stability.

In fact, the following chapters will show the Statute is full of these kinds of 'checks and balances', the roots of most of these going back to the report of the Delors Committee.

CHAPTER 4: SELECTED ESCB ARTICLES (CLUSTER I)

Content

Selected articles: Article 1 (Constitution), Article 2 (Objectives), Article 3.1 and 3.2 (Basic tasks), Article 7 (Independence), Article 10.4 (Minutes), Articles 11.2, 11.3, 11.4, 11.5 and 11.7 (Personal and financial independence executive board members), Article 14.2 (Personal independence NCB governors), Article 21 (Operations with public entities), Article 27 (Auditing), Article 28.2 (ECB's shareholders), Article 41 (Simplified amendment procedure).[1]

***Additionally selected** articles from EC Treaty: Articles 109-EC (Exchange rate policy), 109b-EC (Inter-institutional provisions) and 109C(2)-EC (Economic and Financial Committee).*

Article 4 (Advisory functions) will be dealt with in passing under Art. 109C(2)-EC; Article 11.1 (Composition Executive Board and prohibition personal unions) and Article 50 (Initial appointment of Executive Board members) under Article 11.2, and Article 42 (Complementary legislation) under Art. 41.

4.1 INTRODUCTION

For this chapter we have selected those articles which have a bearing on the position of the ESCB vis-à-vis the 'other' branches of government. Communication with the public (and press) is included in this cluster, as this aspect is related to the issue of accountability of the System.[2] Articles belonging to this cluster but which are of minor importance will not be dealt with.

Structure
For every article the description of its genesis will be preceded by (i) an introductory paragraph, describing the main economic reasons (*raison-d-être*) for including the article in the Statute and the main sensitivities around its formulation, and (ii) in some cases by a description of comparable features of the Federal Reserve System, which can be illuminating

[1] By covering these articles we also cover the following articles of the EC Treaty: Article 4a(1) (=Art. 1-ESCB); Article 104 (=Art.21-ESCB); Article 105(1)-ESCB (=Art. 2-ESCB); Article 105(2) (=Art. 3.1-ESCB); Article 105(3) (=Art. 3.2-ESCB); Article 105a(1) (=Art. 16-ESCB); Article 106(1) (=Art. 1.2-ESCB); Art. 106(2) (=Art. 9.1-ESCB); Article 106(3) (=Art. 8-ESCB); Article 106(5) (=Art. 41-ESCB); Article 106(6) (=Art. 42-ESCB); Article 107 (=Art. 7-ESCB); Article 109a (=Artt. 10.1, 11.1 and 11.2-ESCB); Article 109b(3) (=Art. 15.3-ESCB). Art. 109m will be touched upon under Art. 109-EC.
Observations are also made on the following EC Treaty articles (we refer to the Article Index for the exact location): Articles 3a (activities of the Community), 103 (economic policy coordination), 104a (no priviliged access), 104b (no bail-out clause), 104c (no excessive deficits), 105a(2) (issue of coins), 109d (right to request the Commission to make a recommendation or a proposal).

[2] See especially under Art. 10.4-ESCB.

for understanding the issues and choices made in designing the ESCB. We then continue with the description of the history of the article, starting with the deliberations in the Delors Committee, followed by a description of the drafting process of the ESCB Statute within the Committee of Governors and its committees (finalised in November 1990)[3] and a description of the discussions in the IGC.
It should be noted that the central bank governors had been meeting and co-operating already for many years in the context of the Committee of Governors, established in 1964.[4] They had established not only good relations, but their views on the world had also converged as they had been shaped by the same developments (ERM crises, success or non-success in fighting inflation). Nonetheless, national preferences and traditions must have influenced the way the governors looked at the world. For instance, their views on the role of central banks in supervision was probably to a large extent determined by traditions at home. For this reason, in a number of cases tables will be presented showing the national differences. It will become clear that the views of the governors had converged a lot more than their national central bank laws might suggest.

The descriptions will be as factual as possible. The conclusions we want to draw - also in terms of checks and balances - are presented in chapter 5. This procedure is repeated for cluster II and III in chapters 6-11.
As regards this chapter, it is advisable to read Articles 1 and 7 first (on the constitution and the independence, respectively) in view of their overriding importance and then the other articles. In every cluster the articles are presented in numerical order.

[3] An extended version, also including *inter alia* the chapter on financial provisions, was offered to the IGC in April 1991.
[4] Council Decision of 8 May 1964 on cooperation between the central banks of the Member States of the European Economic Community (64/300/EEC).

4.2 GENESIS OF SELECTED ARTICLES (CLUSTER I)

Article 1:

Article 1: The European System of Central Banks

" 1.1 The European System of Central banks (ESCB) and the European Central Bank (ECB) shall be established in accordance with Article 4A of this Treaty; they shall perform their tasks and carry on their activities in accordance with the provision of this Treaty and of this Statute.

1.2 In accordance with Article 106(1) of this Treaty, the ESCB shall be composed of the ECB and of the central banks of the Member States ('national central banks'). The Institut monétaire luxembourgeois will be the central bank of Luxembourg."

(to be read in conjunction with: Article 2-EC (Community principles), Article 3a-EC (Community activities); Article 7-ESCB (independence); Article 8 (decision-making bodies); Article 9-ESCB (legal capacity ECB); Article 12.1, first and second paragraph (division of labour between ECB Governing Council and Executive Board); Article 28 (capital ECB); Article 34-ESCB (legal acts); Article 105(1)-EC (which is a copy of Article 2-ESCB); Article 106(1-3)-EC (mirroring Articles 1.2, 8, 9.1 and 9.2-ESCB))

This section also deals with the genesis of Article 4a of the EC Treaty:

"Article 4a-EC

A European System of Central banks (hereinafter referred to as "ESCB") and a European Central Bank (hereinafter referred to as "ECB") shall be established in accordance with the procedures laid down in this Treaty; they shall act within the limits of the powers conferred upon them by this Treaty and by the Statute of the ESCB and of the ECB (hereinafter referred to as "Statute of the ESCB") annexed thereto."

I. INTRODUCTION

I.1 *General introduction*

An important decision made by the Delors Committee was to propose to establish a System of central banks, and not a new Central Bank replacing and/or absorbing all existing central banks. Within this new System an entity would be created (the European Central Bank) to act as the central coordinating and decision-making point and with (at least the possibility of) operational tasks.[1] Delors envisaged a System with a *federal* nature. Federal in the German sense of the word, with all elements of the System participating in the decision-making (the precise balance between the centre and the NCBs, for instance in terms of voting rights, being left open), though effective and decisive decision-making should be guaranteed. A federal

[1] See section II *infra*.

nature for the System was a German demand.[2] Germany itself had been an effectively governed, federal state since 1949. The UK, especially then prime minister Margaret Thatcher, resented federalism, which she equated with concentrating and handing over power to anonymous, not accountable bureaucrats. Here national traditions played a role: government in the UK is relatively strongly centralized, whereas in Germany the Bundesrat (in which the Prime Ministers of the governments of the Laender play an important role) does exert political influence.[3]

We will come to the decision-making structure later (Article 8-ESCB and Article 106(3)-EC), but it is useful to refer to the diagram below which maps out the governing structure of the Eurosystem. The IGC decided that the central banks of EU Member States with a derogation (i.e. not fulfilling the conditions for the adoption of the single currency)[4] would nonetheless be part of the ESCB, though - of course - they would not take part in the operations and the decision-making of the System (see Chapter IX of the ESCB Statute on the Transitional and other provisions for the ESCB, esp. Articles 43, 45 and 47). This explains why the Article 1-ESCB refers to *the* (i.e. *all*) EU central banks.

Many articles only apply to the ECB and the NCBs of the *participating* countries, which can only be seen by reading these article in conjunction with articles 43 and 47. This group has later been labelled by the term **'Eurosystem'**.

DIAGRAM 1 [5]

('Eurosystem policy making process') (= Figure 8.1 of 'The Economics of the Euro Area', van Bergeijk (2000), next page; on January 1, 2001 Greece entered the euro area)

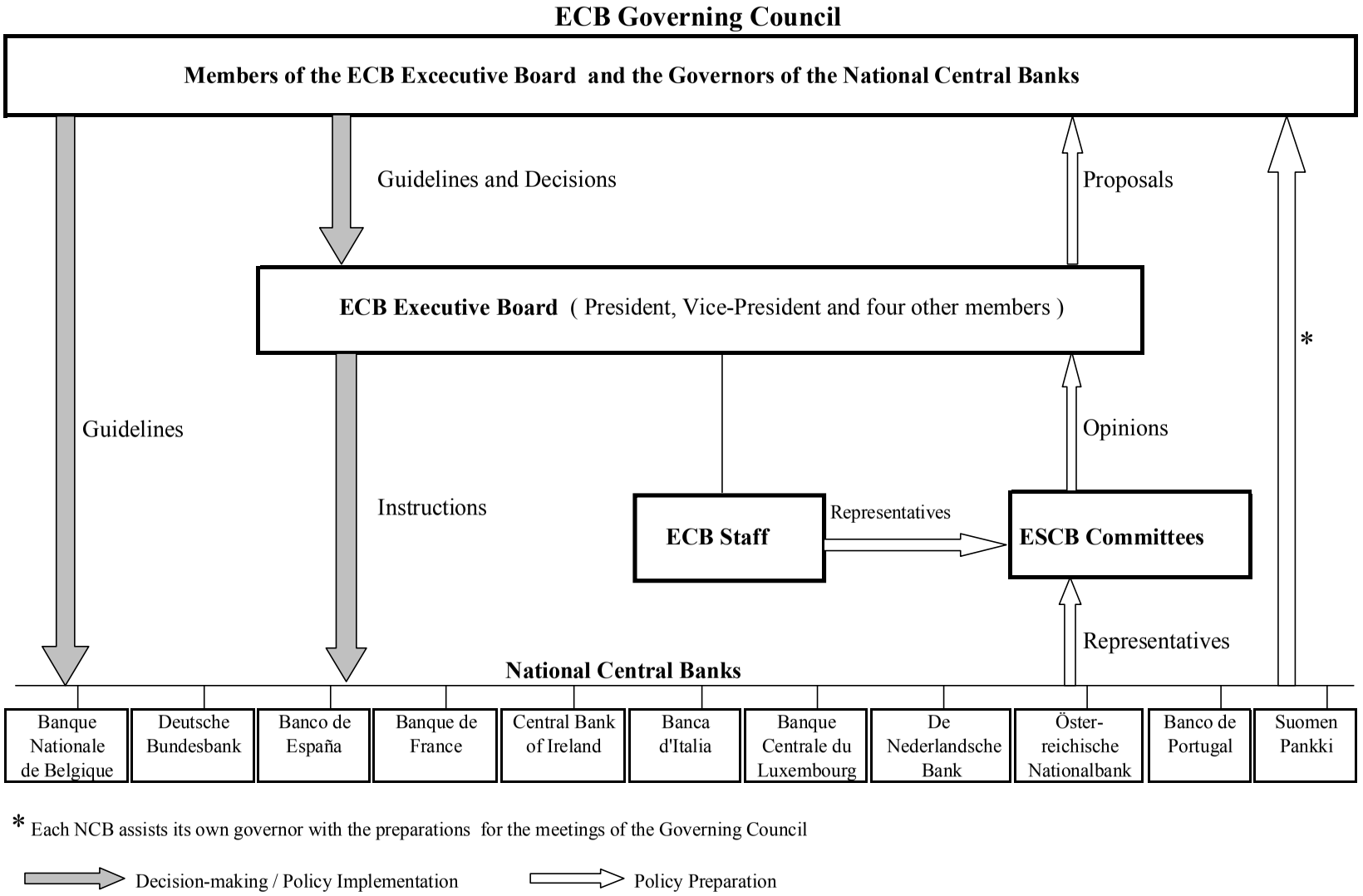
[2] See for instance the Memorandum of the German Minister of Finance Gerhard Stoltenberg ('The further development of monetary cooperation in Europe', dated March 15 1988), in which he reacts on earlier memoranda of Amato, Balladur and Genscher hinting at the possibility of Economic and Monetary Union. According to Stoltenberg "An Economic and Monetary Union also includes a European Central Bank, which in our opinion should meet in particular the following criteria: - It must be committed to the goal of price stability; - In fulfilling its task it must be independent of instructions from member governments or other Community bodies; - The decision-making process must strike the proper balance between central and federative elements." Printed in German in HWWA 1993. Cf. also the internal position paper of the Bundesbank of April 1988, Sektion IIB.4: "Ohnehin ist vor dem Endstadium einer Einheitswährung nur ein föderatives Zentralbanksystem denkbar." This text reappears in a paper submitted by Pöhl to the Delors Committee ('The further development of the European Monetary System' (September 1988)), printed in the appendix to the Delors Report.

[3] For a further discussion on the concept of federalism as applied to States and central banks, see Zilioli and Selmayer (1999b), pp.190-200.

[4] The UK and Denmark negotiated a special position, allowing them to hold a referendum on the question whether or not to adopt the single currency - see Protocols nr 11 and 12 of the Treaty of Maastricht.

[5] There is an important difference between this representation and that by Smits (1997), p. 145, and Zilioli (1999b), p.203. Both put the ECB in the top of the hierarchy, where our figure puts the Governing Council at the top.

Figure 8.1 Eurosystem policy-making process



* Each NCB assists its own governor with the preparations for the meetings of the Governing Council

Decision-making / Policy Implementation

Policy Preparation

The diagram shows the ECB is not standing over and above the NCBs. It is the Governing Council (GovC) which decides on policy. The ECB, apart from being endowed with the competence to carry out operational central bank functions itself,[6] is instrumental in seeing to it that the policy-decisions of the GovC are carried out. To this end the Executive Board may - and where necessary will - issue guidelines and instructions to the NCBs. The tasks and competences of the Executive Board (relative to those of the GovC) are dealt with under Article 12.1, first and second paragraph). The Executive Board also prepares the meetings of the GovC (Article 12.2-ESCB). The GovC has established a number of committees in which experts participate of both the ECB and the NCBs. The Statute does not refer to the role (or the existence) of such committees. The committees are established under the rules of procedure of the GovC (see Article 12.3). The committees do not prepare the meetings of the GovC, but do give input for their decisions and discussions - and in this sense add to the federal character of the System. Committee reports are presented to the GovC via the Executive Board, which may comment on it. More on the internal structure of the System can be found in Cluster II.

Initially when drafting the first versions of the ESCB Statute the Committee of Governors gave legal personality to the System as such. This was rejected – see section II.2 below - by their legal experts. Only the ECB and the NCBs were to have legal personality. Legal personality, either for the System or the ECB, is necessary for the System/ECB to be endowed with capital and to hold, buy and sell assets. Without legal personality the System/ECB could only act on behalf of the Community - the foreign reserve assets would have fallen under the control of the European Community and it would have weakened the role of the System/ECB in exchange rate matters.
A by-product of not giving legal personality to the system was that the governing bodies of the ESCB (composed of the ECB and NCBs together) had to be allocated to either the ECB or an NCB, because for legal reasons they could not be allocated to a body without legal personality.[7] This explains that Article 8-ESCB states: 'The ESCB shall be governed by the decision-making bodies of the ECB.' This is cause for a lot of confusion. From the above it should be clear that the Governing Council and the Executive Board are governing bodies for the System as a whole, with decision-making by the EB being limited to implementing (or making NCBs implement), and not deciding on, monetary policy (Article 12.1, second paragraph). In the same vein, it is not the System which becomes party to a contract, but the ECB *on behalf of the System* (see Article 39-ESCB and Article 13.2-ESCB). The financial provisions are also in line with this structure (Article 32 and 33). It is not the System which generates income, but the NCBs and the ECB. The seigniorage of the NCBs and the profits of the ECB are distributed over the NCBs. In case of losses by the ECB, the Governing Council can decide to offset these losses against the monetary income generated by the NCBs.

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[6] Actual participation of the ECB in the regular monetary policy operations would require a decision by the Governing Council, as at the moment these operations are carried out by the NCBs. See 'The Single Monetary Policy in Stage Three - **General Documentation** on ESCB monetary policy instruments and procedures', ECB, September 1998, Chapter 1. See also Art. 12.1. third paragraph in cluster II.

[7] This would have created the risk that the Governing Council and the Executive Board would have become Community institutions, like the Commission, which also does not have legal personality, but acts on behalf of the European Community. The European Community does have legal personality on the basis of Article 210-EEC/EC: 'The Community shall have legal personality.'

An alternative option, though only considered for a short time,[8] was to limit the role of the central institution to being merely a management committee, while the System would represent a group of central banks. The balance sheet of the 'System' would consist of the aggregated balance sheets of the NCBs, while the highest executive body would consist of the governors and the management committee. The question would still have been: who owns the shares of the system? One obvious possibility would have been the Member States. Now it is the other way around: the NCBs own the shares of the ECB, which strengthens both the independence and the federal character of the system, because it strengthens the hand of the governors relative to the Board members.

I.2 *Relevant features of the Federal Reserve System*

In the US the situation is as follows.[9] The Federal Reserve System (FRS) consists of the twelve Federal Reserve Banks (district banks) and the Federal Reserve Board (Washington D.C.). Each district bank is a banking corporation operating under a charter issued by the U.S. Federal Government (Federal Reserve Act, Section 1.4). The stocks of these Federal Reserve Banks are owned by local banks. [10] The Board of Governors is a separate legal entity; it is an independent agency within the government responsible to the U.S. Congress (Federal Reserve Act, Section 10.1, 10.3 and 10.4). The System as such does not have legal personality. In fact, the original Federal Reserve Act of 1913 did not use the phrase 'Federal Reserve System'. This only appeared in 1935, when the composition of the Federal Reserve Board was changed and it was renamed into 'Board of Governors of the Federal Reserve System'.[11] The Board of Governors is accountable to the Congress (Federal Reserve Act, Section 10.7). The status of the Board of Governors is different from a ministerial agency, such as a Treasury Department, which is part of the Executive Branch and ultimately under the authority of the President. Since the U.S. have distinctly separate Executive and Legislative Branches of the Federal Government, it is possible to have agencies within the Legislative Branch that are accountable to Congress. The Board of Governors is one such agency. (A similar constitutional structure does not exist in the European Union.)

A major question for the founders of the FRS had been the degree to which the U.S. central bank should be a public or a private institution. We quote former governor Meyer (2000) on this: 'Bankers wanted a largely private central bank. Populists wanted a public institution. President Wilson and Congressman Glass steered a middle course. There would be a Federal Reserve Board which was completely public and Federal Reserve Banks that would have significant characteristics of private institutions.'

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[8] See section II.2 below and Art. 12.1, first and second paragraph, section II.2 in cluster III on the respective roles of the Board and the Governing Council.

[9] Based upon: "Federal Reserve System: Purposes and Functions" (1994) and "The Federal Reserve Act & other Statutory Provisions Affecting the Federal Reserve System (As Amended Through August 1988)".

[10] The nation's banks can be divided into three types according to which governmental body has chartered them and whether or not they are members of the FRS. Those chartered by the federal government (through the Office of the Comptroller of the Currency in the Department of the Treasury) are national banks; by law, they are members of the FRS, they are stockholder in the FRB of the district they are located in and they have a say in the appointment of part of the board of directors of the district bank. Banks chartered by the states are divided into those that are members of the FRS (state member banks) and those that are not (state nonmember banks). See also sections I.2 of Art. 16- and 28-ESCB.

[11] See Art. 12.1-ESCB, third paragraph, section I.2 and Appendix 1, for a further description of the evolution of the Federal Reserve in its early years.

A major component of the FRS is the Federal Open Market Committee (FOMC), established in 1933.[12] The FOMC sets operational targets for the federal funds rate, that is the operational money market rate against which banks borrow reserves held by other banks at their local FRB. More specifically, the FOMC instructs the New York Fed to influence the conditions in the reserve markets through open market operations in such a way that these conditions are consistent with achieving the desired federal funds rate. The FOMC is composed of the seven members of the Board of Governors and five of the twelve Reserve Bank presidents.[13] The president of the New York Fed is a permanent member; the other presidents serve one-year terms on a rotating basis. All the presidents though participate in FOMC discussions, contributing to the Committee's assessment of the economy and of policy options, but only the five presidents with voting power take part in the decisions. [14]

Comparing the Fed and the ESCB

We note here that both in the US and the eurosystem all components of the central bank system including the central institution have legal personality - and not the system as such. A difference is that the Board of Governors, unlike the Executive Board of the ECB, is not empowered to perform operational tasks itself. US Congress aimed, inter alia, at reducing the dominance of New York City, and not at creating a new dominant financial centre.[15] In Europe, it was not parliament drafting the draft Statutes, but the governors themselves. Their aim was not to break down the power of one particular financial centre, but to create a centre which would be impressive both vis-à-vis the political authorities and effective vis-à-vis the financial markets. Therefore, they gave the ECB a balance sheet and the *possibility* of operational powers. This last decision might have been facilitated by the fact that the decision on the location of the ECB was postponed.[16] Though both the (components of the) ESCB and the Fed have legal personality, the ESCB is more independent, because it is not an agency 'within the government'. It is an institution *sui generis* with constitutional status.[17]

II.1 HISTORY: DELORS REPORT

The Delors Report notes that 'a single monetary policy is an inescapable consequence of monetary union.' The responsibility for the single monetary policy would 'have to be vested in a new institution.' [18]

This new institution should be 'placed in the constellation of Community institutions (European Parliament, European Council, Council of Ministers, Commission and Court of Justice).'[19]

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[12] See also section I under Article 12.1, third paragraph, which is dealt with under Cluster II.

[13] Federal Reserve Act (FRA), Section 12A.

[14] For more details, see section I of Article 10.2, second paragraph *infra*.

[15] See under Art. 12.1, third paragraph, section I.2 in Cluster II. At the same time one had to bring the banks in the System, as until then the banks had been used to manage their reserve positions without a central bank, with the Treasury exercising some benevolent, but ineffective influence through the (re)placement of its deposits. See A. Jerome Clifford (1965), 'The Independence of the Federal Reserve System', pp. 48-55 and 73-75. See also Article 16, section I.2 in cluster II for a description of the American banking system before 1913.

[16] In the Governors' draft the seat was left open. In the version adopted by the IGC the decision was referred to the Heads of State, to be taken before the end of 1992 (Art. 37-ESCB). Under strong pressure from Germany the choice would fall on Frankfurt, even though this was already the seat of the German Bundesbank.

[17] This also effects its relation with parliament - see under Art. 10.4-ESCB and Art. 109b-EC.

[18] Delors Report, par. 24.

The Delors Report chose for a federal form: 'Considering the political structure of the Community and the advantages of making existing central banks part of a new system, the domestic and international monetary policy-making of the Community should be organized in a federal form, in what might be called a *European System of Central Banks* (ESCB). This new System would have to be given full status of an autonomous Community institution. It would operate in accordance with the provisions of the Treaty, and could consist of a central institution (with its **own balance sheet** - emphasis by the author) and the national central banks. At the final stage the ESCB - acting through its Council - would be responsible for formulating and implementing monetary policy as well as managing the Community's exchange rate policy *vis-à-vis* third currencies. The national central banks would be entrusted with the implementation of policies in conformity with guidelines established by the Council of the ESCB and in accordance with instructions from the central institution.' [20]

The Delors Committee put emphasis on the creation of a System, of which both the new central institution and the existing NCBs would be parts. It is also useful to quote the section of the Delors Report on the structure of the ESCB:

'**Structure and organization [of the ESCB]**
- A federative structure, since this would correspond best to the political diversity of the Community;
- establishment of an ESCB Council (composed of the Governors of the central banks and the members of the Board, the latter to be appointed by the European Council), which would be responsible for the formulation of and decisions on the thrust of monetary policy; modalities of voting procedures would have to be provided for in the Treaty;
- establishment of a Board (with supporting staff), which would monitor monetary developments and oversee the implementation of the common monetary policy;
- national central banks, which would execute operations in accordance with the decisions taken by the ESCB Council.[21]

Delors Report, par. 32

The Delors Committee also clearly envisaged that establishing EMU would require an amendment of the Treaty of Rome establishing the European Economic Communities (Delors Report, par. 18 and 54). This followed from the fact that the EEC did not have competences in monetary affairs. Therefore, a European central bank could not be established by means of normal Community legislation. Any such decision would require a Treaty change. This was also safeguarded by the wording of Art. 102a-EEC, inserted in the EEC Treaty in 1985. This

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[19] Delors Report, par. 31. The inclusion of the European Council (which brings together the Heads of State or Government and the President of the Commission) in the list of Community institutions surprises, because the European Council is not one of the Community institutions or organs. It is not part of the Community decision-making structure. Its role would be defined formally by Article D of the Treaty of Maastricht: 'The European Council shall provide the Union with the necessary impetus for the development and shall define the general political guidelines thereof.' The Heads of State or Government can take decisions in two forms: as the Council (of Ministers) in the composition of the Heads of State or Government or when a decision is called for 'by common accord of the governments of the Member States at the level of Heads of State or Government.'

[20] Delors Report, par. 32. The Delors Report did not give a name to the central institution.

[21] Delors report, ibidem. For more information on the discussions on the division of labor between the NCBs and the centre see Article 12.1, third paragraph.

wording had been chosen so as to block an effort by Delors to create a potential monetary competence for the EEC.[22]

The Delors Report envisaged that the ESCB would be established in stage two of EMU. It would absorp the EMCF and the Committee of EEC Central Bank Governors. However, the Committee of Governors would not be able to come to a unanimous view on the question as to *when* to establish the ESCB.[23] In the end the IGC was to decide that the ESCB be established just before the start at the third stage to allow it to prepare the regulatory, organizational and logistical framework necessary for the ESCB to perform its tasks in the third stage (Article 4.2 of the Statute of the EMI).

II.2 HISTORY: COMMITTEE OF GOVERNORS

The Committee of Governors took - as had been proposed by the Delors Committee - the federal structure of the new system as their starting point. The discussion in the Committee of Governors (and the committee of their Alternates) centered on a few (related) issues: the name of the system (should it be European Central Bank System or European System of Central Banks - the first name putting more emphasis on it being one unity); the status of the System within the Community framework (should it be added to the list of existing Community institutions or should it be listed separately); the position of the ECB within the

[22] In 1985 Delors had tried to use the Single European Act to insert a monetary capacity in the Treaty of Rome as a first step towards establishing EMU. Kohl brokered a compromise between on the one hand Delors and Mitterrand and on the other hand Bundesbankpresident Pöhl, Bundesfinanzminster Stoltenberg and Thatcher, who had resisted Delors' proposal. Kohl pressed successfully for a Treaty provision (Article 102a-EEC) on 'monetary capacity' which stopped short of providing the EEC with formal competence in monetary affairs and which gave no new role to the EC Commission in this respect. He had asked Tietmeyer, then under-Secretary of the German Ministry of Finance, to draft a text acceptable to all parties. The new article (Article 102a) contained a phrase stating that, in furthering co-operation in economic and monetary policy, Member States 'shall respect existing powers in this field.' This phrase was seen as safeguarding the Bundesbank's independence. (Dyson/Featherstone (1999), p. 319.) The last paragraph of Article 102a is important in its own respect. It read: 'Insofar as further development in the field of economic and monetary policy necessitates institutional changes, the provisions of Article 236 shall apply. The Monetary Committee and the Committee of Governors of the Central Banks shall also be consulted regarding institutional changes in the monetary area.' (Article 236-EECs determines that a Treaty change has to be prepared by an Intergovernmental Conference and has to be ratified by the Member States according to their national ratification procedures.) This formulation ruled out that in these fields new institutions could be created by the Council of Ministers using Article 235-EEC, as Delors had proposed in his earlier draft of Article 102a. (Szász (1999), p. 94.) Article 235 allowed ministers to take - by unanimity - all these measures not provided for by the Treaty, but deemed necessary for the realization of the internal market. This article had been used to establish the European Monetary Co-operation Fund, which according to the recitals of the Regulation establishing the EMCF was 'to be integrated at a later stage into a Community organization of central banks' - see recital of Council Regulation (EEC) No 907/73 of 3 April 1973. The EMCF played a role in facilitating the smooth operation of the exchange rate arrangements in the Community (the Snake). This procedure was clearly seen as a dangerous precedent by the central bank governors.

[23] The background of this was that the German and Dutch NCBs feared monetary integration would risk never reaching stage three, in which case an ESCB already established in stage two with for instance operational tasks in the field of foreign exchange management could undermine the independent position of the Bundesbank. And, would an ESCB-in-stage-two already be as independent as in stage three? Moreover, the Dutch and German NCBs feared that some countries might even actively wish to stay in stage two, once an ESCB-in-waiting owning foreign exchange reserves was established. See also section II.1 of Art. 12.1, third paragraph, in cluster II.

ESCB (should it be prominent or dominant?). These questions had not been listed in advance, they came to the fore during the discussion on the draft texts, which were continuously being revised on the basis of the discussions.

In the very first draft of the ESCB Statute (dated 11 June 1990)[24] two alternatives were mentioned for the name of the System*: European System of Central Banks* and *European Central Bank System*, as used in the German translation of the Delors Report (Europäisches Zentralbanksystem). Some Alternates supported this last name because it reflected more adequately the unity of purpose and action which is required for an indivisible monetary policy in the Union.[25] The name of the central institution was also discussed. The first draft had used two alternative formulations: "a central monetary institution/ [European Central Bank]". The term "central monetary institution" was criticized by some, because it suggested the new centre, and not the system as such, would decide monetary policy. The term "European Central Bank" was criticized by others, because it seemed to imply that the central body would carry out a substantial share of the financial operations of the system. In their view a name reflecting a lower profile (Authority, Board, Council, Agency) should be adopted to reflect a more decentralized pattern of operations, in line with the principle of subsidiarity. [26]

We quote the draft for Article 1 as it looked at the end of June 1990:

"Article 1 - The [ESCB][ECBS]

A [European System of Central Banks] [European Central Bank System], consisting of a central monetary institution [European Central Bank] and the national central banks [whose currencies participate in the monetary union], is hereby established.

The ESCB shall be governed by the provisions of the Economic and Monetary Union Treaty and by these Statutes."

draft 22 June 1990

As of July the central banks' legal experts had started to delve into the questions of legal personality. The experts discussed questions such as: does the inclusion of the NCBs into the System ("the NCBs are an integral part of the System")[27] imply (only) a limitation of the use of their own legal personality, or the acquisition of a dual personality (one founded on national law, the other on the European law), or the transfer of their legal personality to the System (or the central institution within it)? Does the System as a whole need legal personality?

[24] For a description of the main players and committees, see the Introductory Chapter.
[25] Taken from draft versions dated 22 June and 3 July 1990.
[26] Ibidem.
[27] Sentence prepared by the Secretariat of the Committee of Governors following their discussion on 10 July, during which it was stressed that the centre should not have 'large number of operational and supporting staff', while it should be made clear the 'NCBs [would be] acting as an operational arm of the Council [of the ECB].' The sentence would become part of Art. 14.3-ESCB.

This is specific legal ground. However, the following considerations can be understood easily: [28]

1) Legal personality is a basic requirement in order to assume ordinary functions of central banks (to acquire assets and liabilities).
2) If legal personality were attributed *only* to the System, the national central banks would have to be subsumed by the System. This was not in line with the current thinking of the governors.[29] It would also have been impractical, because most NCBs als perform non-System tasks (e.g. supervision of banks, printing banknotes), and efficiency would have been affected negatively (e.g. in the field of collecting statistics and overseeing national payment systems, both of which have national and ESCB-related elements).
3) If both the System and the NCBs had their own legal personality, but not the central institution, it would still not be possible to shift operations to the central institution. In the eyes of the experts the draft statute implied that the central institution should at least be able to perform directly the principal activities of a central bank.[30]
4) It follows that the experts recommended that the central institution should have legal personality. It was considered an advantage that this solution left open the future distribution of power and operations between the central institution and the national central banks.

The experts discussed in more detail the issue whether the System should be added to the list of Community institutions in Article 4, or be treated differently, like the European Investment Bank and the Court of Auditors. The legal experts basically listed four arguments in favour of <u>not</u> adding the System to the list of Community institutions:
- unlike the listed Community institutions the ECB is a functionally limited body; [31]
- listing the ESCB as a Community institution could lead to complications as some Treaty provisions generally applicable to Community institutions should not apply to the ESCB (e.g. budget approval); [32]
- classifying the System as a separate institution would not imply the System would fall outside the Community legal framework; [33]

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[28] Taken from (1) a note called List of questions (and preliminary answers), dated 2nd August 1990 and prepared by the Legal Department of the National Bank of Belgium as background for a meeting of the legal experts, (2) the report of that meeting, and (3) the chairman's (Gunter Baer) summary of that meeting.
[29] Apart from this, subsuming NCBs in the System would have been politically undesirable, if not unacceptable: Germany would not have giving up the Bundesbank.
[30] One could dispute this. At that moment the draft statute still left open the possibility that the central institution would be merely a management committee.
[31] According to the legal experts, the four institutions mentioned in Article 4 (European Parliament, Council of Ministers, Commission and Court of Justice) could be regarded as "Constitutional organs", "Verfassungsorgane", of the Community. The ECB and the EIB (European Investment Bank) were seen a functionally limited bodies.
[32] Many provisions in the EC-Treaty mention the institutions (e.g. financial provisions, provisions on professional secrecy, languages). The legal experts observed that in some cases the references to institutions clearly concerned only the four main organs, while other provisions are applicable to every Community organ.
[33] In the words of the legal experts, classifying a body not as an Community institution does not mean such a body is exempt from the application of general rules of Community law (under the case law of the Court of Justice some general provisions of Community law have been applied to autonomous organs like the EIB and the Centre for Vocational Training. Cf. a ruling of the Court of Justice on the EIB: the high degree of operational and institutional autonomy of the EIB 'does not mean the EIB is totally separated from the Communities and exempt from every rule of Community law.' (Sentence take from a ruling by the Court of Justice on the legal status of the EIB. See R. Smits (1997), page 93.)

- in order to avoid uncertainty arising from the possible implicit application to the System of general provisions relating to Community institutions, the System should not be classified in Article 4.1 (but be mentioned in a new paragraph 2 of Article 4) [34] and the draft Statute should include specific provisions on each topic for which they were needed, relating, for example, to staff, budgetary issues, auditing, secrecy and judicial control.

The governors agreed with the proposal that the central institution and the NCBs should have legal personality, after the chairman of the Alternates (Rey) had explained that such a solution would be compatible with the assumption that the System should operate through both the central institution and the NCBs.[35] The governors also went along with the suggestion that the System should be inserted in a new par. 2 of Article 4 of the EEC Treaty.

The legal experts gave special attention to the question of whether the decision-making bodies (the Council and the Executive Board) should be attached to the System or the ECB. They favoured placing them inside the ECB. It was considered legally unclear to attach them to a body without legal personality, which would have created a serious risk that in the process of negotiations in the IGC the decision-making bodies would be regarded as "Community bodies".[36] Such might have had two consequences: the ECB Council might have become a Community institution, which - in turn - could be seen as a justification for including (only) non-central bank members in the Council of the ECB. [37]

The decision to give legal personality to the new institution and the NCBs, and not to the System, had implications for the draft Statute. This was explained in a letter by the chairman of the legal experts to the Alternates Committee[38]: "[T]he use of the term System must be restricted to those passages of the Statute where it describes (like "a label") the co-existence of the ECB and the NCBs, which are governed by common rules and which jointly pursue the objectives of the System and the tasks entrusted to it.[39] [40] However, whenever reference is made to decisions, advisory functions and operations, these must be clearly attributed to the ECB (or the Council and the Executive Board) and the NCBs." [41] These changes did not

[34] This became Article 4a-EC Treaty.

[35] Governors' meeting of 11 September 1990. The legal personality and capacity of the ECB would come to be mentioned in a new article (Art. 9). The statute did not need to extend legal personality to the NCBs, which already existed as legal personalities. Article 9-draft Statute is quoted at the end of this section.

[36] Or as "authorities of the Community" (similar to the existing Community institutions) which itself is an institutional legal person. 'Thus, in a law case coming out of a decision taken by the Council [of the ESCB] and/or the Executive Board, they may be involved as "representatives" of the Community, just as the Commission and the Council of the Community may be sued if EC decisions are challenged.' Taken from the Report of Legal Experts, dated 8th October 1990.

[37] Therefore, (then) Article 7 ('The decision-making bodies of the ESCB shall be the Council of Governors and the Executive Board') was changed into Article 8 ('General principles'): 'The System shall be governed by the decision-making bodies of the ECB.' (Draft version of 5 October 1990.) Article 8 underlines that the authority of the Council and the Executive Board, which are the decision-making bodies of the ECB, extends to the whole System. (Commentary with draft ESCB Statute of 27 November 1990.)

[38] Letter dated 8 October 1990.

[39] Therefore, the objective and tasks are attributed to the System (ESCB).

[40] See also Article 14.4.

[41] The System, not being a legal person, could not perform tasks nor conduct operations. Therefore, a number of articles were revised. For instance Article 3 ("The basic tasks of the System shall be") was changed into "The basic tasks carried out through the System shall be". Article 4 ("The System shall be consulted regarding any

affect Article 1. Tietmeyer considered that the amendments proposed by the Legal Experts (changing System into ECB and/or NCBs in many places) altered the balance of the text arrived at by the Governors in earlier discussions and were to the detriment of the System. While recognising the legal arguments for locating the Council inside the ECB (legal simplicity and clarity of responsibility in case of litigation), Tietmeyer noted that the Legal Experts had nevertheless concluded that it was feasible to position the Council outside and above the ECB and the NCBs. He felt that this latter approach had some important presentational advantages. In any event, he felt that the powers to make decisions and issue instructions for the System as a whole should be vested explicitly in the Council, rather than in an organ of the ECB.[42] The suggestions of the legal experts were nonetheless taken aboard. In retrospect this has been a very important decision for the ECB, as it enormously increased the standing of the ECB within the system.[43]

Article 1-ESCB of the final version of the draft Statute would read:

Article 1 - The System

Pursuant to Article .... of the EEC Treaty, a system, consisting of a central institution to be known as "The European Central Bank" (hereinafter "the ECB") and of the participating national central banks of the Member States of the Community (hereinafter "national central banks"), is hereby established and shall be known as the "European System of Central Banks" (hereinafter the "System").

draft 27 November 1990

Below we quote part of the Commentary on Article 1 accompanying the draft Statute, which refers to the status of the ESCB within the Community framework: [44]

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draft Community legislation (in its field)") was changed into "The ECB shall be consulted ...". Here the ECB would act as the System's central institution (in which the NCBs are represented through their governors). In other articles the term "the System" was replaced by a reference to both the ECB and the NCBs. For instance, Article 8 (later Article 7) stated that "neither the System, nor any member of its decision-making bodies may seek or receive any instruction etc". This was to be changed into "neither the ECB nor a national central bank nor any member of their decision-making bodies etc". Another example is Article 17 (later Article 18), according to which "the System shall be entitled (to operate in the financial markets by buying and selling etc.)". This was to be replaced by "... the ECB and the NCBs may etc." All changes were first introduced in the version of October 8. For the same reason Article 15 (later Article 16) which read "The Council shall have the exclusive right to authorize the issue of notes within the Community which shall be the only legal tender" was changed into "The Council shall have the exclusive right to authorize the issue of notes within the Community. The notes issued by the ECB and the national central banks shall be the only legal tender for any amount." This change was introduced in the draft of October 25th.

[42] At the same time - but not inconsistent with the foregoing - Pöhl and Tietmeyer favored a clear position of the Executive Board vis-à-vis the Council to avoid the situation they knew from home, where in the Zentralbankrat it was sometimes difficult to adopt certain decisions due to the presence of the presidents of the Landeszentralbanken who also had a majority in the Zentralbankrat. See discussion on Article 12, first and second paragraph (responsibilities of the decision-making bodies), especially the comments made in the draft versions of October 19 and 25, 1990.

[43] Remark made by one of the drafters of the texts, who later worked at the ECB. The issue of centralization or decentralization of operational tasks will be dealt with in Cluster II under Art. 12.1, third paragraph.

[44] Until mid-October the draft had contained *internal working comments* per article, mostly pointing out unresolved issues. However, later drafts would contain for each article a specific explanatory *Commentary*, which Commentary would be sent to the IGC together with a more general Introductory Report.

The accompanying Commentary with Article 1 read:

> *"Article 1 - The System*
>
> *[...]*
>
> *Neither the System nor the ECB are to be classified as a Community institution under Article 4, paragraph 1 of the EEC Treaty. Instead, it is suggested to refer to the establishment of the System in a new paragraph of this Article. In order to avoid any legal uncertainty arising from the possible application to the System of general provisions relating to Community institutions, Chapter VII includes the necessary provisions governing the general aspects of the System [aspects governing staff, budgetary issues, auditing, judicial control, professional secrecy, non-contractual liability, signatories, seat, priviliges and immunities].*
>
> *[...]."*
>
> *Commentary 27 November 1990*

For completeness' sake, we also cite Article 9.1 to 9.3 on the legal personality, capacity and immunity of the ECB:

> "Article 9 - The European Central Bank
>
> 9.1 The ECB is hereby established[45] and shall have legal personality.
>
> 9.2 In each of the Member States the ECB shall enjoy the most extensive legal capacity accorded to legal persons under their laws; it may, in particular, acquire or dispose of movable and immovable property and may be a party to legal proceedings.
>
> 9.3 The property of the ECB shall be exempt from all forms of requisition or expropriation. [....]"
>
> 9.4 …..
>
> draft 27 November 1990

As it was still foreseen that the ESCB could be established before it was even clear which countries would qualify for stage three of EMU, the governors had accepted that the central banks of the Member States not yet qualifying could still be participating in the ESCB, be it that the chapter on Transitional Provisions (which still had to be written) would indicate their rights and obligations. However, views were split on how to deal with central banks of Member States not willing to join EMU (read: the UK). This issue had to be resolved by the IGC.

II.3 HISTORY: IGC

The IGC would discuss the monetary side of EMU along two venues: first, along the monetary articles to be included in the Treaty (based on the draft Treaty proposals by the Commission, France and Germany and the text proposals made during the IGC by other delegations); second, through a number of separate sessions of the IGC deputies on the draft Statute prepared by the Governors.[46]

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[45] The mentioning of the establishment of the ECB would later be moved to Article 1, which already mentioned the establishment of the ESCB.

[46] The IGC would leave the Statute relatively untouched. At two occasions the Committee of Governors would react to changes resulting from IGC: it would react to the Luxembourg's non-paper of 6 June 1990 (letter to the IGC dated 5 September 1991, CONF-UEM 1617/91) and to the Dutch presidency's consolidated draft Treaty text of 28 October (letter to the IGC dated 13 November 1991, UEM/101/91).

The IGC would not challenge the federal structure, as proposed by the Committee of Governors (and already by the Delors Committee), neither would the IGC challenge the view that the ESCB should be mentioned in a new paragraph of Article 4, making it distinct from the existing Community institutions. The IGC would contribute to Article 1 by finding a solution for the definition of 'participating' central banks.[47]

Below we will follow the draft texts discussed during the Luxembourg presidency relating to Art. 1-ESCB and Art. 4-EC. As a starting point we look at the draft Treaty texts proposed by the Commission, France and Germany. The proposals from the UK and Spain hardly played a role in the negotiations, because their proposals basically aimed at stage two of EMU, during which the 'hard ecu' should increasingly substitute for the national currencies. This road had been rejected by the Delors Committee and the governors.
The Commission's draft treaty [48] adopted the position of the Governors not to mention the ESCB in Article 4.1-EC (containing the Communtity institutions), but indeed in a new paragraph 4.2:

> 4.2-EC Monetary policy shall be defined and pursued by a European System of Central Banks (herinafter referred to as "Eurofed") acting within the limits of the powers conferred upon it by this Treaty and the Statute annexed hereto.
>
> Commission's draft December 1990

Article 106 of the Commission's draft provided that "Eurofed shall be made up of the European Central Bank and the central banks of the Member States." [49] [50] The European Central Bank should have legal personality. In describing the objectives and tasks of the Eurofed the Commission stayed close to the draft Statute of the Governors, though there were also important differences.[51] The Commission accepted the idea that the Statute should get the status of a Protocol annexed to the Treaty and the idea that the ESCB should *not* get the status of a Community institution.
The French draft[52] paid a lot of attention to the institutional provisions and to stage two of EMU. The articles on monetary policy were clearly based on the draft Statute of the Governors, with a number of important exceptions.[53] The German draft[54] placed the ESCB in

[47] Solution based on a Dutch presidency's proposal to create (1) in stage two a new institution not being the ECB (but the European Monetary Institute, in which every central bank would participate) and (2) a third decision-making body of the ESCB, with only advisory functions.
[48] Draft Treaty amending the Treaty establishing the European Economic Community with a view to achieving Economic and Monetary Union, 10 December 1990.
[49] While the draft ESCB Statute had spoken of the 'participating' central banks (at the insistence of the UK), the Commission draft used the term 'central banks'. According to Article 109D(1) of the Commission's draft the Eurofed would be established at the start of stage two. This explains why the Commission wanted all central banks to participate in the Eurofed.
[50] The Commission had chosen to fit the articles on EMU in the existing chapter on economic policy, replacing Articles 102-109. This explains why the articles in the Commission's draft ran from 102 to 109H.
[51] Some differences were: a different name; a more political procedure for appointing the ECB Board members; exchange rate policy is determined by Ecofin; ownership of foreign reserve assets is transferred to the Community (and not to the ESCB); no role in the area of supervision.
[52] Projet de Traité sur l'Union Economique et Monétaire, 25 janvier 1991. Printed in HWWA (1993).
[53] The ESCB was made independent of political instructions in the exercise of its functions, though at the same time the French draft stated that 'le Conseil Européen définit, sur rapport du Conseil [des Ministres], de la Commission et du S.E.B.C., les grandes orientations de l'Union Economique et Monétaire.' (During a meeting of the deputies IGC in February 1991 the French personal representative (Trichet, then from the Trésor)

a new Article 4a ("An independent European System of Central Banks (ESCB) is hereby set up which, as provided in this Treaty and the Statute annexed thereto shall conduct the Community's currency and monetary policy with the overriding objective of maintaining price stability.") The ECB would have legal personality. The German draft was quite elaborate on Economic Union, but as short as possible on Monetary Union. The German authorities wanted to duplicate the Statute as little as possible in the Treaty, thus giving added status to the Statute as such. Both the French and the German draft proposed that the ESCB should consist of an ECB and the NCBs of the Member States and that the ECB should have legal personality.

In the first half of 1991 the Luxembourg presidency would regularly issue so-called non-papers which aimed 'to reflect the prevailing drift rather than the positions of each Member State taken in the IGC meetings' In a first non-paper covering articles 2 to 6 of the EEC Treaty[55] Article 4A read:

> Article 4a
> A European System of Central Banks (ESCB) is hereby set up; it shall act within the limits and powers conferred upon it by this Treaty and the Statutes annexed thereto.
> non-paper, 29 June 1991

Article 4A would remain unchanged throughout the Luxembourg presidency, apart from changing 'hereby' into 'according to the procedures laid down in the Treaty'. Article 1 of the draft ESCB Statute was brought in line with Article 4A, the main difference with the version of the Governors being the deletion of the word '*participating'*. [56] The deletion of the word 'participating' left open the precise modalities of the participation of the central banks of the countries which would not join Monetary Union from the start. Possible solutions which came to mind in these days were: central banks of countries not joining would not have the right to vote in the ECB Council, they would not be allowed to subscribe to the ECB's capital.[57] In the final Non-Paper of the Luxembourg presidency, before handing the presidency over to the Dutch, Article 1 read as follows:

> Article 1 - The System
> The "European System of Central Banks" (hereinafter the "System"), set up pursuant to Article 4A of the Treaty, consists of a central institution to be known as the "European
> ./.

defended this by saying the ECB would not be under instruction of the European Council, these 'orientations' merely constituted guidelines, like the ECB would be allowed to express its opinions on wage policy.) Furthermore, the French draft limited the role of the ESCB in matters relating to exchange rate policy to executing the orientations set by the Council of Ministers. And the capital of the ECB was to be held by the Member States. This last proposal was to come back in November 1991 (suggestion by the French Minister Bérégovoy, but again rejected). See discussion on Article 28-ESCB.

[54] Composite proposal; UEM/2991 and CONF-UEM 1612/91, dated February 26 1991. Printed in HWWA (1993).

[55] UEM/15/91, dated 29 January 1991.

[56] The issue was complicated because according to some the ECB should be established quite early in Stage Two, at which time it would not yet be clear which Member States would participate in Stage Three from the beginning.

[57] Taken from an internal note of the Dutch central bank of June 20 1991.

Central Bank" (hereinafter "the ECB") and of the central banks of the Member States of the Community (hereinafter "national central banks").

non-paper, 6 June 1991

According to some legal experts Article 4A should also have mentioned the establishment of the ECB (or at least mention that the ESCB consists of the ECB and the NCBs) to bring it on equal footing with the European Investment Bank which is explicitly named in Article 4B ("A European Investment Bank is hereby established etcetera"). During the Dutch presidency the ECB would indeed be added to Article 4A.

The first draft of the Dutch presidency containing Article 4A and the ESCB Statute was presented on 28 October 1991.[58] The words 'participating' had not reappeared, the reason being that consensus had emerged to establish a third decision-making body for the ESCB, the General Council (at that time called the Chamber of Governors) - see the Dutch draft of Chapter IX of the ESCB Statute, UEM/82/91.[59] The General Council would consist of all central banker governors, also those of the derogation countries. This new body would not be a decision-making body, but merely contribute to the collection of statistical information and to the advisory function of the ECB.
Nonetheless, the construction allowed all central banks to say they were part of the European System of Central Banks. But the derogation central banks would of course not sit in the Governing Council of the ECB. At the very last moment (i.e. during Maastricht) the UK would create a special position for itself, by producing a protocol which gave it the right not to participate, even if it were to qualify. This protocol gave the UK the same rights as the derogation countries.[60]
During November 1991 it was decided that Article 4A and therefore also Article 1-ESCB should mention the establishment of the ESCB and of the ECB. Article 1-ESCB was split in two parts: a first section referring to the establishment of the ESCB and the ECB (and the limits on their powers) and a second one referring to the composition of the ESCB (ECB + NCBs)[61]. During the nettoyage juridique some further slight editing of Article 1.1 took place,[62] after which the final form cited at the start of section I above, was reached.[63]

[58] UEM/82/91, annexed to UEM/90/91. The first months of the presidency the discussion in the IGC had focused on finding political solutions for the most pressing issues, like the transition to stage three, the transition to and the content of stage two, external monetary policy in stage three and economic policy in stage three. See UEM/49/91, report on the working procedure under the Dutch presidency.
[59] To be exact, the General Council is the third decision-making body of the ECB, because it was considered desirable to allocate the decision-making bodies to an institution with legal personality.
[60] Protocol nr 11 attached to the Treaty of Maastricht.
[61] See UEM/112/91 of November 22, 1991.
[62] "(in the Statute called "ESCB")" was replaced by "(ESCB)"; "perform their functions" was replaced by "perform their tasks".
[63] The sentence referring to Luxembourg in Art. 1.2 had been added to make clear that Luxembourg would participate in the ESCB, even though its monetary institution was not called a national central bank. Luxembourg had long been in a monetary association with its big neighbour Belgium (with for instance the Belgian franc being legal tender in Luxembourg too) - with the Belgium central bank performing the basic monetary central bank functions for both countries.

Article 2:[1]

Article 2-ESCB: Objectives

"In accordance with Article 105(1) of this Treaty, the primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 of this Treaty. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a of this Treaty."

(to be read in conjunction with: Article 2-EC (Community principles), Article 3a-EC (Community activities); Article 7-ESCB (independence); Article 12.1-ESCB, first and second paragraph (division of labour between ECB Governing Council and Executive Board); Article 34-ESCB (legal acts))

Nota bene: This section also deals with the genesis of **Article 105(1) of the EC Treaty**. Article 105(1) reads exactly the same as Article 2-ESCB except for a few changes reflecting the fact that the articles of the Statute refer to the corresponding article in the Treaty (the Treaty article does not refer to the corresponding article in the Statute):

"Article 105-EC
1. The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a."

I. INTRODUCTION

I.1 Price stability
I.2 Independence and a narrow mandate
I.3 Secondary objective
I.4 Market conformity
I.5 Relevant features of the Federal Reserve System

I.1 *Price stability*

The ESCB is entrusted with one overriding objective: to maintain price stability in the euro area.[2] This was, together with the independence of the new ESCB, a precondition of the

[1] Preferably, Article 7 should be read first, as Article 1 and 7 cover an important part of the historic and institutional background of the process leading to the ESCB statute.

German authorities (government and central bank) for even considering to give up their own national currency. Price stability together with Erhard's Soziale Marktwirtschaft (social market economy) had formed the foundation for the economic success of post-war Germany. For Erhard the social market economy was always and foremost a market economic system. The dynamics of the market were for Erhard the source of affluence. Erhard "believed that monetary stability deserved to be counted among the 'basic human rights'. The free play of market forces requires, above all else, stable money. Monetary stability is also of great importance for social peace. For monetary instability always acts to the disadvantage of the weaker members of a society." [3] [4]
Because of its long record of low inflation the German currency had become the strongest of the European currencies. Only some of the smaller currencies managed to maintain their parity with the Dmark, other currencies had to devalue frequently. Devaluations were usually felt as an embarrassment by the government of the devaluing country.

Part of the orthodoxy in mainstream economic thinking in the late eighties and early nineties was that price stability creates the best climate for durable economic growth. This was a reaction to the dismal experiences of stagflation in the seventies, which could not be solely attributed to the adverse impact of the first oil shock of 1973, but also to accommodating policies, especially in the monetary field. In other words, belief in a downward-sloping Phillips curve waned, implying no durable trade-off between inflation and unemployment. Monetary policy may at best only temporarily increase output, but at the cost of a sustained higher rate of price increases.[5] Part of the orthodoxy was also that price stability was best achieved by an independent central bank. An independent bank, that is a central bank not susceptible to political pressure, solves the time-inconsistency problem in monetary policy, assuming the central banker is more 'conservative' than the government and assuming an independent central banker is less inclined to please the electorate with short-term monetary relaxation. This problem arises from the policy-makers' natural bias to stimulate output above the natural level and to finance government deficits as cheaply as possible, resulting in an inflationary bias. In other words, the problem arises when the authorities cannot credibly commit to price stability. This will lead not only to a once-off higher inflation, but permanent higher inflation and increased risk premia in real long-term interest rates. In these circumstances appointing a central banker who puts more weight on price stability than on

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[2] Price stability is not only the objective of the single monetary policy, but also of the Community's exchange rate policy. See Article 3a(2)-EC which describes the activities of the Member States and the Community:
"Concurrently with the foregoing, and as provided in this Treaty and in accordance with the timetable and the procedures set out therein, these activities shall include the irrevocable fixing of exchange rates leading to the introduction of a single currency, the ecu, and the definition and conduct of a single monetary policy and exchange-rate policy *the primary objective of both of which shall be to maintain price stability* [emphasis by the author] and, without prejudice to this objective, to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition."
[3] See Tietmeyer (1999), p. 9. See ibidem pp. 5-13 for an exposé of Erhard's concept of the Social Market Economy.
[4] Indeed, price stability was considered important, because it contributes to the social fabric. It does not only have economic, but also social benefits, for instance because inflation hits persons with fixed savings, like parents who save to pay for the university study of a child, or who saved for a fixed pension. Phrased in terms more familiar to economists: inflation leads to wealth redistribution with negative effects for the less sophisticated (usually poorer) economic agents. This last observation is supported by recent research, see W. Easterly and S. Fischer (2001).
[5] See Houben (2000*),* p. 38.

output or employment stabilization improves the outcome also for the government relative to government setting policy itself.[6] Increasing the independence of a central bank will make that central bank's commitment to price stability more credible. It will also reduce election-induced uncertainties. However, the independence comes at a cost of less flexibility for the government, which leads some authors to suggest the option for the government to overrule the central bank in 'extreme circumstances'. (However, this belies both the independence - and therefore the credibility factor - of the central bank, thus not solving the time-inconsistency problem, and the fact that in 'extreme circumstances' central bankers are flexible themselves. See for instance McCallum (1995) versus Lohmann (1992).)

An exact definition of price stability was not discussed at the time of Maastricht. The issue of defining price stability was just never raised.[7] This might surprise now, but it should be understood against the following background. First, 'maintaining price stability' was already more specific than the mandate of many central banks, including that of the Bundesbank. Most mandates spoke of 'maintaining the value of the currency' or similar variants.[8] Many central bank statutes had been written in a period in which the value of money was not a policy target, either because according to economic theory prices were assumed rigid, or because of the pre-war world of the gold standard, in which price level changes (vis-à-vis other countries) were supposed to be mean-reverting through the contractory or expansionary effects of gold exports or imports which financed current account imbalances resulting from diverging price levels. Second, the so-called strategy of direct inflation targeting (a strategy with an explicit target for the inflation rate - usually a range) was not yet practiced, at least not in Europe. The first country to experiment with direct inflation targeting was New Zealand as of 1989, followed by Canada in 1991 and in 1992 by the UK. [9] The Treaty left the issue of defining price stability - or in a broader sense detailing the monetary strategy - to the ESCB.
In 1998 the Eurosystem would define price stability as follows (text taken from ECB Press release entitled "A stability-oriented monetary policy strategy for the ESCB", 13 October 1998: **"(...) the Governing Council of the ECB has adopted the following definition: 'Price stability shall be defined as a year-on-year increase in the Harmonized Index of Consumer Prices (HICP) for the euro area of below 2%'. Price stability is to be maintained over the medium term. (...)**
(...) the statement that 'price stability is to be maintained over the medium term' reflects the need for monetary policy to have a forward-looking, medium-term orientation. It also acknowledges the existence of short-term volatility in prices which cannot be controlled by monetary policy."

[6] This problem was first defined and treated in these terms by Rogoff (1985), who put the problem in terms of a 'conservative' versus a less conservative central banker. See also previous chapter, under the heading Independence.
[7] Neither was it raised in the context of the definition of the so-called convergence criteria, which Member States had to conform to before being allowed to adopt the euro, because the price convergence criterium was defined in relative terms (inflation should not 'exceed by more than 1-1.5 percentage points that of, at most, the three best performing Member States' - see Protocol nr 6 (on the Convergence Criteria) attached to the Treaty of Maastricht).
[8] See table 2.1 in section II.1 below.
[9] See Houben (2000), pp. 104-105 and 244-246.

Such a definition should not be equated with direct inflation targeting. As is explained by Issing c.s. (2001, p.65) the monetary policy strategy is the way in which a central bank plans to achieve its mandatory objective. The ECB argued that the public announcement of a quantitative definition for the price stability objective would represent an important form of commitment. The announcement can be seen as an integral part of its strategy, which is furthermore based on a reference value for money growth and a broad based assessment of indicators of prospective price pressures. In other words, the ECB's strategy emphasizes a prominent role for money, but at the same time allows for the input of many other nominal and real variables which influence future price developments.
Within this zone of price stability a preference grew to be in the range of 1-2 % - see remark made by president Duisenberg before the Committee on Economic and Financial Affairs of the European Parliament.[10] Recent studies on the relation between inflation and growth indicate that inflation starts to have net negative effects on growth, when it rises over 1-3%, depending on the study.[11] More recently, i.e. in May 2003, the Governing Council clarified that, while sticking to its earlier definition, it aims at an inflation rate close to but below 2% over the medium-term. This clarification underlines the ECB's commitment to provide a sufficient safety margin to guard against the risks of deflation and also takes into account the possible presence of a measurement bias in the HICP and the implications of inflation differentials within the euro area (ECB Press Release, 8 May 2003).

I.2 *Independence and narrow mandate*

There is a broad consensus among practitioners and academics that an independent central bank is more likely to achieve price stability than a central bank which is under instruction of the government.[12] The importance of central bank independence also gained ground in practice, as evidenced by the move towards more central bank independence in many countries (mostly anglosaxon countries) that changed their monetary policy regime towards direct inflation targeting in the early nineties - though the independence has remained limited to the daily policy decisions, as it did not include the specification of price stability, which remained in the hands of the government. This is sometimes referred to as instrument vs. goal independence. A central bank has instrument independence when it has full discretion to deploy monetary policy the way it sees most fit to attain its (in some cases externally given)

[10] 17 February 2003. Answer in response to question by chairwoman Randzio-Plath. ".. in practice, we are more inclined to act when inflation falls below 1% and we are also inclined to act when inflation threatens to exceed 2% in the medium-term. Short-term movements in the actual inflation rates have no impact on our policy considerations and decisions."

[11] See e.g. Dotsey and Ireland (1996), M.S. Khan and Sendhadji (2000) and M.S. Khan (2002), who see a threshold value for industrialised countries of 2%, 1-3% and 1% respectively. The optimality of the inflation rate is not researched in this study. For our purposes is relevant that among economists there is no agreement on the optimal level of inflation – see also section I.3 *infra*.

[12] Maastricht coincided, if not triggered, an increasing volume of empirical and comparative research supporting this orthodoxy. The first extensive empirical research seems to have been done by Cukierman as a follow-up to earlier, more theoretical studies into the relationship between central bank behavior and credibility (see Cukierman (1992) and by Eijffinger and Schaling (1992). But also see Alesina and Summers (1993) who find that a lower degree of independence leads to a higher level and variability of inflation. For a review of recent literature see Berger, de Haan and Eijffinger (2001). Berger c.s. conclude that the negative relationship between central bank independence and inflation is quite robust despite measurability and possible causality problems. For some other early writings on central bank independence see Rogoff (1985), De Haan and Sturm (1992), S. Fischer (1995) and Eijffinger-de Haan (1996), chapter 6.

goal. According to Fischer (1994) a central bank has goal independence when its goals are imprecisely defined.[13] However, in a democracy independence for an institution established by law is only acceptable if the mandate and powers of that institution are well circumscribed. If the ESCB would have received a broader mandate (e.g. stabilizing prices and maximizing employment), the call for political control would have - justifiedly - been stronger. The broader the mandate, the stronger the call for, and need for, political control. At the same time the powers attributed to the institution have to be commensurate with the objective it has to realize, in other words they should enable the institution to realize its mandate, but should not go beyond.[14]

I.3 *The ESCB's "secondary" objective*

According to Article 2 the ESCB 'shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 of the Treaty[15],' but 'without prejudice to the primary objective of price stability'. Price stability takes precedence. This idea of a broader secondary objective was borrowed from the Bundesbank law (see section II.1 below).
Three remarks on this. First, it is clear there is only one *overriding* objective: price stability. There is no goal-sharing. Indeed, it would complicate the life of the ESCB, if it would have to hit two balls (inflation rate, economic policies) at the same time with one stick (the only stick it can wield is the interest rate, or to be more exact: the price of central bank money). From the viewpoint of effectiveness and accountability it is clearly preferable for the ESCB to have one goal. Second, the words '*policies in the Community'* (and not: policy <u>of</u> the Community) are used, because economic policy is not centralized at Community level. Third, Smits (1997) points out that the word '<u>general</u>' is used in *'general economic policies'*. This implies according to Smits (1997) that the ESCB's actions can never be judged in terms of support of a specific course of action, but only in terms of support of underlying trends in economic policy.[16]

It is very difficult to make this secondary objective operational. Maintaining price stability is a never-ending, continuous task, which leaves little room for actively pursuing the secondary objective. The secondary objective could, however, be taken to express the general wish that interest rates should not be higher than necessary, based on the idea that - provided inflationary expectations are not negatively affected, depending in turn on the size of the

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[13] See e.g. S. Fischer (1994), p. 292. An alternative definition could be that the lack of a precise definition of a central bank's objective implies goal independence. This shows goal independence can be seen as a sort of continuum.
[14] In the case of the ESCB its only real instrument is the interest rate (and volume) on its refinancing operations and the interest rates applying to its standing facilities (see also section I.4 below).
[15] Article 2-EC reads: *'The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing the common policies or activities referred to in Article 3 and 3a, to promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.'*
[16] Smits (1997), p. 188.

output gap and the prevalence of structural rigidities - lower interest rates support economic growth. [17]
To a large part this wish has been 'accommodated' in the way the ESCB has formulated its monetary policy strategy.
First, the eurosystem aims at a positive inflation rate. This is implicit in the use of the word '*increase'* in its definition of price stability as 'a year-on-year *increase* of the harmonized consumer price index'. The word 'increase' captures the fact that most price indicators (including the HICP) tend to overstate the rate of inflation, due to a measurement bias. For instance, some price increases may be due to improvement in quality or functionality, but are still measured as a general price increase for an unchanged product. Therefore a state of zero inflation, or even a positive, but still small rate of measured inflation, could actually mean a *de facto* situation of a decreasing price level.[18] [19]
And second, the eurosystem has chosen to maintain price stability over the *medium-term* (see section I.1). According to many researchers and practitioners the time-lag between a monetary policy move and its full impact on the inflation rate is 18 to 24 months.[20] Trying to reach a similar impact in a shorter period would require much stronger measures, leading to strong output shocks. In case of price shocks the concern of the ESCB lies more with the risk of a feed-through of the first round price effects into a wage-price spiral. If that is likely, the ESCB should act in a timely fashion to head off such risks.

I.4 *Market conformity*

The ESCB has to operate according to the principles of the market economy.[21] It is not allowed to impose quantitative restrictions on bank credit and price controls. The one instrument which could be considered an infringement on the market economy is the requirement for credit institutions to hold minimum reserves with the central banks (Article 19-ESCB). The basis for the minimum reserves and the maximum reserve ratio are therefore

[17] See Duisenberg's answer to a question during the ECB press conference of 8 November 2001 whether the ECB by lowering interest rates had not gone beyond its first priority: '[....] maintenance of price stability remains our first priority. You can almost literally quote the Treaty in this respect, since today's move [to lower interest rates - cvdb] could be taken 'without prejudice to price stability', and it thereby supported the other goals of Economic and Monetary Union, such as economic growth.'
[18] The **Boskin report** (Final Report to the US Senate Finance Committee of the Advisory Commission To Study The Consumer Price Index, 1996, 'Toward a more accurate measure of the cost of living') concluded in 1996 that inflation in the US was 1.1 percentage points lower than was measured. 0.6 of this reflected improved quality of goods and services (quality bias/new product bias) and 0.4 was due to the failure to detect changed spending by consumers as relative prices changed (until then the US Bureau of Labour Statistics updated its basket of goods and services only once every 10 years). The outcome of the report went not undisputed, inter alia because it threatened to lower the cost of living adjustment for social security benefits. The measurement bias in Europe is probably somewhat smaller. A Bundesbank study carried out by Hoffmann (1998) indicated the overall bias in Germany might be smaller, in the order of 0.75 percentage point per year, partly on account of more regular re-weighing of the basket. According to the ECB the positive measurement bias in the European HICP is minimal (Issing, lecture City University Buiness School London, 12 May 2004).
[19] On the problems for monetary policy in dealing with a situation of negative real growth and negative inflation (in other words deflation), see Cees Ullersma (2002).
[20] This period was also mentioned by Otmar Issing, Executive Board Member responsible for the ECB's Monetary Directorate, during an ECB central banking conference 'Why price stability?' on 2-3 November 2000.
[21] The axiom therefore is the existence of deregulated markets. Regulating markets (and thereby interfering in the competitive relations between commercial banks) usually requires approval by, or a framework set by, the Ministry of Finance, which creates a dependency (see Art. 7, section I.1).

regulated by the political authorities. [22] Minimum reserves may be necessary to ensure that banks have to borrow from the central bank - otherwise the central bank would find it difficult to make its refinancing rate effective and it could lose its grip on the price of money. In order to enforce compliance with its regulations and its decisions directed at third parties (credit institutions), the ECB is entitled to impose fines. The Council of Ministers defines the limits within which (and conditions under which) the ECB is allowed to impose fines - see Article 34.3.
The ESCB has the right to authorize (and thus veto) the issuance of banknotes and could in theory control (limit) the volume of banknotes. In practice however, the ECB accommodates the demand for banknotes, the only instrument it uses is setting the price banks pay for borrowing central bank money, whether for the purpose of buying of banknotes or adding liquidity to their accounts at the central bank.

I.5 *Relevant features of the Federal Reserve System*

The mandate of the Federal Reserve System of the United States is considerably broader in scope than that of the ESCB. Section 2A of the Federal Reserve Act (introduced as part of the Federal Reserve Reform Act of 16 November 1977) defines the objective in the following way:
"The Board of Governors of the Federal Reserve System and of the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, **so as to promote the goals of maximum employment, stable prices, and moderate long-term interest rates**."

Worth mentioning here is that the Administration does not have the right to give directives to the Fed nor can it raise a veto on Fed decisions. The Fed is only accountable to Congress. (See also the discussion on Article 7-ESCB.) The broad mandate does not mean price stability plays second fiddle in the United States. Like the ECB, the Fed sees price stability as conducive to supporting maximum sustainable economic growth over time. At a conference in Mexico City on 14th November 2000 Alan Greenspan, Chairman of the US Federal Reserve, said: "Monetary policy makers must keep hold of the anchor of price stability so as to support maximum sustainable economic growth over time." (Source: Morning Press, IMF External Relations Department, November 15 2000.) Nonetheless, the FED is seen as trying (successfully) to manage growth and price stability, whereas the ECB is seen as focussing purely on price stability, which sometimes leads to comments from financial specialists that it is 'behind the curve' (i.e. reacting too late to developments in the real economy).

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[22] Council Decision (EC) No 2531/98 of 23 November 1988 concerning the application of minimum reserves by the European Central Bank. Within the limits set by this Council Decision the ECB can determine the actual reserve ratio. It is also up to the ECB (Governing Council) to decide on the remuneration, which could be set at zero. Any remuneration below the prevailing market rates can be seen as a form of 'taxation'. Under complete capital liberalisation this will drive off certain parts of the banking business to other, possibly off-shore, centres. In fact, the ECB has decided to remunerate the minimum reserves at a level corresponding to the rate of the ECB's main refinancing operations (Governing Council Decision of 7 July 1998). But even then the minimum reserve requirement could be seen as an instrument *forcing* banks to hold part of their assets in a form possibly not of their own choice.

The Fed has not quantified its definition of price stability. In a statement before the Subcommittee on Economic Growth and Credit Formation of the Committee on Banking, Finance and Urban Affairs of the House of Representatives on February 22, 1994 Greenspan used a by now famous, qualitative definition of price stability: "It follows that price stability, with inflation expectations essentially negligible, should be a long-run goal of macroeconomic policy. *We will be at price stability when households and businesses need not factor expectations of changes in the average level of prices into their decisions*." [23]

An interesting account of why the Federal Reserve Act (FRA) of 1913 did not contain a reference to price stability is given by Alfred Broaddus Jr, president of the FRB of Richmond (1993).[24] The direct cause for wanting to establish a central bank was not so much concern over price stability, but the recurrence of banking crises, the most recent one of which had taken place in 1907.[25] Bank runs, apart from the damage done directly to the deposit holders, also led to short-term interest rate spikes, sometimes of over 10 percentage points. Also, there was a pronounced seasonal pattern in short-term interest rates. The withdrawal of interbank balances in peak agricultural and holiday periods, in combination with the practice of pyramiding reserves within the banking system, [26] tended to exacerbate seasonal pressures on the banking system. Short-term interest rates varied seasonally by as much as 6 percentage points over the course of the year.

Under the FRA 12 FRBs were to be established around the country as depositories for the required reserves that previously had been held at correspondent banks in New York City and elsewhere. By requiring that private banks hold reserves directly in a FRB, the act eliminated reserve pyramiding and eased the seasonal strain on the banking system. The most important power given to the central bank, however, was the authority to issue currency and to create bank reserves at least partly independently of the nation's monetary gold reserves. Until then the national money supply was closely linked to the nation's stock of monetary gold (it was the time of the gold standard). As Broaddus describes, the gold standard 'had good features and not-so-good features. On the good side, the gold standard did keep the aggregate price level under control over the very long run.' It was a credible anchor and the public understood the mechanism. [27] However at the same time, 'the strict discipline of the gold standard did not allow the money supply to increase rapidly in response to domestic disturbances such as a bank panic or a stock market crash.'

This background is reflected in the FRA of 1913. In the preamble the purpose of the FRA was stated as **'to provide for the establishment of Federal reserve banks, to fournish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes'.** Section 2 of the FRA stipulates the designation of 'not less than eight nor more than twelve cities to be known as Federal reserve cities', in which FRBs would be established. [28] In conclusion, the

[23] Published in Federal Reserve Bulletin of April 1994, p. 302.
[24] Broaddus (1993).
[25] Major banking panics occurred in 1873, 1884, 1890, 1893 and 1907.
[26] Interbank balances were mostly concentrated in big-city banks, especially in New York. This so-called 'pyramiding' was stimulated by the reserve requirement provision of the National Banking Act, according to which correspondent balances counted as legal reserves. See also under Real Bills doctrine.
[27] The aggregate level of prices in 1914, for example, was not very different from the level 30 years before in the early 1880s.
[28] See also under Article 10.1 and 10.2-ESCB.

prevailing presumption was that '[t]he gold standard would guarantee price stability, as long as the Federal Reserve respected its obligatory minimum gold reserve ratio, and the new central bank could focus on stabilizing the banking system and interest rates. No separate mandate to resist inflation or deflation was needed.'

Meltzer (2003) in his recent History of the Federal Reserve mentions legislative proposals in the mid-1920's by Congressmen, most of them from powerful cotton states, to add the promotion of a stable price level to the FRA. However, the Federal Reserve, which was much more in favour of applying the principles of the gold standard, united in their opposition to any "mechanical formula" for setting policy. Moreover, neither existed much agreement on how such policy could be conducted.[29]

Only in 1977 the words 'stable prices' entered into the FRA. The 1977 amendment of the FRA introduced a new Section 2A containing inter alia the wording quoted at the beginning of this section ('[....], so as to promote the goals of maximum employment, stable prices and moderate long-time interest rates'). However, the purpose of the 1977 amendment was not so much to specify the goals of monetary policy, but to require the Fed to report to Congress on its monetary targets for the upcoming twelve months.[30] The essential point of the 1977 amendment were the reporting requirements and not the first sentence of Section 2A, though it has become common practice, especially by the Fed, to quote this sentence when it wants to describe the objectives of the Federal Reserve System.

Comparing the Fed and the ESCB

The drafters of the FRA wanted to design a system that could prevent the recurring liquidity squeezes in the country which occasionally led to bank runs and periods of deflation. The drafters of the ESCB Statute had in mind a central bank which would not be obliged to finance government and would be focussed on preventing the erosion of the internal value of their money. Especially the German mind-set was influenced by the occurrence of hyperinflation in the twenties, which with some exaggeration could be said to have led the basis for the rising of the national socialist party in Germany.

Nonetheless, practices of the Fed and the ESB have converged in that sense that for the Fed price stability is the prime objective for their policy. Price stability is recognized to be the best condition for sustainable growth. The experience in the seventies with stagflation had shown there was no durable trade-off between inflation and unemployment, meaning that loose monetary policy in the end only led to higher inflation and not more output. (Differences in policy reactions between the Fed and the ESCB, as are sometimes perceived in the press, are mostly due to the differences in shocks and differences in the monetary transmission, inter alia due to the fact that American consumers hold relatively more financial assets than in

[29] For instance, Fed Chairman Miller testified there existed no link from changes in the volume of credit and currency to the level of prices. He also stated the Fed could not influence the total volume of money in circulation, as this was determined by the community. For him the way to provide economic and price stability was to prevent speculations based on credit. (Meltzer (2003), p.183-192.)

[30] The 1977 amendment was later modified (though not the sentence just quoted) through the Full Employment and Balanced Growth ('Humphrey-Hawkins') Act of 27 October 1978, which contained amendments on both the Employment Act of 1946 and the FRA. See also W. Eizenga (1983), p.3-4. In December 2000 Congress created a new Section 2B, titled 'Appearances Before and Reports to Congress', substituting for a part of Section 2A.

Europe and that in Europe bank lending is a relatively more important financing channel than financing through the financial markets compared to the US.)
The German experience had also pointed to the need for a central bank with a high degree of independence. A high degree of independence would not have been compatible with a broad mandate. (As will be pointed out under Art. 7, section I.2, the issue of independence did not play an important role when the FRS was designed, because there was no history of a central bank being an appendix of the government. [31]

II.1 HISTORY: DELORS REPORT

Even before the Delors Committee was established, the Bundesbank had prepared an internal position paper on the issue of Economic and Monetary Union, because developments in this area were clearly accelerating. [32] Even so, Pöhl was not among the believers.[33] The first concept of their internal paper dates back to April 1988. In September 1988 this paper would be submitted by Pöhl to the Delors Committee (it is reprinted in the annex to the Delors report, together with the contributions of other member of the Delors Committee).

[31] The First and Second Bank of the United States could extend only limited loans to the government. See Sleijpen (1999), p. 115.

[32] Developments were clearly in a swing: the 'Comité pour l'Union Monétaire de l'Europe', established (in December 1996) and chaired by **Schmidt and Giscard d'Estaing**, had finalised on March 31, 1988 a blueprint for European monetary integration (in their words*: un "programme pour l'action" couvrant l'ensemble des aspects de la construction monétaire européenne*), in which they proposed the establishment of a European Central Bank which would have as its *'mission essentiel d'assurer le respect de l'objectif de* ***stabilité monétaire*** *et la libre convertibilité des monnaies de l'union monétaire europeénne a taux fixe entre elles'*, while it would also be responsible for issuing ecu's, which would circulate as a parallel currency (Comité pour l'Union Monétaire de l'Europe, Un Programme pour l'Action (Proposition no.1, section II), 31 Mars 1988). In December 1987 **Balladur** had proposed to create in the future (in French: 'à terme') a European central bank and a European currency, the so-called Balladur memorandum (in: HWWA 1993, p.337). In his six page memorandum only one page deals with this idea, the other pages deal with the asymmetries of the EMS and ways to reinforce monetary cohesion within the context of the EMS. **Genscher** had taken up the idea of an European Central Bank in his Memorandum of 26 February 1988, in which he also called for the creation of a Sachverständigengremium ('5 - 7 Weisen') by the Hanover Council in June 1988, which should among other things come up with a statute of a European central bank and a concept for how to get there (in: HWWA 1993, p.31.).

[33] In his press conference following the Zentralbankrat-meeting of 5 May 1988, at which they had discussed the secret position paper, Pöhl mentioned the ZBR had discussed questions relating to monetary cooperation in Europe, but at the same time he pointed to many examples of free trade zones *without* a common currency. Talking then about *possible* future developments he stated that a European central bank system should have a federal character (like that of the Bundesbank or the American Federal Reserve System) and that it should have a clear objective*: 'Sie sollte mit dem Ziel des Bundesbanksgesetzes übereinstimmen "die Währung zu sichern". Darunter wird allgemein verstanden, die Preise stabil zu halten.'* Pöhl did not mention the existence of the internal position paper.

In paragraph IIB.1 the paper mentions:

> *"1. The mandate of the central bank must be to maintain stability of the value of money as the prime objective of European monetary policy. While fulfilling this task, the central bank has to support general economic policy as laid down at Community level."*[34]
>
> *Bundesbank paper April/September 1988*

This formulation leaned heavily on Article 3 and 12 of the Bundesbankgesetz[35]:

Par. 3: Aufgabe
"Die Deutsche Bundesbank regelt mit Hilfe der währungspolitischen Befugnisse, die ihr nach diesem Gesetz zustehen, den Geldumlauf und die Kreditversorgung der Wirtschaft mit dem Ziel, die Währung zu sichern, und sorgt für die bankmässige Abwicklung des Zahlungsverkehrs im Inland und mit dem Ausland."
Par. 12: Verhältnis der Bank zur Bundesregierung
"Die Bundesbank ist verpflichtet, unter Wahrung ihrer Aufgabe die allgemeine Wirtschaftspolitk der Bundesregierung zu unterstützen. ...."

Seen from today, Pöhl's first formulation for the mandate of the ECB and the mandate of the Bundesbank seem surprisingly vague. The formulations do not directly relate to the consumer price index and the formulation can be seen as relating both to internal and external value of money (the exchange rate). However, the formulation of the mandate of most other European central banks was even vaguer (see table 2.1 below).

[34] It is interesting to continue this quotation: "Domestic stability of the value of money must take precedence over exchange rate stability. This does not exclude the possibility that depreciation vis-à-vis third currencies and the associated import of inflation be counteracted by appropriate monetary policy measures. In the event of the establishment of an international monetary system with limited exchange rate flexibility vis-à-vis third currencies, the central bank would need to be given at least the right to participate in discussions on parity changes." We will come back to this when dealing with Article 109-EC.
[35] Bundesbankgesetz 1957.

Table 2.1 Economic/monetary objectives of a number of central banks [36] (situation in 1989)

Austria:	"(3) It (die Oesterreichische Nationalbank) shall ensure with all the means at its disposal that the value of the Austrian currency is maintained with regard both to its domestic purchasing power and to its relationship with stable foreign currencies. (4) It shall be obliged to ensure within the framework of its credit policy that the credits it places at the disposal of the economy are distributed with due regard to the requirements of the economy." (Art. 2.3 and 2.4 Nationalbankgesetz 1955)
Belgium:	*not specified*
Denmark:	"to maintain **a safe and secure currency system** and to facilitate and regulate the traffic in money and the extension of credit" (Art. 1 of Bank Act)
Germany:	"The deutsche Bundesbank shall regulate the amount of money in circulation and of credit supplied to the economy using the monetary powers conferred on it by this Act, with the aim of **safeguarding the currency**, and shall arrange for the handling by banks of domestic and external payments" (Art. 3 BBankG 1957) "The deutsche Bundesbank shall be obliged insofar as is consistent with its functions, to support the general economic policy of the Federal Government." (Art. 12 BBankG 1957) [37]
Greece:	*not specified*
Spain:	"The Bank of Spain … conducts monetary policy in accordance with the general objectives determined by the government, while using the means it considers most adequate for achieving these objectives, in particular the safeguarding of the value of the currency." (Loi du 21.6.80, art. 3)
France:	'The Banque de France is the institution which, in the framework of the economic and financial policy of the nation, receives from the State the mission of watching over the currency and credit. As such the Banque de France makes sure the banking system is functioning properly.' (Art. I, Statutes BdF 1973)

./.

[36] The countries are listed in alphabetical order using their names as spelled in their national language. Reference is made only to the countries which were then EU member: Belgium, Denmark, Germany, Greece, Spain, France, Ireland, Italy, Netherlands, Portugal and the UK; Luxembourg is left out, because it did not have its own central bank. Austria is added for reference sake because of its tradition of having a relatively independent central bank. Information based on national central bank laws, European Commission (1990a); Hans Aufricht (1967), Central Bank Legislation, Vol. II: Europe, IMF Monograph Series no. 4; and G. Toniolo (ed.) (1988), *Central Banks' Independence in Historical Perspective*. '*Not specified'* means usually the Bank Act only enumerates responsibilities of the central bank, like issuing the currency, acting as the Government Cashier (e.g. art. 17, Belgian Bank Law 1939), managing clearing houses (art. 44, Banca d'Italia Statute 1936). In a way the Banque de France objective is also 'not specified', in the sense that it does not contain an economic objective or orientation. Cf. Committee of Governors (1992), Annex II.

[37] For the origins of this formulation see appendix 3 at the end of cluster III.

Ireland:	"The Bank shall have the general function and duty of taking ... such steps that the Board may from time to time deem appropriate and advisable towards **safeguarding the integrity of the currency** and ensuring that, in what pertains to the control of credit, the constant and predominant aim shall be the welfare of the people as a whole." (Section 6 (1) of Bank Act 1942)
Italy:	*not specified*
Netherlands:	"It shall be the duty of the Bank to regulate the value of the Netherlands' monetary unit in such a manner as will be most conducive to the nation's prosperity and welfare, and in so doing seek to **keep the value as stable as possible**." (Section 9 (1), Bank Act 1948) [38]
Portugal:	*not specified*
UK:	no explicit rule

The table shows two things. First, the mandate was nowhere specified as just maintaining *internal* price stability. The objective is usually broader: sometimes the external value is part of the objective (sometimes only implicitly) and in other cases the central bank has to support the general economic policies (or it has to operate within a framework set by the government). The emphasis on internal price stability constituted a new development. Second, the table shows how often the objectives of the central banks were formulated in such a broad general way, making it indeed difficult to imagine them operating as completely independent institutions. Indeed, complete independence in formulating monetary policy goals and implementing monetary policy was a scarce good. (See for an overview of the relations with the government Article 7-ESCB.)

The first draft of Chapter II (The final stage of economic and monetary union) of the Delors Report, dated 2 December 1988, contained the following formulation, closely reflecting the wording of Pöhl's paper[39] :

"- the mandate of the system must be to maintain the stability of money as the prime objective of the Community's monetary policy. While fulfilling this task, the system has to support the general economic policy of the Community. Stability of the currency in terms of prices must take precedence over exchange rate stability;

- the system must be independent of instructions from national governments and Community authorities ...."

CSEMU/5/88, December 1988

During the meetings of the Delors Committee a number of alternative formulations would be tabled. During the meeting of 13 December 1988 Pöhl handed in the following text:[40]

"- a commitment to regulate the amount of money in circulation and of credit supplied by banks and other financial institutions under criteria designed to assure non-inflationary economic growth as well as to preserve a properly functioning payment system;"

Pöhl, December 1988

[38] For a description of the origin of the formulation, see André Szász (2001), par. 15.3, and A.M. de Jong (1960), p. 409-15.

[39] CSEMU/5/1988, page 15.

[40] Paper of 2 December 1988, called 'Outline of a Report to the European Council on Economic and Monetary Union'.

This mandate was even vaguer than the one already on the table. For instance, in Pöhl's new version it was not clear whether domestic price stability should take precedence over external stability.[41] Seeing this text Duisenberg immediately reacted by saying he preferred to see a clear distinction between the task of the ECB and the instruments; the task should preferably be formulated in terms of stabilizing the value of money, making at the same time a distinction between internal stability (price stability) and external stability (exchange rate stability).

During the meeting of 10 January 1989, Duisenberg handed out his preferred formulation, borrowing heavily from the text of CSEMU/5/1988:

"- The mandate of the system must be to maintain the stability of money as the prime objective of the Community's monetary policy. While fulfilling this task, the system has to support the general economic policy of the Community. Stability of the currency in terms of prices must take precedence over exchange rate stability.[42]
- The system will be responsible for the formulation of monetary policy at Community level and for the preservation of a properly functioning payments system. The instruments at its disposal will be enumerated in the statute of the system with a procedure for amending this enumeration.
- The system will be responsible for the formulation of banking supervision policy at Community level and coordination of banking supervision policies of the national supervisory authorities."[43]

Duisenberg, January 1989

The next draft of the rapporteurs[44] would mention Pöhl's and Duisenberg's texts as alternatives. At that moment it was unclear how the final formulation would read.
On 14 March 1989 the discussion in the Delors Committee almost derailed. Pöhl had thirty pages of proposed amendments (he especially disliked the ideas centering on the promotion of the Ecu) and preferred a substantial reduction of the report. The Danish governor Hoffmeyer (chairman of the Committee of Governors) said he would also not be in a position to sign the report in its present form. De Larosière said a signal was needed that Europe would embark in the direction of economic and monetary union; therefore he had proposed the creation of a special fund, the European Reserve Fund, in stage two of EMU (which Pöhl and others had

[41] Pöhl's formulation was closer to the mandate of the Bundesbank, but - like the Bundesbank formulation - lacked a hierarchy: it took away the notion of domestic price stability taking precedence over external stability. Pöhl's formulation would be stubborn: it would more or less reappear in the draft Treaty proposal of the German IGC delegation. This would be the only instance in which the German draft texts would deviate from the governors' draft ESCB Statute. (It is not clear why the Germans were so stubborn on this: maybe they hoped their formulation (which emphasized the importance of managing money and credit supply) would help them securing their favourite monetary strategy, i.e. monetary targeting (as opposed to interest rate targeting, like had been applied by the Fed in the past - or direct inflation targeting, though that strategy still had to be invented). Sources from the Bundesbank have said Pöhl quickly came to regret his proposal, 'which he had meant as a compromise' - though it is unclear whom Pöhl had sought to please.
[42] The latter sentence borrowed from CSEMU/5/88.
[43] Implicit in this formulation is that visiting banks should remain a task of the national supervisor. This was the view held within the Dutch central bank.
[44] CSEMU/10/89, dated 31 January 1989 (section 18).

already indicated they did not like).[45] Pöhl reacted strongly to de Larosière and Delors by saying that large parts of the report were unacceptable to him. He distinguished four steps. First, all countries should become members of the EMS. Second, a complete adoption of full liberalization of capital movements had to be fulfilled by all Member States. *Third, the political priority for central banks must be price stability.* Fourth, budget discipline.
Delors tried to conclude the discussion by suggesting the following changes to the draft report: first, the report should make clear that a significant amount of sovereignty had to be transferred. Second, the objective of an economic and monetary union should in particular be price stability [emphasis by the author]. Third, a treaty change was necessary, sooner or later,[46] and he supported the proposal put forward by Duisenberg to ask the European Council to invite the competent Community bodies to make concrete proposals on the basis of the report of this committee.[47] (Duisenberg's proposal was important, because it secured the involvement of the Committee of Governors and the Monetary Committee in later stages.)
The rapporteurs and Delors prepared a new draft[48] which was to be discussed on 11 and 12 April 1989. They inserted for the first time the term 'price stability'[49] as the objective for the ESCB. The mandate was formulated as follows:

> " Mandate and functions
> - the System would be responsible for the formulation of monetary policy at the Community level and its implementation at the national level, for the full convertibility of European currencies, and for the maintenance of a properly functioning payment system; [the System would have to regulate the amount of money in circulation and the volume of credit supplied by banks and other financial institutions with a view to safeguarding overall price stability;] or ["the System would be committed to promoting price stability as well as economic growth"][50]
> - the System would participate in the co-ordination of banking supervision policies of the national supervisory authorities."
>
> CSEMU/14/89, March 1989, par. 33

[45] The fund's functions would include intervening in the foreign exchange market and progressively setting up a body to exercise surveillance over monetary and exchange rate trends. (See De Larosière's paper in the Annex to the Delors report.)
[46] The Germans and Dutch were not willing to accept a step-by-step approach based on Community legislation. That could lead to a half-way house and meant that the independence would be based not on a Treaty, but on legislation of a lesser status (and more easily amendable).
[47] Subsequently when the Committee discussed the text paragraph by paragraph, many of Pöhl's reservations came to be reflected in the text, much to the regret of de Larosière. He said he had yielded as regards the question of the ECU as a parallel currency and it would be a pity for him if one would kill the little bird that was left. Pöhl yielded somewhat, and the final outcome was that the following text:

"48. Thirdly, the Committee examined the possibility of using the official ECU as an *instrument in the conduct of a common monetary policy.* The main features of possible schemes are described in the Collection of papers submitted to the Committee, *which represent personal contributions*. [last emphasis by the author.]

49. Fourthly, the Committee agreed that there should be no discrimination against the *private use of the ECU* and that existing administrative obstacles should be removed."

[48] CSEMU/14/89 (31 March 1989).
[49] Seen from today's perspective, this is an improvement over the term 'stability of money', as used in their draft of December 1988 and in the proposal submitted by Duisenberg, because the term 'stability of money' had had in the past the double meaning of external and internal stability.
[50] Second alternative proposed by UK Governor Leigh-Pemberton.

Probably unintentionally, the so-called secondary objective had dropped out of the text. Before the meeting Pöhl handed out an alternative of his own, including his earlier secondary objective:

> " Mandate and functions
> - the System would be responsible for the formulation of monetary policy at the Community level and its implementation at the national level, for the full convertibility of Europea currencies and exchange rate management as well as the maintenance of a properly functioning payment system;
> - the System would be committed to price stability;
> - within the limits of this objective the System would support the general economic policy of the Community."
>
> Pöhl April 1989

This was rearranged during the meeting into the following final outcome:

> " **Mandate and functions**
> - The System would be committed to price stability;
> - subject to the foregoing, the System should support the general economic policy set at the Community level by the competent bodies;[51]
> - the System would be responsible for the formulation and implementation of monetary policy, exchange rate and reserve management, and the maintenance of a properly functioning payment system;
> - the System would participate in the coordination of banking supervision policies of the supervisory authorities."
>
> Delors Report, par. 32

II.2 HISTORY: COMMITTEE OF GOVERNORS

The governors would stay quite close to what they had agreed upon in the Delors Committee. Article 2 of the Committee of Governors' final draft of the ESCB Statute, dated 27 November 1990, would read:

> **"Article 2 - Objectives**
> **2.1 The primary objective of the System shall be to maintain price stability.**
> **2.2 Without prejudice to the objective of price stability, the System shall support the general economic policy of the Community.**
> **2.3 The System shall act consistently with free and competitive markets."**

The accompanying Commentary with Article 2 read:

> *"*Article 2 - *Objectives*
> *Article 2.1 expresses the unequivocal commitment to maintain price stability as the primary objective of the System. However, since monetary policy is not considered in isolation of other economic policy objectives, Article 2.2 explicitly states that without*
> *./.*

[51] At that stage it was still unclear how the general economic policy should be managed, but this had eventually to be decided by the ECOFIN-council. (Source: Summary by Hoffmeyer of the meeting of 11-12 April 1989.)

prejudice to the objective of price stability, the System shall support the general economic policy of the Community. Article 2.3 confirms the adherence of the System to the fundamental principle of a market-based economy."

To be more specific, the first draft of the ESCB Statute dates back from 11 June 1990. [52] The governors had given their Committee of Alternates a mandate to draw up draft Statutes for the ESCB. Article 2 of the draft of 11 June was called '**Objectives and basic tasks**'. Within that article, Article 2.1 read:

"2.1 The primary objective of the ESCB shall be to maintain price stability within the Community; without prejudice to that objective, it shall support the general economic policy adopted by the competent Community bodies."

draft 11 June 1990

(Article 2.2 listed the tasks of the ESCB. In the subsequent drafts Article 2.2 would become an article of its own, i.e. Article 3.)

During their discussion on 18 June the Alternates would add a third paragraph, i.e. the obligation to promote free and competitive markets.

"Article 2 - Objectives

2.1 The primary objective of the ESCB shall be to maintain price stability within the Community.

[2.2 Without prejudice to the objective of price stability, the ESCB shall support the general economic policy of the Community.] [53]

2.3 When exercising its competence, the ESCB shall promote free and competitive markets"

draft 22 June 1990

During their meeting on 29 June 1990 the British Alternate, Crockett, proposed to add 'A further objective of the ESCB will be to preserve the integrity of the financial system.' However, Tietmeyer had this placed between square brackets: he considered this to be a task, and not an objective. (This would indeed be delegated back to Article 3. This issue is dealt with under Article 3.3.) The wording of Article 2.3 was changed into 'In exercising its functions, the ESCB shall act consistently with free and competitive markets'.[54] During their meeting of 10 July Governors had to choose between 'price stability within the Community' and 'price stability within the Union'. The outcome was just to refer to 'price stability' (the mandate could of course only apply to the Monetary Union area).

[52] The Committee of Governors had used the latter half of 1989 especially for adapting the mandate of the Committee to the new demands of stage one of EMU, which started the first of July 1990. This required a amendment in the Council Decision (64/300/EEC) of 8th May 1964 establishing the Committee of Governors, for which amendment the Committee was asked to make a recommendation. The amended version was adopted by the Council on 12th March 1990 (90/142/EC).

[53] Between square brackets because one Alternate preferred to insert this provision in Article 12.2, the main reason being that this provision would detract from the primary objective. The governors would decide to retain the text and drop the brackets.

[54] This is more a condition than an objective.

When presenting a progress report to the ministers of finance during the informal Ecofin meeting on 7 to 9 September 1990, Pöhl (in his capacity of chairman of the Committee of Governors) [55] strongly underlined the importance of the System's primary objective of price stability: "(....) we want to underline the unequivocal statement in the Delors Report that the primary objective of the System must be to preserve price stability. But, of course, giving primacy to this objective should not be misinterpreted as an invitation to act in a single-minded manner and without due regard to other economic policy objectives. There is full recognition that monetary policy is not conducted in a vacuum and the new System shall, without prejudice to the objective of price stability, support the general economic policy of the Community. (....) However, there should be no misunderstanding: in the event of a conflict between price stability and other economic objectives, the governing bodies of the System will have no choice but to give priority to its primary objective. (....) The System will have to act consistently with free and competitive markets and in doing so will regulate money and credit predominantly through indirect money market interventions, as has become the widespread practice in countries with deregulated financial markets." [56]

On 13 November 1990 there would be one last discussion on Article 2.3. Duisenberg put forward the question of whether the setting of key official interest rates could not be seen as an exogenous act not being in conformity with local market conditions. De Larosière agreed and felt the governors should be careful not to limit the scope of the System. Chairman Pöhl, however, supported inclusion of Article 2.3 because it prevented the use of direct monetary instruments such as credit controls. He felt the System should not be able to set quantitative limits for controlling credit or suspend the use of market-oriented instruments. The Irish, Italian and UK governors also wished to retain Article 2.3, as it would happen, implying that the following text was sent to the IGC:

"<u>Article 2</u> - <u>Objectives</u>

2.1 The primary objective of the System shall be to maintain price stability.

2.2 Without prejudice to the objective of price stability, the System shall support the general economic policy of the Community.

2.3 The System shall act consistently with free and competitive markets."

draft ESCB Statute, 27 November 1990

II.3 HISTORY: IGC

During the IGC there would be no efforts to give the ESCB another or multiple objectives, which could have been a way to bring the ESCB under more political control. However, the issue of whether (and under which circumstances) exchange rate stability could have

[55] Pöhl had been elected chairman as of 1 January 1990. The governors had increased the term of the chairman from one to three year (Rules of procedure of the Committee of Governors of the Central Banks of the European Economic Community, as amended by the Committee of Governors on 11 June 1990) to strengthen the position of their chairmen. The amended 1964-Council Decision (see footnote 52) had conferred new tasks to the Committee of Governors relating to the start of stage one as of 1 July 1990. When changing the Rules of Procedure, the governors had also decided to extend the support of the Committee by installing - apart from the existing Secretariat - an Economic Unit of initially five persons. The task of the Economic Unit was inter alia to prepare research and analytical papers, to identify issues for discussion by the Committee and to draft the Committee's Annual Report.

[56] Statement by President Pöhl on the Statute of the System at the ECOFIN meeting on 7 to 9 September 1990.

precedence over price stability was not solved, but for the last minute and even then left certain questions unsolved (see Article 109-EC.) Another risk emanated from the French Treaty proposal to allow the European Council to establish 'grandes orientations de l'Union Economique et Monétaire'. Their proposal found minimal support (see Article 7-ESCB) and was not taken aboard by the Luxembourg presidency.

"Article 4-1-EC
1 - Le Conseil Européen définit, sur rapport du Conseil, de la Commission et du SEBC, les grandes orientations de l'Union Economique et Monétaire. Il est garant de son bon fonctionnement." [57]

French draft January 1991

The German draft proposal is also worth citing, because it introduced the concept that both exchange rate and monetary policy should have as their overriding objective to maintain price stability. The German draft dates from 26 February 1991.[58]

"Article 3a-EC (Activities of the Community in economic and monetary union) [59]
1. (..... securing convergent economic policies, in particular securing budgetary policies geared to stability, on the basis of close co-ordination.)
2. In addition, as provided in this Treaty and in accordance with the timetable set out therein, the activities of the Community shall include: the irrevocable fixing of exchange rates between the currencies of the Member States and the introduction of a single currency, the definition and conduct of a uniform currency [= exchange rate - cvdb] and monetary policy the overriding objective of which shall be to maintain price stability."

"Article 4a-EC (European System of Central Banks)
An independent European System of Central Banks (ESCB) is hereby set up which, as provided in this Treaty and the Statute annexed thereto shall conduct the Community's currency and monetary policy with the overriding objective of maintaining price stability."

"Article 109a-EC (European System of Central Banks)
1. (...)
2. In accordance with the Statute, the ESCB shall regulate the circulation of money and the provision of credit in the Community with the overriding objective of ensuring price stability.
3. Insofar as is possible without jeopardizing the objective of price stability, the ESCB shall support the general economic policy objectives of the Member States and the Community."

German draft February 1991[60]

[57] The Commission draft had provided for multi-annual guidelines submitted by the Commission to the European Council, but these did not pertain to EMU, but were restricted to budgetary developments, cost control, the level of saving and investment and social cohesion/structural policies. This idea of 'grandes orientations de la politique économique de la Communauté et de ses Etats membres' would survive in Article 103-EC.
[58] CONF-UEM 1612/91, published by Europe/Documents No. 1700 of 20 March 1991. See also section II.3.2 of Art. 109-EC below.
[59] In Article 3a of the German draft economic and monetary union are dealt with separately, we cite here only the part relating to monetary union.
[60] The German representative in the deputies IGC, Horst Köhler, was very adamant on the importance of price stability. He reacted quite strongly to the suggestion by the Dutch representative, Cees Maas, to extend the

The Luxembourg presidency more or less copied the text of the German Article 3a in their non-paper of 29 January 1991,[61] though they added the name of the single currency: the ecu[62]. The Luxembourg presidency did not include a separate article on the objective of the ESCB, limiting themselves to referring in the chapter on EMU to the existence of the statute.[63]
As mentioned before, the Dutch presidency, which took over in the second half of 1991, first focussed on a few very contentious, unsolved issues, like the content of stage two, the criteria for transition to the stage three and the responsibilities for exchange rate policy. As regards the articles on the ESCB and monetary policy the Dutch presidency decided to stick as much as possible to the wording of the draft Statute.[64] To this end, the wording of the objectives and tasks[65] from the draft Statute were copied into the draft Treaty.[66] As regards Article 2, it was added that the ESCB's conditional support for the general economic policies in the Community was meant to contribute 'to the realisation of the objectives of the Community (as laid down in Article 2 of the European Communities), in accordance with the principles set out in Article 3A of this Treaty.' [67]

On 28 October 1991 Minister Wim Kok presented a complete Dutch Presidency proposal on all Treaty provisions concerning EMU, including several protocols, among which the Statute of the ESCB.

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multilateral surveillance exercise with a discussion on the policy mix. Trichet supported this, but Köhler came out strongly, saying that monetary stability was the basis for sustained growth, adding that "monetary stability is a basic right, especially for the small man." (Report of Deputies IGC meeting of January 29, 1991.)

[61] UEM/15/91.

[62] It is well-known the Germans disliked the name 'ecu', which they associated with a basket whose value had been depreciating continuously against the Dmark (and had been called an esperanto currency). During the nettoyage after the signing of the Treaty of Maastricht Grosche (then German Finance Ministry and later secretary of the Monetary Committee) insisted ecu would be written as ECU - to indicate it is an acronym (European Currency Unit) and not necessarily a name - obviously to keep the option open to give the ECU another name . The French and Italian delegations objected. The compromise found was to translate 'ecu' in the national languages in the same way as had been done in the translation of the Single Act (Article 102A). Depending on the language ecu was written as 'écu', 'Ecu' or (as in German) 'ECU'. (Report of nettoyage meeting on 14 January 1992.) In 1995 Waigel, supported by Kohl, would insist the name of the single currency should be 'euro', which had the additional advantage that it was a name everybody could pronounce in more or less the same way (see Conclusions of European Council meeting in Madrid, December 1995).

[63] The Italian and Dutch delegations had proposed texts for the objective of the ESCB (numbered Article 106B respectively 106A) which were exact copies of article 2 of the draft ESCB Statute.

[64] To avoid interpretation problems that could arise if different phrasing were used in the Treaty and the Statute. Furthermore the Dutch presidency preferred to lay down in the Treaty the obligations of the ESCB vis-à-vis the Community institutions and vice versa, and to incorporate in the Statute the rules and obligations within the ESCB. Source: internal note from Ministry of Finance, dated 29 August 1991.

[65] An exception being the formulation on the exchange rate policy and supervision, see Article 109-EC and Article 3.3-ESCB respectively.

[66] At some stage the Dutch presidency wanted to partially 'empty' the statute, by taking out all articles which were mentioned in the Treaty and instead use in the Statute cross-references to the relevant Treaty articles. This was the case in an internal draft version by the Ministry of Finance of August 1991. The Dutch central bank pressed the presidency to keep the Statute self-reading.

[67] See Annex 4.

"Article 2-ESCB - Objectives

As is stated in Article 105 paragraph 1 of this Treaty, the primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Community with a view to contributing to the realisation of the objectives of the Community as laid down in Article 2 of this Treaty, in accordance with the principles set out in Article 3A of this Treaty. It shall act consistently with the principle of open markets with free competition." [68]

Dutch presidency proposal 28 October 1991

For completeness' sake we also present the final version of Article 3A-EC.

"Article 3A-EC

1. (....) [69]

2. Concurrently with the foregoing, and as provided for in this Treaty and in accordance with the timetable and the procedures set out therein, these activities shall include the irrevocable fixing of exchange rates between the currencies of the Member States leading to the introduction of a single currency, the ECU, the definition and conduct of a single monetary and exchange rate policy the primary objective of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policy in the Community, in a manner compatible with free and competitive market principles."

Dutch presidency proposal 28 October 1991

During the remainder of the IGC Article 2 underwent only some editorial changes.

[68] The Dutch draft of 28 October had substituted the words 'general economic policy of the Community' (which was used in the draft ESCB Statute) by 'general economic policies in the Community', because unlike an individual country the Community did not (and does) not have a single economic policy. Both the Member States and Brussels conduct economic policies. The same reasoning was applied to Article 3A-EC, though there the 'policy' was not changed into 'policies' (plural).

[69] Article 3A(1)-EC dealt with the economic policy.

Article 3.1 and 3.2:

Art. 3.1 and 3.2: Tasks [1]

"3.1 In accordance with Article 105(2) of this Treaty, the basic tasks to be carried out through the ESCB shall be:
- to define and implement the monetary policy of the Community;
- to conduct foreign-exchange operations consistent with the provisions of Article 109 of this Treaty;
- to hold and manage the official foreign reserves of the Member States;
- to promote the smooth operation of payment systems.

3.2 In accordance with Article 105(3) of this Treaty, the third indent of Article 3.1 shall be without prejudice to the holding and management by the governments of the Member States of foreign-exchange working balances."

(to be read in conjunction with Art. 30-ESCB (pooled reserves); Art. 31-ESCB (non-pooled reserves); Art. 41-ESCB (discussion on general enabling clause); Art. 43-ESCB (list of articles which do not apply to derogation countries); Art. 105(2)-EC (mirrors Art. 3.1-ESCB in the Treaty); Art. 109-EC (exchange rate policy))

I. INTRODUCTION

I.1 *General introduction*

Article 3.1 shows the *basic* tasks of the System. These tasks are disentangled from the System's objective, which is mentioned in Art. 2. The *basic* tasks are the normal basic tasks of a central bank. The expression 'basic task' is not used in the remainder of the Statute, nor in the Treaty.[2] The 'basic tasks' are the tasks with the highest profile and the highest policy-making content, though of course, for instance, the collection of reliable statistics is a *sine qua non* for good decision-making. Other (non-basic) tasks which are mentioned in Chapter II of the ESCB ('Objectives and Tasks of the ESCB') are covered by in Art. 3.3 (a contributory function in the area of supervision and financial stability), Art. 4 (advisory functions), Art. 5 (collection of statistical information) and Art. 6 (international cooperation). The Statute also contains a detailed description of operations and activities of the System.[3] This can especially be found in Chapter IV of the Statute.

The precise formulation of the basic tasks will be dealt with below. The *first* indent on defining and implementing monetary policy (the natural task for a central bank) was indeed hardly contentious. Seen from the perspective of the ESCB it is important that it is not only responsible for implementing monetary policy, but also for its definition. The *second* indent

[1] Art. 3.3 on prudential supervision and financial stability will be dealt with under Cluster II, the bone of content being basically 'who should do what?' (national or supranational authorities). Had the outcome been a clear responsibility for the System, we would have dealt with that article in the present cluster.
[2] In other words, the Statute does not use a generic distinction between basic or non-basic tasks.
[3] Examples are the issuance of banknotes (Art. 16) and the function of fiscal agent (Art. 21).

(on foreign currency operations) touched upon a difficult and sensitive issue, i.e. who will decide on foreign currency operations. This was not solved in the context of this article, but carried over to the IGC (see Art. 109-EC). The *third* indent shows a number of 'catches': it does not determine who 'owns' the reserves;[4] the indent is clear though in that it pertains to all the reserves of the Member States, and not only those in the hands of the NCBs.[5] Therefore, even where reserves are owned by the State, such ownership is without any right as to the investment or buying or selling of these reserves, the ratio being twofold. First, transactions and interventions by the State could interfere with the ECB's monetary policy (because of the effects on market liquidity and their possible signalling function). This was especially relevant because some central banks feared an activist exchange rate policy by the political authorities (e.g. vis-à-vis the dollar), which would impede on the monetary independence of the ECB. Second, a communautarian exchange rate policy would be impossible if twelve or more States could intervene independently.

I.2 *Relevant features of the Federal Reserve System*

The introduction to the Federal Reserve Act (a short kind of recital) comes closest to the formulation of the basic tasks of the Federal Reserve System: 'To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.' The Act does not contain an article with an overview of a precise list of permitted tasks. The FRA first of all deals with the institutional set-up of the system. It starts with an extensive description of the FRS's districts, its branches within the districts and the organization of the Federal Reserve Banks. Art 2A of the FRA (inserted only in 1977) comes closest to the formulation of an objective for the FRS: 'to maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.' Most of the System's tasks are mentioned in Sections 11, 13-16, 19(c) and 21 of the FRA.
The Fed did not and does not have a formal responsibility in exchange rate matters. This is the preserve of Congress, which has delegated this to the Treasury (see under Art. 109, section I.2).

II.1 HISTORY: DELORS REPORT

The Delors Committee paid attention to the objective of the System, but not so much to the tasks of the System. This is understandable, because these tasks looked quite straightforward - an exception being the exchange rate management, because that task was considered to involve both the System and the political authorities (see Article 109-EC).

[4] The 'holder' does not need to be the 'owner'.
[5] At the start of the participation of a Member State in the euro area its reserves have to be handed over to the NCBs, which will 'hold' them (an exception is allowed for limited working balances - see below).

The final version of the Delors Report (April 1988) contained the following descriptions of the System's tasks:

> "**Mandate and functions**
> - [objective]
> - the System would be responsible for the formulation and implementation of monetary policy, exchange rate and reserve management, and the maintenance of a properly functioning payment system;
> - the System would participate in the coordination of banking supervision policies of the supervisory authorities."
>
> Delors Report, par. 32

Some of these tasks would also be mentioned in slightly different wording in paragraph 60 of the Delors Report. Paragraph 60 repeats which tasks would befall on the ESCB once it would roll into stage three of EMU:

> " In particular:
> - [....] the responsibility for the formulation and implementation of monetary policy in the Community [....];
> - decisions on exchange market interventions in third currencies would be made on the sole responsibility of the ESCB Council in accordance with Community exchange rate policy; the execution of interventions would be entrusted either to national central banks or to the ESCB;
> - official reserves would be pooled and managed by the ESCB;" [6]
>
> Delors Report, par. 60

Earlier drafts had been less specific on the list of tasks of the ESCB. For instance the draft of 31 January 1989 [7] had contained two alternative versions for the 'Mandate and functions' of the System, one by Duisenberg and one by Pöhl (reflecting closely the wording of the Bundesbank Law).[8] Duisenberg's text was based on elements of an earlier draft of the Delors Report by the rapporteurs of the Committee and elements of Pöhl's proposal, e.g. the reference to the properly functioning payment system.[9]

The formulation (using the words 'official reserves' and not '<u>the</u> official reserves') left open whether all reserves would be pooled and managed by the System. In the end, it would be decided that <u>all</u> reserves would fall under the management of the System, though not all of them would be pooled (see Article 31-ESCB). [10]

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[6] The Delors Report (par. 57) envisaged that already during stage two 'a certain amount of exchange reserves would be pooled and would be used to conduct exchange market interventions in accordance with guidelines established by the ESCB Council.' Pöhl would later distance himself from this aspect of the Delors Report – see for the reasons of his hesitation section II.2 of Art. 1 and section II.1 of Art. 12.1c.

[7] CSEMU/10/89.

[8] See Article 2-ESCB, section II.1.

[9] A reference to a function in the area of payment systems was not unique among the European NCBs. For instance, Art. 3 of the Bundesbank Law (1957) mentioned that the Bundesbank 'shall ensure appropriate payments through banks within the country as well as to and from foreign countries.' The Dutch Bank Act (Art. 9.2) of 1948 mentioned that the Dutch central bank shall 'facilitate domestic and external money transfers.' Art. 44 of the Statute of the Italian central bank mentioned that 'the Bank of Italy shall manage the existing clearing houses and those which, with its approval, are established in the future.'

[10] The management of the reserves is under full responsibility of the central banks. Efforts by the government to influence the bank's reserve management would contradict the Treaty-imposed independence of the central

II.2 HISTORY: COMMITTEE OF GOVERNORS

The very first draft for the ESCB Statute listed the following tasks, clearly inspired by the Delors Report:

> Art. 2.2 The basic tasks of the ESCB shall be:
> - to formulate and implement the monetary policy of the monetary union;
> - to implement the Community's exchange rate policy and manage the foreign exchange reserves;
> - to contribute to the smooth operation of the payment systems and the financial markets;
> - to participate in the co-ordination of the banking supervision policies of the supervisory authorities;
>
> draft 11 June 1990

The Alternates of the Committee of Governors discussed this text on 18 June 1989. The Dutch and German alternates (Szász and Rieke) proposed to change the second indent regarding the conduct of exchange rate policy. They wanted to prevent that the ESCB would be merely implementing the exchange rate policy of others. They feared an activist exchange rate policy by the political authorities, which could conflict with the ESCB's monetary policy independence. They preferred the use of the word 'operation'. (This would be inserted after the meeting of the Governors of 10 July - see below.)

In light of the discussion among the Alternates the second indent was split (into indent three and four). The next version would thus read:

> "Art. 3 - Basic Tasks [11]
> 3.1 The basic tasks of the ESCB shall be:
> - to issue notes [and coins] which shall circulate as means of payment within the Community;[12]
> - to formulate and implement the monetary policy of the Community;
> - to conduct foreign exchange policy of the Community in accordance with the exchange rate regime adopted by the Community;
> - to manage the foreign exchange reserves of the ESCB;
> - to promote the smooth operation of the payment systems;
>
> ./.

---

bank. Cf. Welteke in the Frankfurter Allgemeine of 18 October 2001: 'Eine Uebertragung auf andere öffentliche Institutionen sowie jeder Versuch staatlicher Stellen, die Bank bei der Verwaltung der Währungsreserven zu beeinflussen, würden einen Bruch des Vertrages bedeuten und die Unabhängigkeit der Bundesbank verletzen.'

[11] The Alternates had decided to separate the System's objectives (Art. 2) and the System's tasks (Art. 3).

[12] Note issuance would be transferred to Chapter IV (Monetary Functions and Operations of the System) at the suggestion of Doyle, the Irish governor (see Article 16-ESCB): Banknotes). The Luxembourg presidency, when drafting the amendments for the EC Treaty, would mention bank note issuance in Art. 105(2), with Art. 105(1) enumerating the basic tasks of the System and Art. 105(3) the supervisory related tasks. During the summer months of 1991 the Dutch presidency would replace all articles of the Statute which figured in the Treaty (like the establishment of the ESCB, its objective, its tasks) by simple cross-references to the relevant Treaty articles. This internal exercise was criticized, i.a. by the Dutch central bank, which wanted the Statute to remain self-contained and self-reading. The presidency then dropped the idea of substituting texts by cross-references - but in this process Article 15 (by then renumbered into Art. 16) had become the last article of Chapter III (Organization of the ESCB) instead of the first article of Chapter IV.

- to promote the stability of the financial markets;[13]
[-to participate as necessary in the formulation and execution of policies relating to banking supervision].[14]
3.2 Other tasks may be conferred by a decision of the Council of the European Communities in order to promote the primary objective of EMU whilst preserving the objectives contained in Article 2 of the present statutes." [15]

draft 22 June 1990

During the meeting on 29 June 1990, the French and British alternates (Lagayette and Crockett) aimed for more clarity for the situation in which an international exchange rate agreement would be lacking. To this end they proposed to reformulate the third indent into:
'- to formulate in consultation with the relevant Community bodies the exchange rate policy of the Community in accordance with the established regime.'

Szász counter argued that their formulation allowed the Council of Ministers, even in the *absence* of international exchange rate obligations, to declare - unilaterally - an exchange rate policy, e.g. aiming at a certain exchange rate vis-à-vis the dollar or an effective (weighted) exchange rate. The Council of Ministers could subsequently delegate the job to the ESCB, which could find itself before a job impossible to execute (at least impossible without distorting its domestic monetary strategy, as the only instruments available for the ESCB are the interest rate and interventions). Therefore, the ESCB would not be free to pursue the monetary policy it considered best.[16] Szász proposed to bring the matter before the governors.

As regards the fourth indent, Szász proposed to reformulate this indent into 'to hold and manage the foreign exchange reserves'. This was accepted. Tietmeyer and Szász emphasized that this indent should apply to all reserves of a Member State, and not only to the reserves held by the central banks. On this point Crockett disagreed (the British reserves were kept by the Exchange Equalization Fund and he could not imagine these reserves being handed over to the ESCB). The French and Portugese alternates (Lagayette and Borges) sided with Crockett. Szász proposed to put this important issue before the governors. Szász was concerned that disunity among the governments with respect to the exchange rate, possibly enlarged by conflicting Member States' foreign exchange transactions, would spill-over in disagreement on the right monetary policy and thus in pressure on the ESCB.

[13] This indent will be dealt with further under Art. 3.3-ESCB.
[14] The last indent was put between brackets to indicate that the appropriateness of the formulation would be reviewed in the light of a report by the Banking Supervisory Sub-Committee. This indent will be further dealt with under Art. 3.3-ESCB.
[15] Article 3.2 contains a very general so-called 'enabling clause'. For the further development of the idea of an enabling clause' we refer to Article 3.3-ESCB, sections II.2 and II.3. Suffice here to say that the governors postponed - and later dropped - the idea of a general enabling clause. Instead they introduced a so-called 'simplified (=light) amendment procedure was introduced for a number of technical articles (in the extended draft version of the Statute of April 1991, Art. 41). A specific 'enabling clause' would be retained in the supervisory area - see Article 25 which is dealt with in the context of Art. 3.3-ESCB.
[16] This concern was shared by Tietmeyer, who was worried that the European Council would use its political authority (which extended into the area of exchange rate issues) to counter the stability policy of the ESCB. (Dyson/Featherstone (1999), p. 388.)

By 3 July Art. 3.1 would read:[17]

"3.1 The basic tasks of the ESCB shall be:
- to formulate and implement the monetary policy of the Community;
- to determine the supply of money and credit and to issue notes [and coins] which shall circulate as means of payment within the Community;
[- to formulate in consultation with the other relevant bodies[18] of the Community the exchange rate policy of the Community in accordance with the established exchange rate regime];
- to conduct foreign exchange operations;
- to hold and manage [the] official foreign reserves [of the Community];
- to ensure the smooth operation of the payment system;
[- to preserve the integrity of the financial system];
[- to participate as necessary in the formulation and execution of policies relating to banking supervision]."

draft 3 July 1990

The governors met on 10 July 1990. De Larosière said he would not be able to sell at home any solution according to which governments would only be involved in decisions on the exchange rate *regime*. Changing parities within an existing regime had always been the prerogative of the government. He saw no need to change this. Pöhl was hesitant: implementation of, for instance, a G7 agreement to stabilize volatile exchange rate was only possible insofar it would not jeopardize the System's first priority of price stability. A compromise was found by substituting 'prevailing' for 'established (regime)' and by including a reference to Art. 4.3 which defined the notion of exchange rate regime:

'- to conduct foreign exchange operations in accordance with the prevailing exchange rate regime as referred to in Article 4.3.'

draft 13 July 1990

Art. 4.3 (version of 3 July) had read: [19]

'4.3 The ESCB shall be consulted with a view to reaching consensus prior to any decision relating to the exchange rate regime of the Community, including, in particular, the adoption, abandonment or change in central rates or exchange rate objectives vis-à-vis third currencies. [Opinions in accordance with Article 4.3 shall be published unless it is contrary to the best interests of the Community.]'

draft 3 July 1990

However, Pöhl said he could not accept the use of the words 'exchange rate objectives', after which the Committee agreed to use the words 'exchange rate policies'. (The final wording of 27 November 1990 of Art. 3 is shown in the box below.)

As regards ownership and management of the reserves, views did not converge. For the sake of clarity, we will first present the discussion among the governors on the foreign reserve

[17] Square brackets were used to indicate disagreement among the Alternates. The last two (bracketed) indents would later be moved to a separate article 3.3.
[18] The word 'other' had been inserted, probably to indicate the ESCB was also itself a 'relevant' body.
[19] For the development of Art. 4.3, eventually into Art. 109, see Art. 109-EC.

issue until the end and then come back to the other tasks.[20] During the governors' meeting of 11 September 1990 Leigh-Pemberton mentioned the idea that individual governments would probably wish to continue to undertake transactions which would require a certain level of reserves. In his view it would be axiomatic that governments would want to retain a certain proportion of their reserves. (This idea would resurface during the IGC and would result in a new Article 3.2, allowing governments to retain (minimum) working balances in foreign reserve assets.)[21] During the governors' meeting of 13 November it became clear that removing the square brackets around the word [the] still posed a problem to the UK. Leigh-Pemberton said his Majesty's Treasury was not prepared to cede all or part of the reserves to a central institution. Pressure by the other governors increased. De Larosière said he had 'conceptual difficulties' with the British position, while Duisenberg felt it was unacceptable to leave outside the System reserves which might be used for transactions which could run counter to the policies of the ECB. However, Leigh-Pemberton did not budge and the brackets were retained in the text sent to the IGC.[22]

As regards the other indents, the following can be said:
The indent relating to banknote issuance was deleted, because banknote issuance was dealt with separately in Article 16 of the Statute. The indent of the formulation and implementation of monetary policy in the Community was not amended. [23] The indent relating to the smooth operation of payment systems had been strengthened somewhat by replacing 'promoting' by 'ensuring'. The indents on supervision and the stability of financial markets would be relegated to a separate Article 3.3 during the IGC (see Article 3.3-ESCB).

The final version of Article 3 of the governors' draft would read:

"Article 3 - Tasks

The basic tasks to be carried out through the System shall be:

- to formulate and implement the monetary policy of the Community;
- to conduct foreign exchange operations in accordance with the prevailing exchange rate regime of the Community as referred to in Article 4.3;
- to hold and manage [the] official foreign reserves of the participating countries;
- to ensure the smooth operation of payment systems;

./.

[20] At stake was not the issue of pooling of reserves: the governors agreed that the ECB would have to be endowed with at least some reserves. The centre would be responsible for deciding on interventions. To be credible in the markets it would have to be able to intervene with reserves of its own, though possibly it could use the NCBs as agents to carry out the actual operations. (For a discussion on the degree of centralization of the operations, see Cluster II).

[21] The alternates would continue to discuss Article 4.3. In the end the part relating to 'or exchange rate policies' would be put between square brackets, while it was also made clear that the consultations aimed at reaching consensus should be guided by the overriding principle of price stability. See for more details Article 109-EC.

[22] To be complete, the words ' of the Community' were changed into 'of the participating countries' and the square brackets around these words were deleted. The text of 27 November 1990 which was sent to the IGC contained only a few brackets. They related to the exchange rate issue (Art. 3.1 and Art. 4.3) and to the issue of division of labor between the centre and the NCBs (Art. 12.1 and Art. 14.4 of the draft Statute). Art. 18.1 also contained brackets, related to the question whether the ESCB would only be allowed to extend credits against collateral.

[23] The reference to 'the Community' should be read in conjunction with Art. 43-ESCB, which makes clear that Art. 3 does not confer any rights or obligations on Member States with a derogation. Same applies to the UK.

- to participate as necessary in the formulation, co-ordination and execution of policies relating to prudential supervision and the stability of the financial system."

draft 27 November 1990

We also show the most relevant part of the accompanying Commentary:

"All except one of the Community central banks agreed on the need to bring all official foreign reserve assets (including gold) of the participating countries into the System (i.e. into the NCBs) not later than at the beginning of Stage Three. This would require a Treaty provision according to which all foreign reserve assets held by official non-central bank bodies should be transferred to the NCBs of the countries concerned before the start of Stage Three (see also comments on Article 31). The reason for bringing all such assets into the System is to ensure that exchange rate and monetary policy operations are not affected by transactions in official foreign reserve assets undertaken by official bodies outside the System. The Bank of England, which does not hold the official foreign reserves of the United Kingdom,[24] sees no need for bringing such reserves into the System."

Commentary with Article 3-ESCB, November 1990

II.3 HISTORY: IGC

During the IGC it became clear that the UK position was untenable. To make a compromise possible the Dutch presidency introduced the idea (suggested by the UK) of making an exception for (limited) working balances. At the same time the Dutch presidency reformulated the relationship between the conduct of foreign-exchange operations by the ESCB and Art. 109, which stipulates the relative competences of the Council of Ministers and the ESCB in the area of exchange rate matters.[25]

The tasks of the System are typically elements to be repeated in the Treaty itself. Below we first cite the working document of the Commission and the draft Treaty texts of the French and German delegation.

Article 106b

1. For the purpose of the preceding Article,[26] Eurofed's tasks shall be:
- to determine and conduct monetary policy; [27]
- to issue notes and coins denominated in ecus as the only legal tender throughout the Community, subject to the provisions of Article 109h(2); [28]

[24] The other exception was the Banca d'Italia: the Italian reserves were held and managed not by the Banca d'Italia, but by the Ufficio dei Cambi, though the Ufficio was chaired by the president of the Banca d'Italia. (In France reserves were located at the Banque de France, ownership however was claimed by the Trésor. This was disputed by the Banque de France, which claimed it also owned the reserves.)

[25] Likewise compromises on Article 109 itself came under reach only under the Dutch presidency. According to Grosche (member of the German delegation) a stalemate in the area of exchange rate policy was only warded off thanks to the due diligence of the Dutch presidency. (Conversation with Grosche November 2001.)

[26] Containing the objective and the independence of the ECB.

[27] Differs from the governors' text (which used the words 'formulate and implement'), but this is probably due to translation from the French. Many Commission documents were drafted in French.

[28] Refers to an article providing for the possibility of technical arrangements under which Member States' national currencies may provisionally remain legal tender as well.

- to conduct foreign-exchange operations in accordance with the guidelines laid down by the Council;
- to hold and manage foreign reserves;
- to participate in international monetary cooperation;
- to monitor the smooth operation of the payments system; [29]
- to participate as necessary in the formulation, coordination and execution of policies relating to banking supervision and the stability of the financial system.

2. In order to carry out the tasks assigned to it, Eurofed shall:
- conduct credit operations and operate in the money and financial markets;
- hold the foreign reserves of the Member States, ownership of which will have been transferred to the Community;
- have its own decision-making powers, and in particular the power to require institutions to lodge reserves with it."[30]

Commission draft December 1990

Article 2-4

1. Les missions fondamentales du SEBC sont:
- la définition et la mise en oeuvre de la politique monétaire de la Communauté;
- l'exécution des opérations de change, et la gestion de réserves officielles de change, conformément aux dispositions du chapitre 3 ci-après;

2. Pour mener à bien les missions qui lui sont assignées le SEBC:[31]
- règle l'émission des signes monétaires en écu ayant seuls force libératoire dans l'ensemble de la Communauté;
- oeuvre des comptes au bénéfice des institutions de crédit, organismes monétaires et financiers;
- peut mettre en oeuvre d'autres méthodes de controle monétaire dans les conditions fixées au paragraphe 3 ci-dessous;
- peut établir des rélations avec des banques ou institutions financières de pays tiers ou internationales, et effectuer des transactions de change;
- participe à la BRI [BIS] et, sous réserve de l'approbation du Conseil, à d'autres institutions internationales;
- exerce toute autre compétence qui pourrait lui être dévolué par le Conseil, statuant à l'unanimité." [32]

French Treaty draft January 1991

As mentioned before, the German text on the monetary part of EMU was very concise, emphasizing that the German delegation strongly supported the governors' draft ESCB

[29] 'Monitoring' is less far-reaching than 'ensuring'. The Commission might have wished a stronger role for itself in this field.
[30] Instruments are dealt with under chapter IV-ESCB (artt. 17-24).
[31] What follows mostly constitutes a list of instruments.
[32] This resembles a general enabling clause; for this topic see Article 41 (dealt with under Art. 3.3-ESCB).

Statute.[33] The German draft did not mention the tasks, or basic tasks, of the system, except in the following paragraph:

> Art. 109a (ESCB), paragraph 2:
> "In accordance with the Statute, the ESCB shall regulate the circulation of money and the provision of credit in the Community with the overriding objective of ensuring price stability."
>
> German Treaty draft February 1991

During a first discussion among the IGC deputies (on 26 February 1991) Horst Köhler stressed his preference to include in the Treaty only the essential elements, like the objective, but not the tasks of the ESCB. Wicks (HM Treasury) put on the table the wish of the British government to continue to have its own foreign exchange reserves. The Dutch (Cees Maas) replied it would be unacceptable that, for instance, all Dutch reserve assets would be controlled by the ESCB, but not all reserves of the UK.

The Luxembourg presidency would not include the instruments in its non-papers (these papers reflected not so much the consensus, but the 'flow of the discussions'). Article 105 of its non-papers listed the tasks of the ESCB:

> " Article 105
> 1. The ESCB shall define and implement the monetary policy of the Community with a view to contributing to the realization of the objectives of economic and monetary union, as laid down in Article 2A, in accordance with the principles set out in Article 3A.
>
> The ESCB shall conduct the exchange transactions and shall hold and manage official exchange reserves in accordance with the provisions of Article 109. [34] [35]
>
> It shall ensure the smooth operation of the system of payments.
>
> It shall take part, as required, in the definition, co-ordination and execution of policies relating to the prudential control and stability of the financial system."
>
> Luxembourg presidency 10 May 1991

The Luxembourg presidency's paper had combined the conduct of exchange transactions and the management of the reserves into one article; both would have to be 'in accordance with the provisions of Art. 109'. [36]

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[33] During the deputies IGC of 12 March 1991, Horst Köhler remarked that, 'although the German government did not agree with all details of the draft Statute, it did accept the draft Statute as the outcome of sensitive negotiations.'

[34] At that stage Article 109 read as follows: 'The Council [....] and after consultation of the Bank in an endeavour to reach consensus [consistent] with the objective of price stability, shall determine [guidelines for the Community's exchange rate policy,] the exchange rate system of the Community, including, in particular, the adoption, adjustment and abandoning of central rates vis-à-vis third currencies.'

[35] The text contained a footnote saying: 'Still under discussion at this stage is the question of whether the ESCB holds and manages "the" (i.e. all) exchange reserves or simply "exchange reserves" (i.e. some of them) and the way in which these reserves are to be held and managed.'

[36] The Dutch presidency would split the article: the management of reserves has nothing to do with Art. 109. The Dutch presidency would adapt the terminology 'in accordance with the provisions of Art. 109' into 'consistent with the provisions of Art. 109' - which created more room for the ESCB (consistency being easier achieved

The Luxembourg presidency's paper did not contain a separate article nor an explicit reference to the overriding objective of monetary policy. [37] This probably explains why they needed the reference to Article 2A and 3A in their first indent of Article 105(1). In the meantime, the deputies IGC also had discussed the individual articles of the draft Statute. Like most articles Article 3 remained intact, be it that the last indent relating to supervision was again put between brackets, awaiting further discussion in the Monetary Committee.[38] The brackets in '[the] official foreign reserves' remained in place, also awaiting the outcome of the discussion in the Monetary Committee.

The Monetary Committee discussed the issue on 17 May 1991. A clear majority was of the opinion that the reserves, also those of the governments, had to be to brought into the System, being the only way to ensure that those reserves cannot be used in such a way, or at such moments, which would conflict with the Community's exchange rate policy. Wicks and the French Trésor called on the principle of subsidiarity and claimed that ownership of the non-pooled reserves could remain as it was in each Member State. Conthe (Spain) sided with them. Chairman Maas concluded (1) that everybody agreed that all reserves should at least be managed by rules of the System and (2) that opinions diverged with regard to ownership of the reserves.

The Dutch presidency issued a first consolidated new draft proposal on 28 October 1991. As regards the external competences of the ESCB the draft followed the outcome of the Monetary Committee, while at the same time splitting the second indent in two indents (one on foreign exchange operations and one on holding reserves). To overcome British reluctance, the Dutch presidency inserted the notion of working balances for governments in a separate article 3.3.[39] The Dutch also inserted a new paragraph mentioning the primary objective of the ESCB, allowing them to return to the text of the governors, restoring the unequivocal primacy of the objective of price stability for the ECB, which had not been clear from the Luxemburg version of Art. 105.1. Only 'without prejudice to price stability' should the ECB's policy contribute to the support of the Community's objectives as mentioned in Art. 2 of the Treaty (into which Art. 2A had been merged).

" Article 105 1. The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the realization of the objectives of the Community as laid down in Article 2, in accordance with the principles set out in Article 3A. The ESCB shall act in accordance with the principles of an open market economy with free competition.

than being in accordance with, but at the same time was more general than the formulation of the governors (which had referred to being in accordance with the 'prevailing exchange rate regime').

[37] The same is true for the Commission's document of December 1990.

[38] See for a further discussion Art. 3.3-ESCB.

[39] In retrospect, one could say this is a neat solution, as in a society of open and competitive markets and free capital flows all economic agents (including the public sector) should be free to acquire, hold and use foreign assets. The solution ensured there would be only one official operator in terms of exchange rate policy, i.e. the ESCB, while limits could be set above which governments would need approval for carrying out foreign exchange transactions.

2. The basic tasks to be carried out through the ESCB shall be: [40]
- to define and implement the monetary policy of the Community;
- to conduct foreign exchange operations consistent with the provisions of Article 109;
- to hold and manage the official foreign reserves of the Member States;
- to promote the smooth operation of payment systems; [41]
- to contribute to a smooth conduct of policies relating to prudential supervision of credit institutions and the stability of financial markets.

3. From the holding and management of the official foreign reserves as mentioned in paragraph 2 may be excluded official working balances for non-monetary transactions.[42]

4. [relates to the issuance of banknotes]"

presidency's text of 28 October 1991

The Dutch presidency reformulated Article 3.1 of the draft Statute according to the same line.[43] The presidency's text left open the issue of ownership. Whatever the ownership of nationally held reserves, reserves pooled to the ECB can be considered as virtually being owned by the ECB, based on the wording used in Art. 30.1: "[....] the ECB shall be provided by the NCBs with foreign reserve assets [....] up to an amount equivalent of ECU 50.0000 million. [....] the ECB shall have the full right to hold and manage the foreign reserves that are transferred to it." [44]

[40] The Dutch presidency used the wording 'carried out through the ESCB' to allow for the fact that the ESCB has no legal personality and could therefore not carry out a task itself. In this respect the Dutch presidency returned to the wording used in the governors' draft.

[41] Change at the instigation of, inter alia, the UK. The expression 'to promote' is weaker than the expression 'to ensure'. Apparently this preference was not shared by everybody: during the EMU Working Group session of 6 November at least the Danish and Italian delegation suggested to replace 'promote' again by 'ensure'. The UK feared too much interference with private sector operated payment systems.

[42] Among these are small purchases, but probably also covert diplomatic and other financial transactions. The transactions with non-pooled reserves have to respect the limit referred to in Art. 31.2-ESCB (version of 28 October 1991): "All other operations [i.e. other than those necessary to fulfil obligations towards international organizations] in foreign reserve assets remaining with the NCB's after the transfers referred to in Article 30 [pooling of reserves], and Member State transactions with foreign assets of the working balances shall, above a certain limit to be established [by the Governing Council], be subject to approval by the ECB in order to ensure consistency with the exchange rate and monetary policy of the Community." These limits have been set at euro 200 million for outright transactions against the euro and at euro 500 million for cross-currency transactions (gross) for central governments; for regional governments higher limits have been set, while the limit for the Commission (though on a net basis) is lower - see Governing Council decision of 3 November 1998).

[43]

"Article 3 - Tasks

3.1 As set out in Article 105 paragraph 2 of this Treaty, the basic tasks to be carried out through the ESCB shall be:
- to define and implement the monetary policy of the Community;
- to conduct [etcetera]

3.2 In accordance with Article 105 paragraph 3 of this Treaty, official working balances for non-monetary transactions may be excluded from the holding and management of the official foreign reserves as mentioned in paragraph 1."

[44] In a late stage the last sentence would be extended with the following addition: "and to use them for the purposes set out in this Statute." (UK suggestion during the EMU Working Group meeting on 6 November 1991.)

The ownership issue was discussed by the EMU Working Group, chaired by Bernard ter Haar of the Dutch Ministry of Finance, on 6 November 1991. The UK and France preferred to drop 'to hold' and just mention 'to manage'. Others (Italy, Denmark, Greece, Spain and Ireland) considered this to be too weak, because it would seem to exclude the possibility of unwanted 'guidance' by the 'owner'. The UK also levied a protest against the expression 'working balances for non-monetary transactions'. 'Working' implies a small amount, while the UK envisaged four categories of expenditures which should be covered by exemption: future government outlays, increases in the reserve position in the IMF, debt service on sovereign debt and 'a stock of assets in a range of currencies for international emergencies'. There was no support for the UK. Paragraph 3 was already a gesture in their direction. The Italian delegation (Papadia) threatened to withdraw its support for the entire paragraph, if the UK would continue to insist. In the end the text was rephrased into: 'The third indent of paragraph 2 shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances.' - to make very clear that the use of these funds below the threshold is not subject to approval by the ECB.

Article 7:

Article 7: Independence

"In accordance with Article 107 of this Treaty, when exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and this Statute, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State of from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks."

(to be read in conjunction with Article 2 (Objectives); Article 10.2 (Voting procedure); Articles 11.2, 11.3 and 11.4-ESCB (Executive Board); Articles 14.1 and 14.2-ESCB (NCBs and their governors); Article 107-EC (Independence); Article 109-EC (Exchange rate policy); Article 109b-EC (Relation with Ecofin Council, Commission and European Parliament))

I. INTRODUCTION

I.1 *General introduction*

For the ESCB this is one of the most important articles of the Statute. It defines the institutional independence of the system: it is not allowed to take **instructions** from its political masters, neither from the executive nor from the legislative branch (both national and communautaire).[1] The Treaty even prohibits political bodies or persons to seek to influence the ESCB, though sanctions in case they do are lacking. Therefore, de facto we are talking of self-restraint, and at occasions politicians will cross the borderline. These politicians risk that the Governing Council of the ECB will feel that it has to postpone certain measures in order to prove its independence.[2] Attempts to influence members of the Governing Council can also be made behind the screens. This should be prevented. We will make a recommendation in this respect in section 4 of Chapter 5.

At the same time the Treaty specifies ways in which the ECB and the political authorities could and should communicate. The **dialogue** with the ministers of finance takes the form of the presence of the chairman of the Ecofin and a member of the Commission in the meetings of the Governing Council of the ECB and the presence of the president of the ECB in the Ecofin Council whenever this Council discusses matters relating to the objectives and tasks of

[1] See also section I.1 of Article 2-ESCB and chapter 3 above.

[2] Two possible cases which come to mind are the interest rate reduction the ECB decided to early 1999 only after the resignation of Oskar Lafontaine (who had pressured the ECB to lower interest rates) and the interest rate reduction in May 2001, a few weeks after the Belgian minister of finance (in his capacity of chairman of the Ecofin Council) had stopped publicly encouraging the ECB to do so.

the ESCB. [3] This allows the ministers of finance to take best possible informed decisions in their field of responsibility. [4] Apart from this, the president and other members of the Executive Board of the ECB may be heard by the competent committees of the European Parliament. The first president of the ECB, Wim Duisenberg, has introduced the tradition to appear at least four times a year before the Committee on Economic and Monetary Affairs of the European Parliament to discuss with the committee members the policies of the ECB. This is part of the efforts of the ECB to increase visibly its democratic accountability, even though the European Parliament has no decision-making competences in monetary matters. [5] In that sense the position of the European Parliament differs from that of the US Congress, which is endowed by the American Constitution with monetary competences, but has delegated them by law (the Federal Reserve Act) to the Federal Reserve System (see below). (The EU Treaty only specifies the dialogue at the European level. It is up to the national governors to appear or not before their national parliaments.) In these appearances – whether public or in restricted sessions – the Governing Council members governors are bound by the confidentiality regime of the ECB, implying they are not allowed to give details about the discussions within the Governing Council (see Art. 10.4) nor indications about intended policy measures.

As mentioned before in Chapter 1 many authors on the issue of central bank independence distinguish institutional, personal, functional and financial independence.[6] *Institutional* independence means that the institution is not subject to instructions by third parties. However, independence of instructions is insufficient to guarantee real independence. Other provisions in the Statute 'give it practical effect by determining the functional, operational and financial conditions which need to be met so that the System can act with the necessary degree of autonomy.' [7] *Personal* independence is based on safeguards against dismissal. In the case of the ESCB this is guaranteed by ensuring that the members of the Governing Council (also the central bank governors) cannot be dismissed at political will, and by assuring a term of office which is sufficiently long. [8] *Functional* independence implies that the use of instruments is not subject to the approval of third parties either. This form of independence (sometimes called operational or instrumental independence) is guaranteed by

[3] They have the right to speak (and even the right to submit a motion - which has until now never happened), but not the right to vote. See Article 109b-EC.

[4] There are many more channels of communication between the ECB, the central banks and the Treasuries, one example being that both central bank board members and high officials of the Treasuries are member of the Economic and Financial Committee, a committee which delivers opinions (asked for and unasked for) to the Ecofin Council (Article 109C(2)-EC).

[5] This will not change if in the future Treaty amendments were to need the assent of the European Parliament, because such assent would extend only to changes, and not - retroactively - to for instance the establishment of the ESCB. At present the 'monetary' power of the EP is limited to (1) its specialised committees having the right to hear members of the ECB's Executive Board and (2) holding a general (plenary) debate on the ECB's Annual Report which is presented to the EP by the president of the ECB (Art. 109b(3)-EC). There are also two instances in which the EP's assent is necessary: (i) when the Council of Ministers would use the simplified amendment procedure to amend the ESCB Statute, which is possible for a few non-essential, technical articles (Art. 106(5)-EC); (ii) when the Council of Ministers would want to confer 'special tasks' in the supervisory field to the ECB (Art. 105(6)-EC). The fact that the EP has a role here is mostly due to last-minute efforts of the Dutch presidency to increase the role of the EP.

[6] See also Smits (1997), p.155.

[7] Quote from the Commentary with the draft ESCB Statute of 27 November 1990.

[8] Artt. 11.3 and 11.4-ESCB (Executive Board) and Art. 14.2-ESCB (NCB governors).

giving the ESCB all the powers it needs to wield all the monetary instruments a modern central bank is supposed to have at its disposal without the need for permission by political authorities. The ESCB relies on indirect instruments, i.e. the price of money – see section I.4 of Art. 2 above. Indeed, relying on direct instruments (i.e. instruments not based on market principles, like credit controls, capital controls or interest rate caps) is not recommended, because the use of these instruments usually requires approval by, or consultation with, the executive and legislative branch, making for a dependent relationship. It would also contravene Art. 3a-EC, which obliges the ESCB to respect the principle of an open market economy with free competition. An important element of operational independence is also that the central bank is not obliged to finance the government, i.e. to grant credit to the government or to buy newly issued debt of the government. The latter is different from open market operations by the central bank in the secondary market, which can be used to influence the liquidity in the markets. The ESCB Statute not only guards the ESCB from *obligatory* monetary financing, it even forbids the ESCB to take part in any form of direct monetary financing (see Art. 21-ESCB).
Financial independence is achieved by ensuring that the ECB is not dependent on budgetary appropriations by a national or supranational government. The ECB's income and expenditures do not fall under the Community budget (which would have given and the Commission and the Council of Ministers and possibly also the European Parliament an instrument to put pressure on the ESCB).[9] We note that the NCB's traditionally fund their expenditures out of their seigniorage.

For **Germany** independence was a *sine qua non* for surrendering monetary sovereignty to a new institution. The independent Bundesbank had guarded over one of the most important economic post-war successes of Germany: the stable Deutschmark. Price stability was considered a social good (see also Article 2-ESCB) and an independent central bank was considered the best guarantee for price stability. The degree of independence of the Bundesbank was unique in Europe, as can be seen from the table 2.2 presented at the end of this sub-paragraph.

The ESCB is granted full independence, but only for a narrowly defined overriding purpose: to maintain **price stability.** This raises the question of whether all ESCB tasks, as formulated in Artt. 3.1 and 3.2 are related to price stability. For monetary policy, this is self-evident. For the tasks related to managing foreign reserves and the exchange rate, this is also true, as buying or selling operations in foreign currency do affect the liquidity in the system and could be counterproductive to the monetary policy intentions of the ECB. [10] This backdoor had to be closed, to make the ESCB meaningfully independent. As regards financial stability, the health of the financial system is also clearly relevant for the ESCB: when the financial system breaks down and the financial markets come to a halt, the normal monetary transmission mechanisms break down too and monetary policy loses a good deal of its effectiveness. This creates good grounds for giving the ESCB the task "to contribute to the smooth conduct of policies by the competent authorities [in these areas]". [11] The other tasks of the ESCB are advisory tasks

[9] Article 27.1 ensures the books of the ECB and of the NCB's are audited by external and independent private sector auditors, while Article 27.2 allows the European Court of Auditors to form itself an opinion on the "operational efficiency of the management of the ECB". See Article 27-ESCB.
[10] See Article 3.1-ESCB, second and third indent and Article 109-EC.
[11] See Article 3.3-ESCB.

(Article 4-ESCB), a task in the field of the collection of statistics necessary for the ESCB to perform its tasks (Article 5-ESCB) and the participation in international monetary institutions (Article 6-ESCB).

The foregoing justifies that the independence of the ESCB extends to the tasks mentioned in Art. 3 and the undertakings necessary to perform these tasks. This raises the question, however, whether this independence applies also to **non-System functions of NCBs**, which functions they are allowed to perform unless the Governing Council decides these functions interfere with the objectives and tasks of the ESCB (Article 14.4-ESCB). As regards the *financial* and *personal* independence the answer should be obvious: these elements may not be put in jeopardy. For instance, a central bank should not take on undue financial risks which might make it dependent on budgetary means. Also, it should not be possible for the government to dismiss board members for badly managing non-System functions, not going beyond serious misconduct as specified in Art. 14.2-ESCB; neither should the remuneration of board members depend on the performance in these non-System areas, as it might make them indirectly vulnerable to outside pressure. It would also seem desirable for an NCB to take on board only well-defined functions which can be performed without detailed or frequent *instructions* from the government, lest the central bank be hindered to act as an independent institution, even if these tasks do not per se interfere with monetary management. [12] This also implies the NCB should be given a reasonable degree of *functional* independence in these non-System areas.

The following table shows the unique position of the Bundesbank among the other European central banks as regards its legal independence before the Treaty of Maastricht.

Table 2.2 Independence (situation in 1989) [13]

Austria:	"In determining the general directives on monetary and credit policy which the Austrian National Bank is to observe in this field for the purpose of performing the functions incumbent upon it, due regard shall be had for the economic policy of the Federal Government." (Art. 4 Nationalbankgesetz 1955)
Belgium:	Monetary policy is run at the initiative of the Bank under the political responsibility of the Government.
Denmark:	Monetary policy is determined in – an informal – cooperation between the Government and the Bank. The Government cannot issue directives to the Bank.
Germany:	"Without prejudice to the performance of its functions, the Deutsche Bundesbank shall be required to support the general economic policy of the Federal Government. In exercising the powers conferred upon it by this Act it shall be independent of instructions from the Federal Government." (Art. 12 BBankG)

[12] Or, as René Smits puts it, "The distinction between competences exercised in complete independence and functions which are subject to a higher degree of political involvement may have a bearing upon the acceptability of such other functions being entrusted to the monetary authority." (Smits (1997), p. 158.)

[13] Sources: see footnote with table 2.1 (Art. 2)

Greece:	The Bank is responsible for implementing guidelines for monetary policy which are set by the Government. The Bank is consulted when monetary policy is formulated.
Spain:	"The Bank of Spain … conducts monetary policy in accordance with the general objectives determined by the government, while using the means it considers most adequate for achieving these objectives, in particular the safeguarding of the value of the currency." (Loi du 21.6.80, art. 3)
France:	"The Bank helps to prepare and takes part in the implementation of the monetary policy that has been decided by the government, with the assistance of the Conseil National du Crédit, according to its terms of reference." (Article 4 de la Loi de 1973)
Ireland:	Considerable degree of formal autonomy, but in practice broad monetary policy is defined by the Minister of Finance.
Italy:	An interministerial committee defines the guidelines for monetary policy and the Treasury sets the discount rate, but due its technical competence the Bank of Italy has a significant influence on monetary policy.
Netherlands:	The minister may give directives to the Bank. A serious disagreement would have to be discussed by the whole Cabinet and would be published formally. A directive has never been give. The heavy-handed procedure has assured the Bank has considerable autonomy. (Article 26, Bank Act 1948)
Portugal:	No autonomy.
UK:	Monetary policy is formulated by the Treasury.

I.2 *Relevant features of the Federal Reserve System*

The typical characterisation of the **Federal Reserve System** of the United States is that it is "independent within the government". [14] The Constitution has vested in Congress - and not in the Administration - the nation's monetary power - "to coin Money" and "to regulate the Value thereof". Congress has delegated the job to the Fed with a broad grant of discretion and independence.[15] For instance, the members of the Board of Governors are appointed for a term of 14 years (non-renewable).[16] The President of the United States appoints new

[14] Expression used by Allan Sproul, president of the New York Fed, during Congressional hearings in March 1952 on the meaning of the independence of the Fed. Congress had been unhappy that the Treasury had dominated the Fed during the wars (the Fed had kept interest stable at a low level to help the government finance its war efforts). Sproul's complete statement went as follows: "The Fed's independence does not mean independence from the government but independence within government." According to Sproul the "Federal Reserve System" was "an agency of Congress set up in a special form to bear responsibility for that particular task which constitutionally belongs to the legislative branch of the government." (Moore (1990), *The Federal Reserve System – A History of the First 75 Years,* p.113; Ketll (1986), p.76-77)

[15] Kettl (1986), *Leadership at the Fed*, p.3. Section 8 of the Constitution of the United States of America: "The Congress shall have the power [....] To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standards of Weights and Measures;"

[16] The term of office used to be 10 year, when the Board (i.e. before 1935) consisted of two Treasury people and five appointees by the president. The ten years terms of the five presidential appointees were staggered, implying a president could in any one term appoint a few members, and not a whole new board. In 1922 the number of appointive members was raised to six (allowing for representation of agricultural interests – Cushman (1941), p. 518), and in 1933 their term of office was raised to twelve years (J.T. Woolley (1984), p. 37; Cushman (1941), p. 745.) Following the 1935 Banking Act the size was reduced to seven members again, and the two Treasury people were replaced by two additional presidential appointees. Their term was increased to 14 years, upholding

members, but the Senate has to approve. Through presidential appointment of the members of the Board, the framers of the act hoped to avoid a system that had even the appearance of a monopolistic institution, likely to fall victim to partisan politics as had the First and Second Banks of the United States. [17] Once appointed, the governors are not responsible to the president, who has no official channel of communication to the Fed and no legal power over the Fed's policies. The governors can only be dismissed for personal malfeasance. The official formulation is that the governors serve their full term 'unless sooner removed for cause by the President' (FRA, Section 10), a standard never tested. [18] In the early years two of the seven seats in the Federal Reserve Board were occupied by the Secretary of the Treasury (chairman) and the Comptroller of the Currency. The 1935 Banking Act discontinued their ex officio membership of the Federal Reserve Board (then also renamed into Board of Governors). [19] [20] The FRA of 1913 also stipulated that 'no Senator or Representative in Congress shall be a member of the Board of Governors of the Federal Reserve System or an officer or a director of a Federal reserve bank.' (FRA (1913), Section 4.13), trying to create some distance between Congress and the Fed.

One of the seven governors is designated by the President, by and with the advice and consent of the Senate, to serve as Chairman of the Board for a term of four years (FRA, Section 10). On purpose, this four-year term does not coincide with that of the president. In a few cases the chairman was not redesignated, while his term as governor had not yet ended. This was the case with Eccles in 1948 and Burns in 1978, in both cases because the president disagreed with their policy, while McCabe was clearly pressured to resign.[21] Volcker had wanted to be reappointed, but apparently only under conditions of a fulsome declaration of support of Volcker's stewardship by the president, which he needed, because his authority within the Board had dwindled (partly because of dissenting opinions of earlier appointees by the sitting president Ronald Reagan). Volcker did not receive this support and resigned.[22]

The most important decision-making body of the FRS, the FOMC, consists of the seven Board members and five vote-carrying presidents of FRBs. These presidents (and their possible replacements, the first vice presidents) are elected and appointed by their board of directors for a term of five years.[23] [24] However, their appointment is subject to approval by the

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the check-and-balance that as a rule a president can only appoint one member every two years. Fourteen year is long by any standard; it is only surpassed by the fifteen-year term served by the head of Congress' General Accounting Office and the lifetime appointments of federal judges. See also Article 11.2, section I.2, *infra*.

[17] Dykes and Whitehouse (1989), p. 228.

[18] Kettl (1986), p.4.

[19] According to Marrines Eccles (*Beckoning Frontiers*, New York, Knopf ,1951, p.216n) it was at the insistence of senator Glass (a former Treasury Secretary) that the membership of the Secretary of the Treasury was dropped, because Glass knew from own experience "the Secretary of the Treasury had too much influence upon the Board, and I do not think he ought to be there." The membership of the Comptroller ended at the same time, because then Secretary of the Treasury Morgenthau did not like the idea he had to leave while a subordinate of his was allowed to stay. See Friedman and Schwartz (1963), p. 445n. Eccles was Fed chairman from 1934-1948.

[20] The Fed was housed in the Treasury until 1937! See Dykes and Whitehouse (1989), p. 240/1.

[21] Kettl (1986), pp. 63-64, 74-75 and 169.

[22] W. Greider (1987), *Secrets of the Temple*, p. 712-714.

[23] Congress has balked at this procedure several times, because part of the monetary policy-makers is chosen without their consent. This has led to a court case, in which the judge has declared that this procedure is. constitutional. (John Berry (1996a), 'Is the Fed's Power Legitimate?', in Central Banking Vol. VI, nr 4, Spring 1996, p. 45.) The District Court referring to the rich history of private participation in U.S. central banking and in open market operations before the inception of the FOMC, pointed out it considered the current system to be

Board of Governors (FRA, Section 4.4.5), while the Board of Governors can also suspend or remove them (FRA, Section 11(f)), making the Board all powerful. The level of *personal* independence in the FOMC is quite high, either because of their term (14 years – this applies to the governors) or because they are not elected by the Administration or heard by Congress (this applies to the FRB members of the FOMC). [25]

As said, the Fed is not responsible to the Administration, nor does the Executive have the right to give directions or raise a veto on Fed decisions. Instead the Fed is responsible to, and must report to, Congress. Section 10 of FRA(1913) mentions that the Board 'shall annually make a full report to the Speaker of the House of Representatives, who shall cause the same report to be presented for the information of the Congress.' In the early seventies pressures increased to improve the transparency of all government agencies. In 1977 the Fed's regular appearance before the financial committee of the House and of the Senate was put into law. [26] The 'Full Employment and Balanced Growth Act' (more popular called the 'Humphrey-Hawkins Act') of 1978 required more in detail that the Fed Chairman should make a written report to Congress twice a year in February and July, in which he is obliged to review economic trends, to sketch the objectives and plans of the Board and the FOMC with respect to the ranges of growth of money and credit aggregates and to explain how the Fed's monetary goals fit the president's economic policy. [27] The Fed is not held to its announced objectives for money and credit, if conditions change (provided that in subsequent consultation the Board shall include an explanation of the reasons for any revision to or deviation from such objectives and plans). In practice, the Fed started to present projections for many variables, in the form of ranges, in order to keep hands free as much as possible. [28] The HH-act did not require the Fed to follow specific policies nor did it require that the policies should aim at specific economic goals. Policy-making remained (and remains) in the remit of the Fed, acting as an independent government agency. The *institutional* independence was never really endangered.[29] Nonetheless, attacks on the Fed's policies are quite common. To give one example: during the recession in 1981-1982 20 to 30 Federal Reserve reform bills were tabled in Congress. Usually these spontaneous reform bills lack substantive support. Kettl describes Congressional interest in the Fed's policies is greatest when interest rates are highest. But this is counterbalanced by the fact that Congress is reluctant to take the

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'the product of an unusual degree of debate and reflection within the legislative branch', representing 'an exquisitely balanced approach to an extremely difficult problem.' (Akhtar and Howe (1991), p. 366.)

[24] The board of directors of an FRB can 'dismiss at pleasure' all executive officers (among which are the president and the first vice president) and employees (FRA, Section 4.4). This does not mean that the member banks determine the FRB's policy. According to Eccles during hearings in 1938: "Ownership of stock by member banks does not enable the bankers to control the Federal Reserve System. It is more nearly in the nature of compulsory capital contribution than stock ownership." (Cited in Louis (1989), p. 294.) A further factor creating some distance between the private sector and the FRS is that members of the Board of Governors are not allowed to be employed, or to have a stake in, financial institutions (FRA(1988), Section 10.4.)

[25] Regularly this leads to questions by Congress members, who are outraged that the presidents of the FRBs are chosen by local bankers, business men and the like. See for instance, H. Reuss, 'The Once and Future Fed', in *Challenges,* March-April 1983, and The Economist of 25 October 1993, p.97.

[26] The Federal Reserve Reform Act of 1977.

[27] FRA(1988), Section 2A.

[28] Kettl (1986), p.150: '[Then-chairman Burns] deployed shields like multiple measures of money, with broad ranges for each, and technical jargon.'

[29] A permanent difference though with the ESCB is that in the US the FRA can be changed by a simple majority in Congress, while an amendment to the ESCB Statute would require ratification by all EU Member States.

seat of the Fed. Congress finds it is difficult to articulate what the Fed ought to do and according to some Congress 'preferred having the Fed as an institution to be scapegoated.'[30]

Neither can Congress use financial pressure on the Fed, for the Fed is *financially* independent. As banknote issuing institutions, Federal Reserve Banks generate seigniorage. They are allowed to pay their expenses, pay an annual dividend of six percent to their shareholders and build up a surplus fund (FRA(1913), Section 7). [31] Excess earnings are transferred to the Treasury. [32] The Board of Governors is entitled to levy semi-annually an assessment upon the FRBs, in proportion to their capital stock and surplus, to cover the projected expenses of the Board of Governors (FRA(1913), Section 10.3). The Banking Act of 1933 has added to this that 'funds derived from such assessments shall not be construed to be Government funds or appropriated moneys." (FRA(1988), Section 10.4.) Therefore, the Fed will not have to come to Congress for an appropriation. The 1933 amendment also meant that the General Accounting Office (the auditing arm of Congress, established in 1921) had to stop auditing the Fed. [33] Instead the Fed hired private audit firms. In the early seventies Congress adopted a bill - much to the regret of the Fed - according to which the GAO would again audit the Fed. Senator Patman, one of the driving forces behind the Congressional efforts, had aimed at having a full evaluation of how the Fed performed its core functions (the GAO had moved from narrow auditing of accounts to broader evaluation of federal programs). [34] The Fed could not prevent the adoption of the GAO audit bill, but it succeeded, with the help of two Fed allies in Congress, in limiting the scope of the bill. The GAO was only to examine the *administrative* expenditures. Furthermore, the GAO was prohibited from auditing international transactions, monetary policy discussions and operations and FOMC activities, and safeguards were introduced to prevent the disclosure of information.[35] The Fed feared that a full audit would probably lead to leakage of sensitive information and questions about the transactions with single market participants, which sometimes unavoidably make a profit. Such would disrupt the Fed's carefully cultivated relationship with government securities dealers. (In case of the ESCB the European Court of Auditors is only allowed to conduct an 'examination of the operational efficiency of the management of the ECB'.) [36]

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[30] Kettl (1986), pp. 163 ff. See also Amtenbrink (1999), p. 293/4.

[31] Salaries paid by FRBs to directors, officers or employees are subject to approval of the Federal Reserve Board/Board of Governors (FRA, Section 4.22). The Board has the power to examine at its discretion the accounts, books and affairs of each FRB (FRA, Section 11(a)).

[32] To this end, the Annual Reports of the FRBs mention the following phrase (taken from 1999 Annual Report of the FRBNY, p. 49): "Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury excess earnings after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in."

[33] Before 1921 auditing was carried out by the Treasury.

[34] Kettl (1986), p.153-159; Moore (1990), p. 144.

[35] The Federal Banking Agency Audit Act (Public Law 95-320) amending the Accounting and Audit Act of 1950: "[prohibits] the GAO from auditing: (1) transactions conducted on behalf of or with foreign central banks, foreign governments, and non-private international financing organizations; (2) deliberations, decisions and actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations; (3) transactions made under the direction of the FOMC including transactions of the Federal Reserve System Open Market Account; and (4) those portions of oral, written, telegraphic, or telephonic discussions and communications among or between members of the Board of Governors, and officers and employees of the FRS which deal with topics listed in this Act. [....] Sets forth prohibitions on the public disclosure of certain information."

[36] See Article 27-ESCB. For examples of GAO reports on the Fed, see p. 160n.

Comparing the Fed and the ESCB

In the U.S. central bankers would stress the Fed is part of the government, denying such would trigger the wrath of Congress. In Europe central bankers would stress their independence of the government, that is both of the executive and the legislative branch. The difference is due to the fact that the US has a unique constitutional relationship between parliament and central bank: the Constitution gives Congress, not the Executive, the power to coin money and regulating its value. Congress has delegated these functions to a governmental agency (the Fed) protected as much as possible from party politics, which had led to the discontinuation of both the First and the Second Bank of the United States. In Europe circulation banks had usually received their charter from the sovereign [or the government], even though in many cases circulation banks were partly owned by private stockholders. [37] However, policy was not by the private sector stock holders, but by the government. Many of these governments abused their monopoly, leading to inflationary outbursts (quite often related to war efforts).

So, whereas the drafters of the FRA positioned the central bank outside the reach of partisan politics by delegating monetary powers to an autonomous governmental agency, the drafters of the ESCB Statute were more focussed on safeguarding the autonomy of the central banks vis-à-vis the government. For instance, it is striking that the Statute explicitly forbids the government to instruct or influence the ECB's decision-making bodies, whereas in the US this was never considered necessary, because the Fed is not under government instruction, nor of Congress nor of the Administration. [38] Nonetheless, the Fed values a good relationship with the Administration. During his (re)confirmation hearings in 1992 Greenspan explained he had monthly meetings with the Council of Economic Advisors and with the Treasury. Occasionally he would meet the president. It seems that the regular luncheons between the Fed chairman and the Secretary of the Treasury are more conducive to a good understanding and relationship than meetings between the Fed chairman and the president, because the president usually 'wants something' when he meets the chairman of the Fed. [39] Havrilesky (1996) takes a statistical approach, counting Wall Street Journal articles mentioning Administration desires on monetary policy (easing or tightening) to construct an index for signalling from the Administration to the FRS. He finds proof of episodically effective political arm-twisting, though the effect increases in periods of intense legislative branch

[37] A nice historical example is taken from Viebig (1999), who quotes from a speech in March 1806 by Napoleon (just crowned emperor after having established the Banque de France in the first place in 1800 as First Consul), who wanted to reduce the influence of the shareholders in the Banque de France ('La Banque n'appartient pas seulement aux actionnaires, elle appartient aussi à l'Etat puisqu'il lui donne le privilège de battre monnaie.'), though not completely: "Je veux que la Banque soit assez dans la main du gouvernment, mais qu'elle n'y soit trop.' Cited from Introductory speech Jospin at 'Bicentennial Symposium: Independence and Accountability' (May 2000), Colloque du Bicentenaire, Banque de France, p. 45.)

[38] In the latter case, one would expect Congress coming to the rescue of 'their' Fed, though in practice support had to be elicited – see e.g. Kettl (1986), p. 62-79 for the period 1945-1952. Situation Europe is quite different, where the European parliament has no monetary capacity, much to its regret, and where the European parliament is rather more inclined to criticize the ECB than to defend it against the ministers.

[39] This was the case under president Kennedy and Johnson. The chairman and the president would meet bilaterally or occasionally during meetings of the 'Quadriad'. The Quadriad is composed of the chairman of the Council of Economic Advisers, secretary of the Treasury, chairman of the Board of Governors and the director of the budget, and is sometimes joined by the president. (Leibbrandt (1968), p. 91-92.) Under the Nixon Administrations (1968-1972; 1972-1974) the roles were reversed, with Burns at occasion lecturing president Nixon what the administration should do, though there was also a lot of pressure from the White House on Burns (see Kettl (1986), p 91-96; Greider (1987), p. 342-343; Moore (1990), p. 116 and 132).

(Congress) threats to the Fed, or when the chairman is close to the Administration. He also finds that movements in the Federal funds rate can be partly explained by Senatorial remarks (relatively small predictive power though), which he links to the Senate's veto power over appointments to the Board of Governors, including the Board chairman's reappointment.
In practice, the Fed has to live with considerable *political risks*.[40] As observed by Kettl, it is the principal responsibility of the chairman to recognize the boundaries on its decisions, beyond which lie political attack. [41] Of course, the Fed values independence as much as the ECB, but it has to tread at least as carefully. [42] See for instance Alan Greenspan in a speech before a Congressional subcommittee on October 25, 1989: ".. independence enables the central bank to resist short-term inflationary biases that might be inherent in some aspects of the political process. The Federal Reserve must take actions that, while sometimes unpopular in the short run, are in the long run in the best interests of the country."

Another threat to the independence could come from exchange rate policy. In practice the Treasury is responsible for exchange rate policy - if there is any - of the US (see also Article 109-EC). This could hinder monetary policy, as exchange rate agreements could imply the need for large-scale interventions affecting the liquidity in the money markets or even a preferred interest rate policy. However, most Administrations have tended to be non-interventionist as regards the exchange rate. Furthermore, it is standard practice of the Fed to sterilize the money market effect of any intervention in the foreign currency market.

II.1 HISTORY: DELORS REPORT

Even before the Delors Committee started its deliberations, it was clear that the new institution was to be independent from national governments and Community authorities. When **Genscher** wrote his famous 'Memorandum für die Schaffung eines Europäisches Währungsraumes und einer Europäischen Zentralbank' [43], with which he surprised and annoyed the German Finance Ministry and the Bundesbank, [44] he realized a European central bank would only be acceptable to the German public when that central bank would be independent, like the Bundesbank. [45] In his memorandum Genscher wrote: 'Die Schaffung einer europäischen Währung würde die Notwendigkeit der Autonomie einer Europäischen Zentralbank und ihre eindeutige Verpflichtung auf Preisstabilität umso dringlicher machen.' In this sense Genscher was more specific than **Balladur** in his memorandum of December

[40] Pressure may arise from the Administration (see e.g. Kettl (1986), p. 10, 111, 130, and Meyer (2000)) or from Congress (see few pages above).
[41] Kettl (1986), p.13.
[42] In the case of the FRS there are also unique elements which help secure the independence from the body politique, such as the fact the Federal Reserve Bank presidents, who also vote - on a rotating basis - on the Federal Open Market Committee (FOMC), are appointed by their boards of directors - with the approval of the Board of Governors - and not by the US president. A further element strengthening the Fed's independence is their relatively long term of office (14 years).
[43] Memorandum dated 26 February 1988, in: HWWA (1993), p. 309.
[44] See Dyson/Featherstone (1999), p. 332 and Szász (1999), p. 104-5.
[45] This view is also ventilated in Dyson/Featherstone (1999), p. 330: "the Genscher memorandum was an attempt to build the initiative around ideas acceptable to the Finance Ministry and to the Bundesbank, without drawing them into formal consultations." For Genscher's motives, see Dyson/Featherstone (1999), pp. 326-332 and Szász (1999), p. 214/5. Genscher was committed to European integration and was afraid French-German cooperation would suffer a serious setback when the EMS would break down.

1987 ('La Construction Monétaire Européenne'), in which Balladur had pursued the logic of creating a zone with a single currency and a central bank system after the Internal Market would have been completed in 1992. Balladur acknowledged the difficulties raised by proposals for an ECB and confined himself merely to listing a number of questions, one of them how to regulate the relations between the European central bank on the one hand and the political bodies of the Community and the national monetary authorities on the other. In this sense Balladur followed the Werner Report of 1970 on the realisation by stages of Economic and Monetary Union. The report had been concerned with coordination procedures between the monetary authorities and the centre of decision for economic policy, and not so much with the status of the 'Community system of central banks'. [46]

The German Finance Ministry was taken off guard and turned to the offensive with **Stoltenberg's** Memorandum on the Further Development of Monetary Cooperation in Europe of 15 March 1988. The memorandum advocated that European political union should precede monetary union.[47] On a future ECB it stated that it should be independent from 'Weisungen der Mitgliedsregierungen oder anderer Gemeinschaftsorgane'. [48]

A press statement issued by the Bundesbank on 5 May 1988, following a discussion within the Zentralbankrat on monetary cooperation in Europe, was also quite clear: 'Konsens besteht in der Bundesrepublik auch darüber, dass eine europäisches Notenbanksystem unabhängig sein sollte; unabhängig nicht nur von nationalen Regierungen, sondern auch von den Einrichtung der EG, also der Kommission und der Ministerrats.' [49] A similar position was taken by the representative of the German Finance Ministry, **Hans Tietmeyer**, in the Monetary Committee meeting of 3 May 1988. According to Tietmeyer the European Central Bank System should have the statutory objective to pursue price stability, should be independent from instructions of other Community institutions and of national governments and should have a federal character (a mixture of central and national elements). This position is very close to the wording of an internal working paper of the Bundesbank of April 1988, which speaks of: 'personelle und funktionelle Unabhängigkeit von den nationalen Regierungen und den Gemeinschaftsinstanzen', 'Berufung für eine mindestens 8 - 10 Jahre umfassende Amtsperiode' and '[e]in föderatives Aufbau der Zentralbank - etwa nach dem

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[46] Dyson/Featherstone (1999, p. 162) make the interesting observation that domestic political reasons were the prime motivation behind Balladur's letter. Balladur and then-prime minister Chirac, both members of the not-so-European RPR, were afraid to be outflanked on European issues by the Giscard's and Barre's UDF, which had a strong commitment to *construction européenne* (which did well in the polls). This explains the cautious approach in Balladur's letter. Giscard had been active alongside Helmut Schmidt in the Comité pour l'Union Monétaire de l'Europe which had started to meet in December 1986. The first time Balladur broached the issue of a future European central bank was in June 1987 (Szász (1999), *The Road to Monetary Union*, p.102).

[47] 'Als auf Dauer angelegte und alle Unterschiede in der Wirtschafts- und Währungsentwicklung ausgleichende Solidargemeinschaft mit einer einheitlichen Währung oder irreversibelen Wechselkursen [....] muss sie vor allem durch eine weitgehende politisch-institutionelle Umgestaltung der Gemeinschaft in Richtung einer umfassenden Union gefundiert werden.' Stoltenberg-memorandum 'Zur weiteren Entwicklung der währungspolitischen Zusammenarbeit in Europa', 15 March 1988, in HWWA (1993), p. 311.

[48] Ibidem, p.312.

[49] Presseauszüge Bundesbank. An earlier internal position paper of April 1988 had been even clearer on this issue: 'Die Verpflichtung der Zentral bank auf Preisstabilität ist durch deren personelle und funktionelle Unabhängigkeit von den nationalen Regierungen und den Gemeinschaftsinstanzen abzusichern. Die personelle Unabhängigkeit der Organmitglieder wäre durch Berufung für eine mindestens 8 - 10 Jahre umfassende Amtsperiode ohne Möglichkeit der Abberufung aus politischen Gründen zu sichern.' This position was repeated in the contribution of Pöhl to the Delors Committee (see part 2 of the Delors Report: 'Collection of papers submitted to the Committee for the Study of Economic and Monetary Union', p. 137).

Muster des amerikanischen Federal Reserve System - wäre in Anbetracht der nach wie vor bestehenden nationalstaatlichen Souveränität angebracht und würde die Unabhängigkeit der Zentralbank absichern.' [50]
Therefore, even before the European Council of June 1988 decided to establish a working group under the chairmanship of Delors Germany had drawn a line in the sand. The first preliminary draft written by the rapporteurs of the Delors Committee (December 1988) contained wording close to the German position: [51]
"- the system must be independent of instructions from national governments and Community authorities.
[....] The Board members would be appointed for a term of office of [eight] years by the European Council." [52]

The draft version of 31 March 1989 showed an additional sentence (italics by the author): [53]
" Status
- independence of instructions from national governments and Community authorities; *this should be ensured by a Treaty provision stating that central bank governors in their position as members of the ESCB Council should act independently of their government.*
- [....] tenure of Board members would be for five to seven years and would be irrevocable;"

During the meeting of the Delors Committee on April 11 and 12 the two sentences of the first indent were integrated into one, in order to best 'secure the independence of members of the central banks system'.[54] As of now the independence would be clearly linked, not so much to the new institution itself, but to the members of the decision-making body of the new institution. This change was considered to strengthen the independence.

The fifth paragraph of section 32 of the final version of the Delors report would read:

" **Status**
- Independence: the ECB *Council* should be independent of instructions from national governments and Community authorities; to that effect the members of the ESCB Council, both Governors and the Board members, should have appropriate security of tenure;"

Delors Report April 1989

[50] This would be repeated in almost exactly the same wording in Pöhl's paper of September 1990 submitted to the Delors Committee (published in the Collection of papers annexed to the Delors report). The Germans did of course not mention that in Germany members of the government could participate in meetings of the Zentralbankrat and could request for the postponement of decision for not more than two weeks (rescinded in 1997). This would be brought up by the French in their draft Treaty proposal of 26 January 1991 (published in HWWA (1993)), who had copied this element [-unknown to the Banque de France law-] from the German central bank law. See Art. 109-EC, sections I.1 and II.3, *infra* treated in this cluster.
[51] CSEMU/5/88, 2 December 1988, p.15-16.
[52] CSEMU/10/89 of 31 January 1989 (p.15-16) would contain similar wording, though the appointment of the Board members was now described as 'for relatively long periods on an irrevocable basis'. Directors of the German Zentralbankrat were appointed for 'eight years, or in exceptional cases for a shorter period, but not less than two years.' (Bundesbank Law 1957, Art. 7(3).)
[53] CSEMU/14/1989, p.19.
[54] Quote taken from report of this meeting by Hoffmeyer.

All in all the Delors Committee stayed close to the demand Germany had put on the table from the very beginning. It had even strengthened on it. [55]

II.1A: THE POSITION OF THE MAIN POLITICAL ACTORS AS REGARDS INDEPENDENCE

At this place it might be interesting to look for evidence about the position of the German chancellor, the French president and of Delors himself on the issue of independence before and after the publication of the Delors Report.

Kohl always acted carefully, seldom taking a final position at an early stage. From conversations of Dutch diplomats with officers of the Bundeskanzleramt in May 1988 it becomes clear that Kohl neither wanted Genscher's personal ideas to become leading nor could he 'ignore' Genscher's memorandum. [56] In a speech before the plenum of the Bundestag on 24 June 1988 Kohl touched upon the issues to be dealt with during the Hannover European Council summit. On EMU he mentioned the need to act carefully. A possible European central bank 'muss am Ende des Weges eingebettet in einer europäisches Zentralbanksystem stehen'. At a very early stage he therefore opted for a *federal* central bank system. He said Hannover would be used to ask for a report on the conditions necessary for such a development. 'Es ist selbstverständlich, dass wir in diese Diskussion unsere hervorragenden Erfahrungen mit der Bundesbank mit ihrer Unabhängigkeit, ihrer dezentraler Organisation und vor allem mit ihrer Verpflichtung auf die Geldwertstabilität einbringen werden.'

More than a year later, during a meeting of ministers of foreign affairs in Brussels on 18-19 December 1989, the acting minister for Germany (mrs Adam-Schwaetzer) requested to include in the minutes of that meeting the following unequivocal statement 'on behalf of the German republic' (which surely must have carried the approval and weight of Kohl):

> "Protokollerklärung der Bundesrepublik Deutschland:
> The German federal government considers the independence of a future European central bank system from national and Community institutions to be indispensable for the realization EMU. The government interprets the first sentence of the third point of the chapter on EMU in the conclusions of the European Council in Strassbourg in this way." [57]

This must have been a clear signal in the direction of the French. There is no evidence Helmut Kohl ever indicated to the French the independence of the ECB was negotiable. Of course,

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[55] The Committee of Governors would even go further and would link the independence not only to the institutions, but also to the members of their decision-making bodies.

[56] Dyson/Featherstone (1999) also mention rivalry between Genscher and Kohl as to whom would be credited for the success of the German EC presidency (p.330). Kohl even distrusted Genscher and saw 'the Genscher Memorandum as an effort to sow dissension and embarass the Chancellor' at a moment the Chancellor was weakened by local electoral setbacks (p. 335). According to Dyson/Featherstone Kohl felt he retook the initiative by his proposal to appoint Delors as chairman of a committee while at the same time including all central bank governors, which deviated from Genscher's proposal for a committee of five to seven 'wise men'. As a source at the Bundeskanzleramt said: 'Es gibt keine weisere [als die Gouverneure selbst]'.

[57] The first sentence of section III of the conclusions of the Strassburg summit of 8-9 December 1989 read rather differently: "The European Council emphasized, in this context, the need to ensure the proper observance of democratic control in each of the Member States." The need for proper democratic control could be read as a corollary to central bank independence, but the latter element had been absent in the conclusions, which the Germand apparently regretted later.

Kohl also knew the independence was needed to 'bind' in the Bundesbank to a stage-by-stage process to EMU.[58] Kohl was probably not so much committed to the independence of the ECB, as to the success of monetary integration, because Kohl had decided for himself that European integration, and the active participation in that process by Germany, was the condition for creating trust with the allies and their readiness to accept a re-united Germany.
Kohl saw the revival of the European integration process as one of his most important objectives, when he became Chancellor in 1982. [59] Since his first days as Chancellor (and before) Kohl had been convinced that further steps to European Union were required, before Germany could try to seize the new diplomatic opportunities which were emerging in Eastern Europe since Gorbachov's appointment as General-Secretary of the Soviet Communist Party in 1985. [60] In 1988 Kohl was supportive of the Genscher initiative, but in the Bundeskanzleramt he made clear his stakes were higher than a European central bank: his aim was a real European community in the form of a federal state or a federation of states, which of course would have one currency. [61] In 1989 and 1990 developments in East-Germany accelerated and according to Kohl he and Mitterrand agreed German unity and European integration were two sides of the same coin.[62] The proposal by him and Mitterrand early 1989 to call not only an IGC on EMU but also one on European Political Union, was again meant to show the Germans credentials.[63]

Mitterrand's position on the independence of the ECB is less clear. Mitterrand had been president of the French republic since May 1981. He never challenged the German wish for an independent ECB. [64] The French governor **De Larosière** signalled to Pöhl before the first major working meeting of the Delors Committee that he had persuaded Mitterrand to accept an independent ECB, mandated to achieve price stability, as a non-negotiable basic principle of EMU. [65] [66] According to Dyson/Featherstone, Pöhl trusted de Larosière, whom he supposed to be longing for an independent Banque de France.

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[58] Dyson/Featherstone (1999), p. 349.
[59] Helmut Kohl (1996), *Ich wollte Deutschlands Einheit*, p. 26-27.
[60] Dyson/Featherstone (1999), p.334. Kohl was confronted with EMU in discussions with the French Elysée. The issue would be raised by the French side. The first meeting at which Kohl gave a positive signal was at the Franco-German summit at Heidelberg on 26 August 1986. He then spoke of having problems with EMU but of being prepared to make sacrifices for Europe, implying he saw EMU as a German sacrifice, but a sacrifice he was willing to make.
[61] According to sources at the Bundeskanzleramt in May 1988, as reported by Dutch diplomatic service.
[62] Kohl (1996), p. 358.
[63] Ibidem, p. 409.
[64] He would do so later, after the conclusion of the IGC, by stating in an interview for the French television, seen by the author, on the eve of the French referendum on the Treaty of Maastricht that the ECB had to work within the framework set by the European Council and 'the technicians of the [European] Central Bank are charged with applying in the monetary domain the decisions of the European Council.' Cited by Bernard Connolly (1995), p. 141/2, and later also commented upon by Szász in the following way: "Not very encouraging was the statement early September by president Mitterrand that even in the third stage the policy decisions would still be taken by the European Council, which 'the technicians of the European Central Bank only would have to execute.' " (Szász (1993), p.150.)
[65] The meeting between De Larosière and Mitterrand took place on 1 December 1988 (Dyson/Featherstone (1999), p. 345). Mitterrand would give the same signal to the Dutch prime minister in a conversation on 3 April 1990 in Paris.
[66] The Trésor was kept uninformed. Bérégovoy had great difficulties with an independent central bank. He was so angered by reading the conclusions of the Delors Report (which in the words of Trichet (then Trésor) was 'too Germanic' in content), that he summoned de Larosière to the Trésor on 27 April 1989. After de Larosière had

Mitterrand's interest for EMU dated from discussions with Roland Dumas, who in search of themes for the Mitterrand presidency had set out the idea of more concerted policy and, eventually, a European currency as the best protection against 'external risk', read: dominance of the US dollar. [67] Europe needed a true European and international currency.
Mitterrand knew it was not opportune to press the issue too hard and publicly on the Germans. The key was to induce the Germans to take the initiative on EMU. Dumas relationship with Genscher was to be instrumental, for instance in succeeding to write a chapter on EMU in the Single European Act of 1986 (the amendment of the EEC Treaty on the completion of the Internal market by the end of 1992). Kohl had been persuaded too, but, after being briefed by a worried Tietmeyer, insisted at a late moment that the EMU chapter would have to confirm that progress on EMU would require resort to the full Treaty amendment procedure of Article 236 (IGC), implying EMU could not be imposed by the Ecofin or the European Council.[68] This was a disappointment for Mitterrand. He had been reminded of the power of the German Finance Ministry and of the Bundesbank.
In the end, the French would get their ECB,[69] but it would not be the political instrument they had wished themselves for the purpose of international monetary diplomacy and politics.[70]

It is interesting to note that **Delors** himself swaggered a bit on the issue of independence of an ECB. [71] In a restricted meeting of foreign affair ministers on 7 May 1990, he is said to have shown some liking for the model of independence of the Dutch central bank. This bank was in practice very independent, but in theory the government may give an instruction. The central bank may refuse, after which parliament will discuss the arguments - and in the Dutch

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pointed out he had worked on the basis of a negotiation position cleared with the president, Bérégovoy threw his support behind de Larosière, but after the meeting he would instruct his apparatus to find a strong EC political mechanism for ensuring co-ordination of economic policy, which mechanism should 'balance' the new monetary power. To the outside world he would package this in terms of stressing the importance of democratic control and accountability. (Dyson/Featherstone (1999), p. 186; see also p. 181/2.) In the Ecofin Council of 11 June 1990 Bérégovoy intervened according to this line.

[67] The so-called Dumas memorandum of 1 June 1984. See Dyson/Featherstone (1999), p. 151-156.

[68] See Article 102A of the EEC Treaty as amended by the Single Act (signed in 1986).

[69] Mitterrand had succeeded in attaining a fixed final date for stage 3. This had been his wish at least as early as October 1990. The IGC had gone as far as possible in scribing 'irreversibility' into the Treaty (including supportive procedures – an idea which had originated in the French Foreign Office and for which they had gotten Kohl's support), but still without a date. Only in Maastricht, at the level of the Heads of State, the idea of a fixed date was tabled by the Italian prime minister Andreotti and agreed upon (the latest possible date being 1 January 1999). This implied Mitterrand had succeeded in gaining against all odds what was to him the 'chief price' over worries shared in many quarters that this would reduce the relevance of the economic convergence criteria and would thus be unacceptable to the Germans; this scepticism even existed among his closest associates, such as Bérégovoy. (Dyson/Featherstone (1999), pp. 202, 243-252, 442-448; Viebig (1999), pp. 401/2 and 512.)

[70] Indeed, while many would emphasis the euro as the currency belonging to and completing the Internal Market, the traditional French position is to stress the importance of the euro as a global currency.
Even in May 2001, prime minister Jospin would in an introduction before the French National Commission on the euro describe the physical introduction of the euro in the form of banknotes and coins as of 1 January 2002 as 'the condition for receiving full confirmation of the euro as a global currency.' (Dutch newspaper *Financieele Dagblad*, 12 May 2001.)

[71] This could have been expected, because German style independence might have been contre coeur, though Delors knew this to be an essential element of the Delors Report. On the other hand, Delors must have realized that a unanimous report would create political momentum, and once that effect took hold it was far from certain whether events would follow the path described in the report (Szász (1999), p.119). Also, the Delors Report would not be 'adopted' by the Madrid European Council of 26-27 June 1989, because Thatcher opposed. The European Council would only conclude the report 'fulfilled the mandate given in Hannover.'

constellation the government (mostly coalition cabinets) would probably not survive. The Dutch had internally concluded their model was not workable at the European level, because the Council of Ministers (the most likely body to give an instruction) could not be sacked, implying a greater risk the Council would actually start using its right to give instructions. [72]
In Delors' proposal the Commission would become involved, when the ECB would refuse to follow an instruction given by the Council of Ministers: the Commission would have to defend the instruction before the European Parliament. If the parliament would side with the Commission, the ECB would be obliged to obey.
If the parliament would not support the Commission, the Commission might have to step down. [73] A spokesman of Delors later said Delors had only intended to compare different possible models. [74]
There are more indications Delors was not per se in favor of complete independence of the ECB. In this respect it is relevant to know that Delors, who was not only president of the Commission, but had also retained the monetary portfolio for himself in 1985, had a hands-on style of leadership. [75] All Commission papers on EMU, prepared for the Ecofin Council or the Monetary Committee, probably carried the approval of Delors himself. A Commission paper of March 1990 ('EMU - the Economic Rationale and Design of the System') called for 'a large degree of independence [....] Factors determining the degree of independence include: - the freedom from obligations to take actions which would undermine the basic objective of stability'. Such a formulation raises immediately the question who would determine whether an action would undermine the objective of stability. An informal Commission paper of May 1990 ('EMU - Institutional note', prepared as a companion paper to the paper of March, which had been discussed during the informal ecofin meeting on 31 March 1990 in Ashford castle, Ireland) carried a more strict formulation: 'In performing their responsibilities, the members of the Council shall be entirely independent and shall act in the general interest of the Community. The Member States shall undertake not to seek to influence the members of the EuroFed Council in performing their responsibilities.' However, in that specific document monetary policy was said to have two objectives, apparently carrying the same weight, i.e. 'to ensure price stability and to support the general economic policy adopted at Community level.' In August the Commission published another document ('Economic and Monetary Union'),[76] which followed the line of the March document. The Commission draft Treaty proposal of December 1990 would leave less room for doubt, as it would follow the

[72] This position was discussed in a published exchange of letters between the Dutch central bank and the Minister of Finance. (Press Notice Ministry of Finance, nr. 91/72 of 28 March 1991, also distributed to the members of the Monetary Committee (doc. II/169/91).)
[73] *Europa van Morgen*, nr 16, 16 May 1990. (*Europa van Morgen* is a publication of the Representative Office of the European Commission in the Netherlands.) In the Ecofin of 11 June 1990 Delors would repeat the idea that the Commission, being the only institution accountable to the European Parliament, should take the responsibility to defend such a decision, even if taken by another body, before parliament. (This can be interpreted as an effort by the Commission president to create a monetary competence for the Commission, as the Commission would probably first have to make up her own mind whether or not to side with the Council of Ministers.)
[74] Dutch newspaper *NRC Handelsblad*, 8 May 1990.
[75] Dyson/Featherstone (1999), p.703.
[76] European Commission (1990d), pp. 175 ff.

formulation of the Committee of Governors' draft ESCB Statute in having a clear primary objective. [77]

Here we see that the prime motives were political, i.e. cementing European integration. For the French the dominance of the Bundesbank was a thorn in their side, but this in itself was not sufficient reason for Germany to surrender monetary souvereignty to the European level. However, the oncoming trepidations in Eastern Europe were a reason for people like Genscher and Kohl to forge ahead, paving the way for German re-unification – in which indeed they were very successful. The main political actors, Kohl with Genscher, Mitterrand with Dumas and Delors, were less interested in the design of the European central bank system than in making sure it would happen. Because of the Bundesbank's strong popular support in Germany Kohl sided with the Bundesbank's demand (shared supported by the German Ministry of Finance) that the future ESCB should be protected from political influence. A federal structure in which all central banks would continue to exist was considered to enhance the acceptability to the Member States. This element had already been mentioned in an early stage (Balladur, Stoltenberg). The precise structure of the system, and its checks and balances, were left to the more 'technical' level of the central bankers and the Finance ministries. Nonetheless, two important benchmarks had been set: independence vis-à-vis the political authorities and the continued existence of the NCBs – against which the new central institution would have to be positioned. This would be the subject of the deliberations in the Delors Committee, the Committee of Governors, the Monetary Committee and the IGC – see also chapter 1.

II.2: HISTORY: COMMITTEE OF GOVERNORS

The first draft for discussion by the Committee of Alternates [78] already showed wording close to the final outcome:

> 'Article 12 - Independence
>
> 12.1 In exercising the powers and performing the duties conferred upon them by the Treaty and these Statutes, the ESCB and the members of its decision-making bodies may neither seek nor receive any instructions from Community institutions or national governments.'
>
> draft 11 June 1990

In the draft version of 3 July 1990 the words **'or any other body'** appeared at the end of the sentence, probably to capture also the European Council, not yet being a Community institution. On 8 September Pöhl in his capacity of chairman of the Committee of Governors gave an elaborate statement in the informal Ecofin, in which he articulated the governors were convinced, based on actual experience in their countries, that the success of pursuing a

[77] Commission's proposal for a draft Treaty amending the Treaty establishing the European Economic Community with a view to achieving Economic and Monetary Union, Commission document SEC(90) 2500/2, 10 December 1990, Article 106a (see section II.3 below).

[78] A document called 'Legal foundations of the European System of Central Banks (ESCB)' (dd 11 June 1990) prepared by the Secretariat of the Committee of Governors under guidance of Jean-Jacques Rey, chairman of the Committee of Alternates. Annex I of that document referred to the articles which should be embodied in the Treaty, Annex II to the articles to be embodied in the statute.

monetary policy in accordance with the primary objective of price stability hinged critically on safeguards against political pressures. [79]
This text was improved upon during the next months in the following way:

- a second sentence was added (at the advice of the legal experts group) saying that the political authorities should refrain from instructing or even influencing the ESCB
- the word 'system' was replaced by 'ECB and NCBs'
- 'duties' was replaced by 'tasks and duties' in order to broaden the scope of the independence.

This resulted in the following final wording in the governors' draft statute:

> "Article 7 - Independence
>
> In exercising the powers and performing the tasks and duties conferred upon them by the Treaty and this Statute, neither the ECB nor a NCB nor any member of their decision-making bodies may seek or take any instruction from Community institutions, governments of Member States or any other body.
> The Community and each Member State undertake to respect this principle and not to seek to influence the ECB, the NCBs and the members of their decision-making bodies in the performance of their tasks."
>
> draft 27 November 1990

It is interesting to note that the wording is largely based on the existing wording used to define the independence of the members of the Commission:[80]

> "The members of the Commission shall, in the general interest of the Communities, be completely independent in the performance of their duties.
> In the performance of these duties, they shall neither seek nor take instructions from any Government or from any other body. They shall refrain from any action incompatible with their duties. Each Member State undertakes to respect this principle and not to seek to influence the members of the Commission in the performance of their tasks."
>
> Article 10.2, Merger Treaty 1967 (replacing Article 157(2) of the EEC Treaty) [81]

[79] This was not disputed by the ministers, though according to Bérégovoy the question had to be answered who would be responsible for economic policy in the Community and who would set out the broad orientations for monetary policy. In July the Monetary Committee, in which both Treasuries and central banks were represented had finished a report to the ministers called 'EMU beyond stage 1: orientations for the preparation of the IGC'- published in HWWA(1993). This report, which stressed the need for an independent ESCB, had been adopted by all members (including the French (Trichet)), except for the UK delegation. It is interesting to note that the report also mentioned that the members of the Governing Council should 'not act as representatives of their governments or central banks.' (Emphasis added by the author.) This makes sense as the governors are not expected to represent their country or territory, but they are supposed to act as independent experts; while assembled as a group they bring together a broad spectrum of first-hand knowledge of the state of the economy and a broad range of views enriching the debate on what should be the right course for monetary policy. That the governors do not represent their central banks means they do not travel to Frankfurt with a voting instruction of their board of directors. This would also paralyse decision-making in the Governing Council.

[80] The commentary of the draft version of 8 October specifically mentions that the new second sentence finds its origins in Article 157 of the EEC Treaty, as amended by Article 10 of the Merger Treaty.

[81] Official Journal of the European Communities, No 152, 13 July 1967.

It must be said here this formulation, though strong on paper, has not been strong in practice. There have been too many examples in which Commissioners clearly went out of their way to support the position of their national government. Therefore, the strength of Article 7-ESCB (the core article defining the independence of the ESCB) has to be tested in practice. As mentioned before, sanctions are lacking.

II.3 HISTORY: IGC

Most draft Treaty texts by national delegations tabled before, or during the IGC which started in December 1990, were in line with the outcome of the Delors Report, and therefore in line with the text of the Committee of Governors.
The draft by the French Finance Ministry was a bit of an exception. [82] The French had selected the first and not the fourth sentence of Article 10.2 of the Merger Treaty (relating to the reciprocal good behaviour of the political authorities).

Article 2-3(2)
"Dans l'exercice des missions qui lui sont conférées par le présent Traité, le SEBC ne sollicite ni ne recoit aucune instruction du Conseil , de la Commission, du Parlement et des Etats membres."

Article 2-5(3)
"[....] Les membres du Conseil et du Directoire de la Banque exercent leurs fonctions en pleine indépendance dans l'intéret général de la Communauté."

French draft January 1991

On February 26 1991 the German delegation presented their draft Treaty text in an effort to regain the initiative in the IGC. [83] Their draft Treaty text showed the imprint of the Economics Ministry in its emphasis that economic union should be based on free market principles and its dislike for the concept of a Community economic policy. The Economics Ministry's aim was to stress the principle of subsidiarity in economic policy (economic policy was to remain with the member states). In that sense the German position was different from the position taken in par. 27 of the Delors Report, which spoke of both the need for binding rules in the budgetary field and other arrangements 'to design an overall economic policy framework for the Community as a whole', though at other places policies (par. 30-Delors Report) this framework boiled down to no more than a common overall assessment of the short-term and medium-term developments in the Community, which would facilitate a better coordination of national economic. Horst Köhler, State Secretary in the Finance Ministry and leader of the German IGC delegation, had to defend these principles and get them engrained in the Treaty. His real worry, however, was directed at the French who had proposed that the European Council could issue 'grandes orientations' for EMU. Köhler feared these 'orientations' could extend to monetary policy, and thus violate the ECB's independence. [84]

[82] Projet de Traité sur l'Union Economique et Monétaire, 25 January 1991, printed in HWWA (1993), p. 343 ff.
[83] Dyson/Featherstone (1999), p. 408.
[84] In the deputies meeting on 26 February 1991, Trichet defended the French position. He said the French accepted an independent ECB: according to the French draft texts, the ECB would be subject to no one. At the same time the European Council should be able to issue guidelines (not instructions) for monetary policy, like the ECB was free to give her advice on for instance wage policies. In reaction Köhler expressed himself strongly

These guidelines, however, received no support at all in the IGC.[85] The French draft contained more inroads on the independence of the ECB through other articles, the most important one relating to the exchange rate policy - see Article 109-EC. Another example is the term of office for the members of the Executive Board, which the French put at five years, whereas Germany supported the Governors' draft, which had mentioned eight years. [86] A further example concerned the French proposal that the president of the Ecofin should have the power to suspend for two weeks a decision of the ECB (their Article 4-3(1)).
Yet another example refers to the question who owns the capital of the ECB. Article 29 of the draft Statute of the Committee of Governors had expressed that the NCBs shall be the sole subscribers to and holders of the capital of the ECB. The French draft (Article 2-6(1)) stated that 'le capital de la Banque centrale européenne est détenu par les Etats membres.'
As regards the use of guidelines and the role of the European Council, some strong encounters took place in the deputies meeting between Köhler and Trichet. During the deputies IGC of 29 January 1991 Trichet had noted that giving the European Council an important role in the determination of economic policy was a 'core issue' to the French negotiators. The Dutch (Maas), German (Köhler) and Irish representatives objected. Köhler wanted even to forbid the European Council to discuss economic policy without the Ecofin ministers being present. Köhler also protested against a remark by Maas, who had suggested to include into the multilateral surveillance exercise a discussion of the policy mix. According to Köhler monetary stability is the foundation for sustained growth. 'Monetary stability is a basic right, especially for the small man' and should not be tinkered with via the surveillance procedure. The ministerial IGC of 25 February 1991 saw a repeat of the French and German positions.

In its concluding document the Luxembourg presidency presented the following text for inclusion in the Treaty[87]:

"Article 107
When exercising the powers and carrying out the tasks and duties conferred upon them, neither the ECB, nor a central bank of a Member State, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a member State or from any other body. The Community institutions and bodies and the Governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB and of the central banks of the Member States in the performance of their tasks."

non-paper 12 June 1991

against any form of ex ante influencing via public opinion. Köhler's opinion mattered a lot, as Köhler had privileged access to Chancellor Kohl and because Waigel put complete trust Köhler's abilities to negotiate for a technically viable and durable EMU. See Dyson/Featherstone (1999), p. 423-424.

[85] The French draft also contained a proposal for guidelines (grandes orientations) relating to economic policy (and not EMU). The Commission's draft Treaty text had contained the idea of multi-annual economic guidelines (Art. 102c of the Commission's text). In the end these so-called broad economic guidelines would become part of the Treaty (Article 103-EC), however in the form of (non-binding) recommendations (Art. 103(2)-EC, third paragraph).

[86] See under Article 11.2-ESCB.

[87] UEM/52/91.

The presidency had replaced 'Community institutions' by 'Community institutions or bodies', the idea being that this formulation would also capture the European Council, which did not have the status of a Community institution. [88] The reference in the second sentence was now to the members of the decision-making bodies only, and not anymore to the institutions (ECB, NCBs) themselves. [89] One could argue that this specific modification opens the possibility for the Ecofin to influence the Governing Council or the institution as a whole, e.g. by expressing in public its opinion on what the ECB as an institution should do. On the other hand, influencing the institution should be regarded as influencing the members of its decision-making bodies, which is not allowed.

The Dutch presidency took over in July 1991. They presented a consolidated text on October 28th (UEM/82/91), which as regards Article 107 only showed minor editorial improvements.[90] There was no further tinkering with independence - the battle had been fought in the early stages - and the text was changed no more. (The final text is shown at the outset of this paragraph.)

[88] Argumentation used by Yves Mersch, the Luxembourg chairman of the deputies IGC, during the deputies IGC of 4 June 1991. The European Council would retain a role in (i) the appointment of Executive Board members (Article 109a(2)-EC), (ii) the procedure for economic policy coordination (Article 103-EC), (iii) in receiving the Annual Report of the ECB (Article 109b(3)-EC) and (iv) in the procedures for deciding on the start of the Third Stage of EMU. A more general article (Common Provisions, Article D) states that the 'European Council shall provide the Union with the necessary impetus for its development and shall define the general political guidelines thereof.' (The European Council includes the Commission president, whereas the Council in the composition of the Heads of State and Government does not; the latter can take decisions, the former not.)

[89] Reasons unknown. Article 7 of the draft Statute was changed accordingly.

[90] Like changing 'a central bank of a Member State' into 'a national central bank'.

Article 10.4:

Art. 10.4 (Minutes Governing Council)

"10.4 The proceedings of the meetings shall be confidential. The Governing Council may decide to make the outcome of the proceedings public."

(to be read in conjunction with Art. 109b-EC (Institutional dialogue); Art. 10.2 (Voting); Art. 12.2 (Executive Board prepares Governing Council))

I. INTRODUCTION

The formulation allows the Governing Council to publish the 'outcome' of the proceedings, not the proceedings themselves. By not being obliged to publish the proceedings the voting behaviour of the individual members of the Governing Council could be shielded from the public eye, thus preventing them from coming under national criticism or political pressure. However, the word 'outcome' still leaves quite some room for interpretation. For instance, does 'outcome' only refer to the decision *sec*, or does it also include the arguments used or even to the number of votes for and against the decision? To explore what is possible, we first describe a number of existing and past practices. We distinguish between information released immediately after a decision is taken and delayed information in the form of minutes or a summary thereof. We will see at the time of the drafting of the ESCB Statute and the subsequent IGC there was a wide variety of practices, most of which were far less transparent than what would be proposed and adopted for the ESCB. We describe the procedures of the Bundesbank, the FOMC, the Bank of England and the ECB respectively as regards the release of **immediate information** and as regards the release of **delayed information** (minutes), followed by a comparative analysis.

Immediate information:

1. The **Bundesbank** (before EMU) issued press releases every time its governing board, the Zentralbankrat, changed (one of) its key interest rates.[1] The press releases were very short. The explanation for the rate change was usually captured in at most a few sentences (in times of rising rates the ZBR usually underlined its determination to protect the internal and external value of the Dmark and/or the need to slow down the growth of M3.[2]) Press conferences were only used to inform the public about special topics.
2. Until 1994 the **FOMC**, which meets on average every six weeks,[3] did not even announce the outcome of its deliberations (i.e. the targeted level for the federal funds rate over the period until the next FOMC meeting): the markets had to gauge the outcome by looking at the open market operations of the New York Fed. Indeed - and this may surprise -, the FOMC is in no way obliged to publish immediately its proposed actions. The only

[1] Discount or Lombard rate.
[2] The Bundesbank had never defined price stability. Every year it would announce a corridor (in earlier years: a point target) for the desired growth of the monetary aggregate M3, which corridor was based inter alia on a normative rate of inflation that it found acceptable in the medium term (since 1985 this was put at 2 per cent or less; before the figure had been higher (and had been called 'unavoidable inflation'); see Houben (2000), p. 308.
[3] According to the FRA, section 12A(a), the FOMC has to meet at least four times a year.

obligation is for the Board of Governors to keep 'a complete record of the actions taken by the Board and by the FOMC upon all questions of policy relating to open-market transactions and shall record therein the votes taken [....] in each instance' and include this record in each year's Annual Report (FRA, Section 10(10)).[4] The FOMC's decisions were published after the *following* FOMC meeting, then usually four to five weeks later, in the form of a *Record of Policy Action*. The core of the FOMC decisions was and is its **policy directive** to the New York Fed, the executive arm of the FRS. Before 1975 the FOMC published its *Record of Policy Action* containing the directive with a 90-day delay. As a result of congressional pressure the FOMC reduced the waiting period to 45 days in April 1975. However in 1976 a federal district court concluded in the case *R. Merrill v FOMC* that the 45-day delay "cannot be equated with 'promptness' " as required under the Freedom of Information Act. The federal district court found that the FOMC should publish its decisions within one business day after the Actions were adopted. At its next meeting (May 1976) the FOMC decided to publish its directives immediately after the *next* FOMC meeting, then usually four to five weeks later, while at the same time filing a notice of appeal against the ruling of the district court to publish within one day. It should be remarked here that the directives could include directions like a bias to lower rates at the end of the period until the next FOMC meeting. The FOMC was of the opinion that such information could not be released before the period was over, as this would reveal the FOMC's strategy of trading in the market for government securities, which would, in turn, allow the market to better anticipate its moves and thereby make its market operations more costly. This would be the argument - basically an argument that the government's commercial interests could be harmed - on the basis of which the Supreme Court, to which the FOMC had finally appealed, remanded the case back in 1979 to the federal district court. In 1981 this court ruled in favour of the FOMC.[5] The Sunshine act of 1976 did have more consequences for the Board of Governors which is an 'agency' as defined in the act. We take the following quotes from the board's 1978 Annual Report: 'Under the Government in the Sunshine Act [....] which became effective March 12, 1976, the Board opened more than a third of its meetings in 1978 to public observation, either entirely or in part. Items considered in closed sessions under exemptions in the Act related primarily to monetary policy [....] and to supervision of banks and bank holding companies [....] To aid the public in obtaining the maximum possible benefit from the Board's open meetings, copies of most staff memoranda considered by the Board at open meetings are made available to the public and an agenda summarizing the issues to be discussed is provided at each meeting.' Open to the public are for instance meetings dealing with proposed banking regulation. Under the Sunshine act publications may be delayed when premature disclosure would be likely to lead to significant speculation in currencies, securities or commodities.[6] This argument has also been used by Greenspan: there remain 'certain areas where the premature release of information could frustrate our legislative mission .... to open up our

[4] Section 10(10) was inserted in the FRA in 1935 (Second Banking Act).

[5] Marvin Goodfriend (1986), 'Monetary Mystique: Secrecy and Central Banking', *Journal of Monetary Economics*, Vol. 17, nr. 1, January 1986, p.63-92. In 1976 the FOMC also decided, out of precaution, to discontinue its 'memoranda of discussion' (sort of summarized transcripts), which it used to publish with a five-year delay. As formulated by Kettl (1986), p. 153: '[t]he Fed could not be forced [under the Freedom of Information Act] to release minutes that did not exist.' See also next section on the publication of minutes.

[6] Amtenbrink (1999), p. 312. A precise description of the exemptions can be found in US Code, Title 5, Part 1, Chapter 5, Subchapter II, Sec. 552b – Open meetings.

debates on monetary policy fully to immediate disclosure would unsettle the financial markets and constrain our discussions in a manner that would undercut our ability to function.' [7] The Sunshine act did not apply to the FOMC.[8] The described procedures changed in February 1994, when the FOMC began issuing an *immediate* press release every time it changed the federal funds target rate.[9] Since May 1999, the FOMC issues a press release immediately after *each* meeting (whether or not it changed the funds rate). These press releases included a 'policy bias' of the Committee for the inter-meeting period in terms of the most likely direction for the federal funds rate. As of February 2000 the FOMC has stopped publishing a policy bias, but instead each press release conveys whether the Committee sees the risk of higher inflation or of a weaker economy, i.e. a statement on the 'balance of risks'.[10] An example of such a press statement is presented below in box 2, which gives an impression of the information content of a FOMC press release. Since March 2002 the press release also shows how each FOMC member voted.

3. The **Bank of England** is obliged by law (1998) to publish its decisions 'as soon as practical after each meeting'.[11] In practice, this is the same day. The accompanying press notice contains a short economic background for the decision, usually covering real growth, wage developments, current and expected inflation (in a qualitative sense). There is no press notice if the rate is left unchanged.
4. The **ECB's** Governing Council meets basically every fortnight. In the early years each meeting was followed by a press release ('Monetary Policy Decisions') with the Council's decision (not changing interest rates is also a decision) but without arguments. Every first meeting of the month was also followed by a press conference by the president and vice-president of the ECB, during which the president of the ECB will comment on the considerations underlying the Council's decision. The frequency of the monetary

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[7] Cited in Krause (1999), p. 39.

[8] Compare the FOMC Statements of Policy and the FOMC Rules of Procedure, to be found in *Federal Reserve Regulatory Service, Volume IV* (issued by the Federal Reserve Board):
- '[T]he FOMC does not fall within the scope of an "agency" or "subdivision" as defined in the Government-in-the-Sunshine Act [1976] and consequently is not subject to the provisions of that act.' (FOMC Statements of Policy (3/94), Section 281.2 - Policy Regarding the Government in the Sunshine Act.);
- 'There ordinarily is no published notice of proposed action by the Committee or public procedure thereon, as described in section 553 of title 5 of the United States Code, because such notice and procedure are impracticable, unnecessary, or contrary to the public interest.' (FOMC Rules of Procedure (3/94), Section 272.5 - Notice and Public Procedure).
It should be added that in the wake of the Watergate scandal (Nixon resigned in 1974) strong support had developed for eliminating any possible 'secrecy' in government agencies. (See Moore (1990), p. 142 ff.)

[9] This procedural change was formalized in February 1995. For a history of changes in the FOMC's disclosure policy, see Robert Rasche (2001), 'The World of Central Banking: Then and Now', in *Reflections on Economics and Econometrics - Essays in Honour of Martin M. G. Fase*, De Nederlandsche Bank, pp. 89-96. Rasche (p. 91) concludes that the experience with the immediate release of the content of the Directive since 1994 has negated a number of the historical justifications of the Federal Reserve for secrecy. For instance, he does not see evidence that the immediate release has interfered with the orderly execution of policies or has permitted speculators or others to gain unfair profits.

[10] The publication of the policy bias was felt to bind the hands of the FOMC too much, because it created specific expectations in the markets. (The ECB could learn from this, as the ECB sometimes uses the phrase 'we don't expect changes for the foreseeable future' for the interest rates themselves, instead of for the monetary circumstances.)

[11] Bank of England Act 1998, section 14(1). An exception is made for decisions to intervene in financial markets the publication of which would be likely to impede or frustrate the achievement of the intervention's purpose. Such decisions will be published at a later 'safe' date. Ibidem, section 14(5).

deliberations has been reduced to once a month (first meeting of the month) as of 2002, though in case of need meetings can be called at very short notice. (This lower frequency is an improvement, as follows from the arguments given in chapter 3.4 below.) If interest rates are changed when no press conference is planned, the press release will contain the most important considerations for the decision.[12] The press conference is usually opened by an extensive introductory statement by the president,[13] which is followed by a Q-and-A session. The introductory statement basically only shows arguments supportive of the decision: it does not show whether there were tensions or a heated debate (in that sense it does not really reflect the deliberations of the council), whether some members would have preferred larger/smaller interest rate steps nor does it show the individual views.[14] [15] In a way this is understandable as the newly established Governing Council made an effort in trying to appear as a united body with converging views, which could not become a toy or a target for politicians.

Therefore in practice we see clear differences in transparency between central banks as regards the immediate announcement of interest rate decisions. At the time of Maastricht, one central bank (Fed) did not even publish the outcome of its decision. Most central banks only publish the information *sec - without explanation or press conference.* Only the ECB tries to explain immediately its decision in terms of its monetary policy strategy.[16] Finally, some central banks (Fed) show a policy bias for the future (this is something the ECB tries to avoid, while the Fed has come back from a too clear policy bias).

[12] See for examples the press releases of 31 August 2000 and of 17 September 2001 - to be found on the ECB's website (http://www.ecb.int)

[13] The text of the introductory statement is reviewed by the Governing Council before the press conference.

[14] Because the introductory statement does not show the flow of the arguments it cannot be called 'minutes' or 'quasi-minutes', though it does reveal a lot of the thinking of the Governing Council.

[15] For a complete overview of the ECB's communication efforts (including Annual Report, Monthly Bulletin speeches and appearances), see Issing, Gaspar, Angeloni and Tristani (2001), table 9.1 (p. 140).

[16] For the ECB's monetary strategy, see under Article 2, section I. Preferably, central banks should explain their decisions in terms of their strategy. Without such a strategy, the markets will be at loss as to how the central bank will react to new information. Central banks are more effective if all players, or at least most, are aligned. While this is intuitively clear, it can even be argued that higher transparency leads to lower inflation variability – see M. Demertzis and A.H. Hallett (2002).

Example of Federal Reserve press release: [17]

Box 2: Federal Reserve Press Release
(Release Date: June 28, 2000)

"The Federal Open Market Committee at its meeting today decided to maintain the existing stance of monetary policy, keeping its target for the federal funds rate at 6-1/2 percent.
Recent data suggest that the expansion of aggregate demand may be moderated toward a pace closer to the rate of growth of the economy's potential to produce. Although core measures of prices are rising slightly faster than a year ago, continuing rapid advances in productivity have been containing costs and holding down underlying price pressures.
Nonetheless, signs that growth in demand is moving to a sustainable pace are still tentative and preliminary, and the utilization of the pool of available workers remains at an unusually high level.
In these circumstances, and against the backdrop of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes *the risks continue to be weighted mainly toward* conditions that may generate heightened inflation pressures in the foreseeable future."

Minutes (delayed information):

1. The **Bundesbank** keeps summary (not *verbatim*) minutes. These are kept secret for the public for 30 years.[18]
2. As noted above, in 1976 the **FOMC** discontinued the memoranda of discussion (or 'memoranda of understanding') (sort of summary minutes), which it used to publish with *a five year delay*.[19] However, late 1993 staff of Congressman Gonzalez (a long-time critic of the Fed) more or less stumbled on to the fact that the transcripts of the audio tapes of the FOMC meetings, meant to be of help in preparing the minutes, had never been destroyed. This had been known to Greenspan and at least one other Fed governor. The upshot was that the transcripts of each year's meetings - lightly edited verbatim records of the deliberations, with redactions for sensitive information related to foreign governments or specific businesses or individuals - are again being released with a lag of *five years*.[20] The reports on the FOMC meetings containing the policy directives to the New York Fed used to be called 'policy record' (officially: 'Record of Policy Action'). These records, which since 1976 had been made available within a few days after the *next* regularly scheduled meeting, were not complete enough to be called 'minutes'. In 1994 the character of these records changed somewhat (we quote Berry (1996) on this): 'Beginning in 1994 the "policy record" became [more like] "minutes", with much more detail about precisely who was present, the major points raised in discussing the state of the economy and the arguments supporting various policy options. However, one thing has not changed: no participant's views are identified by name unless a member dissents from the committee's

[17] Discount rate changes are approved by the Board of Governors. If such a decision is taken on the same day (which usually is the case; to this end the FOMC meeting is adjourned for a few minutes to allow the Board of Governors to approve the requests of the FRBs after which the FOMC meeting is resumed), this decision is mentioned in the same press release.
[18] Amtenbrink (1999), dissertation, p. 310.
[19] See also Amtenbrink (1999), dissertation, p. 312-3.
[20] John Berry (1996a), p. 44.

policy decision.' [21] In other words, these summary records take the form of 'non-attributed minutes', i.e. minutes showing the information available to and the discussion within the committee, but not showing who used which argument ('non-attributed'). At the end of each meeting the committee always takes a vote on the instructions to be given to the FRB of New York, the executive arm of the FRS. The minutes show how each individual member has voted. These non-attributed minutes are published shortly after the next FOMC meeting.[22] Since March 2002 the votes are published earlier, viz. as part of press release immediately following the FOMC meeting. Apart from the votes there is no obligation to publish. However, the FOMC does publish its Record of Policy Action, shortly after the FOMC's next meeting. This Record mimics 'the [Government in the Sunshine] act's minutes requirements, in that it contains a full and accurate report of all matters of policy discussed and views presented, clearly sets forth all policy actions taken by the FOMC and the reasons therefore, and includes the votes by individual members on each policy action.' [....] The timing of release of the Record of Policy Action is fully consistent with the act's provisions assuring against premature release of any item of discussion in an agency's minutes that contains information of a sensitive nature.' [23]

3. After a short stint in the European Exchange Rate Mechanism (October 1990 - September 1992) the **UK monetary authorities** switched to a strategy of direct inflation targeting (applicable as of 1993). In order to gain credibility the monetary authorities decided to become more transparent about the decision-making process by publishing the minutes of the monthly meetings of the Chancellor of the Exchequer and the governor of the Bank of England with a six weeks delay, showing their positions and possible disagreements and the Chancellor's decision.[24] In connection with the newly established inflation targets, the BoE began publishing in February 1993 a quarterly inflation report which reveals both the current inflation and the prospects of inflation over the next 18-24 months.[25] [26] The Bank of England Act 1998 granted the BoE more independence. The act stipulates new rules for the bank's communication policy: the minutes of the monthly meetings of its new decision-making body, the Monetary Policy Committee (MPC), have to be published

[21] Ibidem, p. 44. Examples of dissenting votes and the presentation of their arguments can be found in most Annual Reports of the Board of Governors of the Federal Reserve System, which contain minutes of all FOMC meetings.

[22] For more details on how the FOMC comes to a decision, see Art. 12.2, section I.2, in cluster III.

[23] FOMC Statements of Policy (3/94), Section 281.2 - Policy Regarding the Government in the Sunshine Act.

[24] In an interesting exercise Eijffinger, Hoeberichts and Schaling show that if the credibility problem of a central bank is large relative to the need for flexibility, optimal central bank institutions will be very open and transparent. The reverse is also true: if the credibility problem is small relative to the flexibility problem, society may benefit from uncertainty about the policymaker's preferences, for uncertainty (non-predictability) leads to lower variance of output, under circumstances outweighing the costs due to more monetary uncertainty. See Eijffinger, Hoeberichts and Schaling (2000), 'Why Money Talks and Wealth Whispers: Monetary Uncertainty and Mystique', in *Journal of Credit, Money and Banking*, Vol. 32, No. 2 (May 2000).

[25] See also Amtenbrink (1999), pp. 323-3. As of September 1993 the Chancellor announced that the inflation reports no longer required the approval of the Treasury.

[26] At the time of writing the ESCB Statute the situation in the UK had been radically different. In these days to BoE was strictly subservient to the Treasury. Public justification both of the objectives of monetary policy and of its tactics for reaching such ends, lay with the Chancellor and the government (Blinder, Goodhart, Hildebrand, Lipton and Wyplosz (2001), *How Do Central Banks Talk*, International Center for Monetary and Banking Studies/Centre for Economic Policy Research, p. 84-85.

before the end of the period of 6 weeks beginning with the day of the meeting.[27] The minutes are de facto made available on internet after two weeks. The minutes give an overview of the discussion, but do not attribute arguments to individual members referred to by name. The minutes do show how in the end each individual MPC member voted.

4. The **ECB** keeps summary minutes, which are kept secret for 30 years. The minutes on the monetary policy discussions are nameless, except for the names of the Executive Board members who introduce the topic .[28] Both the president of the eurogroup and a member of the Commission are allowed - in a non-voting capacity - to attend the meetings, guaranteeing the policy dialogue with the political authorities is permanent and real-time. Nonetheless, the eurogroup president and the Commissioner are bound to secrecy, even in their relations with their colleagues, as regards confidential aspects of the discussion (e.g. the individual views).

Therefore based on existing practices, we could devise the following **spectrum of openness**, going from open to restrictive:

1) *Verbatim* (or sometimes edited) proceedings (taped material).
   Practised by: the Fed, with a five year delay.
2) Attributed minutes including individual votes.
   Not practised by any of the central banks mentioned.
3) 'Non-attributed' minutes (a de-personalized summary of the discussion showing the arguments pro and con) plus voting preferences of the individual members.
   Practised by: the FOMC and the Bank of England's MPC. FOMC members who are outvoted have their minority view explicitly included in the minutes. These (summarized) FOMC minutes are published after the committees' next meeting, the individual votes are published immediately.
4) 'Non-attributed' minutes, only showing the number of votes for and against the decision, but not the individual votes.
   Not practised by any of the central banks mentioned.
5) 'Non-attributed' minutes (presenting the exchange of arguments) and the decision itself without any reference to votes.
   Not practised by any of the central banks mentioned.
6) The decision and only 'selected' arguments, viz. mainly those supportive of the outcome
   Practised by: the Bundesbank in the past and now by the ECB, an important difference being the ECB's regular press conference, which allows for more colouring of the decision made.
7) Presenting only the decision.
   Practised by: the Bundesbank.
8) Not even presenting the decision.
   Practised by: FOMC before 1994.

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[27] Bank of England Act 1998, section 15. An exception is made for those parts of the minutes relating to decisions to intervene in the financial markets, the publication of which would be likely to counteract the proposed measure. These parts of the minutes are published with a safe delay.

[28] In practice, the Executive Board member responsible for the monetary and economic analysis usually starts off with an introduction on the monetary, economic and financial environment and an interest rate proposal. (This is unlike the procedure at the FOMC, where Greenspan only formulates a proposal after having heard all committee members, and the Bank of England where the governor formulates a proposal at the end of the meeting.)

For some recommendations in this area, see Chapter 5.4.

Comparing the Fed and the ESCB
Though the Fed is usually characterized as an open and transparent institution, this is based on how the Fed behaves in practice, and not the Federal Reserve Act. At the time of drafting of the ESCB Statute, the FOMC did not even publish the outcome of its decisions immediately. The markets had to gauge the outcome by looking at the actions by the New York Fed, which executes the open-market operations of the System. The openness required by the FRA is limited to ex post accountability: public and Congress must be able to judge how well the Fed has acquitted itself of its monetary tasks. The Fed has long had a preference hiding its intentions. Under Greenspan the Fed has become more open, though only gradually. In the early years of his chairmanship Greenspan defended the Fed's policy of not showing its hand. Greenspan's attitude however has changed since 1994, though there is no clear trigger for this change. In practice the markets understood pretty well what the Fed was doing. Nor has Congress asked the Fed to be more transparent (apart from the request to publish - with a delay - the transcripts which turned out to be still existing). Nonetheless, the Fed, the markets and politicians seem quite pleased with the change.[29]
The ESCB has known a similar development. For its days the ESCB was designed neither as a conservative nor as a progressive institution in terms of openness and transparency.[30] In practice, the ECB's first president Duisenberg has taken several steps to increase the ECB's transparency: he holds monthly press conferences, briefs the European Parliament on the monetary and economic situation at least four times a year (see Art. 109b-EC), while the ECB also uses its Monthly Bulletin to explain its policy stance. This is not to say transparency could not be improved.

II.1 HISTORY: DELORS COMMITTEE

The Delors Committee touched upon the issue of accountability at several instances, though this did not lead to in-depth discussions. A first paper paying attention to this topic was a paper by Thygesen, expert member of the committee. In his paper, dated 31 October 1988 and called 'A European central bank system - some institutional considerations', he dedicated one section to 'Autonomy and Accountability'.[31] He framed the need for accountability in terms of how to organize a constructive dialogue between the central bank system and the political authorities (while actually he should have focussed on forms of democratic legitimacy). Thygesen saw four possible venues: (1) regular reporting to the Ecofin, inspired by the Humphrey-Hawkins hearings in the US; (2) a monitoring role for the Monetary Committee; (3) the right for the ESCB president and the president of Ecofin (and of the Commission) to be present at each others meetings; (4) six-monthly reporting to the Monetary Affairs Committee of the European Parliament. In terms of democratic legitimacy the last venue is the best, because these sessions would be public and European Parliament is a supranational

[29] Blinder c.s. (2001), p. 66-70.
[30] Though for instance the coordination with the Executive branch (Ecofin) is more formalized in the case of the ESCB - see Art. 109b-EC - than in the case of the Fed, because in the ESCB's case the chairman of the Ecofin (and a member of the Commission) formally attend the meetings of the Governing Council, while in the US contacts with the Administration are not based on legislation.
[31] A revised version (not including this section) was included in the Collection of papers submitted to the Delors Committee (which were attached to the Report).

body, while the Ecofin in fact is no more than an intergovernmental body, of which the members (the ministers) are responsible not to a European body, but to their national parliaments. The other venues are useful coordination mechanisms.
In the first version of the so-called skeleton report of 2 December 1988 it was signalled that 'the system should be subject to democratic control and therefore accountable for its actions and policies; [How? Does the formulation of the mandate suffice? Should there be regular reporting? On what? To whom? Council of Ministers? Monetary Affairs Committee of the European Parliament?]' [32]

In the final version of the Delors Report the sub-paragraph on accountability would read as follows:
'- accountability: reporting would be in the form of submission of an annual report by the ESCB to the European Parliament and the European Council; moreover, the Chairman of the ESCB could be invited to report to these institutions. [....]' [33]Another paragraph contained proposals for a coordination procedure between ESCB and Ecofin.[34]

We conclude that the Delors Report did not pay attention to the ESCB's communication policy. There was no tradition in Europe of publishing internal votes or to release the minutes of the central banks' decision-making bodies. (This is quite understandable for those countries which followed a hard-currency policy, as the markets could only get one message to prevent any attacks on the currency). The Delors Committee focussed its attention on balancing the ESCB's desired independence with accountability in terms of reporting to the European Parliament and by institutionalizing a dialogue between the ESCB and the political authorities. Informing the public or the markets were not considered as topics in themselves.

II.2 HISTORY: COMMITTEE OF GOVERNORS

The first reference to the confidentiality of the proceedings appears in the draft ESCB Statute of 22 June 1990.

> "Article 9 - The Council
> [....]
> 9.4 The proceedings of the meetings shall be secret. The Council may authorize the President to make the outcome of its deliberations public."
>
> draft 22 June 1989

A comment was added stating that the following: "Confidentiality: With respect to Article 9.4, consideration should be given to the question of the releases of minutes following a certain time lapse." [35]

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[32] CSEMU/5/88, p. 15.
[33] Delors Report, par. 32.
[34] This is treated under Art. 109b-EC.
[35] In English 'proceedings' could mean both the records of the meetings or the meetings themselves. In the authorized French version this part reads: 'Les réunions sont confidentielles.' In German it reads: 'Die Aussprachen in den Ratssitzungen sind vertraulich.' These translations seem to indicate that individually expressed opinions have to be kept secret; this is also true for the English, otherwise the drafters could have written 'the proceedings are confidential'. It is therefore not clear what the drafters had in mind when they wrote

Late June the article was edited into: '[t]he proceedings of the meetings shall be confidential. The Council may decide to make the outcome of its deliberations public.' The special external role of the president of the ECB was as of then captured in another article (Art. 7.3, later Art. 13.2). The governors did not discuss Article 9.4 during their meeting on 10 July (nor during their meeting in September and November). In the draft of 13 July, the specific comment which was quoted above had disappeared.

The final version of the draft ESCB Statute contained the following text:

> "Article 10 - The Council
>
> [...]
>
> Art. 10.4 The proceedings of the meetings shall be confidential. The Council may decide to make the outcome of its deliberations public."
>
> draft 27 November 1990

The accompanying Commentary does not spend a remark on Article 10.4. The phrase 'transparency' does appear in the Introductory Report, which was sent to the IGC together with the draft ESCB Statute of 27 November 1990. However, transparency was limited to regular reporting:

> ' (e) Democratic accountability of the System
>
> [....]
>
> Transparency is an important element of democratic accountability. To this end, the Statute calls for the preparation of an annual report which the President of the Council [of the ECB] shall present to the European Council, the Council of the European Communities and the Parliament. The transparency of the System is further enhanced in Article 15 by enabling the President of the Council of the European Communities and a member of the Commission to attend meetings of the Council of the ECB. In addition, the ECB will report regularly on the activities of the System and will publish consolidated financial statements of the System.'
>
> Introductory Report accompanying the draft Statute of 27 November

From today's perspective one might ask why the issue was not more discussed. The answer probably is that the European central bankers were used to convincing the financial markets without the votes of the their board members being published. In addition, governors might very well have seen the confidentiality of their discussions in the Governing Council as an important way to protect their personal independence, in other words to prevent the recurrence of national pressures. [36]

II.3 HISTORY: IGC

The article was not discussed during the IGC. No delegation raised the issue of non-publication of the minutes of the ECB's Governing Council. (The only change was that 'Council' was replaced by 'Governing Council'.) This might surprise as seen from today, but

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in their early commentary that minutes could be released after a certain period. Anyhow, there is only express authorization to make the outcome public.

[36] This argument is shared by Blinder c.s. (2001, p.50 and p. 63-64), though they recommend to publish the overall voting pattern without names. Their argument in favour of publishing the overall voting pattern, however relates to the optimal way to inform the financial markets, and not to the issue of democratic accountability.

in those days monetary policy, especially for the members of the Exchange Rate Mechanism of the European Monetary System, was considered to be secretive business. Any openness creating ambiguity could trigger reactions in the foreign exchange markets. Also, there was no precedence in Europe of a central bank publishing how the members of its directorate voted, the emphasis lying on collegial decision-making and not on individual accountability.

Article 11.2 and 11.7:[1]

Article 11.2 and 11.7: Executive Board

"11.2 In accordance with Article 109a(2)(b) if this Treaty, the President, the Vice-President and the other Members of the Executive Board shall be appointed from among persons of recognized standing and professional experience in monetary or banking matters by common accord of the governments of the Member States at the level of the Heads of State and Government, on a recommendation from the Council [of Ministers] after it has consulted the European Parliament and the Governing Council.

Their term of office shall be eight years and shall not be renewable.

Only nationals of Member States may be members of the Executive Board."

"11.7 Any vacancy on the Executive Board shall be filled by the appointment of a new member in accordance with Article 11.2"

(to be read in conjunction with Art. 7-ESCB (independence); Art. 10.2 (one person, one vote within Governing Council); Art. 11.1 (Executive Board composed of six persons); Art. 11.3-4 (conditions of employment and dismissal); Art. 11.5 (one person, one vote within Executive Board); Art. 14.2-ESCB (appointment NCB governors); Art. 109a2(b)-EC (reflecting Art. 11.2-ESCB); and Art. 50-ESCB (initial appointment))

I. INTRODUCTION

I.1 *General introduction*

The issue at stake here is the risk that the Executive Board members might start behaving like political appointees, trying to please their 'appointeurs'. The non-renewability is one safeguard against this, though it does not protect against the risk that a board member aspires a political or civil service career after his term.[2] The non-renewability is a unique figure in the constitutional structure of the EU. Both the Commissioners, the Judges of the Court of Justice and the members of the Court of Auditors can be reappointed.[3] The length of the term of office for the executive board members (8 years) is another 'safeguard', in that it contributes to a strong so-called 'Becket-effect', which stands for the phenomenon that people tend to start defending the interests of the organization they have entered rather quickly, especially when this organization is independent; in other words they lose very quickly their loyalty to

[1] Also contains a description of the genesis of Art. 11.1 (at the end of section II.2) and of Art. 50 (at the end of section II.3).

[2] Some recommend that the term of office of the individual board members is set at such a length it will end with a compulsory retirement age (e.g. 70 years), with the appointment age set at a minimum of 45 and a maximum of 55 years. The chairman could be chosen for intervals of say five to ten years from among them. (Neumann (1991), Open Economies Review 2, p. 104-105; see also Endler (1998), p.436).

[3] See Article 158(1), 167 and 188b(3)-EC respectively.

their former employer.[4] There is also no upper age limit, which could have reduced the length of their term. Their term of office is relatively long compared to that of the Commissioners (5 years)[5] and the members of the Court of Justice and the Court of Auditors (both 6 years).[6] Salaries for the executive board members are such that they do not constitute an incentive for the members to leave mid-term for financial reasons. [7]

The appointment procedure contains three safeguards against the appointment of political 'cronies'. **First**, the appointment decision requires *unanimity* among the governments of the participating Member States. **Second**, nominees have to be of a *good professional reputation*. One could wonder whether a minister of finance without a previous banking or academic career in economics could be regarded as such. In this respect it is significant that the Luxembourg prime minister (and ex-minister of finance) Jean-Claude Juncker has said in public – in reaction to rumours he would succeed the ECB's first president, Wim Duisenberg – that he did not consider himself qualified.[8] On the other hand, neither does it seem necessary to require that board members be recruited from among (ex) central bankers. See for instance the experience of the Fed: since the reform of the FRS in 1935 none of its chairmen had served on the Board previously and only Paul Volcker had first won his spurs as head of a regional Reserve Bank.[9] Nonetheless, a young organization could strongly benefit from previous central banking experience.[10] **Third**, the *ECB Council* has to *be consulted*. (The fact that the board members are appointed by the *Heads of State* in itself strengthens their positions vis-à-vis the ministers of finance - compared to the situation in which the ministers would have appointed them.) There is also protection against so-called 'personal unions', i.e. a person serving at the same time in the legislative, judicial or executive branch (in our case: the central bank), as Art. 11.1-ESCB determines no board member shall be otherwise employed, gainfully or not, unless expressly approved by the Governing Council. (The Committee of Governors had already been proposed such a rule in Art. 11.1 of their draft ESCB Statute.)

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[4] See for a description Endler (1998, p.249). The phrase refers to Thomas Becket who became Archbishop of Canterbury after having served as the King's Chancellor of the Exchequer and his adviser. When bishop he became a relentless critic of the King's usurpation of power. (In 1170 he was killed by vassals of the King ....)

[5] Four years at the time of the negotiations. It would become five years with the Treaty of Maastricht. See Article 158(1)-EC (ex-Article 11-Merger Treaty).

[6] Article 167 and Article 188b(3)-EC (ex-Article 206-EEC) respectively.

[7] The terms and conditions of employment of the Executive Board members are set according to a procedure laid down in Article 11.3-ESCB. The salary of a member of the Executive Board is about 10 per cent higher than the highest Director-General's salary at the European Commission. The salary of the president is 40 per cent higher than the salary of an Executive Director. (Answer by the British PM to questions of the Commons (written procedure 17 May 1999). This can be calculated to be around euro 390.000 per annum.) According to the Guardian of 16 July 1998 Duisenberg promised the European Parliament to reveal his salary. The salaries of the EU central bank governors vary: in 1996 the salary of the Bundesbankpresident was estimated at DM 600.000 (around euro 300.000) (See Endler (1998), p. 437.)

[8] 'Der luxembourgische Premierminister meinte, ein Politiker, der kein Währungsfachmann sei, dürfe für den EZB-Spitzenposten ohnehin nicht im Frage kommen.' (Article in the German newspaper Handelsblatt of 5 July 2001, based on interview with Juncker.)

[9] Majorie Deane (1996).

[10] In this respect the ECB is fortunate that four out of the six first-appointed members of the first Executive Board have a central banking background: Duisenberg (ex president of the Nederlandsche Bank and of the European Monetary Institute), Hämäläinen (ex governor of the Finnish central bank), Issing (ex member of the Direktorium of the Bundesbank) and Padoa-Schioppa (ex vice governor of the Banca d'Italia). Noyer had made a career in the French Trésor and Domingo Solans was an academic with banking experience.

Continuity of experience within the Board is guaranteed by the procedure of Article 50 which foresees staggered (non-overlapping) terms of office. However, this could be undermined by Article 11.7 (any vacancy, also mid-term ones, will be filled by new candidates appointed for 8 years). This could lead to some clustering in the terms of office. An alternative would have been to make persons who are appointed within a term, reappointable for the next full term, like in the US.

Traditions among member states varied at the time of the Delors Committee. The terms of office varied from unspecified (and no protection against dismissal) (Banque de France) to 8 years (Bundesbank) and in practice indefinite (the governor of Banca d'Italia).[11] In the meantime, i.e. after the signing of the Treaty of Maastricht, the statutes of the NCBs have been brought in line with the ESCB Statute, meaning that the term of office of each national central bank governor has been set at a minimum of 5 years, while at the same time they enjoy protection against politically motivated dismissal (see Article 14.2). Table 2-3 shows the situation of 1989: term of office, possibilities of reappointment and the procedure for, *casu quo* the protection against removal from office.
In order to complete the picture, table 2-4 shows the new situation of all present euro area NCBs. The table shows the names of the governors, their term of office, the end of their present term, the term of office of their colleague directors (which is sometimes different from theirs). The end of the term of office of the present Executive Board members is also shown to give a complete picture.

Table 2-3: Terms of office NCB governors before EMU (situation in 1989) [12]

	Term of office	**Renewability**	**Removal from office**
	(years)	*(Y/N)*	
Austria:	5	Y	By President of the Republic if governor ceases to meet requirements of appointment
Belgium:	5	Y	At any time by government
Denmark:	Unlimited	Not relevant	By the King (Government)[13]
Germany:	8 [14]	Y (usual second term)	Cannot be dismissed except for personal reasons

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[11] According to the letter of the Italian bank law the term of office is 'unspecified'. However, it is very difficult for the Italian government to remove the governor (see table 2-3).
[12] Sources: see footnote with table 2.1 (Art. 2). Length of term of office of the members of the Executive Board or Board of Directors/Governors was usually the same as that of the governor/chairman, with the exceptions of Belgium and Ireland. Dismissal procedures were usually more difficult in case of the governor.
[13] Danish central bank governors have never been removed from office. For instance, at the time of the Delors Committee Eric Hoffmeyer had been serving for 30 years as central bank governor (1965-1995).
[14] Bundesbankgesetz (1957), Article 7(2): '[….] Die Mitglieder werden für acht Jahre, ausnahmeweise auch für kürzere Zeit, mindest jedoch für zwei Jahre bestellt. …'

Greece:	4	Y	By General Meeting of shareholders, only in case of fault
Spain:	4	Y	Not specified
France:	Unspecified	Not relevant	At any moment
Ireland:	7	Y	Only in case of personal incapacity
Italy:	Unspecified	Not relevant	By the Consiglio Superiore (Board of Directors, consisting of 13 members elected by the shareholders (= financial institutions) for 14 regional offices (2 offices share a representative)
Netherlands:	7	Y	Dismissal possible if governor does not comply with governmental directive ex section 26.[15]
Portugal:	5	Y	At any time
UK:	5	Y	No specific procedure

Table 2-4: Terms of office members ESCB Governing Council (situation of January 2004) [16]

	Name *(yr of birth)*	**Term of office** *(yrs)*	**End of tenure** *(date)*	**Reappointable** *(Y/N)*	**Tenure for other Board/ Directorate members** *(number of them between brackets)*
Austria:	Liebscher (1939)	5 yrs	Sep 2008	Y	5 yrs (3)
Belgium:	Quaden (1945)	5 yrs	Feb 2004 (age limit 67 or 70)	Y	vice gov. 5 yrs, others 6 yrs (4-6 members)
Germany:	Welteke (1942)	8 yrs	Sep 2007	Y	8 yrs (7)[17]
Greece:	Garganas [(1937)]	6 yrs	June 2008	Y	3-6 yrs (12)

./.

[15] The directive is given by the Minister of Finance. There is the possibility of appeal to the Cabinet. If the Cabinet supports the instruction given by the Minister of Finance, the governor may be removed from office (section 23 Bank Act). The Bank's objections and the government's reasons for overruling these have to be published in the National Gazette, which would seriously harm the position of the government (usually coalition governments) in Parliament. Such instruction has never been given. One government is supposed to have come close, see Memoirs of Dutch central bank governor, J. Zijlstra (1992), *Per slot van rekening*, p. 215/6.

[16] Sources: national central bank laws (available on web site ECB →publications → legal documents) as of 2002 (Ireland 2003). For national appointment procedures and references to NCB laws see table 2.5 (Art. 14.2).

[17] The Bundesbank law has been adapted to the new situation by reducing the size of the Zentralbankrat, consisting before out of eight Executive Board members and nine Landeszentralbankpresidenten. The Finance Ministry's proposal to discontinue the membership of the LZB presidents led to fierce opposition by the Länder. In the end, the Ministry's proposal was passed by the Bundesrat, with a stroke of luck with a majority of one vote.

Spain:	Caruana (1947)	6 yrs	July 2006 (age limit: 70)	N	6 yrs (3)
Finland:	Vanhala (1946)	7 yrs	June 2005	Y (once)	5 yrs (up to 4)
France:	Noyer (1950)	6 yrs	Nov 2009 (age limit: 65)	Y (once)	- [18]
Ireland:	Hurley (1945)	7 yrs	March 2009	Y	5 yrs (board of up to 12)
Italy:	Fazio (1936)	5 yrs	Not limited[19]	not relev.	Not limited (3)
Luxemb.:	Mersch (1949)	6 yrs	Jun 2004	Y	6 yrs (2)
Netherl.:	Wellink (1943)	7 yrs	Jun 2004	Y	7 yrs (3-5)
Portugal:	Constancio (1943)	5 yrs	Feb 2005	Y	5 yrs (4-7)

Pro Memoria (situation January 2004)

Executive Board members:

Trichet (1942, FR)	8 yrs	Nov 2011	N (succeeded Duizenberg in Nov. 2003)[20]
Papademos [21] (1947, GR)	8 yrs	Jun 2010	N
mrs Tumpel-Gugerell [22] (1952, AU)	8 yrs	Jun 2011	N
Domingo Solans (1945, ES)	6 yrs	Jun 2004	N (succeeded by González-Parámo (1958, ES) in June 2004)
Padoa-Schioppa (1940, IT)	7 yrs	Jun 2005	N
Issing (1936, DE)	8 yrs	Jun 2006	N

[18] Presidential system. The president is assisted by two deputy governors (appointed for six years). A Monetary Policy Committee (governor, his two deputies and six other members (appointed for nine years) decides on (non-daily) operational issues.

[19] Presidential system. The president is supported by a three-member Directorate. A Board of Directors (the Governor plus thirteen members (each appointed for five years)) is responsible inter alia for decisions on the Bank's operational framework. The Board also decides on appointment and dismissal of the Governor and the (Deputy) Directors-General, which decisions have to be approved by the Italian president.

[20] In February 2002 the first President of the ECB, Wim Duisenberg, appointed for 8 years in June 1998, announced he would step down on 9 July 2003 in view of his age (when he would reach 68). In spring 2003 he was requested to stay longer to allow for the (hoped-for) acquittal of his expected successor Trichet from a court case relating to the period Trichet had been head of the Trésor and problems had started at the state-owned bank Credit Lyonnais, the scope of which became only clear much later. The positive outcome of the case allowed Trichet to take over the presidency as of 1 November 2003.

[21] Successor of Christian Noyer (France), the ECB's first vice-president, who had been appointed for a period of 4 years, according to Article 50 of the ESCB Statute. Noyer became head of the BdF.

[22] Successor of Mrs Hämäläinen, who had been appointed for 5 years under Art. 50-ESCB.

I. 2 *Relevant features of the Federal Reserve System*

Each of the seven members of the Board of Governors is appointed for 14 years by the president of the US by and with the advice and consent of the Senate.[23] Each even-numbered year one seat becomes vacant on 31 January.[24] Reappointment is not possible, once a full term has been served (i.e. someone has been appointed within a term, can be reappointed for a full term).[25]
The chairman and the vice chairman of the Board of Governors are designated for four years from among the governors by the president, by and with the advice and consent of the Senate; both can be reappointed for additional terms for as long as they remain on the Board.[26] Laurence H. Meyer (former member of the Board of Governors) observed that the short, renewable term for the chairman enhances accountability and encourages a strong working relationship between the chairman and the executive and legislative branches.[27] This power of the President to designate (and thereby to dismiss) the chairman was introduced in the Banking Act of 1935, which abolished the ex officio membership and chairmanship of the Secretary of the Treasury. (This power has not been undisputed – see Cushman (1941), p. 682-685, who interestingly mentions that the Interstate Commerce Commission and the Federal Trade Commission choose their own chairmen. According to some this power to designate the chairman injected presidential influence, if not dominance, in the Independent Regulatory Commissions and would tend to undermine their independence.) Whenever a new chairman is appointed, the former chairman traditionally resigns from the Board of Governors, opening (another) seat for the President to appoint a new governor.[28]
The presidents of the FRBs are appointed by each FRB's own board of directors for terms of five year (renewable).[29] Their appointment needs the approval of the Board of Governors, which may also dismiss them. Five of the twelve FRB presidents are elected annually as member of the FOMC by the boards of directors of the FRBs based on a system using fixed groups of Federal Reserve districts.[30] The chairman of the Board of Governors is traditionally elected chairman of the FOMC by the FOMC members during each year's first FOMC meeting.

Other interesting details are that the President 'in selecting the members of the Board, not more than one of whom shall be selected from any one Federal Reserve district, […] shall have due regard of the financial, agricultural, industrial, and commercial interest, and geographical divisions in the country.'[31] 'The members of the Board shall be ineligible during the time they are in office and for two years thereafter to hold any office, position, or

[23] FRA (1988), Section 10.1.
[24] The term of office used to be ten years until 1935. In that year the number of presidentially appointed board members increased from five to seven (and two Treasury persons left the board). To uphold the two-year rule the term of office was increased to 14 year. See footnote in section I.2 of Article 7 above.
[25] FRA (1988), Section 10.2. See also the last page of section II.3 below.
[26] FRA (1988), Section 10.2.
[27] L. H. Meyer (2000).
[28] Akhtar and Howe (1991), p. 346.
[29] FRA (1988), Sections 4(4). The board of directors may dismiss its president 'at pleasure'.
[30] FRA (1988), Section 12A(a). See for more details the penultimate footnote of section II.2 below and Article 10.2, section I.2 (in cluster III).
[31] FRA (1988), Section 10.1. See for a background Art. 7, section I.2 (footnote [21]) above and Art. 10.2, section 10.2, section I.2 (cluster III).

employment in any member bank, except that this restriction shall not apply to a member who has served the full term for which he was appointed.' [32] Salaries of the members of the Federal Reserve Board are relatively low compared to the private sector, which might explain that not all Board members finish their term. [33] The average actual tenure of members of the Board of Governors has been between five and six years over the last twenty-five years. [34] The average actual term of office of the chairmen stay is significantly higher, i.e. an average of eleven years when we take out the short term of office of Miller, whose tenure ended quickly, because he was appointed Secretary of the Treasury.[35]

Comparing the Fed and the ESCB

An important element of the checks and balances in the US is that the constitutional prerogative of the President to appoint the U.S. government officials is counterbalanced by the requirement of senatorial consent and in case of positions requiring distance to (independence from) the Executive branch staggered appointments and/or long to very long tenures[36] and restrictions for presidential dismissal.[37] In case of the Fed a balance was also found between the influence of the private versus the government sector (for which the private sector character of the FRBs was an important tool), while the chosen federal structure also prevented possible dominance by one region, e.g. the eastern (financial) states. In Europe there was no clear need to find a balance between public and private interests, nor between the different governmental branches (i.e. the Executive and Legislature), as the European legislature play(ed)(s) a relatively minor role.[38] The drafters of the ESCB Statute focussed on finding a balance between the ESCB and the political authorities. They could have opted for appointment by one body and consent by another. However, this was unusual practice. Instead one choose for appointment by unanimity,[39] protection against dismissal, long and staggered tenures and profession-related eligibility criteria (professional experience in banking or monetary matters).

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[32] FRA (1988), Section 10.2.

[33] In 1991 the salary of a Fed governor was $ 145,115 with Greenspan making only slightly more. This is considerably less (around 25 per cent) than some top notch officials of the Federal Reserve Banks, that are technically private corporations and set their own guidelines (though in principle subject to approval by the Board of Governors). A more recent figure for Greenspan, mentioned in a 2004 issue of *Central Banking*, is $ 172,000.

[34] Laurence H. Meyer (2000).

[35] Years in office of Fed chairmen: Eccles 1934-1951; McCabe 1948-1951; Martin 1951-1970; Burns 1970-1978; Miller 1978-1979; Volcker 1979-1987; Greenspan 1987 – present.

[36] United States presidents may not serve more than two full terms (rule introduced in [1948]).

[37] See for methods of removal in case of independent governmental agencies Cushman (1941), p. 760.

[38] The similarity though is that one did not want to create a dominant central institution: in Europe one wanted to preserve a substantial role for the NCBs, as they brought with them the connection with the banks and a lot of relevant knowledge, while their continued existence might also have been seen as a way to enhance the credibility of the System vis-à-vis the financial markets. At the same time a large federal board is less sensitive to political pressure than a small board.

[39] The requirement of unanimity was probably felt to add to the independence (or at least incontroversiality) of the appointees, especially if appointed by the Heads of State. Incontroversiality could also be attained by involving other branches/bodies in the appointment procedure. Indeed, this would imply a broader based, more 'democratic' procedure – we will come back to this in chapter 5.4.

II.1 HISTORY: DELORS COMMITTEE

One of the early drafts of the Delors Report[40] mentioned that the Board members should 'be appointed for a term of office of [eight] years by the European Council.' Eight years coincided with the term of office for Bundesbank board members. This formulation was in line with the paper submitted by Pöhl earlier to the Delors Committee in September 1988.[41] However, during the meeting of the Delors Committee on 13 December Pöhl distributed another document ('Outline of a Report to the European Council'), which was less strict than the Bundesbank's earlier position. On the appointment it refrained from mentioning a specific number for the term of office - it only mentioned:
'nomination of members of the Directorate for relatively long periods on an irrevocable basis.'

This formulation was taken aboard in the draft version of the Delors Report of 31 January 1989[42]:
'- appointment of members of the Board for relatively long periods on an irrevocable basis.' [43]
The draft version of 31 March[44] again specified a length for the term of office for the Board:
'appointment of the members of the Board by the European Council on the proposal of the ESCB Council; the tenure of Board members would be for five to seven years and would be irrevocable.' [45]
During the final long-lasting meeting of the committee on 11-12 April 1989 it was decided to strengthen the independence of the system by making clear that the personal independence extended not only to the Executive Board members, but also to the governors of the central banks. This meant the indents mentioning the governors and the board were integrated. As a by-product the number of years for the tenure of the board members again disappeared (as indeed the tenure of board members and governors could differ). The text mentioned the need of appropriate security of tenure for both board members and governors:.

> '- Independence: the ESCB Council should be independent of instructions from national governments and Community authorities; to that effect the members of the ESCB Council, both the Governors and the Board members, should have appropriate security of tenure.' [46]
>
> Delors report, par. 32

[40] CSEMU/5/88, 2 December 1988.
[41] Reprinted in the annex of the Delors Report. The paper followed exactly the content of an earlier internal position written for the Zentralbankrat of the Bundesbank in April 1988. To be more exact Pöhl's paper stated that 'the personal independence of the members of the respective organs [should be] assured by their being appointed to office for a period of at least eight to ten years without the possibility of their being removed from office for political reasons.
[42] CSEMU/10/89, 31 January 1989, p.15.
[43] Pöhl's December document would also be confusing as to the mandate of the ESCB, which was phrased in relatively vague terms and which he apparently had meant as a compromise.
[44] CSEMU/14/89.
[45] For unknown reasons the governors dropped the 8 years. In general the need for a relatively long tenure was shared among the governors, though some considered it to be for the political authorities to decide on the exact number.
[46] The expression ('appropriate tenure') should probably be read as referring both to a minimum length of office and to protection against dismissal at will or for political reasons – see Art. 11.4-ESCB.

II.2 HISTORY: COMMITTEE OF GOVERNORS

The first preliminary draft of the Statute of 11 June 1990 read as follows:

"Article 9.1 – The Board of Management

9.1 The Board of Management shall comprise, in addition to the President and the Vice-President, no fewer than [three] and no more than [five] members. ./.

The members of the Board of Management shall be selected for their monetary or banking expertise; their independence shall be beyond doubt. [47]

The members shall perform their duties on a full-time basis. [….]

9.2 The President shall be appointed by the [European Council] [Council of the European Communities], after the Council of the ESCB has given its opinion, which shall be confidential. The appointment shall be subject to confirmation by the European Parliament. If it is not confirmed, a unanimous decision of the [European Council] [Council of the European Communities] shall be required. Failing that, a new procedure shall be initiated.

9.3 The Vice-President and the other members of the Board of Management shall be appointed by the [European Council] [Council of European Communities] on a proposal from the [Council of the ESCB] [and] [the Commission, after the Council of the ESCB has given its opinion].

9.4 The members of the Board of Management shall be appointed for a period of [five] [eight] years. [They may be re-appointed once.] [They may not be re-appointed.]

draft 11 June 1990

A footnote mentioned one Alternate had suggested the President should not necessarily be a member of the (Executive) Board, but could also be chosen from among the governors.[48] During the meeting of the Alternates on 18 June 1990 the Commission representative supported the chairman's proposal to involve the European Parliament only in the procedure for appointing the president, and not in case of the other members, for fear of triggering political infighting in the European Parliament, if parliament were to be involved in giving an opinion or confirming all board members. During the same meeting Lagayette (the French Alternate) indicated he opposed (i) using different appointment procedures for the president and the other board members and (ii) giving a role to the Commission in this procedure.
During the 10 July meeting the governors would decide in favour of a term of office of eight years. They also decided board members would be re-appointable once, with the exception of the president. They also agreed on the proposal that the other members of the Board (i.e. not

[47] The independence of the institution was dealt with elsewhere. Here, independence refers to their being independent experts.

[48] A complication would arise if the president was chosen from among the governors: would he then remain NCB governor as well? For those who favoured a strong centre this was not an attractive option, because it would weaken the board. (Internal note of the Nederlandsche Bank, BK078e, 27 June 1990). Furthermore, it would not be consistent with the requirement that the board members would perform their duties on a full-time basis. This idea would be dropped during the Alternates meeting of 29 June. (The members of the Court of Justice choose their president from among themselves for a period of 3 years, but of course the judges are full-time employed by the Court of Justice.)

the president) should be appointed by the European Council on a proposal by the ESCB Council. Apparently they were afraid of the possibility of political appointments.[49]
However, during their meeting on 11 September it was agreed, at the suggestion of the chairman, that 'in order to give due regard to democratic accountability, the other members of the Executive Board would be appointed by the European Council after consultation with, and not on a proposal from, the Council of the System.' [50] It was also agreed, at the suggestion of the chairman, to delete the issue of re-appointment for the president as well as for the other board members.[51] During the meeting on 10 July 1990 it had already been decided that no member of the Executive Board, with the exception of the president, should hold office beyond the age of sixty-five.

By early September the new draft read:

"Article 10 – Executive Board

10.1 The Executive Board shall comprise the President, the Vice-President, and 4 other members.
The members of the Executive Board shall be selected among persons of recognised standing and professional experience in monetary or banking matters.
The members shall perform their duties on a full-time basis. [….]

10.2 The President shall be appointed for a period of 8 years by the European Council, after the Council of the System has given its opinion, and after consultation with the European Parliament.

10.3 The Vice-President and the other members of the Executive Board shall be appointed, for a period of 8 years by the European Council after consultation with the Council of the System.[52]

10.4 With the exception of the President, no member of the Executive Board shall hold office beyond the age of 65."

draft 14 September 1990

During the governors' meeting on 13 November 1990 it was decided to have the vice-president appointed in the same manner as the president. The age limit was dropped at the suggestion of the chairman, because the term of office of other Council members (governors) was not be subject to the same restriction. There is also no age limit for judges and advocates-general of the Court of Justice.

[49] Hoffmeyer had even proposed to apply the same procedure, i.e. appointment 'on the proposal of the Council of the System', to the appointment of the president. However, others felt such proposal might raise (political) 'difficulties'.
[50] Minutes of 11 September 1990. No arguments shown.
[51] Reason unknown. Deletion clearly opened the door for re-appointment (even more than once). (See also Viebig (1999), p. 453.) One possible argument might have been that the governors feared it would render it difficult to attract qualified people in case of a short and not renewable term of office. But this would imply they considered eight years to be short. They may also have had in mind the tradition of e.g. the Bundesbank and the Nederlandsche Bank, with traditionally long-serving (and re-appointed) presidents.
[52] The comments accompanying this article, shown in the draft versions of 22 June and 3 July 1990, might shed light on why the president was treated differently: the draft version of 22 June articulated that the special appointment procedure for the president mentioned in Article 9.2 was meant to give the president higher profile. The draft version of 3 July added that the profile of the president could be strengthened by according the president the right to be consulted on the appointment of other Executive Board members.

Another issue deserves attention here. During the governors' meeting on 10 July 1990 a general consensus developed to apply the principle of 'one man, one vote' (see Article 10.2-ESCB), though a definitive decision was postponed, mostly because of German reservations.[53] At the same meeting the governors decided on the number of Executive Board members: they agreed on a board of six members (including president and vice-president).[54] This number was a compromise (among the Alternates there had been support for both five and six).[55] The proportion between the board members and the governors (1:2) was not used as a yardstick. This would have been impossible, as a number of issues were still unresolved. For instance, it had not yet been decided whether all board members would have a right to vote 'or only the president'. Likewise, it was still undecided whether there should be among the governors 'a system of rotation along the lines of the Federal Reserve?', an idea at that stage repeatedly mentioned by the Bundesbank and which would increase the relative weight of the board and, depending on the rotation system, possibly of the larger NCBs [56] All these elements would have influenced the proportion between the votes of the board members and the governors (had that been an issue - *quod non*). During the September 1990 meeting it was first agreed to extend equal votes to all members of the Council ('one person, one vote').

This led to the following final text:

Article 11 - Executive Board

11.1 The Executive Board shall comprise the President, the Vice President and four other members.

The members of the Executive Board shall be selected among persons of recognized standing and professional experience in monetary or banking matters.

The members shall perform their duties on a full-time basis. No member shall, without approval of the Council [of the System] receive a salary or other form of compensation from any source other than the ECB or occupy any other office or employment, whether remunerated or not, except as a nominee of the ECB.

11.2 The President and Vice-President shall be appointed for a period of eight years by the European Council, after the Council [of the System] has given its opinion, and after consultation with the European Parliament.

./.

[53] At that moment it was still an option that the ESCB would be created early during stage two of EMU, which made Pöhl hesistant to accept 'one man, one vote', for he feared not all central banks would by then already have become independent. Indeed, Leigh-Pemberton showed himself in favour of 'one man, one vote', while also de Larosière did not seem unwilling. (Both the British and the French central banks were not the epitomes of central bank independence.) Pöhl might also have been hesitant to share equal voting rights with smaller countries, though there are no indications in this direction. It should be remembered that the smaller central banks were traditionally more stability oriented (i.e. focused on exchange rate stability) than the larger ones.

[54] Art. 11.1-ESCB.

[55] The proponents of an uneven number wanted to make the president's vote more decisive.

[56] Taken from comments to Article 9 (draft version of 3 July 1990). In the **Federal Reserve's FOMC**, created in 1935, the number of votes is limited to 7 votes for the board members and 5 for the presidents of the twelve FRBs. These five votes rotate among the 12 presidents. Of these five the financially most important district (New York) received a permanent vote in 1942 (see Appendix 1). The ratio of 7:5 had been deliberately chosen to ensure enough clout for the board – see Art. 10.2b-ESCB in Cluster III. The discussion in Europe was not burdened with these kind of considerations: governors and board members were expected alike to behave in the interest of the euro area, 'taking a corporate, objective view of Community monetary policy' (quote from Leigh-Pemberton during Committee of Governors meeting of 10 July 1990).

11.3 The other members of the Executive Board shall be appointed, for a period of eight years, by the European Council after the Council [of the System] has given its opinion."
draft Statute 27 November 1990

II.3 HISTORY: IGC

During the IGC the UK would show the strongest resistance against an eight year tenure (it preferred five years). However, they did not prevail. In a late stage it was decided to introduce staggered terms of office for the executive board members to prevent that the board would be renewed in its totality every eight years.
The Commission stuck to a term of office of eight years for the Executive Board members, but proposed to have them appointed, not by the Heads of State, but by the Council of Ministers (which should decide by unanimity).[57]

"Article 107.3
After discussion by the European Council and after consulting the European Parliament, the President and the other members of the Executive Board of the Bank shall be appointed for a period of eight years by the Council, acting unanimously."
Commission draft, 10 December 1990

The French draft mentioned a *5-year* tenure.

"Article 2-5
3. Sur proposition du Conseil et apres consultation du Parlement européenne, le Président et les autres membres du Directoire de la Banque sont nommés pour cinques ans par le Conseil Européen."
French draft 25 January 1991

The German draft did not refer to a specific tenure, but instead referred to the draft Statute of the ESCB, which would become a Protocol annexed to the Treaty.

During a first discussion of the monetary chapter of the draft Treaty by the deputies IGC on 12 March, the UK (Wicks) and France (Trichet) were the only ones to show a preference for a tenure shorter than eight years. During the ministerial IGC held on 18 March, Waigel and Bérégovoy both stated that the tenure should be either 'eight years and non-renewable' or 'five-years and once renewable'. [58] Carli and Kok recommended to stay close to the text of the governors, i.e. eight years. During the same meeting the German finance minster Waigel mentioned three elements, important for Germany, which should safeguard the democratic legitimacy of the ECB: (1) ratification of the Treaty by the national parliaments, (2)

[57] The European Council is not a formal decision-making body - see under Article 1-ESCB, section I.1. It does not have formal decision-making powers. The governors probably had in mind appointment by common accord of the governments. This Commission suggestion was criticized a.o. by de Boissieu (France), who – rightly - pointed out the members of the Court of Justice and the Commission (!) are also appointed through common accord of the governments of the Member States, and not by the Council of Ministers (IGC deputies meeting of 12 March 1991).
[58] Clearly, France and Germany had discussed this in advance, but had apparently not been able to agree.

appointment of the Executive Board members by the European Council on a proposal by the Ecofin Council and appointment of the NCB governors by their own governments, (3) the Ecofin Council and European Parliament should be adequately informed by the ECB. Bérégovoy supported the appointment procedure as proposed by Waigel.[59]

The term of office issue was discussed again by the deputies on 10 May 1991. Köhler considered five to be on the low side. Zodda (Italy) expressed a preference for eight years. The UK, Ireland, Greece and Luxembourg preferred five years and renewable. Trichet, Belgium and Portugal were neutral. Spain preferred seven years. Maas sided with Köhler after having consulted the backbench (where the author advised him that 'his bank would find five years too short', though the author especially disliked the renewability feature, which however he guessed would be less convincing – and even antagonizing - in the direction of the ministry of finance). Chairman Mersch then tried to find a way out of the stalemate (at the same time there was a dispute over the number of executive board members: 5 or 6 or 7). Mersch proposed eight-years (non-renewable) and six board members.[60] This was accepted, except for the UK which made a reservation (five years). Therefore, square brackets were maintained around the eight years and the number of board members. During the ministerial IGC meeting on 10 June 1991 the Luxembourg presidency said it assumed tacit agreement on deleting the brackets around eight year. This was not opposed. The Luxembourg non-papers of 12 June 1991 would read (UEM/52/91): [61]

"Article 108
2. The President, the Vice-President and the other members of the Executive Board shall be appointed by common accord by the governments of the Member States meeting at European Council level, on a proposal from the Council [of ministers][62], after consultation by the European Parliament and the Council of the Bank, from persons of good repute with professional experience in the monetary or banking sectors.
There term of office shall be 8 years. It shall not be renewable."

non-paper 12 June 1991

On 28 October 1991 the Dutch presidency presented its first consolidated draft. It followed the Luxembourg presidency's text of 12 June. It changed 'on a proposal by the ECOFIN' into 'on a recommendation by the ECOFIN' out of due respect for the Heads of State (which should not be asked to rubberstamp a decision).[63] In the early days of December 1991, when more or less permanent last-minute negotiations took place at the level of the ministers of finance, a sentence was added to Article 11.2 stating that 'only nationals of Member States

[59] Internal DNB report of the IGC meeting of 18 March 1991, BK034, 19 March 1991.
[60] Art. 11.1-ESCB.
[61] During their meeting in Dresden in June 1991 the Ministers of Foreign Affairs would decide to delete the part of the sentence referring to the 'proposal by the ECOFIN'. They probably viewed this as trespassing on their turf, because they usually prepare the meetings of the Heads of State. (The members of the Court of Justice and the Commission are formally appointed without a Council proposal.) The Dutch presidency ignored this and would continue from the non-paper of 12 June.
[62] Declaration nr. 3 of the Treaty of Maastricht mentions that the Conference (IGC) confirms that for the purpose of applying the provisions in Title VI on economic and monetary policy of the Treaty the usual practice, according to which the Council meets in the composition of the Economic and Finance Ministers, shall be continued. (The same applies to the articles relating capital flows and payments.)
[63] The presidency had also substituted 'at the level of the European Council' by 'at the level of Heads of State or Government'.

may be members of the Executive Board.' [64] (Here 'Member States' should be read as 'Member States without a derogation' - see Article 43.2-ESCB.)

During the legal nettoyage, following the agreement reached in Maastricht, a new Article 11.7 was added to Article 11.[65]

"Article 11.7. Any vacancy on the Executive Board shall be filled by the appointment of a new member in accordance with Article 11.2"

final text 7 February 1992
(after legal nettoyage)

No conclusive history on this last change is available. It is also not clear how this relates to the important idea of having staggered appointments of the board members. This last idea is expressed in Article 50-ESCB:

"Article 50 - Initial appointment of the members of the Executive Board
[....] The President of the Executive Board shall be appointed for eight years. By way of derogation from Article 11.2, the Vice-President shall be appointed for four years and the other members of the Executive Board for terms of office of between five and eight years. No term of office shall be renewable. The number of members of the Executive Board may be smaller than provided for in Article 11.1, but in no circumstance shall it be less than four." [66] [67]

The ratio behind Article 50 had already been mentioned by minister Kok during a ministerial IGC on 18 March. He had pointed out - during a discussion on the number of executive board members - that in the first round of appointments the terms of office of the board members should be different in order to prevent that the board would have to be renewed in its entirety after eight years. (This could disturb the markets as they would start guessing whether the new board members would more or hawkish - or dovish - than the previous board. It would probably also lead to major political backroom dealings. Both are not conducive for the bank's reputation.)
However, Article 11.7 seems to exclude that the new person is appointed to fill only the remainder of the vacancy. This is confirmed in the toilletage meetings held in Brussels on 14 and 15 January 1992, where the change was interpreted as to document that a vacancy shall be filled with an eight-year appointment (even after dismissal or death). Indeed, if otherwise, the

[64] A similar provision can be found for the Commission: 'Only nationals of Member States may be members of the Commission.', Art. 10-Merger Treaty (1967).
[65] This is the version which has been ratified by the Member States.
[66] The last sentence was to placate the derogation countries. If monetary union would start with a small number, some seats could be left empty for late comers. In the end, monetary union started with a large first group (11 members), which was considered large enough to take up all board seats. These persons cannot be reappointed for a new term (Article 50).
[67] During October 1991 the Dutch presidency and the Committee of Governors had been working in parallel on the Transitional Provisions for the ESCB Statute, while being in close contact. The Committee of Governors' draft of 28 October contained the following article on the initial appointment:
"Art. 43.3 The terms of office of the initial members of the Executive Board shall be staggered. The term of office of the President shall be eight years and no member of the Executive Board shall be appointed for less than five years."
The Dutch presidency's draft of 28 October contained a rather similar article.

Statute should have provided for the possibility for the appointment of another full term, which is not the case. The **Federal Reserve Act** is explicit on this situation: a person who is appointed during a term (because of a sudden vacancy) will first finish the term of the person he/she is replacing, after which he/she may be *reappointed* for a full term (14 year), which otherwise is not allowed. Also, in the case of the Court of Justice, the Court of Auditors and the Commission 'mid-term' appointments are for the remainder of the term.[68]
Below we summarize the arrangements for the Court of Justice, the Court of Auditors and the Commission. We include the dismissal procedures and the financial arrangements to arrange for a complete overview.

Box 2b: Appointment procedures for Judges, Auditors and Commissioners (including dismissal procedures and financial arrangements)

The procedure for the Court of Justice is as follows: their appointment follows a fixed timetable, like the model of the Fed: the thirteen judges[69] are appointed for 6 years (by common accord of the Governments of the Member States) and every three years alternatingly 6 and 7 judges are newly appointed (Article 167-EEC). Furthermore, Art. 7 of the Protocol on the Statute of the Court of Justice provides that 'a judge who is to replace a member of the Court whose term of office has not expired shall be appointed for the remainder of his predecessor's term.' Half of the first appointees were chosen by lot whose term would expire already after three years. (Art. 46-Protocol.) Judges are re-appointable. A judge can only be deprived of his office by his colleagues, i.e. 'if , in the unanimous opinion of the Judges and Advocates-General of the Court, he no longer fulfils the requisite conditions or meets the obligations arising from his office.' (Art. 6-Protocol.)

The procedure for the Court of Auditors is as follows (Art. 206a-EEC, later Art. 188b-EC): the appointment of the members of the Court of Auditors follows a fixed timetable:
twelve auditors[70] are appointed for 6 years (by the Council of Ministers acting unanimously after consulting the European Parliament). When the first appointments were made, four of them were appointed for only four years. Auditors are re-appointable. An irregular vacancy shall be filled for the remainder of the member's term of office. A member of the Court of Auditors may be deprived of his office (or of his right to a pension or other benefits in its stead) 'only if the Court of Justice, at the request of the Court of Auditors, finds that he no longer fulfils the requisite conditions or meets the obligations arising from his office.'
In contrast, commissioners are appointed in one bunch. They were appointed by common accord of the Governments of the member States. Since Maastricht the procedure has changed slightly: first the president is nominated by common accord. Then the governments of the Member States nominate, in consultation with the nominated president, the other members of

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[68] According to some the Treaty does not seem to preclude that an incumbent board member moves up during his term to the position of president of the ECB, say for a remaining four years. However, the risk is that when he steps down after these four years, the procedure could be repeated by appointing another incumbent, who has less than eight years to go. In this way the effective term of the presidency could be reduced permanently to less than 8 years. This could be seen as conflicting with the Treaty's intention, also because those board members with a wish to become president might start behaving 'politically correct' to please the Heads of State.
[69] The number has increased since.
[70] The number has increased since.

the Commission. The whole body thus nominated shall be subject to a vote of approval by the European Parliament, after which all Commission members are appointed by common accord of the governments of the Member States. (Art. 158-EC)[71]
A sudden vacancy is filled for the remainder of the term. Commissioners are re-appointable. 'If any member of the Commission no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct, the Court of Justice may, on application by the Council [of Ministers] or the Commission, compulsory retire him.' (Art. 13-Merger Treaty (1967))[72] A Commissioner may also lose his benefits if he does not respect the obligations arising from his high office. (Art. 10-Merger Treaty)

The salaries are determined by the Council of Ministers. Art. 154-EC (post-Maastricht): 'The Council [of Ministers] shall, acting by a qualified majority, determine the salaries, allowances and pensions of the President and members of the Commission, and of the President, Judges, Advocates-General and Registrar of the Court of Justice. [....].'

[71] The Treaty of Nice, once effective, will introduce new changes: the president is nominated by the Council, meeting in the composition of Heads of State or Government and acting by a qualified majority; his nomination shall be approved by the European Parliament. Subsequently the Council (by common accord with the nominee for president) shall adopt the list of other persons whom it intends to appoint as members of the Commission. The whole body is subject to a vote of approval by the EP. (Art. 158-EC.)

[72] In addition the Treaty of Nice provides for the following procedure (Art. 217(4)): 'A Member of the Commission shall resign if the President so requests, after obtaining the collective approval of the Commission.'

Article 14.1 and 14.2:

Article 14 (national central banks):

"14.1 In accordance with Article 108 of this Treaty, each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation, including the statutes of its national central bank, is compatible with this Treaty and this Statute."

"14.2 The statutes of the national central banks shall, in particular, provide that the term of office of a Governor of a national central bank shall be no less than five years. A Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct. A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Governing Council on grounds of infringement of this Treaty or any rule of law relating to its application. Such proceedings shall be instituted within two months of the publication of the decision or of its notification to the plaintiff or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be."

(to be read in conjunction with Article 7-ESCB (independence), Article 14.3-ESCB (NCBs integral part of ESCB), Article 14.4-ESCB (non-System functions), Article 108-EC (replica of Art. 14.1), Article 109e(5)-EC (second stage of EMU))

I. INTRODUCTION

I.1 *General introduction*

Clearly, there is a need to align the statutes of the NCBs with that of the ESCB, as the NCBs have to function as integral parts of the System.[1] Complete harmonization has not been considered necessary. It was considered enough when NCB laws would 'comply with' the Treaty and the ESCB Statute.[2] One detail was specified, that is the minimum length of office for an NCB governor and the need to protect him against wilful dismissal. In practice, this lack of detailed prescription has led to some remarkable **differences** between the NCB statutes in the area of ESCB related matters. We will touch upon two examples, but only briefly as this is not the core of our study. **First**, there are differences with respect to the appointment procedures. Some governors are appointed for 5, others for 6, 7 or 8 years, while most - though not all - governors are reappointable, but not all. One is appointed for life.[3] See

[1] Art. 14.3-ESCB.

[2] Having national statutes which are compatible with the ESCB statute is one of the convergence criteria (Art. 109j(1)-EC). This was assessed by the EMI, see EMI Convergence Report March 1998, Chapter II.

[3] Italian governor. In 2004 in the wake of critical remarks by him on government policy and possible mishaps in the area of supervision, the Italian government has proposed to change the law to reduce the governor's term to seven years.

table 2.5 on following page. The national appointment procedures also differ. See also table below. For instance, only in a few cases the central bank itself is involved or consulted.

Table 2.5: Term of office of euro area national central bank governors and national appointment procedures (present situation) [4]

Austria:	5 years, reappointable (Art. 33 National Bank Act); appointed by Federal president on proposal by Federal government.
Belgium:	5 years, reappointable (Art. 23 Central bank law); appointed by the King (= government).
Germany:	8 years,[5] reappointable (Art. 7 Bundesbank Act); nominated by the Federal cabinet after consulting the Central Bank Council, appointment by the president.
Greece:	6 years, reappointable (Art. 29 Bank of Greece Statute); appointed by the president on proposal of the government following a proposal by the Bank's General Council.
Spain:	6 years, non-renewable for the same position (Art. 25 Law of Autonomy of Bank of Spain); appointed by the King on a proposal by the government after reporting to parliament (Art. 24).
France:	6 years, once renewable (Art. 13 Statute Banque de France); appointed by the government.
Ireland:	7 years, reappointable (Section 19 Central Bank Act).
Italy:	for life; appointed by the Board of Directors approved by the president of the republic on a proposal from the prime minister in agreement with the minister of finance and after having consulted the other ministers (Art. 19 BdI Statute).
Luxembourg:	6 years, renewable (Art. 12 Central Bank Law); appointed by the Grand Duke on proposal by the government.
Netherlands:	7 years, reappointable (Section 12 Bank Act); appointed by the Crown (= government) based on short-list with three names drawn up by a joint meeting of the Governing Board and the Supervisory Board.
Portugal:	5 years, renewable (Art. 33.2 Bank of Portugal Act); appointed by the cabinet on proposal of the minister of finance (Art. 27).
Finland:	7 years, once renewable for that position (Section 13 Bank of Finland Act); appointed by the president of the republic on proposal by the Parliamentary Supervisory Council (Art. 11 and 13).

The **second** example is the formulation of the NCB's objectives. Though all Statutes make clear that price stability is the primary (overriding) objective, only eight NCBs mention this objective explicitly[6], the other NCBs refer to the corresponding article in the Treaty. The eight central banks that copied the objective of price stability from Art. 2 of the ESCB Statute however do not treat the second sentence of Art. 2, which refers to 'supporting the general economic policies of the Community', in the same way. The Dutch and Irish central bank laws limit this subsidiary central bank function to supporting the general economic policies of

[4] Sources: see footnote with table 2.4 (Art. 11.2).
[5] In exceptional cases for a shorter period, but not for less than five years.
[6] Austria, Germany, Greece, Spain, France, Ireland, Netherlands, Finland.

the *Community*. Others apply the same function to the general economic policy of their *national* government, the Austrian central bank mentions both.[7] Of course, such a reference to *national* policies should not be read as an obligation to vote in favour of a monetary policy which is in the interest of the national economic situation, because the primary objective of price stability refers solely to the euro area average. Therefore, support of the economic policy of their governments can only apply to the non-System functions of an NCB. This should have been specified in these NCBs' statutes.

I.2 *Relevant features of the Federal Reserve System*

The Federal Reserve Act does not contain an article comparable to Art. 14.1-ESCB, as there were no predecessors of the federal reserve district banks whose statutes had to be aligned. The FRA stipulates that the term of office of the board of directors of the FRBs is 3 years.[8] Of the nine directors of each FRB six are appointed by the FRB's local shareholders (banks) and the other three by the Board of Governors. No specific dismissal procedures are foreseen. The FRB's chief executive officer (who is their member in the FOMC) is appointed by the board of directors with the approval of the Board of Governors for a term of five years. This CEO may be dismissed 'at pleasure' by the board of directors,[9] while the Board is empowered to 'suspend or remove any officer or director of any FRB', grounds not limited.[10] The terms of all the presidents of the twelve District Banks run concurrently, ending on the last day of February of years numbered 6 and 1 (for example, 2001, 2006, and 2011). The appointment of a president who takes office after a term has begun ends upon completion of that term. A president of a Reserve Bank may be reappointed. In practice, most FRB presidents leave mid-term, implying that most FRB presidents 'start' mid-term. The average serving period of FRB presidents (situation May 2003) is 9.3 years, with the longest serving president at that moment serving 18 years. The average is higher than that of the Board of Governors (between 5 and 6 years, though the chairman usually stays for more than one term of 14 year).[11] Reserve Bank presidents are subject to mandatory retirement upon becoming 65 years of age.[12]

II.1 HISTORY: DELORS COMMITTEE AND COMMITTEE OF GOVERNORS

The Delors Report was not specific on the statutes of the NCBs (or the need to change national legislation). It envisaged a system with a 'federative structure' and it saw an explicit

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[7] We give three examples. Art. 2 of Austrian National Bank Act: "To the extent that this does not interfere with the objective of price stability, the needs of the national economy with regard to economic growth and employment trends shall be taken into account and the general economic policies in the Community shall be supported." Art. 12 Bundesbank Act: "As far as is possible without prejudice to its tasks as part of the ESCB, it [the Bundesbank] shall support the general economic policy of the Federal Cabinet." Section 2.2 of Dutch Bank Act: "In implementation of the Treaty, the Bank shall, without prejudice to the objective of price stability, support the general economic policies in the European Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 of the Treaty."

[8] FRA (1988), Section 4(9).

[9] FRA (1988), Section 4(4).

[10] FRA (1988), Section 11(f). See also box 4 in appendix 1 at the end of cluster II.

[11] See Art. 11.2, section I.2.

[12] However, presidents initially appointed after age 55 can, at the option of the board of directors, be permitted to serve until attaining ten years of service in the office or age 70, whichever comes first. Source: website Board of Governors of the FRS → About the Fed → Federal Reserve Bank Presidents.

role for the NCBs, 'which would execute operations in accordance with the decisions taken by the ESCB Council.' [13] Therefore, it saw explicitly a continuation of the existence of the NCBs.[14] It did mention though the need for an 'appropriate security of tenure', without putting a specific number to this. See under Art. 11.2, section II.1.

The first draft of the ESCB Statute, prepared by the Secretariat of the Committee of Governors, already contained an article indicating the need for adapting the statutes of the NCBs.

"Article 13 - National central banks
13.1 The statutes of the NCBs must be compatible with these Statutes.
13.2 The NCBs shall be subject to the authority of the ECB to the extent necessary for the latter to exercise its powers.
The ECB may make acts [....] by the NCBs in this regard subject to its prior approval in accordance with the rules it shall lay down.
The ECB shall take the necessary steps to ensure proper compliance by the NCBs with the obligations incumbent on them. It shall have any information of general relevance communicated to it.
The ECB may entrust the execution of certain tasks to the NCBs, or to some of them, on the terms in shall lay down.[15] "

draft 11 June 1990

In the course of the drafting of the Statute by the Committee of Governors the formulation developed quite naturally into the following (article was renumbered):

"14.1 The Member States shall ensure that their national legislation including the statutes of the NCBs is compatible with this Statute and the EEC Treaty."

draft 27 November 1990

The accompanying Commentary mentioned that 'the necessary changes in national laws would be undertaken in accordance with normal national legislative procedures.'

The idea of a minimum term of office of five years was already mentioned in the first draft of this article.[16] During the governors' meeting on 10 July Leigh-Pemberton said he felt it would be unwise to go into great detail when referring to the compatibility of the statutes of the NCBs with the statute of the System. Pöhl however saw the issue of compatibility as essential. If the governors would be less independent than the Executive Board members, he would find it difficult to accept the rule of 'one man, one vote' and to give the Council far-

[13] Delors Report (1989), paragraph 32, under the heading **Structure and organization**.
[14] The Delors Report assumed the System would be given the full status of an autonomous Community institution (Delors Report, paragraph 32, first section). The existing Community institutions do not have legal personality: they can only act on behalf of the European Community. However, the Committee of Governors considered that central banks need legal personality, because they have to buy, sell and hold assets. They considered whether to give the system legal personality or only the components of the system. They opted for the latter, because giving the system legal personality would have meant that the system would have absorbed the NCBs legally and in terms of balance sheets - see under Article 1-ESCB.
[15] Further dealt with under Art. 12.1 and 14.3 in cluster II.
[16] Draft of 11 June 1990; article initially numbered Art. 13.

reaching powers. The issue first centred around the length of the term of office and the dismissal procedure, dismissal needing approval of the Council of Ministers.[17] Tietmeyer (German Alternate) raised a few proposals. First during the Alternates meeting of 29 June he had proposed to have the appointment of the national governors approved at the Community level. This had been opposed by Crockett (BoE). Tietmeyer repeated this proposal during the governors' meeting on 10 July, but then it was strongly opposed by the French governor.[18] The draft Statute of 3 July also shows an alternative version of the German Alternate for the article relating to the NCBs. This alternative proposed that the national governors should be appointed by the Council of the System on a proposal of the Member State. This was changed by the governors during their meeting of 10 July into appointment by the Member State after consultation of the Council.[19] Pöhl remarked he wanted to narrow the grounds for dismissal, in order to protect against dismissal on political or policy grounds.
This resulted in the version of 13 July, which developed almost without change into Art. 14.2 of the final version of 27 November 1990:

> "14.2 The statutes of the NCBs shall in particular provide that the Governor of an NCB is appointed by the national authorities of the Member State after consultation with the Council [of the ESCB]. The term of office shall be no less than 5 years. The Governor may be relieved from office only for serious cause resting in his person.[20] A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Council [of the ESCB]."
>
> draft 27 November 1990

In October 1990 the European Council, meeting in Rome, would decide that the second stage[21] was to start on 1 January 1994 after a number of conditions would have been met, one of which was that 'a process has been set in train designed to ensure the independence of the member of the new monetary institution at the latest when monetary powers have been transferred'.[22] [23]

II.2 HISTORY: IGC

During the IGC it was agreed to create at the start of stage two a new institution, called the European Monetary Institute, and to establish the ESCB only towards the end of the second stage. It was decided that NCBs would have to be independent at the date of the establishment

[17] Draft version of 3 July 1990.
[18] Internal notes of Alternates' meeting of 29 June 1990 and Governors' meeting of 10 July 1990, BT032e.
[19] Involvement of the Council of the System was considered appropriate 'given the important role that NCB governors play in their capacity as Council members' – wording taking from Pöhl's statement before the informal Ecofin on 8 September 1990.
[20] Executive Board members enjoy stronger protection, as in their case only the Court of Justice can take the decision to retire them compulsorily. See Article 11.4-ESCB, which followed the proposal of the governors (Art. 11.5 in their draft of 27 November 1990).
[21] The Madrid European Council of 26-27 June 1989 had decided that the first stage was to start on 1 July 1990.
[22] Conclusions of the presidency of the Rome European Council (27-28 October 1990).
[23] Germany and the Netherlands would dispute this new institution was the future ESCB/ECB. They feared stage two would linger on for a long time (if not forever) and that the 'new' institution, through coordination or possibly even operational responsibilities, would violate the independence of those central banks that formally or informally enjoyed a high degree of independence. Other countries disagreed and wanted to establish the ESCB/ECB early in the course of stage two, though with limited tasks only. The German/Dutch view would prevail.

of the ESCB, i.e. some time before the start of the third stage – see presidency's text below. This made sense, because the ECB would have to decide on the regulatory, operational and logistical framework of the ESCB, designed by the EMI[24], before becoming operational. (The ESCB would only start to exercise its full monetary powers at the start of the third stage.)

Article 108(2) [25] "Each Member State shall ensure, at the latest at the date of the date of the establishment of the ESCB, that its national legislation including the Statutes of its central bank is compatible with this Treaty and the Statute of the ESCB." presidency's text 5 December 1991

At the same time the requirement, mentioned in the European Council Conclusions of Rome, that the 'process' towards making their central banks independent should start even *before* the start of stage two was softened into the requirement to start this process *during* stage two:[26]

Article 109C "5. During the second stage each Member State shall, as appropriate, start the process leading to the independence of its central bank, in accordance with the provisions of Article 108 par.2" presidency's text 5 December 1991

This might have left the governors open to political pressure when acting in their capacity of member of the EMI Council. Formally such pressure was forbidden, because the EMI Statute determined that the members of the EMI's Council[27] were not allowed to seek or take instructions.[28] Nonetheless, 'at home' not all of them were protected against dismissal.

It is worth remarking here that the obligation of central bank independence as of the date of the establishment of the ESCB (Art. 108-EC) also stretches to derogation countries.[29] This was the price they had to pay for becoming 'member' of the ESCB (see Art. 7, section II.3). It was a price they were happy to pay, because countries like Portugal and Greece, but also Spain (who were then not certain about their date of entry to Monetary Union), saw this as a welcome internal disciplining device. An exception was the UK, which in the last week of the IGC produced a specific opt-out protocol, which specified inter alia that Art. 107 and 108 would not apply to the UK.[30](Future EU members will get a derogation status upon entry of the EU and therefore will have to have independent central banks, right as of that moment. Opt-outs in this respect will not be accepted as part of the accession treaties.)

As regards the appointment of the governors, the French, British and Danish IGC delegations expressed reservations against the need to consult the Governing Council when appointing a

[24] See Art. 4.2-EMI.
[25] During the legal nettoyage after Maastricht the other paragraphs of Art. 108 would be moved to Art. 106 and Art. 108 would condense into this paragraph.
[26] CONF-UEM 1620/91, 5 December 1991. After Maastricht Art. 109C would be renumbered into Art. 109e.
[27] The EMI's Council existed of the governors of the NCBs and a president.
[28] Art. 8-EMI Statute.
[29] Art. 109k(3), enumerating the articles not applicable to derogation countries, does not mention Articles 107 and 108.
[30] Denmark also negotiated an opt-out option, which if activated would bring them, unlike the UK, under the regime of derogation countries.

governor. The Dutch presidency accommodated their reservations by deleting this requirement.[31] The Committee of Governors reacted to this deletion in their letter of 13 November 1991, containing their comments on the presidency's draft of 28 October.[32] They suggested the reintroduction of the consultation procedure, 'as a recognition of the fact that the Governor of an NCB is a member of the supreme decision-making body in charge of the Community's monetary policy.' In an internal document they had used harsher words: leaving the process of choosing the Governor entirely in the hands of national authorities may give the impression that a Governor is primarily responsible for the NCB of a Member State and may therefore deflect from his/her functions as one of the members of the supreme decision-making body in charge of the Community's monetary policy.' The issue was raised in the meeting of the EMU Working Group on 27 November by the Dutch delegation, supported by Germany and Italy, but the Dutch (!) presidency considered the topic already closed.

[31] UEM/82/91 of 28 October 1991 (the presidency's first consolidated draft Treaty text).
[32] UEM/101/91, 13 November 1991.

Article 21:

Article 21: Operations with public entities

"21.1 In accordance with Article 104 of this Treaty, overdrafts or any other type of credit facility with the ECB or with the national central banks in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as well as the purchase directly from them by the ECB or national central banks of debt instruments.

21.2 The ECB and national central banks may act as fiscal agents for the entities referred to in Article 21.1.

21.3 The provisions of this Article shall not apply to publicly-owned institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the ECB as private credit institutions."

(to be read in conjunction with Article 7-ESCB (independence); Article 18-ESCB (open market and credit operations); Article 104-EC (same article as Art. 21-ESCB); Article 104A-EC (prohibition of privileged financing for the government); Article 104b(2)-EC (allowing the Council, if need be, to specify definitions for the application of Art. 104))

I. INTRODUCTION

I.1 *General introduction*

The independence of a central bank is not guaranteed when the government can force the central bank to finance the government's expenditures (i.e. when the government can force the central bank to 'print money'). It was clear that forced monetary financing could not be allowed under EMU. The drafters of the Treaty went one step beyond: they also forbid a central bank to finance the government voluntarily, in order to prevent situations in which the central bank might feel obliged, though not necessarily forced, to help the government. The central bank might feel that refusing to help the government might harm its relations with the political authorities, with which it has to cooperate in a number of other areas, e.g. supervision.

The Statute prohibits overdraft and credit facilities of any other type to any type of government. (An exception was made for publicly-owned banks to the extent that they should not be disadvantaged relative to private banks as regards the normal supply liquidity by the central bank to the banking system.)[1] It was also decided to prohibit central banks from buying government debt paper at the *primary* market, i.e. at the moment of issue. This was to

[1] This meant for instance that the Dutch central bank had to stop holding some (small) deposits with a small government-owned bank, even though these deposits were held only for payment purposes. These deposits were not part of the regular supply of reserves to the banking system.

prevent a central bank from being able to be put under pressure to support the price of a government bond issue. Central banks are allowed though to buy government paper on the *secondary* market. Banning a central bank from this market would severely limit the possibilities for the central bank to conduct open market operations (which are usually conducted in this market). A central bank is still allowed to pay out dividends, even to the government, if that government happens to be its shareholder. Of course, there should be limits to such payments or capital transfers to the government: the government may not deplete or reduce the own reserves (the capital) of the central bank to such an extent that the central bank could become dependent on financing by the government. The borderline is difficult to draw. Central banks should be able to carry serious losses on their foreign reserve assets, e.g. due to a depreciation of the dollar. (Assets are booked against market value.) Central banks can also run into losses when banks fail to which they lent money. However, in the case of the ECB and the euro area NCBs this risk is limited, as they are only allowed to extend credit against collateral in the furtherance of the System's objectives.[2] They only accept high-quality collateral. The so-called General Documentation of the ECB provides a list of acceptable high-quality collateral. Deviations from this list are possible, but need the approval of the Governing Council. Therefore, chances are remote that both a bank and its collateral fail at the same time. Nonetheless, the central bank's capital should also be large enough to cover losses on its lending to financial institutions in situations of severe financial distress in the financial system. [3]

I.2 *Relevant features of the Federal Reserve System*

In the United States the Federal Reserve district banks act as fiscal agent. The fiscal agency functions encompass maintaining accounts for the U.S. Department of the Treasury, paying checks drawn on the Treasury[4] as well as conducting nationwide auctions of Treasury securities and issuing, servicing and redeeming Treasury securities. FRBs also perform fiscal agency functions for various federal and federally sponsored agencies. The Treasury and other government agencies reimburse the FRBs for the expenses incurred in providing these services.[5] The fiscal agency function does not encompass extending overdraft facilities to the U.S. Government.[6] The FRBs are allowed to buy and sell 'any bonds, notes or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to the principal and interest [....] without regard to maturities, *but only in*

[2] Art. 18.1-ESCB, second indent.

[3] The definition of monetary financing of the budget could have been broader. For instance, borrowing from abroad has the same effect on the monetary base as borrowing from the central bank. The same could be said of foreign investors buying domestically issued government paper on the secondary market. However, this is difficult to monitor and it would be against the market principle to prohibit this. In case one would want to rely completely on 'budget discipline by market forces', one could consider to forbid governments to borrow in foreign currency.

[4] See Federal Reserve Act, Section 15(1): 'The moneys held in the general fund of the Treasury, ..., may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States; and the revenue of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits.'

[5] Board of Governors of the FRS (1994), *Purposes and Functions*, p. 108.

[6] The powers of the FRBs are enumerated in the Federal Reserve Act. Extending overdrafts to the government is not among them.

the open market.' [7] This prohibition had not been part of the original FRA of 1913. The Federal Reserve was asked to directly underwrite government debt during World War I. Such purchases by Reserve Banks were later eliminated and in the interbellum a statutory prohibition on direct underwriting of government debt was added to the FRA.[8] The FRS holds a very large portfolio in US government paper, which it built up in the context of their open market operations. (In fact, it is one of the largest holders of US government securities, holding almost 10 per cent of the total U.S. Treasury securities outstanding.[9])

II.1 HISTORY: DELORS COMMITTEE

The paper submitted by Pöhl to the Delors Committee in September 1988 [10] already contained some rudimentary thoughts on fiscal policy in a monetary union. The paper advocated clear limits on central bank financing of the government and also warned against excessive fiscal deficits. We will use this paragraph to show how the idea developed that monetary union would only be viable with binding rules in the fiscal area, leading to Art. 104C-EC.[11]
We quote two sections of Pöhl's paper, elements of which would find their way into the Delors Report:

'B - *Principles of a European monetary order*
[...]
5. The *financing of public sector deficits* by the central bank (apart from occasional cash advances) makes effective monetary control impossible over the long term. For a European central bank to be able to fulfil its mandate to ensure monetary stability, strict limitations must be imposed on its granting credit to public authorities of all kinds (including Community authoirites). This also applies to indirect government financing through the granting of credit to any central banks of the member countries that continue to exist.'[12]

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[7] FRA (1988), Section 14(b)(1). Emphasis added by the author. This buying and selling takes place under conditions and regulations of the FOMC (FRA (1988), Section 14(b)(2).)
[8] L.H. Meyer (2000), This is not to say that the Fed did not support the market for government paper at other occasions, e.g. during the Second World War and reluctantly for a number of years afterwards (see Kettl (1986), p. 59-82).
[9] Source: Federal Reserve Bulletin, September 2001 (Table A10) and Monthly Statement of the Public Debt of the United States (December 2001), compiled and issued by the Bureau of the Public Debt.
[10] 'The further development of the European Monetary System', printed in Part 2 of the Delors Report, April 1989, pp. 129-155. This paper was the translated version of an earlier internal position paper of the Bundesbank discussed by the Zentralbankrat in May 1988.
[11] Economic union falls outside the scope of the book. It should be noted however that a number of governors, especially Pöhl and Duisenberg, were strongly of the opinion that monetary and economic integration should move in parallel.
[12] Delors Report, pp. 137-8.

> 'Considerable, or even unlimited, recourse by a Member State (or the central authority) to central bank credit would make monetary control throughout the monetary area difficult, if not impossible, and - no matter how they are financed - excessive national budget deficits would burden the overall current account position of the monetary union.'[13]
>
> paper Pöhl September 1988

Delors recognised this as a genuine demand by the Bundesbank and included this in his list of topics to be discussed.[14] The arguments against excessive deficits would be further developed over the lifetime of the Delors Committee. A first effort would be made in a report written by the two rapporteurs of the Delors Committee, Padoa-Schioppa and Baer. In their report[15] they argue that without binding rules national fiscal policies could start diverging significantly. This would threaten to complicate the formulation and execution of monetary and exchange rate policies in the monetary union. 'Even if recourse to central bank credit were strictly limited or ruled out altogether, large-scale borrowing by national public sector authorities in non-Community currencies could affect the Community's exchange rate (if the proceeds of foreign borrowing were converted in the market) or the monetary stance (if the proceeds were converted by the monetary authorities).' They also argued one could not rely on market discipline for keeping fiscal authorities in check: market discipline, observable through increasing interest rates (spreads) a government has to pay when issuing bonds, was not considered to be strong enough to prevent the emergence of significant divergences between national fiscal policies.[16] Markets react slowly and too weakly to fiscal derailment, and if they do too abrupt and too disruptive.

Arguments were developed further along the following lines:[17]
'[....] uncoordinated and divergent national budgetary policies might not only undermine monetary stability, but would also generate imbalances in the real and financial sectors of the Community and render it difficult, if not impossible, to pursue appropriate macro-economic policies for the Community as a whole. This is why all countries will have to accept that sharing a common market and a single currency area imposes narrow constraints on their national budgetary policies and requires strict fiscal discipline.' In the area of fiscal and budgetary policies 'arrangements are required which will effectively limit the scope for budget deficits [....] Safeguards in this respect will have to include (in accordance with the criteria laid down for a ESCB) strict limits on the maximum permissible access to monetary financing, as well as on borrowing in non-Community currencies. In addition, agreement

[13] Ibidem, p. 134. In May 1988 the Dutch government defined a position quite close to the Bundesbank position. (This was discussed in the Council for European Affairs, a sub-group of the Cabinet consisting of the prime-minister, the ministers of foreign, economic and social affairs and the minister of finance with the president of the central bank attending.) In the budgetary area they defined as their aim the prevention of excessive deficits, because these would burden the capital market or the annual room for monetary expansion in the single currency area. According to them, this might necessitate the use of binding rules.
[14] See CSEMU/4/88 of 27 October 1988 (Issues for discussions for the November meeting), point 3 (a) (v): 'limitations on credit that can be granted to public authorities, including those of the Community.'
[15] CSEMU/3/99 ('Economic Union: implications of a monetary union') of 30 September 1988, p.5.
[16] Ibidem, p.5. 'Rather than differentiating gradually between the quality of different borrowers, the markets' assessment tends to alter abruptly.'
[17] CSEMU/10/89 of 31 January 1989, p. 12 ff.

must be reached on a system of rules which limits the maximum size of national budget deficits.'

The final draft (of April 1989) would read as follows: [18]
'[....] uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community.' Therefore, the Committee considered it necessary to have better coordination of economic policies [19] as well as binding rules for budgetary policies:
'In the budgetary field, binding rules are required that would: firstly, impose effective upper limits on budget deficits of individual member countries of the Community, although in setting these limits the situation of each member country might have to be taken into consideration;[20] secondly, exclude access to direct central bank credit and other forms of monetary financing while, however, permitting central bank open market operations in government securities; thirdly, limit recourse to external borrowing in non-Community currencies. Moreover, the arrangements in the budgetary field should enable the Community to conduct a coherent mix of fiscal and budgetary policies.'
In retrospect, the committee followed two lines of reasoning: first, the committee saw a need for co-ordinating policies (soft co-ordination); second, it saw a need for establishing binding rules to limit the size of budget deficits and central bank financing thereof (hard co-ordination). The first line would lead to Article 103-EC (providing for multilateral surveillance procedures). The second line would lead to Article 104 (no monetary financing) and Article 104C (budget deficit ceiling).[21]

II.2 HISTORY: COMMITTEE OF GOVERNORS

The discussion in the Committee of Governors took mostly place at the level of Alternates and followed two main lines: first, the precise scope of the prohibition of central bank financing and second, the issue of fiscal agent. As regards the first issue, the first draft of the ESCB Statute declared in Art. 19.3 that 'public entities shall not be given overdraft facilities'.[22] This was extended to read: 'overdraft or any other credit facility.' At the same

[18] All quotes taken from par. 30 of the Delors Report.
[19] The Committee relied in this area on common sense, not on institutional revolution. In this respect it is interesting to mention that in a very late stage before the last meeting Pöhl had sprung the following idea on the Committee: he had suggested that with a view to effective control and co-ordination of market borrowing by public entities at all levels, a "public finance co-ordinating authority" consisting of representatives of all such entities should be established. One of its objectives would be to facilitate the conduct of a coherent mix of fiscal and monetary policies. However, this idea lacked details on a number of important issues, like the relation of this co-ordinating body with the Council of Ministers and the Commission. Also its role with regard to the policy-mix was unclear. The idea was not incorporated.
[20] The Maastricht Treaty would show a different outcome: the upper limit would be set at 3 percent of GDP for each Member State (Art. 104C-EC).
[21] The idea of a 'no-bail out' rule (Art. 104B) would be put forward only in a later stage. It was first mentioned by Lawson, the British Finance minister, during the informal Ecofin meeting in S'Agaro (Spain) on 20-21 May 1989, where Delors had debriefed the ministers on the outcome of the Delors Report. Lawson observed that a monetary union did not require a fiscal union - only two rules would be required: no monetisation of government deficits and no obligation on the others to bail out any one who gets into difficulties. (Source: note by the Commission, undated, author's archive.)
[22] The first draft read as follows:

time some Alternates raised the question of whether allowance should be made for facilities to smooth seasonal payment flows in order to neutralise adverse monetary effects.[23] One of the sub-committees of the Committee of Governors, the Monetary Policy Sub-Committee (MPSC), was asked to comment on Chapter IV (Monetary Functions and Operations) of the draft Statute. The MPSC considered that seasonal payment flows could be smoothed out without monetary financing of the Treasuries by the System. The sub-committee also recommended to mention Article 19.3 as the first statement, because of its importance, and supplement it by a provision which would preclude purchases of public sector debt instruments direct from the issuer, 'since such operations would also imply direct monetary financing of state deficits.'

As regards the 'fiscal agent' function, the MPSC proposed to give a more narrow definition of this function, limiting it to a banking and issuing function - see Art. 19.3 and 19.4 below.[24] A number of its suggestions were included in the draft statute, [25] the new version of which read as follows:

Article 19 - Operations with public entities

19.1 The System shall not grant overdrafts or any other type of credit facilities to Community institutions, governments or other public entities of Member States or purchases debt instruments directly from them.[26] [27]

19.2 The System may act as fiscal agent for Community institutions, governments or other public entities of Member States.

19.3 The function of fiscal agent shall comprise all banking functions except those referred to in Article 19.1 above.

19.4 Community institutions, governments and other public entities of Member States for which the System acts as fiscal agent shall issue debt instruments either through the System or in consultation with it.'

draft 5 September 1990

'19.1 - The ESCB may act as fiscal agent for Community institutions, governments of member states and other [major] public authorities. 19.2 - Public entities for which the ESCB acts as fiscal agent normally issue debt instruments via the ESCB. Such public entities shall maintain their liquid funds on accounts with the ESCB except for express arrangements to the contrary with the ESCB. 19.3 - Public entities shall not be given overdraft facilities.'

draft 22 June 1990

[23] See Article 19.3 of the draft Statute of 3 July 1990.

[24] Indeed, most central banks do not use the term 'fiscal agent', but describe the functions of the central bank. For instance, the Dutch central bank was charged with the cost-free custody of the general funds of the Treasury and could be asked by the Minister to act as cashier to the Government and other public institutions (Bank Act 1948 (edition 1991), Section 19). The IMF Articles of Agreement mention the function of 'fiscal agency', when referring to the entity through which the Fund shall deal with each member. ('Each member shall deal with the Fund through its Treasury, central bank, stabilization fund, or other similar fiscal agency , and the Fund shall deal only with or through the same agencies.')

[25] The MPSC had also suggested to limit the fiscal agent function to central government and Community authorities only. The MPSC argued that to the extent that the operations do not pass through central banks accounts, they have no impact on money market conditions. This suggestion was not accommodated.

[26] Only one Alternate considered it useful for the System as fiscal agent to be able to purchase debt instruments directly, although it should be under no constraint to do so.

[27] The central bankers noted Article 19.1 implied that existing credit facilities to smooth seasonal payment flows would have to be abolished. Such credit facilities existed in many countries, also in Germany and the Netherlands.

The governors discussed this article in their meeting of 11 September 1990. One governor (Leigh-Pemberton) said he liked to keep open the possibility for a central bank to influence the market. He preferred the System not being obliged to grant overdrafts to the government, but not being prohibited either. Others pointed out that Art. 17 of the draft Statute allowed central banks to buy and sell government paper (in the secondary market), which basically covered Leigh-Pemberton's point. It was made clear that Art. 19.1 would not apply to publicly-owned credit institutions. The final draft would read as follows:[28]

'Article 21 - Operations with public entities
21.1 The ECB and NCBs shall not grant overdrafts or any other type of credit facility to Community institutions, governments or other public entities of Member States or purchase debt instruments directly from them.[29]
21.2 The ECB and NCBs may act as fiscal agents for Community institutions, governments or other public entities of Member States.
21.3 The function of fiscal agent shall comprise all banking transactions except those referred to in paragraph 1 of the Article.
21.4 Community institutions, governments and other public entities of Member States for which the ECB and NCBs acts as fiscal agents shall issue debt instruments either through the System or in consultation with it.
21.5 The provisions under this Article shall not apply to publicly-owned credit institutions.'
final draft 27 November 1990

Of the Commentary, the following is worth mentioning:

'[....] the ECB and the NCBs will not be prevented from purchasing government securities in the secondary market, but only in the context of monetary policy operations.
The function of fiscal agent referred to in Articles 21.2 to 21.4 describes a service traditionally provided by central banks to governments and other public entities. [....]'
Commentary 27 November 1990

The governors used the Introductory Report, which accompanied the draft Statute, to remind the IGC that economic union and monetary union should be implemented in parallel: '[....] only if adequate progress has been made in the economic field, will the System be able to operate in an environment in which it can successfully attain its primary objective of price stability.' This was as clear a message as they thought they could give to the political authorities. In this respect they relied on both the ideas and arguments mentioned in the Delors Report.[30]

[28] Later in the year 'ESCB' would be replaced by 'ECB and NCBs'. This was a consequence of the decision not to grant legal personality to the System, but only to its constituent parts. See Article 1-ESCB.
[29] This does not exclude the possibility of granting intraday credit to the government, provided it is ensured that intraday credit can never turn into overnight credit. Intraday credit is one way of increasing the liquidity in the national payment system. An example is to be found in the Dutch Bank Law (edition 1999), Section 8, paragraph 3: 'A the request of Our Minister [....] the Bank shall grant the State, whenever the Minister deems this necessary for the purpose of ensuring the smooth settlement of payments for the account of the State, unsecured overdraft facilities subject to a rate of interest agreed between Our Minister and the Bank. The State shall be obliged to repay these overdrafts on the same day as that on which they are granted.'
[30] Making proposals in the budgetary area was in the realm of the Monetary Committee (in which - it should be remembered - the Alternates of the governors were also participating; they were playing chess on two boards). During their meeting on 13 March 1990 the governors (in the presence of their alternates) had discussed the importance of budgetary discipline with Delors. Then De Larosière had suggested that 'no-bail out' and 'no

II.3 HISTORY: IGC

The draft Treaty texts of both Commission, France and Germany contained a prohibition for central banks to finance government deficits. All three drafts also contained - in one form or another - a no-bail out rule and a rule against privileged access of the public authorities to the financial markets. Agreement on the final text would take some time however, because some member states wanted to allow temporary (seasonal) overdrafts at the central bank - they did not succeed -, while the discussion about possibly permitting voluntary direct purchases of government paper also temporarily flared up.

We quote from the Commission's, the French and the German draft:

'

Article 104a

1. The following shall be recognized as incompatible with the economic and monetary union and shall accordingly be prohibited:
(a) the financing of budget deficits by means of direct assistance from Eurofed or through privileged access by the public authorities to the capital market;
(b) the granting by the Community or the Member States of an unconditional guarantee in respect of the public debt of a Member State.
2. Excessive budget deficits shall be avoided. The Council may, to this end, adopt appropriate measures pursuant to the provisions of this Chapter.[31]

Article 106a

3. The ECB may under no circumstances grant to the Community or to one of its Member States or to any public body a loan or other credit facility intended to make good a budget deficit.' [32]

Commission's draft, 10 December 1990

'

Article 1-4

1. Le financement des déficits budgétaires, par concours direct du SEBC, créé en vertu de l'article 2-2, ou accès privilégié des autorités publiques aux marchés de capitaux, est incompatible avec l'UEM et est donc interdit.

---

monetary financing rules' would not suffice, as governments could meet their financing requirements in the banking system. Delors had agreed that this could be just as destabilizing as central bank financing. He had suggested to await the outcome of the deliberations in the Monetary Committee. In its report of July 1990 (EMU beyond stage one) the Monetary Committee would recommend that the Treaty should lay down 'that excessive deficits must be avoided.' 'This would require the exercise of judgment at the Community level.' Only later, i.e. in the course of 1991 during the IGC, would the idea of binding limits for budgetary deficits (3% of GDP) be developed.

[31] Predecessor of Art. 104C. A quantified definition of 'excessive deficit' was not given. The phrase 'excessive deficit' was first used in a report of the Monetary Committee (EMU beyond Stage 1, July 1990), prepared for the Ecofin. The phrase appeared in most draft Treaty texts, submitted to the IGC. In its accompanying commentary the Commission linked 'excessive' to 'unsustainable', which was difficult to define exactly and should be based on a broader assessment.

[32] According to some, the Commission's formulation did not prohibit short-term (seasonal) overdrafts by a government.

> Les Etats membres sont seuls responsables de leur dette publique et ne bénéficient d'aucune garantie, du fait de l'Union Economique et Monétaire, de la part de la Communauté ou des autres Etats membres.'
>
> French draft, 25 January 1991

> 'Article 105b (Budget policy)
> [….]
> 4. Neither the Community nor individual Member States shall assume the commitments of another Member State. The ESCB may not grant any credit to public authorities. Other financial institutions may not be compelled to grant credit to public authorities. Any borrowing in non-Community currencies by the public authorities of Member States shall be subject to surveillance by the Council, which shall reach agreement on this with the Council of the ECB.'
> 5. …..
>
> German draft, 26 February 1991

During the deputy IGC meetings the British, Irish and Greek delegations took the position that voluntary (short-term) overdraft facilities and voluntary purchases on the primary market for government paper should be allowed. Other delegations objected. (The Luxembourg presidency would take a middle position: see non-paper below.) Furthermore, Art. 21.4 of the draft ESCB Statute was criticized by the Irish, Dutch and Spanish: they requested to delete Art. 21.4. (The Luxembourg presidency complied and it would also drop Art. 21.3.) It was suggested to replace 'Community' by 'Community institutions or bodies'. Moreover, the Commission was criticized for a suggestion implying a weakening of the no-bail out clause by apparently allowing 'conditional guarantees'.[33]
In a final section to this paragraph we will expand on the related issue of rules for the size and financing of budget deficits.

The Luxembourg presidency's non-paper of 10 May 1990 showed the following text:

> Article 104
> 1 (a) The granting of overdrafts or any other type of credit facility by the ESCB or by NCBs to Community institutions or bodies, governments, local authorities or other public agencies of Member States and the *obligatory* purchase from them of debt instruments shall be recognized as incompatible with EMU and shall accordingly be prohibited.
> This prohibition also includes any measure determining privileged access by the aforementioned authorities to the financial institutions.
> (b) Neither the Community nor a Member State shall be liable for the commitments of
>
> ./.

[33] Art. 104a(1)(b)-Commission draft (not show here). In a similar vein the Commission had proposed to insert a Community financial assistance mechanism for member states 'in trouble' (Art. 104-Commission draft). This would lead to Art. 103a. Its activation requires unanimity in the Ecofin Council (this was a German demand) - unless difficulties are caused by natural disasters.) We will not deal with Art. 103a any further. The Commission's formulation of the no-bail out clause would be toughened up, along the lines of the German draft of 26 February 1991.

> Community institutions or bodies, governments local authorities or other public agencies of another Member State, without prejudice to mutual guarantees for the joint execution of a specific economic project.[34]
>
> Luxembourg non-paper, 10 May 1991 [35]

The draft version of Art. 21-ESCB of the Luxembourg presidency would read as follows:

> 'Article 21 - Operations with public entities
>
> 21.1 The ECB and NCBs shall not grant overdrafts or any other type of credit facility to the Community institutions or bodies, to Member States and other public entities in the Member States [or purchase debt instruments *directly* from them] [or be *obliged* to purchase debt instruments from them].
>
> 21.1 The ECB and NCBs may act as fiscal agents for the entities referred to in Article 21.1.
>
> 21.3 The provisions under this Article shall not apply to publicly-owned credit institutions.'
>
> annex to Luxembourg non-paper, 6 June 1991[36]

We note a difference between the Luxembourg versions of Art. 104.1(a) and Art. 21.1: in Art. 104.1(a) the Luxembourg presidency presented what they considered to be a possible outcome (i.e. only allowing voluntary direct purchases and not allowing any overdrafts); in Art. 21.1 of the draft ESCB Statute they limited themselves to presenting two alternatives.

The Dutch presidency presented a consolidated version of the draft Treaty on 28 October 1990. It proposed not to allow any direct purchases of debt paper from the government. Article 104 was adapted accordingly.[37]
In the final phase of the negotiations two issues came to the fore: (1) the British and Irish delegations maintained their position that cash arrangements with their governments should be allowed to include short-term overdraft facilities. In the end,[38] they would give up their resistance, though the UK warned it would not accept having to give up its challenged Ways and Means facility already in stage two. (This aspect was taken care of in the British 'opt-out', which was designed by the UK itself.) (2) The words 'The granting of' were deleted in Art. 104, because these words could have been misread as allowing a continuation of the existing overdraft facilities.

Rules for size and financing of budget deficits
The Werner Report (1970) did not explicitly prohibit monetary financing of government deficits. It did observe that EMU entailed that 'the essential features of the whole of the public deficits, and in particular variations in their volume, the size of balances and the methods of financing or utilizing them [=surpluses], will be decided at the Community level'

[34] Par. (c) provided that the Council of Ministers could further define the prohibitions of this article, deciding by qualified majority on a proposal from the Commission. This would lead to Art. 104b(2).
[35] Emphasis (italics) added by the author.
[36] Emphasis (italics) added by the author.
[37] Art. 104a would become Art. 104-EC. The prohibition of privileged access would come to be mentioned in a separate article, *viz*. Art. 104A-EC.
[38] Deputy IGC meeting of 26 November 1991.

(p. 12). Budget policy was considered important not because of its effect on monetary conditions, but because of its influence on the general development of the economy (p. 8-10).
The Delors Report (1989) showed some remnants of Keynesian (demand management) thinking (e.g. in its desire to define the overall stance of fiscal policy over the medium term (par. 33), its desire to contribute more effectively to world economic management (par. 37), but it also stated that 'uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community' (par. 30). Therefore 'binding rules' were required that would 'impose effective upper limits on budget deficits' (possibly country- or situation-specific) and that would 'exclude access to direct central bank credit and other forms of monetary financing' (par. 30).
The Committee of Governors, all of whom had been member of the Delors Committee, took a similar view. Because budgetary rules were not supposed to be covered by the ESCB Statute, they took recourse to adding an Introductory Report accompanying the draft Statute, the last paragraph of which highlighted the need for budgetary discipline. After referring to the Delors Report they wrote: 'Indeed, only if adequate progress has been made in the economic field, in particular with regard to ensuring budgetary discipline, will the System be able to operate in an environment in which it can successfully attain its primary objective of price stability.' The governors thus expressed they had not forgotten this - in their eyes very important – recommendation of the Delors Report. They did not claim a role in the procedures which should ensure budgetary discipline, but they made clear they expected effective rules to be in place. If not, EMU would not be balanced.
The prohibition of monetary financing was easy to translate in a quantifiable rule, *viz*. zero monetary financing. It was more difficult to make the prohibition of excessive deficits into an operational rule. Some clinged to a *relative* definition. The German draft mentioned in Art. 105b(1) that Member States should avoid excessive general government deficits. An excessive deficit was suspected to occur when (i) the deficit in terms of gdp is larger than 1,... times the Community average; or (ii) the ratio of debt to gdp is greater than 1,... times the Community average.' Article 1-4, par. 2 of the French draft called for the avoidance of excessive budget deficits, while par. 3 mentioned the possibility of sanctions in case a recommendation to a Member State to reduce its excessive deficit would remain without effect. However, in their draft 'excessive' was not defined. This shows that both Germany and France aimed for a mechanism to avoid excessive deficits. However, unlike France, Germany wanted to define 'excessive' *ex ante*. (During the deputies IGC of 19 February 1991 Trichet would say France could accept *certain* rules, provided actual decisions would always be taken by the Ecofin Council.) The search for an acceptable definition took a long time. Disagreement also existed over the question whether the definition should be written in the Treaty or only in secondary legislation. Interestingly, France preferred to use *guidelines* to co-ordinate economic policy, while Germany could only accept *recommendations* (as evidenced by the positions taken by Trichet and Köhler during the deputies IGC of 29 January 1991). Therefore, one could say Germany preferred freedom (non-interference) within clear and non-negotiable rules, while France preferred to create more room for political guidance.
In October 1991 (that is in the second half of the IGC) the Monetary Committee, which had continued to meet parallel to the IGC, would agree on the present *absolute* definition, *viz*. deficit lower than 3% GDP and debt lower than 60% GDP or reclining.[39] The deficit ceiling

[39] Monetary Committee – note by the chairman, Excessive Deficit Procedure, 7 October 1991 (mentioned in Viebig (1999), p. 355-364).

could be overshot only in exceptional and temporary circumstances. Financial sanctions were recommended to make the ceilings effective. The recommendations were accepted by the IGC, which also detailed the procedures for operating the 'excessive deficit procedure' (EDP) – laid down in Art. 104C-EC).[40]

In 1995 it became clear Germany was not completely satisfied with the outcome of the IGC, because Waigel saw a need to strengthen Article 104C through an additional so-called stability pact. In his eyes Article 104C left too much room for discretion and did not contain rules for countries to remain at a sensible distance of the 3% limit during the business cycle.[41] These procedures are characterized by a monitoring role for the Commission; when the Council of Ministers has to take a decision relating to an individual country (whether its deficit is actually excessive and on the follow-up including sanctions), the Council decides on the basis of a Commission recommendation (and not as usual: a Commission proposal).[42] A Commission recommendation can be changed by the Council of Ministers by the same majority as required for taking the decision itself, usually qualified majority, whereas a Commission proposal can only be amended by the Council of Ministers by unanimity.

As a side-remark it could be noted that the (deficit and debt) criteria did play a very effective role in the run-up to the start of the third stage of EMU, as countries had to fulfil these criteria before being allowed in. Waigel's initiative resulted in the adoption of a Resolution by the European Council and two Regulations by the Council of Ministers, one strengthening the surveillance procedures under Art. 103-EC and one clarifying the excessive deficit procedure of Art. 104C-EC, the so-called Stability and Growth Pact of July 1997.

[40] In 1997 renumbered into Treaty article 104.
[41] Viebig (1999), p. 367.
[42] Art. 104C(13)-EC.

Article 27:

Article 27: Auditing

27.1 The accounts of the ECB and NCBs shall be audited by independent external auditors recommended by the Governing Council and approved by the Council. The auditors shall have full power to examine all books and accounts of the ECB and NCBs and obtain full information about their transactions.

27.2 The provisions of Article 188c of this Treaty[1] shall only apply to an examination of the operational efficiency of the management of the ECB.

(to be read in conjunction with Art. 4-ESCB (constitution); Art. 7-ESCB (independence); Art. 14.3-ESCB (NCBs); Article 15-ESCB (reporting commitments); Article 26-ESCB (financial accounts))

I. INTRODUCTION

I.1 *General introduction*

It should be noted that at the time of the Delors Committee NCB legislation regarding the auditing showed wide differences, also with regard to the role of national courts of auditors. For instance, in the **Netherlands** a Supervisory Board supervised the way the Bank was managed,[2] while the books of the Bank were audited by external auditors.[3] In **Belgium** a

[1] Art. 188c-EC:
"1. The Court of Auditors shall examine the accounts of all revenue and expenditure of the Community. It shall also examine the accounts of all revenue and expenditure of all bodies set up by the Community in so far as the relevant constituent instrument does not preclude such examination. [...]
2. The Court of Auditors shall examine whether all revenue has been received and all expenditure incurred in a lawful and regular manner and whether the financial management has been sound. [....]
3. [....] The other institutions of the Community and the national audit bodies or, if these do not have the necessary power, the competent national departments, shall forward to the Court of Auditors, at the request, any documentation or information necessary to carry out its task.
4. [...] The Court of Auditors may also, at any time, submit observations, particularly in the form of special reports, on specific questions and deliver opinions at the request of one of the other institutions of the Community."

[2] In view of the desired large degree of autonomy for the central bank, which was formally under the instruction of the government, it had been decreed by law that the State nor the national court of auditors did have access to the books of the Bank. (See Jan Barend Jansen (2001), p. 59-60.) Instead a Supervisory Board supervised the Bank's management and adopted the annual accounts, while external auditors audit the books (Section 28 of the Bank Act 1948). The Minister was kept informed about the Bank's affairs through a Royal Commissioner (a member of the Supervisory Board having access to all information he deemed necessary 'for the proper performance of his supervisory duties') and through regular luncheons with the Bank's president. (This set-up is continued under the new Bank Act of 1998, Artt. 13 and 14 - except for the Royal Commissioner who is replaced by 'one member of the Supervisory Board [....] appointed by the Government'. The members of the Supervisory Board are appointed by the shareholders (= the government) from a list of three nominated for each vacancy by the Supervisory Board and the Bank Council. (Bank Act 1948, Section 27(2).)

[3] The Dutch Court of Auditors is allowed to look into the reports of the external auditor, but is not allowed to make on-site inspections or to claim internal documents of the Bank.

Board of Auditors[4] supervised the operations of the Bank, examined and approved the balance sheet, had access to the books and voted on the 'budget of expenditures'.[5] In **Germany** the Bundesbank's annual statement was prepared by the Direktorium and audited by one or more certified auditors appointed by the Central Bank Council in agreement with the Federal Audit Office, the auditor's report serving as the basis for the audit to be carried out by the Federal Audit Office. The Federal Audit Office may also express opinions about the efficiency with which a Landeszentralbank is run. The auditor's report as well as the findings of the Federal Audit Office thereon are communicated to the Federal Minister of Economics and the Federal Minister of Finance[6] and the budget committee of the German parliament. The Federal Audit Office does not have access to sensitive documents, e.g. relating to monetary policy decisions. And to give a final example, the administration of the **Banque de France** was supervised by two Auditors appointed by the Ministry of Finance.[7]

The drafters of the Delors Committee stayed close to the example of the Dutch central bank, according to which the administration would be supervised independently of the Community bodies, for example by a supervisory board or a committee of independent auditors - see below. The Committee of Governors followed the same line and did not foresee a role for the European Court of Auditors,[8] while the *reliability* of the ECB's accounts and the *legality* and *regularity* of the underlying transactions were to be assessed by external auditors.[9] The external auditors of the ECB and of the NCBs need not be the same. [10] This text drafted by the Committee of Governors became part of the presidency's proposals without much discussion and when the Statute of the EMI had to be drafted a similar procedure was proposed for the European Monetary Institute (EMI). During the IGC discussion on the draft Statute of the EMI the UK put forward that an assessment by external auditors of the *correctness* of the EMI's financial statements would be insufficient: 'the man in the street' also wanted to know whether the EMI's budget was spent efficiently (and not lavishly). This was broadly supported, also by Germany. It was decided to give this task of assessing the 'operational efficiency of the management' of the EMI to the European Court of Auditors (ECA). The Statute of the ECB was adapted accordingly. This specific formulation was chosen to make clear the Court of Auditors was not mandated to express itself on the conducted monetary policy, the positive aspect being public control of the efficiency of an institution not being a

[4] Eight to ten members elected by the General Meeting for a term of three years (Art. 54-55 National Bank Law 1939).
[5] Organic Law of the National Bank 1939.
[6] Art. 26 Bundesbank law 1957.
[7] Codified Statutes of the Banque de France 1936, art. 44-45.
[8] This idea fitted well with the notion - developed during the summer of 1990 - that the ESCB and the ECB should not be listed as Community institutions, which meant they remained outside the scope of the ECA. Compare paragraph 1 of Art. 188c (1), quoted above.
[9] See also Gormley and de Haan (1996), 'The democratic deficit of the European Central Bank', *European Law Review*, April 1996, pp. 95-112; footnote 100.
[10] It should be noted that the ESCB as such does not have legal personality and therefore does not have an official balance sheet. The purpose of the consolidated balance sheet of the eurosystem, which is published under Art. 26-ESCB, is to give a clear picture of the aggregate supply of central bank money to the money markets - see also section II below. Therefore, the audits relate to the books of the ECB and NCBs separately. The NCBs and the ECB also have internal auditing departments. The Governing Council of ECB also established an Internal Auditors Committee (IAC) comprising representatives of the ECB and each NCB. The committee's tasks encompass preparing and co-ordinating eurosystem/ESCB audit plans and their implementation on an annual basis, but might also encompass carrying out audit missions entrusted to it by the Governing Council.

Community institution itself, but still part of the European institutional framework, thus increasing its public credibility and status.

I.2 *Relevant features of the Federal Reserve System*

Until 1933 the Fed (Board and FRBs) had been subject to government audit, initially by the Treasury.[11] When Congress created the General Accounting Office (GAO)[12] in 1921, auditing was transferred from the Treasury Department to the GAO. However, in the wake of the Great Depression Congress wanted to strengthen the position of the Fed and allow the Fed to set its own management decisions. To this end the Banking Act of 1933 provided that the Board's funds 'shall not be construed to be Government funds or appropriated moneys.' This clause ended GAO's audit of the Fed. Since then the Board's own auditors examine the books of the reserve banks, and since 1952 outside auditors examine the Board's own accounts.[13]

In the early 1970's Congressman Patman tried to extend the GAO's remit to the Fed again. In his view GAO's audits should also be used to assess the effectiveness of the Fed's monetary policy (Patman was not convinced Fed chairman Burns was doing enough to combat inflation.) The Fed prevented the bill from being discussed in the Senate, by successfully soliciting 'grass-root support' from local bankers, who flooded members of Congress with mail - the argument being that such an audit would politicize monetary policy and destroy the Fed's operational flexibility. The Fed also enlisted the support of former secretaries of Treasury and Commerce, members of both parties. Fed officials were afraid of leaks of sensitive material. The Fed was also worried that its market operations, which sometimes involves the buying of securities one day and selling them the next day, might be criticized because these operations allow government securities dealers to enhance their profits. Also, the Fed did not want to be known how it conducts transactions to support the dollar and other currencies. Amtenbrink (1999), p. 325, mentions that the main fear of the opponents of an extended audit is that such an audit would involve a general evaluation of the performance of the Board of Governors and the FOMC with regard to monetary policy and that this would deprive the Fed of its independent position. In 1978 however, in the wake of the Sunshine Act, [14] Congress gave GAO to right to audit the Federal Reserve,[15] though - again by lobbying - the Fed successfully pressed to limit the GAO to examining administrative expenses. The amendment prohibits the GAO from auditing: (1) transactions conducted on behalf of or with foreign central banks, foreign governments, and non-private international financial

[11] See also under Art. 7-ESCB, section I.2.

[12] The GAO was established by, and operates as an arm of, Congress. Its purpose is to independently audit Government agencies. Over the years, the Congress has expanded GAO's authority, added new responsibilities and duties, and strengthened GAO's ability to perform independently. The GAO's most prominent activities are audits and evaluations of Government programs and activities. The Office is under the control and direction of the 'Comptroller General of the United States', who is appointed by the President with the advice and consent of the Senate for a term of 15 years.

[13] This paragraph and the next are based on Kettl (1986), *Leadership at the Fed*, pp. 154-159. On the character of the funds provided to the Board, see also A.J. Clifford (1965*), The Independence of the Federal Reserve System*, p. 78.

[14] See also under Article 10.4, section I.2.

[15] By the same act (the Federal Banking Agency Audit Act - amending the Accounting and Auditing Act of 1950) the GAO was authorized to conduct audits of the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

organizations; (2) deliberations, decisions, and actions on monetary policy matters; (3) transactions made under the direction of the FOMC; and (4) all statements, orally or written, dealing with these topics.[16] Kettl (1986) concludes that, while Congress established its right to subject the Fed to audit, its members refused to approve a (political) audit of the Fed's core functions.[17]

We now turn in more detail to the audit of the Federal Reserve Banks. As a starting point it is useful to point to Section 11(j)-FRA (1988) which stipulates that the Board of Governors has the power 'to exercise general supervision over said FRBs.' These supervisory powers are not described in further detail and would seem to give the Board potentially wide-ranging powers as to the management of the FRBs, as long as these do not make an inroad into the prerogatives of the FRBs. More specifically, Section 11(a) of the Federal Reserve Act allows the Board 'to examine at its discretion the accounts, books, and affairs of each FRB and of each member bank and to require such statements and reports as it may deem necessary.' As of 1994 the Board engages the services of accounting firms to audit the financial statements of the FRBs[18] - initially every five years,[19] nowadays on an annual basis. These accountancy firms examine whether an FRB maintains effective internal control over financial reporting - in accordance with standards established by the American Institute of Certified Public Accountants. Furthermore, they audit whether the financial statements of the FRBs are prepared in conformity with the accounting principles, policies and practices established by the Board of Governors.[20]
At each FRB, a full-time staff of *internal* auditors reports directly to the FRB's own board of directors. The Board of Governors' Division of Reserve Bank Operations and Payment Systems, acting on behalf of the Board of Governors, regularly audits the financial operations of each of the Banks and periodically reviews operations in key functional areas. This is done at least every three years. The purpose is to check the efficiency of each FRB's operations. The budget of the FRB's are submitted to the Board of Governors for approval – see also section I.2 of Art. 14.3 in cluster II.

The influence of the Board of Governors on the FRBs stretches outside the audit function. We will come back to the relations between the centre and the FRBs in Cluster II.

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[16] The GAO is prohibited from conducting on-site examinations of supervised financial institutions without the written consent of the appropriate regulatory agency.
[17] The GAO does study though a wide array of subjects, not only relating to internal control, but also to the way the Fed organizes its policy functions. The Budget Review of the Board of Governors over 1999 (available on the Board's website under Publications → Reports to Congress) lists in table C2 the GAO reports relating to the FRS completed since 1979 169 in total), among which, for example and in order to give an indication, the following reports: 'Supervisory Examinations of International Banking Facilities Need Attention' (1984); 'An Examination of Concerns Expressed about the Federal Reserve's Pricing of Check-Clearing Activities' (1985); 'International Financial Crises: Efforts to Anticipate, Avoid and Resolve Sovereign Crises' (1997) and 'High-Loan-to-Value Lending: Information on Loans Exceeding Home Value' (1998).
[18] The balance sheet of an FRB is called "Statement of Condition" and its statement of revenues and expenses "Statement of Income".
[19] Annual Report of the Board of Governors of the FRS over 1994, p. 282; Annual Budget Review of the Board of Governors of the FRS, 1999, Appendix C. The Annual Budget Reviews are discussed by the relevant Senate and House Committees.
[20] These accounting principles and practices are documented in the Financial Accounting Manual for Federal Reserve Banks, which is issued by the Board of Governors, and are explained in the notes to the Financial Statements of each FRB's Annual Report.

II HISTORY: DELORS COMMITTEE, COMMITTEE OF GOVERNORS AND IGC

The **Delors Committee** relatively quickly agreed on the need for an independent monetary authority. At the same time, however, it realized the system should be subject to democratic control and therefore be accountable for its actions and policies. In an early draft of the Delors Report, this took the form of a number of questions: 'the system should be subject to democratic control and therefore be accountable for its actions and policies; [How? Does the formulation of the mandate suffice? Should there be regular reporting? On what? To whom? Council of Ministers? Monetary Affairs Committee of the European Parliament?]' [21]
In January the text had been elaborated somewhat and mentioned a number of principles on which the Community's monetary order should rest, among which the following:

> '- supervision of the administration of the System independently of the Community bodies, for example by a supervisory council or a committee of independent auditors;'
>
> CSEMU/10/89, January 1989, p.16

The issue must not have been very contentious, as the text remained largely unchanged throughout the next drafts, resulting in the following final text:

> 'Supervision of the administration would be carried out independently of the Community bodies, for example by a supervisory council or a committee of independent auditors.'
>
> Delors Report, April 1989, par. 32 [22]

This seemed to mirror especially the situation at the Dutch central bank. See section I.1 above.

A first draft of Article 27 of the ESCB Statute of the **Committee of Governors** appeared only in the draft version of 19 October 1990.

> Article 27 - Auditors
>
> The accounts of the ECB and NCBs shall be audited by independent external auditors recommended by the Council [of the ECB] and approved by the Council of the European Communities. The auditors shall have full power to examine all books and accounts of the ECB and NCBs, and to be fully informed about their transactions.
>
> draft Statute 19 October 1990

On 25 October a new draft was issued taking into account written comments of the NCBs. Article 27 now included the following second paragraph:

> 27.2 The provisions of Articles 203[23] and 206a[24] of the Treaty shall not apply to the ECB or the NCBs.
>
> draft Statute 25 October 1990

[21] Skeleton report covering Chapter II of the final report, CSEMU/5/88, 2 December 1988, p. 15.
[22] Under the heading 'Status'.
[23] Article 203 referred to the budgetary procedures of the Community, including the role of the Commission, parliament and Council.
[24] Article 206a referred to the European Court of Auditors. Article 206a would be renumbered into Article 188c. See footnote in section I.1 above.

The accompanying text read: "Article 27.2 ensures that the System would not be subject to the provisions of the Treaty relating to budgeting and auditing: it would thus safeguard the System's financial independence.'

The governors would discuss the draft version of 25 October at their meeting on 13 November 1990. During this meeting Duisenberg showed some reluctance to involve the Council of Ministers in approving the external auditors. Duisenberg did not want to subject the auditing function to a political process. He preferred to have the auditors recommended by the Executive Board and approved by the Council of the ECB (and not by the Council of Ministers). At the same time, he wanted to install a Supervisory Board, whose members would be appointed by the Council of Ministers.[25] This Board should supervise the administration of the ECB regarding the efficient use of resources. It should also advise on the terms and conditions of employment of the Executive Board members.[26] However according to the minutes of that meeting 'it was agreed that the text as drafted should remain unchanged as it advanced the concept of democratic accountability.'

Even though the choice of the external auditors of the NCBs needs the approval (recommendation) of the Governing Council and the formal approval of the Ecofin Council, the auditing of the NCBs remains a local affair,[27] while the ECB is audited by its own external auditor.[28] However, the Commentary accompanying the draft Statute of 27 November 1990 emphasized the auditors should apply the same principles:

> 'Auditing by independent external auditors and the fact that budgetary provisions contained in the Treaty do not apply to the System are essential for the financial autonomy of the ECB and the NCBs. The procedure for appointing auditors involves the Council of the European Communities in accordance with the principle of democratic accountability.
>
> Article 27.2 does not require that the same auditors audit the accounts of the ECB and the NCBs. However, the principles applied by all auditors should be uniform and the number, status and term of the auditors would have to be specified.'
>
> Commentary, 27 November 1990

[25] The idea of establishing a supervisory council supervising the financial management of the system had earlier been suggested by Dutch Alternate, André Szász, during the meeting of the Alternates on 20 July 1990 when discussing the financial provisions.

[26] This reflected the Dutch model, according to which the Supervisory Board adopts the financial statements. An independent external auditor audits these statements, i.e. he assesses whether the financial statements give a true and fair view of the financial position of the Bank, under the accounting principles applicable to the Bank. It is not clear whether Duisenberg put forward the proposal in detail or whether he stopped once he noticed the others preferred involving the ministers in appointing the external auditors. (The idea of having the efficiency of the organization assessed would not be lost, as a similar suggestion would be out forward by the UK during the IGC - be it an assessment, not by an internal body, but by the European Court of Auditors.)

[27] In most cases though the auditor is one of the established, international active accountancy firms; in some cases (Austria, Netherlands) auditors are appointed *ad personam*. (See OJ L22, 29.1.1999, p.69-70 and OJ L298, 25.11.2000, p.23 for Greece.)

[28] The management of the reserves of the ECB is at present outsourced to the NCBs. The auditing of the management of these reserves is carried out by the external auditors of these NCBs, but this does not exclude the ECB's external auditor carrying out some audit work directly at the NCBs if felt necessary.

At this juncture we should also mention that according to Articles 15 and 26 of the ESCB Statute the System has to present every week a consolidated balance sheet of the ESCB, comprising the assets and liabilities of the ECB and those assets and liabilities of the NCBs that fall within the System (i.e. de facto comprising the eurosystem). The Governing Council is empowered to establish the necessary rules for standardising the accounting and reporting operations undertaken by the NCBs for the purpose of calculating and presenting a consolidated eurosystem balance sheet. Presenting its balance sheet has purely a presentational (monetary) function, as neither the eurosystem nor the ESCB have legal personality. [29]

The **IGC** paid little attention to the auditing of the ECB. Under the Luxembourg presidency Article 27 would remain untouched. The first consolidated draft of the Dutch presidency (i.e. the one of 28 October 1991) would show the same article - except that the reference to Article 203 was dropped. This reference was not essential as it is already clear from Article 4a-EC that the budgetary procedures of the Community do not apply to the ESCB, or its constituents.[30] The draft Treaty text of 28 October also contained a text for the EMI Statute, which included an article similar to Article 27 of the ESCB Statute.[31] During a meeting of the EMU Working Group on 27 November 1991, the UK delegate felt unhappy with the fact that the EMI would only be audited by external accountants: they only look at the reliability of the accounts and the legality of the transactions, while 'the man in the street' also wants to know whether the EMI spends its budget efficiently. To this end the European Court of Auditors (ECA) should be asked to look into the 'operational efficiency of the management of the EMI'. The Court of Auditors would not be allowed though to assess monetary policy. This found broad support, including from the German delegation. With everybody's approval the ESCB Statute was adapted along the same line.[32]

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[29] This is also clear from the Commentary which accompanied the draft Statute of the ESCB of 27 November 1990. We quote the part relating to Article 26: 'As the System has no legal personality, all assets and liabilities relating to the System's operations will be recorded in the balance sheets of the ECB and the NCBs. However, the conduct of a single monetary policy and the need for proper information on sources of money creation throughout the Community will require the consolidation of such assets and liabilities within a single balance sheet structure [....] Article 26 does not preclude NCBs from presenting their own balance sheets in a manner consistent with existing national accounting practices.' (Harmonization of the valuation of foreign reserve holdings would have led to huge shifts in the revaluation and reserve accounts of a number of central banks.)

[30] In its letter to the IGC, containing comments on the Dutch presidency's consolidated draft Treaty text of 28 October 1991, The Committee of Governors would recommend to reintroduce the explicit mentioning of Article 203 for sake of legal clarity (UEM/101/91, dated 13 November 1991). This request was not complied with by the Dutch presidency.

[31] The Dutch presidency's draft followed the formulation proposed by the Committee of Governors, which had sent a draft EMI Statute to the IGC on 28 October 1991 (UEM/91/91, dated 29 October 1991).

[32] The UK proposal might have been inspired by the Select Committee on the Nationalised Industries, which periodically scrutinizes the Bank of England (Fair (1980), p.8). Fair mentions that the Select Committee was concerned chiefly with the pending efficiency of the Bank in an administrative and accounting sense and it was not empowered to examine the Bank on monetary policy and execution nor on its exchange rate activities. (This is understandable, as it is the Treasury ministers who account to Parliament for monetary policy.) The Select Committee was dismantled in 1979.

The presidency's draft of 27 November 1991 would show the following wording (final except for some re-editing):

"Article 27 - Auditing
27.1 The accounts of the ECB and the NCBs shall be audited by independent external auditors recommended by the Governing Council and approved by the Council. The auditors shall have full power to examine all books and accounts of the ECB and NCBs, and to be fully informed about their transactions.
27.2 The provisions of Article 206A [during the legal nettoyage renumbered into Article 188c] of this Treaty shall only apply to an examination of the operational efficiency of the management of the ECB."

Dutch presidency's draft 27 November 1991

It is clear from the text that the remit of the Court of Auditors does not extend to the local central banks, whereas the mandate of the American GAO does. The difference is due to the fact that the surplus profits of the FRBs flow to the Treasury, whereas the surplus profits of the NCBs - i.e. after prescribed additions to their reserves - are paid out to the Member States (the same applies indirectly to the ECB, whose surplus profits are distributed to the NCBs according to their paid-up shares in the ECB's capital.) [33] [34]
The Court of Auditors' report over 2000 might shed light on how the Court interprets its role. The Court of Auditors was critical about the fact that the ECB had budgeted a number of projects for 2000 which it did not realize. The ECB only spent 75% of its initial budget (and 88% of its revised budget). This means the budget is used insufficiently 'as an effective control and management instrument.' [35] The Court also put a question mark on the fact that the rent, paid by the ECB for renting additional floor space in Frankfurt, was based on the rent costs by the rental agency, which included VAT. The ECB however should enjoy tax immunity.
This suggests the ECA follows a narrow interpretation of its remits, at least when compared to the sometimes detailed studies undertaken by the GAO, notwithstanding the fact that even the GAO's mandate is limited - see section I.2. above.

[33] See Articles 32 and 33-ESCB.
[34] It should be noted that neither the GAO nor the ECA 'approve' the financial statements of the Fed and the ECB respectively. They follow these institutions 'critically'. They do not replace the external auditors.
[35] Report by the Court of Auditors on the audit of the operational efficiency of the management of the ECB for the financial year 2000. (Official Journal of the European Communities, C341, Volume 44, 4 December 2001.)

Article 28:

Article 28 (Capital of the ECB)

"28.1 The capital of the ECB, which shall become operational upon its establishment, shall be ecu 5 000 million. The capital may be increased by such an amount as may be decided by the Governing Council acting by the qualified majority provided for in Article 10.3, within the limits and under the conditions set by the Council under the procedure laid down in Article 42.

28.2 The national central banks shall be the sole subscribers to and holders of the capital of the ECB. The subscription of capital shall be according to the key established in accordance with Article 29.

28.3 The Governing Council, acting by the qualified majority provided for in Article 10.3, shall determine the extent to which and the form in which the capital shall be paid up.

28.4 Subject to Article 28.5, the shares of the national central banks in the subscribed capital of the ECB may not be transferred, pledged or attached.

28.5 If the key referred to in Article 29 is adjusted, the national central banks shall transfer among themselves capital shares to the extent necessary to ensure that the distribution of capital shares corresponds to the adjusted key. The Governing Council shall determine the terms and conditions of such transfers."

(to be read in conjunction with Article 1-ESCB (establishment of the ESCB/ECB), Article 10.3-ESCB (weighted voting), Article 29-ESCB (capital key), Article 32-ESCB (monetary income allocation), Article 33-ESCB (maximum to ECB's reserve fund), Article 42-ESCB (complementary legislation) and Article 48-ESCB (transitional provisions for the capital share of NCBs of countries with a derogation))

I. INTRODUCTION

I.1 *General introduction*

We shall deal here exclusively with the genesis of paragraphs 1, 2 and 4 of Article 28, as the other paragraphs are not relevant for our study into the checks and balances of the ESCB. In September 1990 the governors decided that the central institution of the new central bank system should have legal personality.[1] This had already been the working assumption of their Alternates, who had developed the idea that the NCBs should provide the capital and hold the

[1] If the System would have received legal personality, the NCBs would most likely have lost theirs. In that case the shares of the NCBs would have had to be cancelled (possibly leading to large pay-outs to their shareholders, i.e. their governments, due to accumulated NCB profits) and the ECB capital would have been the capital of the whole system. The Member States would have been the most likely candidates to provide the System's capital.

shares of this central institution. During the IGC France proposed to make the member states the holders of the ECB capital. This was not accepted.
Shares may not be transferred, except among the NCBs themselves if necessitated by an adjustment of the capital key which determines the distribution of the shares among the NCBs. Therefore, shares in the ECB's capital cannot be held by private parties, which by the way is the case for some NCBs.[2] A special arrangement was set up for the countries with a derogation (or an opt-out). All EU member state NCBs are member of the ESCB. This membership is made visible by their participation in the General Council (an advisory body) and by the fact that their share in the ECB's capital is already 'reserved' for them. However, they do not yet pay up their subscribed capital. These central banks may be asked (and in fact have been) to pay in a small share of their capital contribution to help defray the costs made also for them by the System (Art. 48-ESCB). The central banks of derogation countries do not participate in the Governing Council. [3]

I.2 *Relevant features of the Federal Reserve System*

The Federal Reserve System, established in 1913, has a mixed private-public character.[4] Since 1836 the United States had been without a central bank.[5] This led to recurring bank panics. In 1911 a bi-partisan National Monetary Committee (the 'Aldrich Committee') had studied the central banks of Europe and had recommended the establishment of one central institution empowered to issue currency and rediscount commercial paper, governed by a board of commercial banks. However, the elections of 1910 had given the Democrats control of Congress. The populists among the Democrats hated the New York 'money trusts' and favoured a decentralized system controlled by the government. A draft act fashioned largely by Virginia Representative Carter Glass moved through Congress in 1913. It called for 20 or more *privately* controlled regional banks that would hold reserves and issue currency. President Wilson (elected in 1912) however asked for a 'capstone', a publicly appointed Federal Reserve Board to provide uniform guidelines for the regional banks. The act was adjusted and narrowly passed Congress. Most banks would eventually become members of the FRS, though they remained overtly hostile to the legislation throughout 1913.[6]
While the Federal Reserve Board (renamed into 'Board of Governors' in 1935) is a governmental agency (with legal identity, but without shareholders), the FRBs have a corporate charter with the shares being owned by their member banks. The shareholders of each FRB receive a fixed dividend, the surplus profits flow to the US Treasury. The influence

[2] An example is the Banca d'Italia. Its shareholders are banks (including state banks), insurance companies and social security institutions (Statute of the Bank of Italy (1936), Article 3). The shares of the Belgian central bank are also partially in hands of private sector agents (see By-laws of the National Bank (1939), Chapter II).
[3] In the articles relating to voting and the transfer of foreign reserves to the ECB, 'shareholder' refers only to central banks of Member States without a derogation (Art. 43-ESCB, par. 3 and 4). See also under Article 1, sections I.1 and II.3.
[4] The rest of this section follows a publication by the FRB of Atlanta, under 'A History of the Atlanta Fed - Origins of the System', available on its website (February 2002).
[5] In that year president Andrew Jackson did not renew the charter of the Second Bank of the United States.
[6] Originally only member banks had access to the discount window of their FRB and only member banks were required to hold minimum reserves at their FRB. This was extended to all depository institutions in 1980 (see appendix 2 at the end of cluster II) and see also Article 3.3, section I.2.

of the shareholders is very limited.[7] The member banks elect six out of the nine members of their board of directors; however, the chairman of the board has to be chosen from among the three board members appointed by the Board of Governors.[8] Furthermore, the Board of Governors has to approve the appointment of the president (the 'ceo') of each FRB, it sets the reserve and margin requirements, it has to approve changes in the discount rate of the FRBs and it exercises general supervision over the FRBs.[9]

II.1 HISTORY: DELORS COMMITTEE

The Delors Committee did not touch upon the issue of capital for the ECB. In fact, the Delors Report never used the words 'European Central Bank'. It did refer to 'a new monetary institution',[10] but this was meant to refer to a *system* based on the existing central banks. This system was named *European System of Central Banks* (ESCB). As to its structure, the Delors Report suggested the system should be governed by 'an ESCB Council (composed of the Governors of the central banks and the members of the Board)'.[11] Therefore, the expression 'ESCB Council' did not necessarily reflect the idea of an additional full-fledged central bank. It could also be read as referring to an overarching governing structure. These are also the terms in which Bundesbankpresident Pöhl expressed himself in a lecture, held in Paris on 16 January 1990.[12] Pöhl stated the ESCB 'could function with a comparatively small staff, say, a number similar to that of the Board of Governors of the Federal Reserve System, as executive functions could largely be transferred to the well-established systems of the national central banks [....]. Numerous other questions have to be answered, such as: how the voting rights are to be determined in a European central banks council; where the ECBS[13] is to have its domicile; [....]' This explains there were no thoughts on the financial structure of the system. Below we will first describe the result of the discussion on the legal situation of the system, which is relevant for the way it should be capitalized.

II.2 HISTORY: MONETARY COMMITTEE AND COMMITTEE OF GOVERNORS

At the time the first drafts of the ESCB Statute were produced by the Secretariat of the Committee of Governors under the guidance of Jean-Jacques Rey, the (Belgian) chairman of the Alternates, a *draft* of a report of the **Monetary Committee**[14], called 'Economic and Monetary Union Beyond Stage 1 - Orientations for the preparation of the IGC'[15], had been available to the Committee of Governors. The Monetary Committee's report had left open the

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[7] Their influence might have been more significant in the early years, when the FRBs were active players in the open market – see also appendix 1 to cluster II and Art. 12.1a, section I.2, in cluster III.
[8] FRA-1988, Section 4.
[9] For more on the relation between the Board and the FRBs, see Art. 14.3-ESCB, section I.2, in cluster II.
[10] Delors Report, par. 31 and 32.
[11] Delors Report, par. 32.
[12] See Bundesbank Presseauszüge.
[13] At that time Pöhl preferred to use the term European Central Bank System, instead of European System of Central Banks.
[14] An advisory expert committee consisting of the highest officials of the Treasury departments and board members of the NCBs.
[15] This draft was dated 26 March 1990. The final version would be dated 19 July 1990 and can be found in HWWA (1993). The draft of 26 March 1990 has been published by Agence Europe in *Europe Documents*, N. 1609, 3 April 1990.

internal constitutional structure of the ESCB. In fact, a sentence used in an earlier draft of their report, which stated that 'the System will consist of *a central organ* and the national central banks',[16] had been suppressed after a first discussion in the Monetary Committee.
This ambiguity was reflected in the first discussions among the Alternates of the **Committee of Governors**. The first draft of the Statute (that of 11 June) referred to a European Central Bank, and not to an overarching board or council:

> 'Article 1 - The ESCB and the ECB
> A European System of Central Banks [European Central Bank System], consisting of a central monetary institution [European Central Bank] and the national central banks [whose currencies participate in the monetary union] is hereby established.'
> draft 11 June 1990

However, the second draft version of the ESCB Statute (that of 22 June) contained the following comment as to the name of the central body[17]: 'the name of the central body requires clarification; it could be called the 'European Central Bank'. This name would probably imply that the central body carried out a substantial share of the financial operations of the system. This option has found little support amongst Alternates. Alternatively, a name reflecting a lower profile (Board, Council, Agency) could be adopted to reflect a more decentralised pattern of operations, in line with the principle of subsidiarity.' [18]

The governors did not come to a conclusion on this matter during their July meeting, as their opinions already clashed on the name of the system. Pöhl insisted to use the name 'European Central Bank System' instead of 'European System of Central Banks', because he wanted to stress the unity of the system. The governors did agree on using the word 'central institution', and not to refer to a 'central body'.
The September meeting[19] started with an introduction by Baer (Secretary General of the committee's secretariat) on the findings of the legal experts as regards the desirable legal structure of the system. They advised to bestow legal personality on the central institution whilst maintaining the separate legal personality of the NCBs.[20] This was seen as compatible with the assumption that the System should be able to operate through both the central institution and the NCBs. Duisenberg insisted on a discussion on the name of the central institution. The outcome was to name the system: the European System of Central Banks, consisting of the European Central Bank and the NCBs. The name (European Central Bank) was in line with the wish of most governors to create the image of a strong centre[21], thereby

[16] Emphasis added by the author.
[17] Comment (c) accompanying Article 1 of the draft ESCB Statute of 22 June 1990.
[18] The central bankers might have had in mind the example of their own Committee, officially called the Committee of the Governors of the Central Banks of the Member States of the European Economic Community, established by Council Decision of 8 May 1964 (64/300/EEC). Their Committee consisted of a council which met ten times a year and was supported by a staff, which was paid out of yearly contributions by the NCBs. (See the Committee's Rules of Procedure, Art. 7-5.)
[19] Governors' meeting of 11 September 1990.
[20] The alternative would have been to bestow legal personality on the System as such. See under Article 1, section II.2.
[21] See under Art. 1, section II.2 and Art. 12.1-ESCB, first and second paragraphs, section II.2.

increasing the credibility of the system, while at the same time leaving open the option of a decentralized implementation .[22]

The **Alternates** had in the meantime discussed issues relating to the financial provisions of an ESCB. In June the British Alternate Crockett had written a note based on the assumption that the NCBs would remain separate entities that would jointly own the central institution (CI). His note also assumed that some of the assets of the NCBs would be transferred to the CI, principally in the form of capital, and that the balance sheets of the CI and the NCBs would be such as to enable all the institutions to be self-financing. The note continued that one extreme case would be where virtually none of the NCBs' assets were transferred; in these circumstances the CI would have no income to meet the expenses of the ESCB Council's activities and would, like the EC Governors Committee at that moment, need to be financed by contributions from the NCBs.[23] Crockett assumed future capital increases should be possible, but considered these to be technical operations, in the sense that risk would only be transferred within the ESCB. In line with this, Crockett assumed NCBs would be the sole subscribers to and holders of the capital of the CI. Tietmeyer went along reluctantly: he was afraid this would create the impression that the centre would be subject to the NCBs.[24] In September Article 25 would read as follows:

'Article 25 - Capital of the Central Institution

25.1 The capital of the CI shall, upon its establishment, be ecu [x] million. The capital may be increased from time to time by such amounts as may be decided by the Council [of the ESCB] acting by qualified majority.

25.2 The NCBs shall be the sole subscribers to and holders of the capital of the CI. The distribution of capital shall be according to the key attached to this Statute.

[25.3 The Council shall determine the form in which capital shall be paid-up.]'

draft 5 September 1990

This was close to the final outcome of the draft ESCB Statute as sent to the IGC on 27 November 1990.[25]

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[22] This was a crucial decision for the internal relations within the System. It touches upon the checks and balances between the ECB and the NCBs, which is dealt with below under Cluster II.

[23] In the end, the IGC would decide that the ECB would be endowed with a considerable amount of foreign reserve assets, viz ecu 50 billion (reserves of the NCBs pooled in the ECB - see Art. 30-ESCB).

[24] At that stage Tietmeyer favoured the system having a strong centre and one single balance sheet. He was afraid of competition between central banks. And in line herewith he favoured Member States being the shareholders of the ECB (report of the meeting of the Alternates on 20 July 1990). He would change his mind after it became clear that the system would be directed from the centre.

[25]

'Article 29 - Capital of the ECB

29.1 The capital of the ECB shall, upon its establishment, be ecu [x] million. The capital may be increased from time to time by such amounts as may be decided by the Council acting by qualified majority.

29.2 The NCBs shall be the sole subscribers to and holders of the capital of the ECB. The subscription of capital shall be according to the key attached to this Statute.

29.3 The Council, acting by qualified majority, shall determine the extent to which and the form in which capital shall be paid-up.

29.4 The shares of the NCBs in the subscribed capital of the ECB may not be transferred, pledged or attached other than in accordance with a decision of the Council [of the ESCB].

29.5 If the key attached to this Statute is modified [etc.]'

draft 27 November 1990

II.3 HISTORY: IGC

The Commission draft did not elaborate on the issue of who should hold the shares of the ECB.[26] The German delegation did initially not present a draft text, as they supported the governors' draft in its entirety, being the outcome of sensitive negotiations.[27] The French would - repeatedly, but unsuccessfully - propose to make the Member States the shareholders of the ECB. The French draft Treaty text contained the following article:

> " Article 2-6
> 1. Le capital de la Banque centrale européenne est détenu par les Etats members." [28]
>
> French draft 26 January 1991

During the meeting of the IGC deputies on 21 May 1991 it appeared that the UK supported the French view. Spain hesitated, others were firmly opposed. The French delegation (de Boissieu) argued member states should have a say in matters like management and personnel policy, the size of the capital and the domicile of the ECB. He also pointed to the fact that any losses of the ECB would be felt by the budgets of the national governments. Haller (German Finance Ministry) disagreed: losses would be carried by the NCBs.
As regards the procedure for increasing the size of the capital, Wicks (UK Treasury) succeeded in soliciting support for the view that the Council of the ECB should not be allowed to increase the size of the capital without the approval of the Ecofin Council. He was supported by Ireland, Portugal, Greece and the Netherlands. Draghi (Italian Treasury) and Rieke (Bundesbank)[29] disagreed: according to Rieke the size of the capital was not a crucial matter and should therefore be left to the council of the ECB.[30] Wicks' point was taken on board by the Luxembourg presidency:

It is interesting to note that the Commentary accompanying the draft Statute mentions that the right of the ESCB's Council to increase the ECB's capital from time to time and to determine the extent to which and the form in which this capital is to be paid represents an important element of financial autonomy.

[26] The Commission though proposed that the ownership of the foreign reserves would be transferred 'to the Community' (as in their view the Eurofed was to act in the foreign exchange markets on behalf of the Community). See Commission draft Treaty text of 10 December 1990 (published in HWWA (1993): Art. 106b and accompanying commentary).

[27] In February they presented a draft, largely concentrating on the economic side of EMU, the content of stage two and the transitional provisions.

[28] The shares would be distributed over the member states according to a table annexed to the Treaty. (Art. 2-6(2)-French draft.)

[29] Germany negotiated with both a Treasury representative and a central banker at the table (front-bench), where the other delegations seated a Treasury representative (usually the Treasury member of the Monetary Committee) and their permanent representative in Brussels (i.e. their Ambassador at the EC).

[30] The Committee of Governors viewed the provisioning of capital by the NCBs to the central institution technically as a transfer of risk within the System. In the words of the British Alternate, Crockett, in his letter of 27 June 1990 to Rey (mentioned in section II.2 above): 'Since the provision of capital by the NCBs to the CI would be a transfer of risk within the ESCB it is also assumed here that there would be no need for decisions on capital matters to receive external approval (e.g. by ECOFIN).'

"Article 28 - Capital of the ECB

28.1 The capital of the ECB shall, on becoming operational, be ECU 5.000 million.[31] The capital may be increased by such amounts as may be decided by the Council of the ECB acting by a qualified majority provided for in Article 10.3, within the limits and under the conditions set by the Council [of Ministers] under the procedure laid down in Article 42.

28.2 The NCBs [on behalf of the Member States][32] shall be the sole subscribers to and holders of the capital of the ECB. The subscription of capital shall be according to the key established pursuant to Article 29.

[....]

28.4 The shares of the NCBs in the subscribed capital of the ECB may not be transferred, pledged or attached other than in accordance with a decision taken by the Council of the ECB.

[....]"

Luxembourg's non-paper 6 June 1991

This procedural change, i.e. to involve the Ecofin, would affect Art. 33.2, because Art. 33.2 borrowed its procedure from Art. 28.1. (Article 33.2 described the procedure for offsetting losses incurred by the ECB by contributions of the NCBs referred to the procedure of Article 28.1.) In their letter to the IGC containing comments on Luxembourg's non-paper of 6 June 1991[33], the Committee of Governors accepted a role for the Ecofin Council in Art. 28.1, but not in Art. 33.2, arguing that such a procedure for loss-covering would be inconsistent with the integral character of the System. The net profits and losses of the ECB formed part of the System's common income. As all profits earned by the ECB (other than those transferred to its reserves) would be re-channelled to the NCBs, the same procedure should apply equally to allocation of losses to the extent that they are not covered by the ECB's reserves. The operational flexibility of the System would be significantly impaired if, in the event of recourse to contributions under 33.2, the ECB Council would have to request a decision under secondary legislation for the increase in the ECB's capital. In the same letter the Governors observed that 'in order to emphasise the integral character of the System the NCBs should be shareholders of the ECB'. This last remark would be taken on board by the Dutch presidency in their draft Treaty proposal of 28 October 1991[34], by deleting the bracketed reference to Member States in Art. 28.2.[35]

[31] The ECB would be allowed to build up a general reserve of up to 100 % of its capital (Art. 33.1(a)-ESCB). The amount of ecu 5 billion had been mentioned by the German delegate Köhler during the meeting of the IGC deputies on 10 May 1991. (Notes of the author.)

[32] The text between brackets reflected the minority position of the French and the British.

[33] CONF-UEM 1617/91, 5 September 1991.

[34] UEM/82/91.

[35] It would take another letter of the Committee of Governors, in which they reiterated their objections to applying the procedure of Art, 28.1 to Art. 33.2, for the Dutch presidency to take that remark on board also. See UEM/101/91 of 13 November 1991 (Comments and suggestions of the Committee of Governors to the IGC) and UEM/112/91 of 22 November 1991 (Consolidated version of revised EMU texts).

"Article 28 - Capital of the ECB

28.1 The capital of the ECB shall, becoming operational upon its establishment, be ECU 5 000 million. The capital may be increased by such amounts as may be decided by the Governing Council acting by the qualified majority provided for in Article 10.3, within the limits and conditions set by the Council [of Ministers] under the procedure laid down in Article 42.

28.2 The NCBs shall be the sole subscribers to and holders of the capital of the ECB. The subscription of capital shall be according to the key established pursuant to Article 29.

[....]

28.4 The shares of the NCBs in the subscribed capital of the ECB may not be transferred, pledged or attached other than in accordance with a decision taken by the Governing Council.

[....]"

Dutch presidency's draft 28 October 1991

During the marathon session of the *ministerial* IGC on 30 November to 3 December 1991, Trichet (French Treasury) proposed on behalf of Bérégovoy that: 'The NCBs shall be the sole subscribers to and holders of the capital of the ECB either for their own account or for the account of the Member States.'[36] Trichet invoked Mitterrand, saying Mitterrand had strong feelings in this regard.[37] France received support from the UK, Italy, Spain and Ireland, while Germany, the Netherlands and Belgium were clearly opposed, with the other countries being rather neutral. The Dutch presidency did not take this on board and France made a (political) reservation. It is not clear whether this point was raised during Maastricht. In any case, the article was not changed.[38] Shareholdership of the Member States would have given them a potentially strong grip on the ECB for all issues where the Governing Council takes decisions with weighted voting and possibly also for approving the ECB's budget and high level staff appointments.

[36] Amendement proposé par M. Bérégovoy. Available in archives of Dutch Ministry of Finance.

[37] Internal report of this meeting of the Netherlandsche Bank, BK217, dated 5 December 1991.

[38] For consistency reasons Art. 28.4 would be edited to read: "Subject to Art. 28.5, the shares of the NCBs in the subscribed capital of the ECB may not be transferred, pledged or attached." (See UEM/112/91, 22 November 1991.) Art. 28.5 refers to the redistribution of shares among NCBs following an adjustment of the capital key.

Article 41:

Article 41: Simplified amendment procedure

41.1. In accordance with Article 106(5) of this Treaty, Articles 5.1, 5.2, 5.3, 17, 18, 19.1, 22, 23, 24, 26, 32.2, 32.3, 32.4, 32.6, 33.1(a) and 36 of this Statute may be amended by the Council, acting either by a qualified majority on a recommendation from the ECB and after consulting the Commission, or unanimously on a proposal from the Commission and after consulting the ECB. In either case the assent of the European Parliament shall be required.

41.2. A recommendation made by the ECB under this Article shall require a unanimous decision by the Governing Council.

(to be read in conjunction with Art. 25.2-ESCB and Art. 105(6)-EC (Enabling clause for specific supervisory tasks), Art. 106(5)-EC (reflecting the same wording as Art. 41-ESCB))

Also containing a description of the genesis of Article 42

"Art. 42 - Complementary legislation
In accordance with Art. 106(6) of this Treaty, immediately after the decision on the date for the beginning of the third stage, the Council, acting by a qualified majority either on a proposal from the Commission and after consulting the European Parliament and the ECB or on a recommendation from the ECB and after consulting the European Parliament and the Commission, shall adopt the provisions referred to in Articles 4, 5.4, 19.2, 20, 28.1, 29.2, 30.4 and 34.3 of this Statute."

I. INTRODUCTION

I.1 *General introduction*

The drafters of the Statute (i.e. the Committee of Governors) realized it was impossible to write a Statute which would accommodate every future development. Therefore, they included in the Statute an article containing a procedure for amending articles dealing with technical and operational aspects of the System without having to go through the cumbersome process of an official Treaty change. The procedure for an official Treaty amendment is explained in Article N of the Maastricht Treaty. The procedure entails calling an official Intergovernmental Conference, which has to agree on amendments, which subsequently have to be ratified by all Member States according to their national ratification procedures - a process which is cumbersome and could take several years. Also, one country could block the outcome. In other words, even technical changes could be held hostage by one country, wanting to trade the outcome for the outcome on another dossier. This could politicize monetary affairs. At the same time the governors realized that a text with Treaty status could not be changed by them afterwards without applying the regular Community procedures, which implies approval by the Ecofin Council. In their draft Statute of 27 November 1990

they would substitute themselves for the Commission as the party which could initiate the amendment procedure. This was not contested during the first half of the IGC, possibly because the idea was that the Commission had in fact no monetary competence. However, the Dutch presidency had made strengthening the role of the Commission and parliament into one of its priorities. This led to a reinsertion of the Commission's right of initiative.
The governors also proposed to include a *general* enabling clause, which would allow the Council of Ministers to endow the ESCB with *new tasks*. This idea would be deleted by the Luxembourg presidency of the IGC, when it became clear that such a decision could have clear non-technical implications.[1] Adding new tasks is still possible, but only through an agreement during a full IGC followed by ratification by all Member States, which procedure can be seen as a protection against efforts to dilute the System's objective.

The governors did make a distinction between the simplified amendment procedure and the procedure for initiating complementary Community legislation necessary for the application of certain articles. This last procedure is provided for in **Article 42**. Article 42 relates to articles whose application requires complementary Community legislation defining in more detail the scope and limits of the obligations the System may impose on third parties in the context of performing its duties. Examples are: the obligation for *Member States* to consult the ECB before adopting national legislative provisions in the field of the ECB's competence; the obligation for *natural and legal persons* to report statistical information; and the obligation for *credit institutions* to hold minimum reserves on accounts of the ECB and/or the NCBs. In this area the governors envisaged an exclusive right of initiative for the Commission.

I.2 *Relevant features of the Federal Reserve System*

The Federal Reserve Act (FRA) does not have constitutional status: it has the status of a law. In the United States laws are drafted and agreed upon by Congress and signed by the president of the United States, which procedure itself is a safeguard against the possibility that the executive or the legislative branch would be able to increase its grip on (in this case) the Federal Reserve. Congress may change the FRA like any act, requiring a majority in both houses and approval by the president. If the president refuses to sign, he can be overruled by a two-thirds majority of Congress.[2]

[1] IGCs are regularly held: in 1991, in 1996 ending in the Treaty of Amsterdam, and in 2000 ending in the Treaty of Nice. The IGC of 2000 has been used to amend Art. 10 of the ESCB Statute, introducing an article that allows for a change of the voting arrangements within the Governing Council (Art. 10.6). However, the smaller countries successfully insisted on a procedure still requiring national ratification in each Member State, though without the need for having to convene an IGC. These smaller countries, especially the Netherlands and Portugal, had been active in preserving the Treaty status of Art. 10.2 as much as possible, because they feared that the larger countries might try to impose a voting arrangement giving preferential treatment to the governors of the central banks of the larger countries (see Art. 10.2-ESCB in cluster II).
[2] Two-thirds both in the House of Representatives and the Senate. Article I, section 7, American Constitution.

II.1 HISTORY: DELORS COMMITTEE

No one within the Delors Committee disputed that EMU needed to be based on a Treaty.[3] The Delors Report did not go into such detail, as to mention the idea of a Statute contained in a Protocol. Protocolized Statutes were a regular feature in the EC; for instance the Court of Justice and the EIB had their Statutes annexed to the Treaty. The idea of taking the initiative in drafting the Statutes of the future European central bank system was mentioned by Pöhl during the meeting of the Committee of Governors on 10 April 1990. Such statutes 'would, for instance, cover matters such as the organization, functions, instruments, voting rights and accession to such institution.' Pöhl's aim was that the governors 'could present a text with alternatives, enabling the governments to be aware of the consequences of transferring power to a central institution.' He did not aim for real negotiations between the governors, because that might 'last for a very long time.' Commissioner Christophersen, present at that meeting, welcomed this initiative, because it would be very useful and make it possible, in particular, to draw up more clearly the more general provisions for the Treaty.
The idea of a Protocol was first mentioned in a Commission document of May 1990.[4] In this document the Commission suggested the following: 'The Statutes of the EuroFed shall be laid down in a protocol attached to the EEC Treaty. On a proposal from the EuroFed Council, the Council of Ministers, after receiving the opinions of the Commission and Parliament, may unanimously amend the following provisions *[ ]* of the Statute.' [5] In fact, we see that the Commission itself at that stage did not claim the right of initiative.

II.2 HISTORY: COMMITTEE OF GOVERNORS

The idea of a specific amendment procedure appeared in a note of the Secretariat of the Committee of Governors to the Committee of Alternates of 11 June 1990.[6] A footnote referred to precedents, like Art. 165 of the EEC Treaty and Art. 4 and 7 of the Protocol on the Statute of the European Investment Bank. These articles opened the possibility for specific, well-defined amendments (like increasing the number of Judges of the Court or altering a method of converting sums expressed in units of account into national currencies and vice versa). These amendments were to be decided by the ministers 'at the request' of the Court of Justice or the EIB's Board of Directors. In these specific cases the Commission had no right of initiative nor was there an obligation to consult the Commission. A draft for a similar specific provision would only appear in early 1991, when the Committee started preparing the chapter with the so-called General Provisions, which was the most logic place for such an article.

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[3] Delors Report (1989), par. 61-63. More specifically, it mentioned that the transfer of monetary sovereignty to a Community level required a Treaty change, while a new Treaty would also be required to ensure parallel progress in the economic and monetary field. The Delors Report mentioned two routes: a single comprehensive Treaty or a new Treaty for each successive stage.
[4] 'Economic and Monetary Union - Institutional Note', circulated in May 1990 to the Committee of Governors for information and comments, and later to the Irish presidency. At that stage the document still had to be discussed by the full Commission.
[5] Section II.7 of said document. This idea was supported by the Alternates of the Committee of Governors in their first meeting devoted to developing draft ESCB Statutes, held on 29 May 1990 in the splendid Salle dorée of the Banque de France in Paris.
[6] 'Legal Foundations of the ESCB - Introductory Report', section II.3.

In the meantime the idea of a *general* enabling clause, allowing the Council of Ministers to confer additional tasks to the ESCB, appeared in the draft version of the ESCB Statutes of 22 June 1990:

> Article 3.2
> 'Other tasks may be conferred by a Decision of the Council of the European Communities [= the Ministers] in order to promote the primary objectives of EMU whilst respecting the objectives contained in Article 2 of the present statutes.'
>
> draft 22 June 1990

At the end of June words were inserted to make clear the article could only be activated following a proposal from the System.[7] By September the text read:

> Art. 3.2
> 'Following a proposal from the System, other tasks may be conferred by a [unanimous] [qualified majority] decision of the Council of the European Communities in order to promote the primary objectives of EMU whilst respecting the objectives contained in Article 2 of the present Statute.'
>
> draft 5 September 1990

During the governors' meeting of 11 September the Committee agreed with the Irish governor (Doyle) that the Treaty might be a more appropriate place for a general enabling clause. It was decided to delete the article from Art. 3 and to point out the need for such a Treaty article in the Comments to be transmitted together with the draft Statute to the IGC. During the same meeting Pöhl remarked that it was important to maintain the idea that the initiative should come from the System and that such a Council decision should be subject to a voting procedure requiring more than a simple majority.

In September the legal experts were consulted on the draft version of 14 September. They advised to include in the Statute a simplified amendment procedure for revising certain articles of a more technical nature and for conferring new tasks upon the System.[8] They recommended to use only one simplified amendment procedure.[9] As the legislative process of the Community was expected to be revised in the context of the IGC on Political Union, the legal experts did not prepare concrete draft proposals. Therefore, the November version of the Statute sent to the IGC merely announced such a provision was in the making. The legal experts had furthermore agreed among themselves - and in defiance of the preference of the Alternates Committee - that democratic legitimacy required the system 'should not be afforded the exclusive right of initiative'.[10] This issue was touched upon in a very indirect manner in the Commentary accompanying the draft version of 27 November, where it was stated that '[d]emocratic legitimacy requires that amendments or complements to the Statute are in accordance with the legislative process of the Community.'[11]

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[7] As suggested by Szász, the Dutch Alternate. Tietmeyer (Bundesbank) and Crockett (BoE) remarked they could do without the article, but Lagayette (BdF) favoured retaining the article.
[8] Note by the Secretary-General of the Secretariat of the Committee of Governors, 28 September 1990.
[9] Chairman's summary, dated 8 October 1990, of the meeting of Legal Experts on the draft Statute, p. 7-8.
[10] See draft Statute, version of 19 October 1990, comments to chapter IX.
[11] Commentary on chapter IX.

In the meantime and following a separate track the Banking Supervisory Sub-Committee had developed for inclusion in the Statute a specific enabling clause in the area of prudential supervision. The governors took this proposal on board in their draft of 27 November 1990, which was sent to the IGC.[12]

The Committee's draft version of April 1991[13] introduced an article providing for a simplified procedure for amending some articles (Art. 41.1), as well as an article, using the same procedure, for conferring additional tasks to the ESCB (Art. 41.2). The right of initiative was restricted to the System, a justification for which was presented in the accompanying comments:

"Article 41 - Simplified amendment procedure

41.1 By way of derogation to Article 236 [14] of the EEC Treaty, Articles 5, 17, 18, 19, 21.2, 21.3, 21.4, 21.5, 22, 23, 24, 26, 32 and 36 may be amended by the Council [of Ministers], at the request of the ECB and after consulting the European Parliament and the Commission. The approval of the ECB's request for amendment requires a decision of the Council [of Ministers] acting by a qualified majority.

41.2 Article 3 may be amended by the Council [of Ministers] in accordance with the procedure referred to in Article 41.1 to the extent necessary to confer upon the System additional tasks which are not at variance with the System's objectives stated in Article 2 and do not impinge on the System's basic tasks defined in Article 3.

41.3 A request made by the ECB under this Article shall require a unanimous decision by the Council of the ECB."

governors' draft Statute 26 April 1991

The accompanying *Commentary* read as follows:[15]
" [....]. As the procedure only relates to provisions dealing with operational and technical aspects of the System,[16] Article 41 confers the exclusive right of initiative to the ECB. [....]
Article 41.2 enables the Council of the ECB to amend also Article 3 in accordance with the simplified amendment procedure; however, this possibility only refers to additional tasks (and not to the basic tasks as currently defined in Article 3)[17]; in addition, these additional tasks

[12] See Art. 25.2-ESCB.
[13] In April 1991 the governors submitted to the IGC a more complete draft of the ESCB Statute, now including the financial provisions and a chapter with general provisions, which had been left open in the November 1990 version. CONF-UEM 1613/91, 29 April 1991.
[14] Art. 236-EEC contains the normal procedure for amending the Treaty (Article N (later Art. 48) of the EU Treaty), i.e. an IGC and ratification by all Member States. This reference to Art. 236-EEC was later dropped as being superfluous.
[15] CONF-UEM 1613/91 ADD 1.
[16] The articles referred cover collection of statistical information (Art. 5), monetary functions and instruments of the ESCB (Artt. 17-24), financial accounts (Art. 26), allocation of monetary income (Art. 32) and an article relating staff (Art. 36). In the course of the IGC the list of articles would be changed by taking out some paragraphs of some of the articles and including Art. 33.1(a); see at the end of section II.3 below.
[17] In the governors' draft Article 3 only contained *basic* tasks (the task of participating in supervisory policies was still among them - see Art. 3.3).

have to be compatible with the objectives defined in Article 2 and the present basic tasks in Article 3. [....]"

It is clear that the governors wanted to introduce some flexibility, but also wanted to retain the exclusive right of initiative.

The draft version of 26 April 1991 also contained a first draft of Art. 42:

> **"Art. 42 - Complementary legislation**
> **The Council of the European Communities, acting by a qualified majority on a proposal from the Commission and after consulting the ECB and the European Parliament, shall enact the legislation necessary for the application of Articles 4.1, 5.3, 16.2, 25.2, 29.2, 30.4 and 34.3."**
>
> **governors' draft Statute 26 April 1991**

The *Commentary* states that the complementary legislation should be enacted according to the 'normal' legislative procedure. However, the ECB should be consulted prior to the adoption of the legislation.

II.3 HISTORY: IGC

The IGC deputies discussed the appropriate simplified amendment procedure during their meeting on 26 February 1991. This discussion took place before the governors presented their completed version of the draft Statute in April 1991 and was triggered by Art. 106(3) of the Commission working document of December 1990, containing already a light amendment procedure:

> 'The Statute of EuroFed and the European Central Bank is set out in a protocol annexed to this Treaty. The Council may, acting by a qualified majority at the request of the European Central Bank, amend Articles [....] of the Statute after consulting the Commission and the European Parliament.'
>
> Commission draft, December 1990

France had proposed a similar text in its draft Treaty text of 25 January 1991:

> Art. 5-7(2)
> "Le Conseil, statuant à l l'unanimité et après consultation de la BCE, peut confiér à cette dernière d'autres fonctions dans les limites prévues à l'article 2-4. [....]'
>
> French draft January 1991

During the meeting France more specifically proposed to introduce the possibility that Ecofin would be able to amend certain articles of the Statute by qualified majority if proposed by the ECB and by unanimity if not.[18] Köhler (Germany) and Maas (Netherlands) disagreed with the last proposition: such a proposal should anyhow always emanate from the ECB. Trichet and Boissieu (France) counterargued that this would de facto give the ECB a right of veto, which

[18] This was in line with French thinking as expressed in their draft Treaty text of 25 January 1991. Art. 5-7(2) read: "Le Conseil, statuant à l l'unanimité et après consultation de la BCE, peut confiér à cette dernière d'autres fonctions dans les limites prévues à l'article 2-4. [....]'

they did not like. Köhler also rejected a right of initiative for the Commission, because the Commission lacked any monetary competence. He also said he would mistrust any country proposing this, fearing political motives which could lead to interference with the ECB's monetary policy. The legal services of the Council explained that simplified amendment procedures applying to specific parts of the Treaty were possible, provided they were spelled out clearly. Reference was also made to Art. 168a-EEC, which gives the Court of Justice the exclusive right of initiative for certain amendments to the Court's statutes.[19] Wicks (UK Treasury) suggested the ministers should be able to decide to change any part of the Statute, though only by unanimity. As a number of delegations said their position on the appropriate procedure depended on the list of articles to which the procedure would apply, chairman Mersch told the representative of the Secretariat of the Committee of Governors it would be helpful if the Committee could establish a positive list of articles subject to simplified amendment.

In April the Committee of Governors presented an extended version of the draft Statute, now including chapters on the Financial and the General Provisions. Art. 41 of the draft ESCB Statute was discussed during the meeting of the deputies IGC of 21 May 1991. Wicks and de Boissieu proposed to give Member States the right to initiate amendments. Rieke (Bundesbank), Gaspar (Portugese Ministry of Finance) and Maas (Dutch Ministry of Finance) objected to this, arguing the provision was only meant for amending articles of a purely technical nature. When de Boissieu counterargued that amending Article 3 was by no means a technical matter, chairman Mersch found reason to delete Article 41.2. Perhaps somewhat surprisingly the Bundesbank delegate Rieke expressed reservations, but his motive was that he was reluctant to change anything at all in the draft Statute. Nonetheless, Art. 41.2 (i.e. the *general* enabling clause) was henceforth dropped.

Because Article 41.1 referred to the Ecofin Council, the article had to appear in the monetary chapter of the Treaty. The Luxembourg presidency drafted it largely along the lines of Art. 41 of the draft Statute:

Art. 106(4)[20]
'The statutes of the ESCB and the ECB shall be the subject of a protocol which is annexed to this Treaty and of which it forms an integral part. Without prejudice to Article 236, Articles 5, 17, 18 [19], 21.2, 21.3, 21.4, 21.5, 22, 23, 24, 26, 32.2, 32.3, 32.4, 32.6 and 36 of the Statutes may be amended at the request of the ECB, and following consultation by the Commission and the European Parliament, by the Council acting by a qualified majority.'
non-paper 12 June 1991[21] [22]

Article 106(4) was discussed very shortly during the deputies IGC of 1 October 1991 and the EMU Working Group on 2-3 October. The UK repeated its earlier position, France proposed

[19] Art. 168a(1): 'At the request of the Court of Justice and after consulting the Commission and the European Parliament, the Council may, acting unanimously, attach to the Court of Justice a court with jurisdiction to hear and determine at first instance, [....].' The article relates to the establishment of the so-called Court of First Instance.
[20] Later renumbered into Art. 106(5).
[21] UEM/52/91.
[22] Compared to the governors' draft, Art. 19 (relating to the possibility to impose minimum reserves) had been put between brackets and Art. 32.1 and 32.5 had been taken out of the list.

that Ecofin would decide by qualified majority, when the ECB supported such amendment, but otherwise act by unanimity. On 8 October Wicks argued against a role for the European Parliament in the procedure of Art. 106.4, arguing the EP also had no formal role either in approving the Treaty and the Statute. Other countries however could live with the proposed consultative role for the EP.

On 28 October the Dutch presidency presented a consolidated version of the EMU texts.[23] The Dutch presidency had made an effort to strengthen the role of the Commission and the European Parliament, inter alia in Art. 106: it proposed to give the Commission a shared right of initiative, and the European Parliament the right to approve ('assent') and, therefore, also the right to reject Council decisions amending the Statute.[24] Furthermore, following the procedure of Art. 168a-EEC, the presidency had changed 'qualified majority' into 'unanimity'. In the end, the assent procedure and the shared right of initiative for the Commission were retained.[25]
When the Council decides on a request of the ECB[26], it only needs qualified majority - reducing the risk that technical requests of the ECB are blocked, which possibility could be misused by a country seeking to put pressure on the ECB's monetary policy. This would have reduced the de facto independence of the ECB. The idea of a *general* enabling clause would pop up again in the EMU Working Group of 6 November, when the *specific enabling clause for prudential tasks* was discussed.[27] At that occasion Germany reluctantly accepted such a specific clause in the supervisory area as formulated by the Dutch presidency, provided it could only be activated by a unanimous decision of the Ecofin. France also went along, but suggested to turn the enabling clause into a general enabling clause, which suggestion however found no support.
The final form of Article 41 has been quoted at the beginning of section I. Below we quote for completeness sake the final form of Art. 106(5):

Article 106(5) (simplified amendment procedure) "Article 5.1, 5.2, 5.3, 17, 18, 19.1, 22, 23, 24, 26, 32.2, 32.3, 32.4, 32.6, 33.1(a) and 36 of the Statute of the ESCB may be amended by the Council, acting either by a qualified majority on a recommendation from the ECB and after consulting the Commission or unanimously on a proposal from the Commission and after consulting the ECB. In either case, the assent of the European Parliament shall be required." final version

Comparing the list of articles with those mentioned in the governor's draft, we note three differences:
1) Art. 5.4 (statistics) and Art. 19.2 (minimum reserves) relate to the need for complementary legislation in case of the collection of statistics and the imposition of minimum reserves

[23] UEM/82/91.
[24] Wim Kok, the Dutch finance minister and chair of the EMU IGC, shared the Ministry of Foreign Affairs' wish to defend as much as possible the 'constitutional' role of the Commission.
[25] The assent procedure had also been inserted in Art. 25.2 (the specific enabling clause in the supervisory area). That is where the analogy stops, because in Art. 25.2 the Commission has the exclusive right of initiative (in other words, there is no shared right of initiative for the ECB).
[26] Art. 41.2 (Art. 41.3 in the governors' draft) specifies that such a request requires unanimity within the Governing Council.
[27] See Art. 25.2-ESCB.

respectively. Changing these procedures would certainly not be technical. Art. 5.4 had already existed as the second sentence of Art. 5.3. Art. 19.2 had been introduced during the IGC at the request of especially the UK and Spain.[28] In the governors' draft Art. 19 entitled the ECB to require credit institutions to hold minimum reserves on accounts with the ECB and NCBs. This decision had been left completely to the ECB. However, minimum reserves can be a real burden for banks, when these reserves are high and unremunerated. Unremunerated minimum reserves were in use in a number of countries, among which Germany. The UK feared this practice would be detrimental to Europe as a financial centre.[29] This led to the introduction of Art. 19.2, laying down the need for secondary legislation before minimum reserves could be imposed.
2) In the governors' draft Art. 32 had been listed in Art. 41. However, Art. 32.1 defines the *principle* that the monetary income generated by the NCBs has to be allocated each year according the technical provisions of the rest of the article. Art. 32.5 defines the key for distributing this income among the NCBs (i.e. according to the paid-up shares in the ECB's capital). Both articles were not considered to be 'technical', and were thus taken out of Art. 41.
3) Art. 33.1(a) allowed the Governing Council of the ECB to transfer part of its annual profit to a general reserve fund of the ECB. During the IGC this transfer was limited in size and the general reserve fund was capped as well. Because the article had now become much more detailed, it was *added* to the articles listed in Art. 41.

Therefore two changes occurred during the IGC. The IGC improved somewhat on the list of articles, and it strengthened the roles of both the Commission and the European Parliament. However, in case of a proposal by the Commission the Ecofin should decide unanimously.

In case of **Art. 42** the IGC would strengthen the role of the ECB by giving it the right to initiate the procedure, be it on the basis of a recommendation. [30]

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[28] The idea of involvement of the Ecofin was first discussed during the deputies IGC meeting of 10 May 1991. This resulted in the addition by the Luxembourg presidency of a sentence reading 'The Council [of Ministers] shall, in accordance with the procedure laid down in Article 42, adopt the *general* rules for the implementation of that Article.' (Non-paper of 6 June 1991.) Germany, which feared the use of minimum reserves could be blocked, objected and the sentence was bracketed. The Dutch presidency specified exactly which elements of the minimum reserve framework the Ecofin Council would set and presented this in a separate paragraph of Art.19, which made it acceptable to Germany (UEM82/91, 28 October 1991). The Ecofin had to define a *ceiling* for the minimum reserves in terms of a maximum ratio and to decide over which bank balance sheet items this ratio would apply.

[29] During the EMU Working Group of 17 October 1991 the UK pointed to the risk of creating incentives for 'offshore banking'. The UK wanted the Ecofin to set a minimum rate of remuneration over these reserves, but did not succeed. Instead a reference to Art. 2 of the Statute was included in Art. 19.1, Art. 2 referring to the principles of an open market economy with free competition. Since the start of Monetary Union minimum reserves have been remunerated at market rates. These reserves are held at the local NCBs. The Ecofin Council has set the boundary for the size of the minimum reserves in Council Regulation 2531/98, dated 23 November 1998.

[30] The difference is that the Ecofin can amend a proposal from the Commission only by unanimity. Recommendation from the Commission are more easily amendable by the Ministers. See Article 189a-EC. One would assume that the same rule holds for recommendations by the ECB. (There are only a few other examples of a shared right of initiative, like Art. 109-EC, par. 1 and 2, in which cases the ECB and the Commission both 'recommend'.)

Article 109.1 and 109.2-EC:

Article 109-EC (exchange rate policy)

1. By way of derogation from Article 228[1], the Council may, acting unanimously on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach consensus consistent with the objective of price stability, after consulting the European Parliament, in accordance with the procedure in paragraph 3 for determining the arrangements, conclude formal agreements [2] on an exchange-rate system for the ecu in relation to non-Community currencies.[3] The Council may, acting by a qualified majority on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach consensus consistent with the objective of price stability, adopt, adjust or abandon the central rates of the ecu within the exchange-rate system. The President of the Council shall inform the European Parliament of the adoption, adjustment or abandonment of the ecu central rates.

2. In the absence of an exchange-rate system in relation to one or more non-Community currencies as referred to in paragraph 1, the Council, acting by a qualified majority on a recommendation from the Commission and after consulting the ECB or on a recommendation from the ECB, may formulate general orientations for exchange-rate policy in relation to these currencies. These general orientations shall be without prejudice to the primary objective of the ESCB to maintain price stability."

(to be read in conjunction with Article 2 (ESCB's objectives); Article 3(1) (ESCB's basic tasks); Article 7 (Independence); Article 3a (2)-EC (Community has a single exchange-rate policy); Article 109m-EC (Exchange rate policy of Member States with a derogation))

I. INTRODUCTION

I.1 *General introduction*

This is an article which even in its final form remained ambiguous. The ambiguity relates to where the final competence over exchange rate policy is located in the absence of a formally concluded exchange rate system. A basic question was whether the ESCB could be forced to

[1] Article 228-EC describes the comitology (Community procedures) for concluding agreements between the Community and one or more States or international organizations: the Commission makes a recommendation to the Council, the Council authorizes the Commission to open the negotiations, the Council concludes the agreement, usually by qualified majority (sometimes unanimity) and after consulting the European Parliament (in some cases: assent).

[2] Declaration nr. 8 ("Declaration on Article 109 of the Treaty establishing the European Community") of the declarations annexed to the 'Treaty of Maastricht' explains this expression is purely *sui generis*: The Conference emphasizes that use of the term 'formal agreements' in Article 109(1) is not intended to create a new category of international agreements within the meaning of Community law."

[3] The exchange-rate policy of a Member State with a derogation is ruled by Article 109m, see section II.3 below.

act in support of an exchange rate, for instance vis-à-vis the dollar, when these actions could undermine the maintenance of domestic price stability? [4]

The article cannot be understood without knowing its history. This history is long and intriguing and can best be apprehended against the background of the different traditions of the Member States. Traditionally the French authorities favoured a more activist approach, and they were less willing to accept the exchange rate as a market price. Also they tended to see the exchange rate as an international diplomatic tool. The British and German authorities were less activist, instead they were more inclined to accept the exchange rate as a normal price, i.e. the outcome of market forces. Traditions also differed among central banks: some central banks gave absolute priority to exchange rate stability vis-à-vis the Dmark, others also aimed for typically domestic monetary targets, such as domestic credit expansion. The priority given to exchange rate stability of course needed the backing of the political authorities to be credible in the markets. Such backing at the same time strongly increased the *de facto* independence of the central banks from the political authorities. During the eighties an increasing number of EU countries adopted a 'hard-currency policy' by giving high priority to exchange rate stability vis-à-vis the Dmark - though some were more successful than others.[5] Exceptions to this trend were Germany itself and the UK, which can be said to have given low priority to exchange rate stability (Germany vis-à-vis the US dollar[6] and the UK vis-à-vis the Dmark respectively).

Nonetheless, the central bank governors participating in the Delors Committee and later when drafting the ESCB Statute had difficulty in determining their position in the area of exchange rate policy. They knew decisions on exchange rate regimes would never become their exclusive territory, because in the past this had never been the case and also because the conclusion of an exchange rate required *political* commitment and therefore *political* decision-making. However, international exchange rate commitments could conflict with their domestic priority. i.e. to maintain price stability. Such had also been the (repeated) experience of the Bundesbank.[7]

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[4] For the ESCB's definition of price stability, see Article 2, section I.1.

[5] The lifting of capital controls forced countries to conduct sound macro-economic policies, as their exchange rates became more sensitive to market forces. For an overview of the abolishment of the last controls by EU Member States, see Bakker (1996), especially chapter 9.

[6] The onus for stabilizing the exchange rate between an ERM currency and the Dmark rested de facto with the non-Dmark currency. This is the so-called asymmetry of the ERM, which was especially criticized by France and Italy and which led to the Balladur memorandum of December 1987 (published in HWWA (1993), p. 337) and Amato's memorandum on the EMS of 1988 (published in HWWA (1993), p. 375; see also Dyson/Featherstone (1999, p. 500)).

[7] During the Bretton Woods era the fixed exchange rate of the Dmark with the (overvalued) dollar had triggered large scale capital inflows into Germany. These flows had distorted their M3 figure (a monetary aggregate), which the Bundesbank used as its leading monetary indicator. The capital flows were relatively more distortive for Germany than the same capital flows were for the - much larger - United States. Moreover, most of the time Germany was at the receiving end of the capital flows. Germany escaped this situation by letting the Dmark float in May 1971 and renewed in March 1973 (see Emminger (1986), chapter 6 and 7), where at earlier occasions Germany had used the possibility of a revaluation (Emminger, pp. 104-129 and p.149 ff.) This experience would be repeated - though on a lesser scale - within the framework of the Snake and the ERM (see Deutsche Bundesbank (1999), *Fifty Years of the Deutsche Mark*, p.752 and 766). When the EMS was established the German government committed itself to agree to the suspension of the Bundesbank's intervention requirements if its stability-oriented monetary policy was threatened (Deutsche Bundesbank (1999), p.758, and Emminger (1986), p.361). The ERM countries pegging themselves to the Dmark had not experienced such a conflict, as they used the Dmark as an external disciplining device. Obviously and for several reasons, the dollar can not

Against this background it is understandable that the central bankers preferred a narrow mandate, i.e. securing domestic price stability. Such a narrow mandate would also minimize the risk of political interference.[8] They accepted that decisions on the exchange rate regime (and parity changes) would be taken by the political authorities, in which area though they claimed a strong advisory role. Undecided was who would be responsible for formulating an exchange rate policy in the absence of a formal exchange rate agreement. During the IGC, it was decided that - in the absence of an exchange-rate system - the Council of Ministers could formulate 'general orientations for exchange-rate policy'. This specific wording was chosen at German insistence to make clear they would not be binding in a legal sense. Apart from that, the orientations have to respect the ESCB's primary objective of maintaining price stability.

I.2 *Relevant features of the Federal Reserve System*

In the **United States** exchange rate policy is the preserve of the Treasury, with the Federal Reserve only acting as a behind-the-scenes adviser. The Treasury's authority is based on the Gold Act of 1934 which established the Exchange Stabilization Fund.[9] Both the Treasury and the Federal Reserve hold foreign exchange assets. The decision to intervene is always taken by the Treasury. The Treasury and the Fed usually intervene, though not always, on a 50/50 basis.[10] All transactions are carried out by the New York Fed. Markets do not know *ex ante* whether the Fed has participated. However, this information can be found *ex post* in the 'statements on foreign exchange operations', which are published quarterly in the Federal Reserve Bulletin.[11] Furthermore, it is standard practice to sterilize the money market effect of interventions, though the size of the interventions is usually just background noise compared to the size of the daily open market operations. The only spokesperson/institution on exchange rate policy is the Treasury. The Fed (including Greenspan) is silent or at least evasive on this issue. This is in line with the division of responsibilities. It is not an example for the euro area, where competences are clearly more of a grey area than in the US. The most

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take over the role as anchor for the new European currency. First, business cycles are less well converged across the Atlantic than within the ERM area - implying that the monetary policy requirements of the two areas would regularly be out of sync. Second, the US traditionally has had higher inflation than Germany.

[8] There is slight resemblance between this issue and possible supervisory functions for a central bank. In both cases the Bundesbank did not want to fulfil 'quasi-political' responsibilities, for fear of being politicized. In both areas the Bundesbank preferred an advisory role, albeit a strong one.

[9] The Exchange Stabilization Fund of the United States Treasury was created and originally financed by the Gold Reserve Act of 1934 to contribute to exchange rate stability and counter disorderly conditions in the foreign exchange market. The Act authorized the Secretary of the Treasury, to deal in gold, foreign exchange, securities, and in instruments of credit, under the exclusive control of the Secretary of the Treasury subject to the approval of the President. The ESF may also provide short-term credit to foreign governments and monetary authorities. (See publications site of the NY Fed under: ESF.) This act gave the Treasury the primacy in the area of foreign exchange policy. Section 10.6 of the FRA(1913) determines that the Federal Reserve Act shall not be "construed as taking away any powers heretofore vested by law in the Secretary of the Treasury [....] and wherever any power vested by this Act [FRA] in the Board of Governors of the FRS or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary." *Constitutionally*, the power over the exchange rate policy rests with Congress (US Constitution, Section 8: "The Congress shall have Power [....] To coin Money, regulate the Value thereof, and of foreign Coin"). Congress has delegated this power to the Treasury by means of legislation, of which the Gold Reserve Act is an important element.

[10] There have been cases when the Fed did not participate, but these cases are reportedly very rare.

[11] If necessary, the ESF can be replenished by swaps with the Federal Reserve.

frequently used expression by the Secretaries of the Treasury over the last years is that 'a strong dollar is in the interest of the United States'.

Comparing the Fed and the ESCB
The governors could have opted for the American construction, where the Treasury determines the exchange rate policy and decides on the interventions. However, two differences between the US and the EU stand out. First, financial markets in the US were (and are) the largest in the world, implying that intervention in the dollar market has relatively limited effect on the domestic liquidity situation. And moreover, the Fed always sterilizes the domestic impact of foreign exchange interventions, which reduces the effectiveness of the interventions. Second, the US had developed a non-interventionist style as regards the exchange rate of its currency. In Europe, tradition was different; the exchange rate was considered to be an economically very important factor. The governors, especially those coming from relatively independent central banks, feared an activist approach by the political authorities, which might lead to restricting the freedom for the central bank, because it was their experience that exchange rate management required the use of the interest rate instrument, flanked by economic measures. What they arrived at was to secure prominence of the internal objective (price stability) over a possible external objective, except where this external objective follows from binding obligations in the context of a multilateral exchange rate regime. Nonetheless, compared to the individual countries before EMU, the euro area as a whole is relatively closed. This makes it unlikely that the exchange rate will ever become an actively used instrument to anchor price stability and less likely to be the dominant economic variable.[12]

II.1 HISTORY: DELORS COMMITTEE

The Delors Committee did not succeed in developing a clear position on the division of responsibilities between the ESCB and the other authorities in the field of exchange rate policy.

Paragraph 33 of the Delors Report places responsibility for **formulating** the Community's exchange rate policy in the hands of the economic authorities (i.e. Ecofin Council), though 'in cooperation with the ESCB Council':

> '[Economic policy] coordination would involve [....] formulating in cooperation with the ESCB Council the Community's exchange rate policy and participation in policy coordination at the international level.'
>
> Delors Report, par. 33

[12] The export-to-GDP ratio for the euro area is 12-18 percent (depending on the precise definition), compared to 12 percent for the US and 10 percent for Japan (2000-figures) and compared to for example 32 percent for Germany, 71 for Belgium and 54 percent for the Netherlands in 1990. (Source: ECB, IMF International Financial Statistics.)

Paragraph 32 puts the emphasis on exchange rate **management**, which is relegated to the System:

> '[…] At the final stage the ESCB - acting through its Council - would be responsible for formulating and implementing monetary policy as well as managing the Community's exchange rate policy[13] *vis-à-vis* third currencies. [...]
> **Mandate and functions**
> - [....]
> - the System would be responsible for the formulation and implementation of monetary policy, exchange rate and reserve management, and the maintenance of a properly functioning payment system;"
>
> Delors Report, par. 32

Paragraph 60 mentions that the ESCB would decide on interventions, but still in accordance with Community exchange rate policy:

> 'In particular:
> - [....]
> - decisions on exchange market interventions in third currencies would be made on the sole responsibility of the ESCB Council in accordance with Community exchange rate policy; the execution of interventions would be entrusted either to national central banks or to the ESCB;
> - official reserves would be pooled and managed by the ESCB;'
>
> Delors Report, par. 60

We will now look into the discussions in the Delors Committee which led to these texts.
Even before the Delors Committee was established, the Bundesbank had produced an internal position paper on the further development of the EMS and the design of a possible European Central Bank System. This paper would be the basis for Pöhl's written contribution to the Delors Report,[14] which states:
'[....] Domestic stability of the value of money must take precedence over exchange rate stability. This does not exclude the possibility that depreciation vis-à-vis third currencies and the associated import of inflation be counteracted by appropriate monetary policy measures. In the event of the establishment of an international monetary system with limited exchange rate flexibility vis-à-vis third currencies, the central bank would need to be given at least the right to participate in discussions[15] on parity changes.' Apparently the Bundesbank considered decisions on parities and regimes as being of a sovereign (i.e. pertaining to the national state) level. But at the same time it tries to morally bind the Sovereign to give precedence to price stability too.[16] The position of de Larosière follows from the last sentence of his submission to the Delors Committee,[17] where he states that with respect to the setting of exchange parities, 'it would seem that the role of the Council of Ministers would have to be decisive.'

[13] The word 'policy' was inserted at German request. (Source: German amendments of 8 March 1989 to CSEMU/12/89.)
[14] Karl-Otto Pöhl, (1988).
[15] In German: Mitspracherecht erhalten.
[16] Later the Bundesbank would also press for a right of consultation for the ESCB in case of Council decisions on the exchange-rate regime. See Dyson/Featherstone (1999), p 382.
[17] De Larosière (1988).

Here we already see the Bundesbank did not claim responsibility over the exchange rate *policy*, but only over its *execution*. (This would recur during the IGC, where the German delegation emphasized the right of the ESCB to be consulted. It declined the right of consent, in the case of exchange rate orientations, because 'consent' meant the ESCB would be bound. Apparently, they strongly valued the freedom for the central bank to decide not to support more informal forms of exchange rate agreements, e.g. exchange rate targets.) These ideas were reflected in the first drafts of chapter III of the report.[18] It should not surprise that the rapporteurs of the Delors Committee leaned strongly on the input of the Bundesbank, as Delors considered it his most important challenge to get a report with a signature of the Bundesbank.[19] During the discussion of the Committee on 13 December 1988 Pöhl handed out a paper containing an alternative formulation for the ESCB's mandate, which could be considered to be a step back, because it muffled away the issue of the System's real first priority, i.e. stable prices.[20] During the meeting in December Duisenberg suggested some improvements on Pöhl's paper, especially with regard to the System's mandate. As a follow-up Duisenberg distributed a reformulated mandate during the meeting on 10 January 1989, taking on board the remarks he made in December.[21] This mandate included the idea that '[s]tability of the currency in terms of prices must take precedence over exchange rate stability'- which idea was borrowed from the first so-called skeleton report by the rapporteurs.[22] In the next draft the rapporteurs would present Duisenberg's and Pöhl's texts as alternatives. In the draft of April the reference to domestic stability taking precedence over external stability had disappeared - for unknown reasons.

[18] For instance, CSEMU/5/88 of 5 December 1988, p. 15, mentioned that 'the [ECB] would be responsible for [....] the execution of the Community's exchange rate policy vis-à-vis third currencies [....] Stability of the currency in terms of prices would take precedence over exchange rate stability; [....]'. CSEMU/6/88 of 22 December 1988 described the steps to be taken at the start of stage three. Paragraph III.4.A(3) read as follows:
'- decisions on exchange market interventions in third currencies would be made entirely under the responsibility of the ESCB Council in accordance with Community exchange rate policy; the execution of interventions would be entrusted to [one or ?] national central banks;'

[19] See under Article 7, section I.1; see also the BBC - Arte TV documentary of 1998 (see bibliography). Dyson/Featherstone (1999) state quite bluntly (p. 347): 'The emerging agreed drafts did not suggest a hard-fought victory for the Bundesbank. In effect, there had been no goalkeeper to block Pöhl's shots.'

[20] The mandate was rather vague (p.12 of said paper): 'a commitment to regulate the amount of money in circulation and of credit supplied by banks and other financial institutions under criteria designed to assure non-inflationary economic growth as well as to preserve a properly functioning payments system.' On exchange rates page 9 mentioned: 'Implementation of exchange rate policy would fall within the responsibility of the central bank governing body.' Maybe his paper (called 'Outline of a Report to the European Council on Economic and Monetary Union') was just meant to provide a structure to the report. But even then it is surprising that on an issue like the mandate the paper was so little specific.

[21] See under Article 2, section I.1.

[22] CSEMU/5/88 (2 December 1988), p. 15.

For the last meeting of the committee on 11-12 April 1989 Pöhl submitted a new text for the mandate and the functions of the System:

> "Mandate and functions
> - the System would be responsible for the formulation of monetary policy at the Community level and its implementation at the national level, for the full convertibility of European currencies and exchange rate management as well as for the maintenance of a properly functioning payments system;
> - [....]"
>
> Pöhl's proposal, early April 1989

Again Pöhl's sole reference to exchange rate *management* seems to imply he only favoured an executive, and not a policy-making, function for the ESCB. In the April meeting a long discussion took place on the decision-making mechanism for deciding on exchange rate policy. A clear result was not obtained as there was a divide between those responsible for decisions on the exchange rate system and the institutions that should have the responsibility for the day-to-day implementation, among which interventions in the foreign-exchange market. In the final version of the Delors report the role of the ESCB in the area of exchange rate policy was upgraded somewhat, though the real implications remained unclear. The formulation that macro-economic co-ordination would involve, inter alia, 'determining, *in close consultation with* the ESCB Council, the Community's exchange rate policy' [23] was changed into 'formulating *in cooperation with* the ESCB Council the Community's exchange rate policy (emphasis added by the author).' [24] In line with an earlier request by Duisenberg the final report would mention in par. 60 that '- official reserves would be pooled and managed by the ESCB'. This was considered very important by the Dutch, as it would at least take away the instrument for the political authorities to start managing the exchange rate unilaterally.

II.1a HISTORY: MONETARY COMMITTEE

Following a mandate by the Ecofin Council in December 1989, the Monetary Committee discussed what should be the main outlines of EMU.[25] These discussions would culminate in a report of 19 July 1990 ('Economic and Monetary Union beyond stage 1 - Orientations for the preparation of the IGC').[26] During the discussions clear differences surfaced with respect to EMU's external policy.

In the Monetary Committee there were those, among whom the French Trésor, who felt that in most countries the external value of the currency was the responsibility of the government, implying that, as regards interventions and management of the reserves, central banks should act as an *agent* of the political authorities. Others, among which the Italians, argued that the distinction between intervention policy and domestic monetary policy was not practical, as interventions were a source of money creation and their timing should therefore be subject to money policy considerations. Tietmeyer (who had just changed from the Finance Ministry to

[23] Par. 34 of CSEMU/14/89.
[24] Par. 33 of final report.
[25] For the role of the Monetary Committee see also chapter 1.
[26] Published in HWWA (1993).

the Bundesbank) argued that implementation of exchange rate policy was a matter for central banks, while reserving decisions on exchange rate regimes for the political authorities. Still others emphasized that the ESCB should act in accordance with the Community's exchange rate policy. They felt there need not be conflicts with price stability, as long as appropriate techniques of sterilization were used. In their view the exchange rate risk will in the end always be borne by the state, therefore the ownership of the reserves should remain with the state (inter alia UK view).
The interim report of 12 March 1990 deepened the conflict. The report mentioned that the political authority must remain responsible for the most important decisions in the field of external monetary policy, 'including in particular those on the exchange rate, adoption and abandonment of central rates, and changes to them, [and] *setting and redefining of target zones*.' (emphasis by the author) Tietmeyer objected strongly to the inclusion of target zones, because of their unclear operational meaning. According to the Trésor target zones could be defined as 'narrow cooperation on the exchange markets', like among the G7. In such cases he was willing to accept that the political authorities will have to 'consult' the ECB. In the end version of the report the reference to target zones was deleted. The report would mention the existence of two opposing views, or in the words of the chairman (Mario Sarcinelli) in his summary report:
'8 External monetary policy will become the responsibility of the Community. The political authority will be responsible for decisions on the exchange rate regime and the central rate, if one is adopted. There was consensus on this. However, it was not possible to reach consensus on other important questions of external monetary policy. Because intervention has consequences for domestic monetary conditions, some members argue that, within a given regime, the decisions to intervene must be the exclusive responsibility of the ESCB. Others, however, consider that the political authority should take the strategic decisions in this area.' [27]

Below we quote the most important part of the Monetary Committee report in relation to the external monetary relations of EMU:

"29 There is also agreement that the Council [of Ministers], while consulting the ECBS, must be responsible for
- decisions on the exchange rate regime,
- adoption and abandonment of central rates against third currencies, and changes to them.

Some members consider that the political authority should also be responsible for the most important decisions in the field of external monetary policy and notably for international cooperation on exchange markets, although consultation with ECBS would be needed. Others, however, hold that in this matter there should be joint responsibility of the political authorities and the ECBS."

report Monetary Committee, July 1990

[27] According to Dyson/Featherstone (1999) Tietmeyer had been pushing for a right of consultation for the ESCB when the Council of Ministers would be making decisions about an exchange rate regime. Köhler (Finance Ministry) had been less supportive on this issue, recognizing that Finance Ministry powers were at stake. (Dyson/Featherstone (1999), p.382.)

II.2 History: Committee of Governors

The first draft of the ESCB Statute (see below) leaned heavily on the text of the March draft report of the Monetary Committee (see section II.1a above):

> "Article 4 - Advisory tasks
> 4.3. The ESCB shall be consulted prior to any decision relating to the exchange rate regime or to the exchange rate policy of the Community, namely the adoption, abandonment or change in central rates or exchange rate objectives vis-à-vis third currencies."
>
> draft 22 June 1990

The drafters of this text had tried to avoid the problem of 'target zones', instead they had inserted a reference to possible 'exchange rate objectives' of the Community. By placing this article under the heading 'advisory tasks', the drafters apparently accepted that the political authorities were the decision-making body. The governors would stay clear from defining the precise role of the Council of Ministers, because this was judged to be the preserve of the coming IGC.
This version was discussed by the Alternates on 29 June 1990. Both Tietmeyer and Crockett (Bank of England) proposed to strengthen the advisory role of the ESCB: it was agreed to insert *'with a view to reaching consensus'* in Article 4.3 before the word 'prior'. Furthermore, Tietmeyer agreed with Szász that any ESCB advice should always be made public. Publication of the advice improves accountability, but it also substantially strengthens the hand of the ESCB, as the political authorities would like to avoid being confronted with a public dissenting opinion of the ESCB. (Of course, this presupposes a high degree of credibility for the ECB as an authorative and objective institution.) This resulted in the following text for the governors.

> "4.3 The ESCB shall be consulted with a view to reaching consensus prior to any decision relating to the exchange rate regime of the Community, including, in particular, the adoption, abandonment or change in central rates or exchange rate objectives vis-à-vis third currencies. [Opinions in accordance with Article 4.3 shall be published unless it is contrary to the best interest of the Community.]"
>
> draft 3 July 1990

Exchange rate policy had also been discussed under Art. 3.1 (Basic tasks of the ESCB). One of the tasks was (as formulated in one of the first draft of the Statute) 'to conduct foreign exchange policy of the Community in accordance with the exchange rate regime of the Community.'[28] At the request of Szász, the Dutch Alternate, and supported by Tietmeyer, 'policy' was changed into 'operations'. Lagayette (Banque de France) and Crockett feared this formulation would lead to a vacuum for exchange rate policy. They proposed to add a basic task of the ESCB, i.e. 'to formulate in consultation with the relevant Community bodies the exchange rate policy of the Community in accordance with the established exchange rate regime.' Szász objected: without formal exchange rate obligations the Community would not

[28] Draft Statute version 22 June 1990 – see Art. 3.1, section II.2 *supra*. In the very first draft the implementation of exchange rate policy and the management of reserves had been mentioned in one indent: '- to implement the Community's exchange rate policy and manage the foreign reserves' – defining both as purely executive (and not policy-making) tasks.

have an exchange rate policy. Szász was especially worried that the Council of Ministers would declare unilaterally an exchange rate policy [29] and would subsequently delegate the execution to the ESCB, which could find itself before a job impossible to execute without distorting its domestic monetary strategy.

Art. 3 - Tasks (third and fourth indent) "[- to formulate in consultation with the other relevant bodies of the Community the exchange rate policy of the Community in accordance with the established exchange rate regime]; [30] - to conduct foreign exchange operations;" draft 3 July 1990

During their meeting on 10 July 1990 the governors first discussed Art. 3.1 and later Art. 4.3. At Duisenberg's proposal the indents three and four were merged to read:[31]

"[Art. 3.1, third indent] - to conduct foreign exchange operations in accordance with the prevailing exchange rate regime of the Community as referred to in Art. 4.3" draft 13 July 1990

As regards Art. 4.3 Pöhl had problems with the reference to 'exchange rate objectives',[32] but acquiesced in having it substituted by 'exchange rate policies'. Pöhl's personal Leitmotiv was that 'it has to be ensured that any agreement on the exchange rate regime does not impair the ability of the System to achieve its objective of price stability.' [33] The bracketed last sentence of Art. 4.3 on the issue of publishing ESCB opinions was made into a separate Art. 4.4. [34]

As of September Tietmeyer started criticizing the compromise reached by the governors in their July meeting. He wanted to drop the words 'or exchange rate policies' and instead add that decisions other than those relating to exchange rate regimes should be subject to prior *consent* by the ESCB, making it a joint responsibility of the ministers and the ESCB. Subsequently, the specification of 'exchange rate regime' and the reference to 'exchange rate policy' were bracketed. The draft version of 25 October and the accompanying Comments read as follows:

'4.3 The ECB[35] shall be consulted with a view to reaching consensus prior to any decision relating to the exchange rate regime of the Community, [including, in particular, the adoption, abandonment or change in central rates or exchange rate policies] vis-à-vis third currencies.' draft 25 October 1990

[29] For instance, aiming at a certain exchange rate vis-à-vis the dollar or an effective (weighted) exchange rate.
[30] Bracketed to indicate disagreement.
[31] The words 'as referred to in Art. 4.3' were added at the urgence of de Larosière, who felt otherwise to be out of bounds with his authorities back home.
[32] Probably because it smacked too much of target zones.
[33] Formulation used in his statement to the informal Ecofin meeting on 7-9 September 1990.
[34] During the IGC Art. 4.4 would be subsumed under a more general article (Art. 34-ESCB), which allowed the ECB to publish any of its decisions, opinions and recommendations. (See also Article 108a-EC.)
[35] The word 'System' had been replaced by 'ECB' at the suggestion of the legal experts of the NCBs. They recommended to assign the advisory role of the System to the ECB, to make clear that NCBs would be allowed to continue their already existing national advisory functions.

Comments:
b) Article 4.3: Some Alternates insisted on deleting the section between brackets. This would leave open the question of ultimate responsibility for exchange rate policies. In addition to the deletion of the section between square brackets, one Alternate proposed adding the following sentence: 'Decisions other than those relating to central rates are subject to prior consent by the ECB to ensure that they do not interfere with the System's monetary policy objectives.'
Comments Article 4.3, 25 October 1990

The Dutch supported Tietmeyer's quest. The governors had a final discussion on the draft ESCB Statute on 13 November 1990. As regards Article 4.3 Pöhl took a very strict position - along the lines of Tietmeyer. However, de Larosière replied he could not agree to deleting the section between square brackets; if the Committee would nonetheless so decide, he would insist that the Commentary indicated that the exchange rate regime included the points listed in the text. He added he could agree to a sentence to the effect that decisions by Member States on exchange rate relationships had to be consistent with the conduct of monetary policy. In order to accommodate the chairman's position, de Larosière suggested adding that the consultations aimed at reaching consensus should be guided by the overriding principle of price stability. Following drafting suggestions by the UK and Portugese governors the Committee agreed to include the words 'consistent with the objective of price stability' after the word 'consensus'. The brackets were now limited to the words [or exchange rate policies]. Chairman Pöhl said the Commentary should reflect the fact that one governor was of the opinion that the exchange rate policy could not be decided without the consent of the ECB. First, this position was ascribed to the Bundesbank only. In a letter dated November 20 Duisenberg made clear the Bundesbank was not standing alone on this issue. Therefore, the Commentary refers to 'some Committee members'. All in all, the governors narrowed down their differences, but were not able to present a unified position. So on this issue the IGC had to start with divided opinions unlike on most other issues with respect to the ESCB.

Below we present the outcome on Art. 4.3 as well as the relevant part of Art. 3.1.

"Article 4 - Advisory functions

4.3 The ECB shall be consulted with a view to reaching consensus, consistent with the objective of price stability, prior to any decision relating to the exchange rate regime of the Community, including, in particular, the adoption, abandonment or change in central rates [or exchange rate policies] vis-à-vis third currencies."

Article 3 - Tasks
The basic tasks to be carried out through the System shall be:
- ....
- to conduct foreign exchange operations in accordance with the prevailing exchange rate regime of the Community as referred to in Article 4.3;
- to hold and manage [the] official foreign reserves of the participating countries;"[36]
draft ESCB Statute 27 November 1990

[36] Art. 3.1 is dealt with separately elsewhere. The brackets in Art. 3 around '[the]' reflect a minority position of the UK.

The accompanying Commentary shed light on the reason behind the disagreement:

"[....] While the political authorities have ultimate responsibility for decisions relating to the exchange rate regime, it is recognised that there is a close interconnection between exchange market operations and [....] the System's ability to attain its primary objective of price stability. For this reason, Article 4.3 establishes the obligation to consult the ECB with a view to reaching consensus consistent with the objective of price stability prior to any decision on the exchange rate regime of the Community. However, views differ with regard to the ECB's role in the formulation of exchange rate policy. Most of the members of the Committee [....] are of the view that decisions on the Community's exchange rate policy should be dealt with in the same way as decisions on the adoption, abandonment or change in central rates vis-à-vis third currencies. Some Committee members are of the view that decisions on the Community's exchange rate policy should be subject to the consent of the ECB."

Commentary with Article 4.3-ESCB, November 1990

II.3 HISTORY: IGC

Before looking into the discussions during the IGC, we first present the drafts for this article as proposed by the European Commission, France and Germany.

The following is taken from the Commission's draft[37]:

"Article 106b

1. For the purpose of the preceding Article, Eurofed's tasks shall be:
- [....]
- to conduct foreign-exchange operations in accordance with the guidelines laid down by the Council;
- to hold and manage foreign reserves;
- to participate in international monetary cooperation;
- [....]

2. In order to carry out the tasks assigned to it, Eurofed shall:
- [....]
- hold the foreign reserves of the Member States, ownership of which will have been transferred to the Community;"

"Article 108

1. The Council, acting by a qualified majority on a proposal from the Commission and in close cooperation with the European Central Bank, shall lay down guidelines for the Community's exchange-rate policy.
In accordance with those guidelines, the European Central Bank shall conduct an appropriate intervention policy.
2. The Council shall adopt, in accordance with the same rules and, where necessary, by urgent procedure, the Community's position in international monetary or financial bodies.[38]

./.

[37] European Commission, Draft Treaty amending the Treaty establishing the European Economic Community with a view to achieving Economic and Monetary Union, 10 December 1990, printed in HWWA(1993).
[38] Idem.

3. Within those bodies, the Community shall be represented by the President of the Council, the President of the Bank and a Member of the Commission."

Commission's draft December 1990

We note inter alia that the Commission proposed to transfer the ownership of foreign reserves to the Community (and presumably also the seigniorage).

The following text is taken from the French draft Treaty text:[39]

"Article 2-4

1. Les missions fondamentales du SEBC sont:
- la définition et la mise en oeuvre de la politique monétaire de la Communauté ;
- l'execution des opérations de change, et la gestion de réserves officielles de change, conformément aux dispositions du chapitre 3 ci-après ;"

"Chapitre 3: Politique monétaire extérieure

Article 3-1

1 - La Communauté mène une politique de change unique.
2 - Le Conseil, statuant à la majorité qualifiée, et après consultation du Conseil de la Banque détermine les orientations de la politique de change de la Communauté.
3. L'exécution des opérations de gestion des réserves de change, et des interventions sur les marchés des changes est assurée par la Banque Centrale Européenne dans le cadre des orientations fixées par le Conseil.
La Banque centrale européenne tient le Conseil informé de son action, de l'évolution des marchés et des interventions nécessaires. Le Comité Monétaire visé à l'article 4-4 fait rapport au Conseil sur la politique de change, selon les modalités arrêtées par celui-ci."

"Article 4-2

2. Dans les déliberations relevant des articles 1-2 à 1-4, ou portant sur la politique monétaire, l'organisation ou le functionnement du SEBC ou la politique de change, le Conseil se prononce sur les propositions soumises par le Président, la Commission ou les Etats membres."

French draft Treaty 25 January 1991

The French draft put responsibility for deciding on the Community's exchange rate policy clearly with the political authorities (Ecofin).

[39] Projet de Traité sur l'Union Economique et Monétaire, République Francaise, 25 January 1991, printed in HWWA(1993).

The German composite draft Treaty proposal (26 February 1991) contained the following paragraphs on the exchange rate issue:[40]

> Article 3a (Activities of the Community in economic and monetary union)
> 1. [....]
> 2. In addition, [....] the activities of the Community shall include: the irrevocable fixing of exchange rates between the currencies of the Member States and the introduction of a single currency, the definition and conduct of a single monetary and currency policy the overriding objective of which shall be to maintain price stability.[41]
>
> Article 109C (external currency policy)
> 1. Decisions on the exchange rate regime of the Community shall be taken unanimously by the Ecofin Council following consultation with the ECB Council with a view to reaching consensus consistent with the objective of price stability. The same procedure shall apply to the adoption or abandonment of or change in central rates within this regime.
> 2. Without prejudice to its primary task ('Aufgabe'), the ESCB may intervene vis-à-vis third currencies."
>
> German draft Treaty 26 February 1991

Mentioning the introduction of a *single exchange rate policy* in Article 3a of the EC Treaty (which enumerates the 'activities' of the Community) was an innovation relative to the Commission document, which only referred to 'the definition and pursuit of a single monetary policy' (Art. 3(ga) of the Commission draft Treaty text). More importantly, price stability was defined as the overriding objective of both monetary and exchange rate policy.

During the deputies meeting of 12 March 1990 the French Treasury (Trichet) indicated its willingness to accept the German formulation of Art. 109C except for the unanimity requirement: decisions on the exchange rate regime should be taken by qualified majority in the French view. In this, he was supported by almost all other delegations. Trichet defined the consultation procedure as an 'endeavour', not an obligation to reach consensus with the ESCB. He also observed that exchange rate fluctuations affected trade and, therefore of necessity, had a political content. However, Germany (Köhler) and the Netherlands rejected this view: 'exchange rate policy is not competitiveness policy'. The exchange rate is the outcome of the overall policy. Köhler also stated that in no way decisions on the exchange regime should endanger price stability. According to the UK (Wicks) intervention policy would always need some political input.
On 18 March the ministers had a long discussion on this topic. Waigel defended the German draft; in case exchange rate and monetary policy would conflict, the ECB should give priority to price stability. A number of other ministers favoured the possibility of exchange rate guidelines in the absence of a 'regime'. The Netherlands wanted to take a middle road. In the absence of a formal exchange rate agreement political authorities should not be able to one-sidedly instruct the ECB to aim for a certain exchange rate, because such instruction could obstruct the ECB is achieving its primary objective. The Dutch Finance Minister, Wim Kok,

[40] UEM/29/91, printed in HWWA(1993).
[41] In German: 'die Festlegung und Durchführung einer einheitlichen Geld- und Währungspolitik mit dem vorrangigen Ziel, die Preisstabilität zu sichern.' 'Währungspolitik' would later be translated in 'exchange rate policy'.

defined 'exchange rate agreements' as parity grids and other forms of both formal and mutual intervention obligations, which could be part of target zones. In these cases the ECB had to operate within the formal framework.
Most ministers were in favour of qualified majority decisions in the Council of Ministers. Christophersen (Commission) supported the idea, according to which the Council would decide on a proposal of the Commission or the ECB. He rejected the idea to extend the right of initiative to Member States (this was also suggested in the non-paper) on the grounds that such would create a lot of uncertainty as regards the Community's exchange rate regime. Juncker (Luxemburg's Finance Minister) suggested as a compromise to decide with unanimity for regime choices and with qualified majority on parity changes. However, Bérégovoy did not see room for compromises, unless it took the form of broader objectives for EMU, not only including price stability but also competitiveness and employment. He could though accept the qualified majority voting, upon which Waigel said time was not ripe for a compromise.
The Luxembourg presidency concluded its presidency with a non-paper (UEM/52/91, 12 June 1991)[42] containing the following, partly bracketed texts:

"Article 3A
2.[....] these activities shall include .... the introduction of a single monetary and exchange policy the overriding objective of which shall be to maintain price stability and ....." [43]

"Article 109
1. The Council, acting [by a qualified majority/unanimously] on a proposal from the Commission, from a Member State or from the ECB, and after consultation by the Council of the Bank in an endeavour to reach a consensus with the Council of the Bank with the objective of price stability, shall determine [guidelines for the Community's exchange policy,] the exchange rate system of the Community, including, in particular, the adoption, adjustment and abandoning of central rates vis-à-vis third currencies.
2. The Council shall decide by a qualified majority on the position of the Community and its representation on the international stage in compliance with the allocation of powers laid down in Articles 103, 105 and in the first paragraph of this Article as regards the issues of particular relevance to economic and monetary union." [44]

Luxembourg non-paper 12 June 1991

This would be the starting point for the Dutch presidency which took over in July. In an issues paper of 29 August 1991 (UEM/55/91) the chairman of the deputies IGC (Cees Maas) put forward a number of questions: *'Do members agree that in the case of flexible exchange rates the responsibility lays with the ECB? In the event guidelines are given, could they be binding? [....] should the ECB or a Member State have the right of initiative?'* The discussion on 3 September did not bring progress: positions hardened. France was leading the pack of those who were of the opinion that responsibility ultimately lies with the Ecofin Council, even in

[42] The non-paper would become an integral part of the so-called Reference document of the Luxembourg presidency of 18 June 1991 covering both the IGC on EMU and the IGC on Political Union (published in HWWA(1993), p. 218-224). The reference paper was not an agreed document, but was a consolidated text based on the prevailing drift to emerge from the work of the two conferences.
[43] The Luxembourg presidency had copied the German idea to make price stability the objective of both monetary and exchange rate policy. In retrospect, this is a very important element of the Treaty.
[44] Will be dealt in the paragraph on Article 109-EC, par. 3-5.

the case of floating (supported by the Belgian, British, Danish, Italian and Irish delegations). They accepted that in practice the guidelines could not be binding, because market circumstances could change quickly. However, this should still be a decision by the Ecofin itself. A German-Dutch-Spanish minority opposed this view. Köhler made clear he could only accept guidelines with which the ECB would be in complete agreement. In case of conflict, the price stability objective should have priority. Köhler might have had in mind the tacit agreement between the Bundesbank and the German government that the Bundesbank was allowed to stop intervening (supporting another ERM currency) 'wenn sie glaubt, mit Rücksicht auf Geldmengenpolitik und anderes das nicht [mehr] tun zu können'.[45]
Deputies' chairman Maas produced a chairman's paper deleting the expression 'guidelines' from the first paragraph and introducing a new paragraph two:

> "Article 109
> 1. [....]
> 2. In the absence of a regime of exchange rates vis-à-vis other currencies as referred to in paragraph 1 of this Article, the Council may, after consulting the Governing Council of the ECB, formulate broad guidelines for exchange rate policies. These guidelines will be without prejudice to the primary responsibility for price stability of the ESCB, as determined in article 2 of the ESCB Statute."
>
> chairman's paper 27 September 1991 [46]

This developed into the following text without brackets, of which we only show the relevant parts:

> "Article 109
> 1a. The Council may, [.....][47] after consulting the ECB in an endeavour [….] determine an exchange rate agreement for the ECU vis-à-vis other currencies, including, in particular, the adoption [….].
> 2. In the absence of an exchange rate agreement vis-à-vis other currencies [….], the Council may, [.....] after consulting the ECB [....] formulate broad guidelines for exchange rate policy. These guidelines shall be without prejudice to the primary objective of price stability of the ECB."
>
> Dutch presidency 28 October 1991 [48]

In paragraph 1 the words '*shall* determine a regime of exchange rate agreements' had been replaced by '*may* determine an exchange rate agreement'. Therefore, there would be no obligation to define the exchange rate regime of the Community.[49] The word 'agreement' was

[45] Quotation from German Economic Minister before the German Bundestag, taken from Otmar Emminger, (1986), p. 361-362. See also C. van den Berg, 'Relationship between the ECB and the Ecofin Council and its implications for the exchange rate policy for the euro', Economic and Financial Computing (European Economics and Financial Centre), Vol. 8, nr. 2, Summer 1998, pp. 81-97.
[46] UEM/71/91.
[47] For the decision-making procedure two basic alternatives were mentioned: one based on a proposal, the other on a recommendation; '[on a recommendation which the Council shall adopt or amend by qualified majority]'. The latter option was probably meant to accommodate the wish of some countries to retain some right of initiative in the area of exchange rate policy.
[48] UEM/82/91, published in HWWA(1993).
[49] Germany would raise objections against the use of the word 'may'. In their view a floating regime is also a regime, which required a Council decision. They would drop this point, since it was a bit far-fetched.

meant to indicate a legal agreement, implying a multilateral agreement, and not a unilateral agreement within the Ecofin Council. The Dutch text envisaged qualified majority voting in the Ecofin Council. Germany, however, insisted on unanimity in case of the exchange rate regime choice, while France and the UK wanted the Council to be able to issue guidelines, even in case of an exchange rate regime. In the case of guidelines (par. 2) the 'endeavour to reach consensus'-clause was dropped from the text. Maas and the German delegation preferred consultation-only, because it meant the ECB would not be bound in by the guidelines.

On 22 and 28 November 1991 the Dutch presidency produced new consolidated draft Treaty texts. In the 28 November version of Article 109, first paragraph, the words 'the Council may [....] determine an exchange rate agreement' had been replaced by *'the Council may conclude formal agreements on an exchange-rate system'*.[50] In the deputies meeting of 26 November, views still differed between Germany on the one hand and France and the UK on the other hand on whether Louvre-like accords were covered by paragraph 1 (Franco-British wish) or by paragraph 2 (German wish).
During the meetings in the Kurhaus in Den Haag on 31 November - 1 December, i.e. in the week preceding Maastricht, Germany requested to change 'broad guidelines' into 'recommendations setting out broad guidelines', apparently because recommendation are not binding according to the terminology used in the Community. France remained silent, the UK raised objections. During the marathon session of the ministers on 2-3 December, Germany succeeded in getting agreement on the need for unanimity in paragraph 1. After French minister Bérégovoy accepted unanimity for paragraph 1, he declared that paragraph 1 was meant for such momentous agreements like the Bretton Woods agreement, which kind of agreements would only occur a few times in a century.[51] The relevance of this statement is in what he implicitly said, *viz*. that apparently Louvre-like agreements would fall under parargaph 2 (with a lighter decision-making procedure). The 'recommendations setting out broad guidelines' of paragraph 2 were replaced by 'general orientations'. Waigel had argued that guidelines (in German: 'Richtlinien') would have been unacceptable, because 'Richtlinien' had always to be obeyed. According to participants the idea was that Louvre-like accords would be covered by the 'general orientations'. The ECB is formally not bound by these orientations, though an outright rejection by the ECB would naturally not have a comforting effect on the markets. In 1997 the Finance ministers decided they would issue 'general orientations' only in exceptional circumstances. This was validated by the Heads of State, see Luxembourg European Council Presidency Conclusions (December 1997), which state that as regards the implementation of the provisions on exchange-rate policy "it is understood that the general exchange-rate policy guidelines vis-à-vis one or more non-Community currencies will be formulated only in exceptional circumstances in the light of the principles and policies defined in the Treaty." [52]

Therefore, in the end a compromise was reached, basically because a compromise had to be reached. The discussions during the IGC had been coloured by the different traditions in the

[50] UEM/118/91 (Revised version of EMU text presented by the chairman of the EMU working group) dated 28 November 1991.
[51] IGC meeting of 5 December 1991
[52] See also Kapteyn/VerLoren van Themaat (1998), p. 1007.

different Member States. Whereas Germany saw the exchange rate as the outcome of the overall policy, France saw it as an economic instrument. Most countries were inclined to side with France on this issue, because traditionally most countries looked upon the exchange rate as a very important economic instrument (stabilizing the exchange rate vis-à-vis the Dmark had been the centrepiece of many a country's economic policy). However, in the new environment the exchange rate had lost its function as an anchor and the price stability objective - automatically - gained in importance as a tool to achieve overall economic and financial stability. In this regard EMU resembles more the US than the individual EMU countries. This might raise the question as to why Germany did not accept an institutional setting as in the US. The answer must lie in (1) the tradition on the continent of a relatively activist exchange rate policy, which should not be given free rein, and (2) the overriding importance attached to price stability - requiring a relatively high degree of independence. In terms of checks and balances the real issue is how far the broader competence of the Council of Ministers can encroach on the limited competence of the ESCB. Though a *modus vivendi* has been found, the issue is not really resolved, as the Council of Ministers could always revisit the use of Art. 109, especially Art. 109(2), for instance when internationally a need arises for more exchange rate coordination. However, in the end the safeguards for the ESCB would seem strong, in the sense that its objective of price stability cannot be overridden by other objectives.

A final remark on the *decision-making procedure*. During the 3 September 1991 meeting of the deputies the idea contained in the Luxembourg non-paper to extend the right of initiative in this area to the ECB and the member states had only elicit protests from the Belgian, Greek and later the Dutch delegation. Therefore, the Dutch presidency's draft of 28 October 1991 mentioned two basic decision-making alternatives: one where the Council decides on a proposal, the other where the Council decides 'on a recommendation which the Council shall adopt or amend by qualified majority'. The second option was probably meant to pacify those that wished to retain some right of initiative in the area of exchange rate policy. During the 25 November IGC Commission president Delors yielded to French pressure and accepted the possibility that the Council could decide on the basis of a recommendation of the Commission or the ECB.[53] However, he did not accept the right of initiative for Member States. IGC chairman Wim Kok requested the experts to look into the procedure of Article 152 of the EEC Treaty and Article 32 of the Euratom Treaty in order to see whether such procedure could be

[53] One could argue as well that the Commission gained, because it received powers in the exchange rate area, which it did not have before.

extended into this area.[54] This led to the following inclusion in the presidency's draft Treaty texts: [55]

Article 109 BB (later Article 109D) "For matters within the scope of Articles 103 par. 4, 104B with the exception of par. 14, 109, 109F, 109G and 109H par. 3 and 4 the Council or a Member State may ask the Commission to make a recommendation or a proposal. The Commission examines this request and submits its conclusions to the Council without delay." presidency's draft 5 December 1991

Though inspired on Art. 152-EEC and Art. 32-Euratom, the procedure is a *novum*. The novelty is that the Commission has to react without delay and can be asked to present a recommendation, which in itself is easier amendable by the Council than a Commission proposal. However, the Commission retains its freedom to determine the content of such a recommendation or proposal.[56]

During November Wim Kok had made an effort to strengthen the role of the European parliament in a number of procedures.[57] This led to the inclusion of the EP in Art. 109: the EP has to be consulted by the Council when it takes a decision on an exchange rate regime, while the EP is informed ex post in case a parity is adopted, adjusted or abandoned. A role of the EP is not foreseen in Article 109.2 (general orientations). An explanation is that Louvre-like agreements are mostly kept confidential, which even excludes informing the EP

Exchange rate relations between the euro and the currencies of EU member States not yet participating in the euro area

Article 109-EC covers the exchange rate relations vis-à-vis third currencies and not the relations between the euro and the currencies of other EU members (i.e. Member States with a derogation status). The exchange-rate policy of Member States with a derogation is ruled by Article 109m, which stipulates that such Member State shall treat its exchange-rate policy as a matter of common concern. (Formulation borrowed from former Article 107-EEC (last amended in 1987): "Each Member State shall treat its policy with regard to rates of exchange as a matter of common concern.") The Exchange Rate Mechanism of the European Monetary System (established in 1978)[58] had been succeeded by the ERM-II (concluded in June

[54] Art. 152-EEC: 'The Council may request the Commission to undertake any studies the Council considers desirable for the attainment of the common objectives, and to submit to it any appropriate proposals.'
Art. 32-Euratom: 'At the request of the Commission or of a Member State, the basic standards may be revised or supplemented in accordance with the procedure laid down in Article 31. The Commission shall examine any request made by a Member State.' (Basic standards relate to the protection of health of workers and the general public against the dangers arising from ionizing radiations.)

[55] CONF-UEM 1620/91 (Draft Treaty Amendments on Economic and Monetary Union as agreed on 3 December 1991).

[56] See also Kapteyn and Verloren van Themaat (1998, p. 410), where they discuss Art. 152-EEC.

[57] Belgium and the Netherlands were the only countries actively pushing for a larger role of the European Parliament in EMU affairs. Germany's support usually did not go further than lipservice. (Position as perceived by the staff of the Dutch Ministry of Finance involved in the IGC preparations.)

[58] See Monetary Committee of the European Community, *Compendium of Community Monetary Texts 1989*, Office for Official Publications of the European Communities, Luxembourg, 1989, Chapter IV.

1997).[59] Both the ERM and ERM-II are based on a Resolution of the European Council (not the Council of Ministers) with the operational procedures being laid down in an agreement between the participating central banks, i.e. the central banks of the Member states in case of the ERM, and between the ECB (Governing Council) and the four non-area NCBs in case of ERM-II. Of these four only two, Denmark and Greece,[60] would participate - participation is voluntary, though Member States with a derogation 'are expected to join' (Article 1.6 of the Resolution of the European Council). Interventions at the limit take place at the request of market participants, who will to this end approach their NCB. These NCBs act as agent for the ECB, but the ECB nor the NCBs will acquire currency of the ERM-II country, as transactions at the limit will be 'financed' automatically by spot buying (or selling) the ERM-II currency from (or to) the central bank of the ERM-II country. This implies that the ESCB will not acquire foreign exchange risk when intervening at the limit. Decisions on adjusting central rates are taken by mutual agreement of the ministers of the euro-area Member States, the ECB and the ministers and central bank governors of the non-euro area Member States, following a common procedure involving the Commission and the EFC. Art. 2.1 of said Resolution determines that 'the ECB and the central banks of the other participants could suspend intervention, if this were to conflict with their primary objective.'

[59] See European Commission, *Economic and Monetary Union - Compilation of Community legislation*, Office for Official Publications of the European Community, Luxembourg, 1999, part G.
[60] In the meantime Greece has adopted the euro as its currency.

Article 109b-EC:

Article 109b-EC: Institutional dialogue [1]

"1. The President of the Council and a member of the Commission may participate, without having the right to vote, in meetings of the Governing Council of the ECB.
The President of the Council may submit a motion for deliberation to the Governing Council of the ECB.
2. The President of the ECB shall be invited to participate in Council meetings when the Council is discussing matters relating to the objectives of and tasks of the ESCB.
3. The ESCB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and current year to the European Parliament, the Council and the Commission, and also to the European Council. The President of the ECB shall present its report to the Council and to the European Parliament, which may hold a general debate on that basis.
The President of the ECB and the other members of the Executive Board may, at the request of the European Parliament or on their own initiative, be heard by the competent Committees of the European Parliament."

(to be read in conjunction with Article 7-ESCB (Independence); Article 11.2-ESCB (Appointment Executive Board); Article 27-ESCB (Auditing).
Also contains a description of Article 15-ESCB (Reporting requirements*))*

I. INTRODUCTION

I.1 *General introduction*

Article 109b covers especially the communication between the ESCB and three of the (then) four Community institutions: the Commission, the ECOFIN and the European Parliament, with the role of the Court of Justice being dealt with in Article 35-ESCB. [2] The provisions only relate to the European level, as monetary policy making is based on euro area wide considerations only. The Committee of Governors made an effort to involve the European Parliament in building the ESCB. First, they proposed to involve the European Parliament in

[1] Art. 109a-EC (covering the composition of the Governing Council and the Executive Board and the appointment procedures for the members of the Executive Board - see Art. 11.1 and 11.2 *supra*), Art. 109b-EC and Art. 109c-EC on the Economic and Financial Committee form together the most important articles of Chapter 3 (Institutional provisions) of Title VI (Economic and Monetary Policy) of the EC Treaty.

[2] At Maastricht (December 1991) it was decided to add the Court of Auditors to the institutions mentioned in Article 4a. For the relation of the ESCB with this Court: see Article 27-ESCB. The Convention preparing the 2004 IGC proposed to introduce the European Council (Heads of State and Union's and Commission president) as a fifth Union's Institution, while placing the Court of Auditors in a separate article under the heading 'Other Institutions'. The Convention considered giving the ECB a similar position, stressing the ECB's sui generis character and at the same time defining the ESCB as the ECB together with the NCBs. However, it could be argued that the headings of the chapters do not contribute enough to setting the ECB apart from the regular Union's Institutions – see also Art. 1, section II.2 and chapter 12.

the appointment procedure for the Executive Board members.[3] Second, the European Parliament was given the opportunity to organize a hearing on the ECB's annual report. This was part of the governors' strategy to be transparent and to build coalitions (one should recall that the European Parliament did not have a monetary capacity, implying it is not a potential adversary, but probably - at least potentially - an ally). This emphasis on a relation with parliament was a new element, as in most countries the Finance minister used to manage the relationship with parliament, also on behalf of the central bank: see table 2-6. Furthermore, the governors stressed that the Treaty itself was to be ratified by *national* parliaments, or in some countries national referenda. This Treaty-base not only protects the ESCB's independence, but it also legitimizes it.

Table 2-6: Relations of central banks with Parliament [4] (situation in 1989) [5]

	No direct relationship	Other arrangements
Austria:	x	
Belgium:	x	
Denmark:		Parliament elects 8 of the 25 members of Board of Directors (which defines broad lines of monetary policies; meets every quarter) among members of Parliament.
Germany:	x	
Greece:		Parliament or Parliamentary Committees may call Bank officials for hearings.
Spain:		Parliament and its Committees have the right to call the governor to inform them on the implementation of monetary policy.
France:	x	
Ireland:		No formal rules.
Italy:		Parliamentary commission frequently invites the governor and other Bank officials.
Netherlands:	x	
Portugal:		Neither legal provisions nor practice that Board members appear before Parliament/committees.

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[3] The combination 'appointment by the Heads of State and consultation of the European Parliament' was a novum, because the Heads of State were not in the habit of consulting parliament. For instance, parliament was not consulted on the appointment of the Commission or the Court of Justice. Parliament is consulted over the appointment for the Court of Auditors, however the auditors are appointed by ECOFIN (Article 206(4)-EEC, later Article 188b(3)-EC). In the mean time, the procedure for the Commission has been changed: while it was decided in Maastricht to consult the EP (Article 158(2)-EC), in Nice (December 2000) it was agreed that the appointment of the Commission would be subject to the approval of parliament (Article 214-TEC).

[4] Source: national central bank laws, European Commission (1990a), H. Aufricht (1967), G. Tonioli (1988). See also Amtenbrink (1999), p. 286-308, for information on the relationship with parliament for the central banks of Germany, the Netherlands, France, UK and ECB. Cf. Committee of Governors (1992).

[5] These relationships may have changed since the start of the third stage of EMU, because ministerial responsibility for central bank matters was rescinded.

UK:	Usual for bank representatives to submit written evidence and appear for oral examination before Committees of House of Commons and House of Lords. The Bank's annual report is laid before Parliament.

Another interesting area is the relation between the central bank and the government. In Europe most governments could overrule the central bank's policy decisions. To this end many a government had eyes and ears in the governing boards of their central banks. This was even true for the Bundesbank, where a member of the cabinet could suspend for two weeks a decision by the Zentralbankrat. For reasons of readability we distinguish five groups: a group with 'German' features (possible attendance of government officials (Ministers) with the right to suspend unwelcome policy decision: Germany); a group with 'Belgian features (regular attendance of a government appointed Commissioner who may suspend decisions which he considers to be contrary to the law or statute: Belgium, Austria, Greece); a 'Dutch' model (a government appointed commissioner who reports to the minister, combined with a large degree of de facto independence: Netherlands); a group with consultation requirement or tradition, but no formal right of instruction for the government: Ireland, Denmark; a last group where the minister/government has to approve or determines interest rates or determines broad monetary policy guidelines: Italy, France, the UK, Spain and Portugal.

Table 2-7: Representation of government in statutory central bank organs (situation in 1989) [6]

Germany:	The members of the Federal Government shall be entitled to take part in the deliberations of the Central Bank Council. They shall have no vote, but may make motions. At their request the taking of a decision shall be deferred, but for not more than two weeks. The Federal Government shall invite the President of the Deutsche Bundesbank to participate in its deliberations on matters of importance in the field of monetary policy. (Section 13 of Deutsche Bundesbank Law, 1957)
Belgium:	Government Commissioner monitors all bank activities. May suspend Bank decisions and report to the Minister of Finance. If the latter does not decide within 8 days, Bank decision takes effect. Never applied. (Section 30 of Organic Law of National Bank, 1939)
Austria:	A state-appointed State Commissioner has the right to attend the meetings of the Board of Directors in an advisory capacity. He has the right to suspend a decision when judged in conflict with existing legislation. The objection is revoked when not confirmed by the Ministry of Finance within seven days. (Artt. 45-46 of National Bank Law, 1955)

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[6] Source: see footnote with table 2.6. See also table 2.2 in Art. 7 and table 2.3 in Art. 11.2 on independence and override mechanisms, and dismissal procedures respectively.

Greece:	The Minister of Finance may nominate a Government Commissioner who shall have the right to attend all General Meetings and meetings of the Board of Directors, without right of vote but with right of suspensive veto when he considers a decision to be contrary to the Statute. (Section 47 of Statutes of the Bank of Greece, 1966)
Netherlands:	A Royal Commissioner appointed by the government supervises the Bank's actions on behalf of the government. The Governing Board is bound to provide him with all the information he deems necessary for the proper exercise of his supervision. (Section 30 of Bankwet 1948)
Ireland:	The Minister may, on such occasions as he shall think proper, request the Governor on behalf of the Board to consult and advise with him in regard to the execution and the performance by the Bank of the general function and duty imposed on the Bank. (Section 6 of Central Bank Act, 1942)
Denmark:	Board of Directors (25 members) is chaired by the Government Commissioner. The Bank is governed by the 3-member Board of Governors. (Section 7 of National Bank of Denmark Act, 1936)
Italy:	The governor participates in the meetings of the Interministerial Committee on Credit and Savings (which defines the main features for monetary policy). He may be invited to participate in meetings of the Interministerial Committee of Economic Policy. He shall make proposals to the Minister of the Treasury concerning changes in the discount rates and in the interest rates on advances. (Section 25 of the Statute of the Bank of Italy, 1936)
France:	Monetary policy is determined by the government (follows from Art. 4 BdF Statutes of 1973).[7] The 'Censeur', appointed by the Minister, can oppose the decisions of the Conseil Général.' [8]
Spain:	BdE policy is determined by the government. The governor may be invited to attend cabinet meetings. Two of the 14 members of the General Council (6 of whom are governmental appointees) are officials of the Ministry of Finance. (The General Council has an advisory function and establishes the annual accounts.) (Bank of Spain Law, 1962)
Portugal:	The government determines BoP's policy. Unusual for members of the board to attend government meetings and for government officials to attend meetings of the Board. (Charter of Bank of Portugal, 1931)
UK:	No special governmental appointees. Treasury defines monetary policy. (Bank of England Act 1946)

We see that in Europe the presence of the political authorities in the decision-making body of the central bank was quite a common feature.

A final point is that in some countries the central banks had developed institutional relations with socio-economic groups (see table 2-8 below). These examples have not been followed by the drafters of the ESCB Statute. This is understandable, because there are as yet no effective

[7] See table 2.2 in Article 7 *supra*.
[8] Most powers rest with the Conseil Général, which could, and in fact did delegate operational powers to the Governor (Tonioli (1988), p. 100).

euro area wide trade unions or employer federations. On the other hand, in Monetary Union it is especially opportune for the central bank to explain directly to the social partners, especially the national ones, how the new monetary environment affects them.

Table 2-8: Relations with socio-economic groups [9]
(situation in 1989)

Austria:	Board of Directors which conducts the Bank's policy consists of a president, two vice-presidents and eleven unremunerated members representing the different economic sectors.
Belgium:	Composition of Conseil de régence (fixes the discount rate) reflects different socio-economic groups.
Denmark:	Board of Directors represents different socio-economic groups and regions.
France:	Socio-economic groups are represented in the Conseil national du crédit (an consultative organ advising on the orientation of monetary policy and the functioning of the banking and the financial system), consisting of 51 members appointed by the Minister of Economic Affairs and Finance.[10]
Germany:	At the Landeszentralbanken advisory councils exist with representatives familiar with credit matters from inter alia labour, business, farming and banking.[11]
Netherlands:	The President of the Bank reports to the Bank Council (composed of different socio-economic groups) on Bank policy.

I.2 *Relevant features of the Federal Reserve System*

Important relations exist between the Fed and the Administration and Congress, while there are also structured contacts with socio-economic groups.
The American Constitution vested all monetary powers in Congress (which has the right 'to coin money'). Congress has delegated this power to the Federal Reserve System through the Federal Reserve Act. The Fed is independent from the Administration, which does not mean that the Administration does not try to force its hand in the direction of the Fed. Many such efforts were made during the Kennedy, Johnson and Nixon Administrations, and less so during the Eisenhower and Ford Administrations.[12] Former Governor Meyer notes that the

[9] Source: see footnote with table 2.6.
[10] The National Credit Council focussed strongly on financial and banking matters, like promotion of savings. (Art. 12-15 of Law of 1945 on nationalization of Banque de France in H. Aufricht (1967).)
[11] Allowing the LZBs to remain close to all groups in the market economy and adding to the Bundesbank's legitimation and credibility by providing a direct voice to these groups - Peter Loedel (1999), p.52.
[12] The relationship between Brady and Greenspan was also not without tensions. Thomas Havrilesky (1996), in *The Pressures on American Monetary Policy* (second ed.), chapters two and three, gives an overview of Executive and Congressional branch pressures on monetary policy. Sometimes the conflicts are brought to the open. Meyer (2000) reported on such a conflict during the Johnson Administration in 1965 and on public pressure by the Treasury in February 1988. Both attempts failed. During both World Wars the Fed however has felt bound to facilitate wartime financing (Meyer (2000). At other occasions relations have been tense. For instance James Baker III, Secretary of the Treasury under Reagan, is known not to have been amused by Volcker's policy of eradicating inflation in the early eighties.

Clinton Administration has respected the independence of the Federal Reserve to a degree that, given the accounts of others, may have exceeded that of any previous Administration (Meyer 2000).
The Board of Governors (previously Federal Reserve Board) is often characterized as a governmental agency.[13] The Federal Open Market Committee (FOMC) however has a more mixed character, because part of its members, *viz* the (vote carrying) presidents of the FRBs, are appointed by the boards of directors of the FRBs, which boards have a private-public character.[14]
Contacts between the Fed and the Administration are predominantly informal. The more formal contacts evolved from the membership of the chairman of the Fed of the now defunct Advisory Board on Economic Growth and Stabilization, erected by the Eisenhower Administration, which included the chairman of the President's Council of Economic Advisers and cabinet members, and of the now also defunct Quadriad, consisting of the CEA chairman, the Secretary of the Treasury and the director of the Budget Bureau. Today the interaction is more informal, but also perhaps more continuous. According to Meyer (2000) the relationship has become less focused on monetary-fiscal policy coordination than on regulatory and international economic issues. He points out that this change reflects the smaller role of fiscal policy in stabilization since the Reagan Administration shifted the focus to longer-run issues related to encouraging more rapid trend growth (supply-side economics). Meyer describes the regular contacts as follows: 'The Secretary of the Treasury and the Fed Chairman meet frequently, many times for breakfast or lunch, often two or three times a week. The meetings are generally short, but not always, with no formal agenda and no staff.[15] [....] Members of the Board and members of the CEA meet monthly for lunch.[16] [....] The President and the Chairman of the Fed meet occasionally - more recently, generally a couple of times a year. These meetings typically are informal discussions [....] They usually also include the Vice President, the Secretary of the Treasury and the President's chief of staff. These are typically opportunities for the Chairman to brief the President on the US and global economic outlooks. The frequency of meetings [....] have varied across Chairmen and Administrations.'

Relations with Congress are of a different nature. In theory, Congress can legislate the Fed's independence away, though this is very unlikely, because the Congress would become responsible for monetary policy itself - something it does not desire.[17] At the same time, it ensures that the Federal Reserve is extremely respectful of the oversight authority of

[13] The members of the Board are appointed by the president (the Administration), with the consent and approval of the Senate. (It is usual that the American president nominates the presidents of governmental agencies, which candidates have to be confirmed by the Senate.)
[14] Six out of the nine directors are elected by the (private sector) member banks of an FRB, the three other directors being appointed by the Board of Governors; the appointment of the chief executive officer of the FRB, who acts as its president, requires the approval by the Board of Governors.
[15] According to John Berry (2001) chairman Greenspan and O'Neill continued this tradition, developed under the Clinton Administration, of meeting almost weekly. Brady and Greenspan suspended their weekly breakfast due to a bitter, open conflict over monetary policy (Mayer (2001), *The Fed – The Inside Story*, p. 207).
[16] The meetings are informal, usually with no agenda. Current issues are discussed regularly, such as prospects for growth and inflation and credit availability, and the handling of financial crises. 'No one divulges their secrets, but it gives us all a chance to talk about everything except monetary policy, which is the Fed's only off-limits area for these meetings', according to a participant. Quoted in Krause (1999),
[17] See also Amtenbrink (1999), p. 293-294.

Congress. Congress cannot fulfil its oversight responsibilities without actively engaging the Fed in a dialogue. Its instruments are questions at hearings, the introduction of bills and resolutions, delaying the nomination process for a new governor, letters sent to the Board of Governors. The Fed chairman testifies frequently before Congress, with the one-year record being twenty-five appearances in 1995, although only seven were directly about monetary policy. The most important testimonies were the semiannual Humphrey-Hawkins hearings. At these occasions the chairman of the Fed presented the so-called 'Monetary Policy Report to the Congress Pursuant to the Full Employment and Balanced Growth Act of 1978.' As of February 2001 this has been renamed into the 'Monetary Policy Report to Congress Pursuant to Section 2B of the Federal Reserve Act'. Under this Act the twice-yearly hearings are continued. However, an important difference is that under the new Article 2B the Fed is no longer required to present its objectives and plans 'with respect to the ranges of growth or dimunition of the monetary and credit aggregates for the current year.' Other governors testify also, though less frequently, with a range of eight to twenty-two appearances per year in recent years.[18] These testimonies are routinely carried live by the C-Span television channel.
For a further description of independence and accountability of the **Federal Reserve System**, see also Article 7-ESCB, section I.2.

As regards contacts with consumers and other socio-economic groups we quote from a publication of the Board of Governors.[19] A Consumer Advisory Council exists, which has thirty members and which meets the Board three times a year on matters concerning consumers and the consumer credit protection laws administered by the Board. The council consists of academics, legal specialists in consumer matters, and members representing the interests of consumers and the financial industry. The FRBs also use advisory committees. Perhaps the most important are the committees (one for each Reserve Bank) that advise the Banks on matters of agriculture and small businesses. Two representatives of each committee meet once a year with the Board of Governors.

Comparing the Fed and the ESCB
In the case of the Fed we see a natural tendency for informal contacts between the central bank and the Treasury Department. The impression one gets is that the independence vis-à-vis the Administration has never been an issue like in Europe. Possibly because the Fed was a

[18] Meyer (2000) under the sub-paragraph 'Federal Reserve and Congress'. The FRA does not mention such a hearing right (except for the hearings mentioned in the previous footnote), but Congress being the Fed's procreator would seem to have a 'natural' right here. Not only board members, but also Fed staff members may be asked to give testimony before congressional committees, in their capacity as expert. For example, in 1999 there were 28 occasions at which Federal Reserve Officials gave testimony before US Congressional Committees, among which eleven times Greenspan (on issues ranging from High-tech industry in the US economy and Social Security to the (Humphrey-Hawkins) semiannual report on monetary policy), nine times other board members, eight times staff (inter alia on bankruptcy legislation, hedge funds/LTCM, money laundering) and once McDonough (president of the NY Fed) on hedge funds. In 2000 there were 19 hearings with Federal Reserve Officials, of which eight with Greenspan (on topics ranging from the economic importance of improving math-science education and the evolution of the equity markets to the Humphrey-Hawkins hearings), five with other board members and six with staff (inter alia on the Commodity Futures Modernization Act, the "I Love You" computer virus, distribution of coin and currency). See site Board of Governors → News and Events → Testimony of Federal Reserve Officials. [It appears that FRB presidents are seldomly heard by Congressional committees, and if they are only on technical-expert issues.] Board members are also active in giving speeches: in 2002 Board members gave 76 speeches.
[19] Board of Governors (1994), *Purposes and Functions*, p. 14-15.

creation by Congress in the first place, but also because there is no formal channel for the Administration for instructing the Fed, the regular appointment of the chairman of the FOMC (every four years from among the Board members) coming closest. The Fed's position is relatively strong as Congress would not want to delegate power to the Administration, while Congress itself apparently does not want to become responsible for the complex task of running monetary policy on a daily basis. But in Europe, the ESCB is not the daughter of Parliament, and it is thus much more open to unilateral pressure from the side of the executive branch. This fact and the existing traditions in a number of countries explain the ESCB's explicitly formalized independence vis-à-vis the executive. Even without their mutual visiting rights the ESCB and the executive would have had an inclination to meet. Their visiting rights have been formalized, but without the executive's right of suspending decision-making.[20] In practice, only the Commissioner responsible for Economic and Monetary Affairs is almost always present in the Governing Council meetings, while the chairman of the Ecofin is usually only present four times a year. This is understandable because he is not responsible for daily economic or budgetary matters, which makes him a knight without a weapon.
As regards the contacts of the Fed with the US Congress, these contacts are formalized, unlike the contacts with the Treasury. This is understandable, as contacts with Congress cannot take place on a informal confidential bilateral (with whom?) basis.

II.1 HISTORY: DELORS COMMITTEE

Within the Delors Committee the independence of the ESCB was not contended. At the same it was acknowledged that there would be a need for consultation between the monetary and fiscal authorities. The following paragraphs of the Delors Report on respectively accountability and attendance procedures can be seen as predecessors of Article 15-ESCB and Article 109b-EC):[21]

> "accountability: reporting would be in the form of submission of an annual report by the ESCB to the European Parliament and the European Council; moreover, the Chairman of the ESCB could be invited to report to these institutions. Supervision of the administration of the System would be carried out independently of the Community bodies, for example by a supervisory council or a committee of independent auditors."
>
> Delors Report par. 32

[20] For the origin of the right of suspension in the Bundesbank Law see appendix 3 at the end of cluster III.
[21] See also under Art. 10.4, section II.1.

"[…] With due respect for the independent status of the ESCB [....] appropriate consultation procedures would have to be set up to allow for effective *coordination of budgetary and monetary policy*. [22] This might involve attendance by the President of the Council and the President of the Commission at meetings of the ESCB Council, without the power to vote or to block decisions taken in accordance with the rules laid down by the ESCB Council. Equally, the Chairman of the ESCB Council might attend meetings of the Council of Ministers, especially on matters of relevance to the conduct of monetary policy. Consideration would also have to be given to the role of the European Parliament, especially in relation with to the new policy functions exercised by the various Community bodies." [23]

Delors Report par. 34

We see a strong resemblance with the Bundesbank as regards the mutual attendance rights. However, the ministerial right to suspend decisions is was not included, while on the other hand direct relations with parliament (in casu the European parliament) were sought.

II.2 HISTORY: COMMITTEE OF GOVERNORS

The ideas contained in par. 32 and 34 of the Delors Report were more or less merged into a single article of the draft Statute. The draft of 3 July 1990 also contained another idea, *viz*. that members of the ECB Council could also be authorized to appear before *national* parliaments.[24]
However, during the governors' meeting on 10 July 1990 Duisenberg clearly rejected this idea, saying that in stage three he could not accept the notion of accountability to a *national* parliament. To the same effect, Leigh-Pemberton raised the question whether Executive Board members could be subject to the jurisdiction of national parliaments. Thereupon, the chairman suggested that the principle of subsidiarity should prevail and the idea was dropped.

The first draft of the ESCB Statute, that of 11 June 1990, contained the idea to establish an Advisory Committee, which would also be chaired by the ECB's president.

"Article 10 - [Advisory Committee]
[The Advisory Committee shall consist of [ ] members, appointed by the Commission on a proposal from the Economic and Social Committee.

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[22] The wording '*coordination* of economic and monetary policy' is not the preferred wording anymore among central bankers: they prefer the word *dialogue*, which more clearly expresses that the ECB will only (and may only) act according to its own mandate, i.e. giving priority to price stability.
[23] An earlier draft version had been more specific on the role of the parliament (CSEMU/10/89, 31 January 1989, p. 19): '[....], the involvement of the European Parliament and national parliaments in the co-ordination process should be strengthened and the European Parliament should be consulted in advance on the stance of economic policy in the Community. The consultation process should include a yearly joint assessment of the overall economic and monetary situation, and the formulation of a general policy guideline for the year to come. Moreover, the Council of Ministers and the Commission would submit a report each year to the European Council and the European Parliament on the functioning and the status of the economic and monetary union.' Such a yearly joint assessment culminating in a general policy guideline would have gone further than the obligations for the Fed under the Humphrey-Hawkins act (see section I.2 of Article 7-ESCB).
[24] Article 14.4 of the 3 July 1990 draft: ['Members of the Council [of the ESCB] may be authorized to appear before national parliaments.']

Their appointment shall be for a period of [ ] years. They may be re-appointed.

The Advisory Committee shall give opinions, either at the request of the Council or the Board of Management, or on its own initiative. It shall discuss matters of general interest connected with the activities of the ESCB.]"

draft 11 June 1990

The idea did not survive for long. During the meeting of the Alternates on 18 June 1990, the Spanish and Italian representatives wanted the article to be dropped. And thus it came to pass (arguments not known from the notes of this meeting).

Below we quote the final outcome of the discussions in the Committee of Governors, including the illustrative accompanying commentary:

"Article 15 - Inter-institutional co-operation and reporting commitments

15.1 The President of the Council of the European Communities and a Member of the Commission may attend meetings of the Council. They may take part in the Council's deliberations but not in the voting.

15.2 The President of the ECB shall be invited to participate in meetings of the European Council and Council of the European Communities when matters relating to the System's objectives and tasks are discussed.

15.3 The ECB shall draw up an annual report on the activities of the System and on the monetary policy of both the previous and current year at a date to be established in the Rules of Procedure. The President shall present the annual report to the European Council, the Council of the European Communities and the European Parliament. The President and members of the Executive Board may attend meetings of the European Parliament's specialised committees, if circumstances justify.

15.4 The ECB shall draw up reports on the activities of the System at regular intervals. These reports and statements are to be published and to be made available to interested parties free of charge.

15.5 A consolidated financial statement of the System shall be published each week."

draft 27 November 1990

The *Commentary* with Article 15 read as follows:

"Article 15 recognises that, with due regard to democratic accountability, appropriate procedures for co-operation and consultation with Community institutions, including reporting commitments, should be set up in order to ensure transparency and to promote a better understanding of the considerations underlying monetary policy. In Article 15.1, it is understood that the right of participation in [ECB] Council meetings will normally be exercised by the President of the ECOFIN Council."

Commentary 27 November 1990

For completeness' sake, we also quote below the articles of the draft Statute relating to the Court of Justice (Art. 35) and the Court of Auditors (Art. 27). The governors did not aim for a special position for the ECB as regards the Court of Justice. However, they saw no role for the Court of Auditors, but only for external independent auditors (who are recommended by the ECB and approved by the Council of Ministers). During the IGC the Court of Auditors would be given a limited role, *viz*. the authority to examine the operational efficiency of the ECB - see Article 27-ESCB.

'Article 35 – Judicial control and related matters

35.1 The acts[25] of the ECB shall be open to review or interpretation by the Court of Justice under the conditions laid down for the legal control of the acts of Community institutions. The ECB may institute proceedings in the same conditions as Community institutions.'

draft 27 November 1990

Article 27 - Auditing

27.1 The accounts of the ECB and the NCBs shall be audited by independent external auditors recommended by the Governing Council and approved by the Council (of Ministers). The auditors shall have full power to examine all books and accounts of the ECB and NCBs, and to be fully informed about their transactions.

27.2 The provisions of Article 203 and 206a of the Treaty shall not apply to the ECB or to the NCBs." [26]

draft 27 November 1990

In his personal report as chairman of the Ecofin Council to the Rome European Council on 27 October 1990 the Italian Minister of Finance Carli observed that the oversight on the activities of the independent ESCB should rest with a political authority, whose own legitimacy derives from general (direct) elections.

Finally, we mention that in September 1991 in an unusual appearance before the Finance Committee of the Bundestag (Germany's parliament) French governor de Larosière stated that during the drafting of the ESCB Statute the governors had not lost sight of the essential concept of accountability ('einen wesentlichen Begriff').[27]

II.3 HISTORY: IGC

The **Commission** tried to gain influence over monetary policy by including in its draft Treaty text the option for the Commission to address observations to the president of the ECB 'which, in its view, have a bearing on the consistency between economic and monetary policy.' The draft also mentioned that the Commission could go public with this opinion.[28] This was ignored by the ministers of finance, who did not want to give any monetary competence to the Commission, while their own competences were already getting smaller.

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[25] We do not deal with Art. 35 hereafter. Therefore, we mention here that at the advice of the EMU Working Group 'acts' would be changed into 'acts and omissions' in order to make it consistent with the relevant Treaty articles (Art. 176-EEC refers to an 'institution whose act has been declared void or whose failure to act has been declared contrary to this Treaty'. (Working Group session of 26-28 November 1991.) It means the ECB can also be held accountable for negligence.

[26] Article 203-EEC described the procedures for the Community institutions for submitting a budget and Article 206a described the role of the European Court of Auditors.

[27] Printed in Bundesbank (1991), Auszuege aus Presseartikeln, 1991, nr. 69. We also refer to box 2 of Art. 7, where is shown that Bérégovoy saw accountability as a way to reduce the independence of the ESCB. But we have also seen that the Bundesbank and the Nederlandsche Bank saw accountability as a way to safeguard or even increase the ESCB's independence. De Larosière's words could be seen as an effort to placate both camps.

[28] Article 109 of the Commission's draft Treaty of 10 December 1990.

The **French** draft stayed close to the Commission's draft, but added two new ideas: first, the idea that the Ecofin should be able to table a motion for discussion in the Governing Council, and second, the idea that the chairman of the Ecofin could suspend a decision of the Governing Council by two weeks. [29] Both ideas were copied from the Bundesbank law [30] and fitted in the French strategy of finding as many ways as possible to bind the ECB in Community coordination procedures (see discussion under Article 7).
The **German** draft was rather short on the monetary side of EMU, referring mostly to the Statute of the ESCB which was to be annexed to the Treaty. With regard to reporting and accountability, the German draft only mentioned that "[t]he ECB shall submit an annual report on monetary policy to the Council [of Ministers] and the European Parliament. The President of the ECB may be asked by the European Parliament to report on the ECB's monetary policy." [31] The Germans did not want the president of the ECB to present the ECB's annual report to the European Council; the Dutch delegation supported them on this, because they did not want to 'institutionalize' the European Council.[32]
During the deputies IGC of 19 March 1991, Köhler indicated he might be willing to accept the European Council as an addressee, but only provided the European Council would never discuss the annual report without the presence of the ministers of finance. The Luxembourg presidency decided to drop the reference to the European Council from their Article 109b(2) - the equivalent of Article 15.2-ESCB.[33] (The Luxembourg presidency would later make a distinction between *sending* the report and *presenting* the report. The report would be sent to the European Council and others, but would be presented only to the Ecofin and European Parliament.)

During the meeting of 19 March 1991 the French proposal to allow the chairman of the Ecofin to *suspend* decisions of the ECB was discussed. The French were supported by the Danish and Irish delegate. However, a strong coalition (Köhler, Stek (Netherlands), Gaspar (Portugal) and Draghi (Italy)) rejected the proposal. Wicks was sympathetic, but was also of the opinion that such a far-reaching decision (i.e. temporarily blocking an ECB decision) would require unanimous support or at least a qualified majority in the Ecofin Council, which was impractical to organize. Boissieu (France, ministry of foreign affairs) conceded it would indeed endow the chairman of the Ecofin with a new sort of power. Subsequently the issue was dropped. The German delegation did not fight the idea that the Ecofin president would be able to submit a motion for deliberation by the Council of the ECB.[34] Most likely the

[29] Projet de Traité sur l'Union Economique et Monétaire, Republique Francaise, 25 January 1991, Article 4-3(1): "[...] Le Conseil peut soumettre une motion à la déliberation du Conseil de la Banque. Le Président du Conseil peut demander au Conseil du SEBC de différer une décision pendant un délai maximum de quinze jours."
[30] Bundesbank Law (1957), Article 13(2): 'The members of the Federal Government shall be entitled to take part in the deliberations of the Central Bank Council. They shall have no vote, but make motions. At their request the taking of a decision shall be deferred, but for not more than two weeks.' The possibility of taking part in the deliberations had also been mentioned in the Delors Report.
[31] Composite proposal by the German delegation, 26 February 1991, Article 109a(5). On 19 March Köhler stated that other Executive Board members should also be allowed to be heard by the European Parliament (i.e. not only the president).
[32] Cf. proposal of the Dutch delegation (UEM/36/91, dated 19 March 1991).
[33] See Article 109B of the Luxembourg non-paper of 27 March 1991 (UEM/38/91).
[34] In French the word 'déliberation' means both discussion and decision-making. In English the word 'deliberation' does not refer to decision-making, but only to formal discussion before reaching a decision, which - as seen from the perspective of the ECB - is less harmful. So far the instrument has never been used. Its operational value would also be doubtful, because the Ecofin president cannot even ask for a vote on his motion.

Germans did not raise objections, because the idea was close to the text of the governors, according to which the president of Ecofin and a member of the Commission could 'take part in the Council's deliberations'. The German IGC delegation used the governors' text as their ultimate benchmark. Internally the Dutch were worried, because they feared Ecofin would be more activist in the use of this instrument than the German government had been, which actually never used it. On the other hand, the Ecofin president would first have to get the backing of a majority of his colleagues, as he could not act à titre personel. The Committee of Governors did react to this point. In a letter to the IGC it stated that the right of the chairman of Ecofin to make formal proposals and to request voting on this matter would not be compatible with the undertaking in Art. 107 not seek to influence the ESCB.[35] The Dutch presidency however felt bound to the outcome of the discussions held in the IGC.

The qualification that Executive Board members could attend meetings of the European Parliament, 'if circumstances justify', restricted the power of parliament to invite board members. This wording was changed during the Luxembourg presidency into 'may, **at the request** of the European parliament **or on their own initiative**, be heard (etcetera)'.
The final document of the Luxembourg presidency (CONF-UP-UEM 2008/91, dated 18 June 1991) would contain the following text on Article 109A (Article 15-ESCB had been changed accordingly):

"Article 109A
1. The President of the Council and a member of the Commission may participate, without the right to vote, in meetings of the Council of the Bank.
The President of the Council [36] may in this context submit a motion for deliberation by the Council of the Bank.
2. The President of the ECB shall be invited to participate in Council meetings when the Council is discussing matters relating to the objectives and tasks of the ESCB.
3. The ECB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and current year to the European Parliament, the European Council, the Council and the Commission. The President of the ECB shall present this report to the Council and to the European Parliament; the latter may open a general debate on that basis.[37]
Furthermore, the President of the ECB and the other members of the Executive Board may, at the request of the European Parliament or on their own initiative, be heard by the competent committees of the European Parliament."

Reference document 18 June 1991

Except for a few editorial remarks this would be the final version of this article.

[35] UEM/101/91, 13 November 1991.
[36] A problem arises when the president of the Council is from a derogation country. The Ecofin has decided that in these cases the chairman of the eurogroup, i.e. the finance minister of the Member State that will become chairman of the Ecofin in the next half year, will attend the ECB meetings. The ECB takes a neutral position on this.
[37] The requirement for the ECB to address an annual report to those mentioned in Art 109b(3) is also contained in Art. 15-ESCB, together with the requirement to publish a weekly financial statement of the ESCB and a quarterly report covering its activities. These reports are to be freely available to the public.

Relations with Parliament in practice
During the first years of the system relations with *parliament* have developed. Duisenberg expressed the wish to visit the competent committee of the European Parliament (the Committee of Monetary and Economic Affairs) four times a year. [38] The president explains the ECB's policy and comments on other subjects, on which he might want to influence parliament's opinion. [39] Other Board members may also be heard by parliament. The Annual Reports of the ECB provide information on the visits of the Executive Board members to the European Parliament.[40]
Apart from this the president also visits parliament (full plenary session) at the occasion of the ECB's annual report. At that occasion parliament discusses and votes on a (non-binding) resolution concerning the ECB. It should be recalled that parliament does not have a monetary competence.

Governors (not the Executive Board members) may appear before their **national** parliaments. During such testimonies the governors cannot discuss future policy intentions nor can they reveal how they or others have voted. This would breach Article 10.4-ESCB, which states that the proceedings of the meetings of the Governing Council shall be confidential.

[38] The Rules of Procedure of the European Parliament now provide the President of the ECB shall be invited to attend the meetings of the competent committees at least four times a year to deliver a statement and answer questions.
[39] Examples are regulatory proposals by the Commission relating for instance to the further unification of the financial markets in Europe (the Commission's Financial Action Plan).
[40] There is no reason why we should not see the same development here as in the US, where also Fed *staff* can be invited to give testimony before congress. This would require approval by the Executive Board, which can be given under either Art. 13.1 ('the President or his nominee shall represent the ECB externally') or 12.3 (Rules of Procedure).

Article 109c:

Article 109c (on the Economic and Financial Committee)

"2. At the start of the third stage, an Economic and Financial Committee shall be set up.
The Monetary Committee provided for in paragraph 1 shall be dissolved.
The Economic and Financial Committee shall have the following tasks:

- **to deliver opinions at the request of the Council or of the Commission, or on its own initiative for submission to those institutions;**
- **to keep under review the economic and financial situation of the Member States and of the Community and to report regularly thereon to the Council and to the Commission, in particular on financial relations with third countries and international institutions;**
- **without prejudice to Article 151, to contribute to the preparation of the work of the Council referred to in Articles 73f, 73g, 103(2), (3), (4) and (5), 103a, 104a, 104b, 104c, 105(6), 105a(2), 106(5) and (6), 109, 109h, 109i(2) and (3), 109k(2), 109l(4) and (5), and to carry out other advisory and preparatory tasks assigned to it by the Council;**
- **to examine, at least once a year, the situation regarding the movement of capital and the freedom of payments, as they result from the application of this Treaty and of measures adopted by the Council; the examination shall cover all measures relating to capital movements and payments; the Committee shall report to the Commission and to the Council on the outcome of this examination.**

The Member States, the Commission and the ECB shall each appoint no more than two members of the Committee. "

(to be read in conjunction with Art. 109b-EC (Institutional dialogue))

(to be read in conjunction with Art. 12.4 (Governing Council exercises the advisory functions); Art. 42 (Complementary legislation); Art. 109-EC (Exchange rate policy))
Also contains the genesis of Art. 4-ESCB (Advisory functions)

I. INTRODUCTION

This article on the Economic and Financial Committee (EFC) is relevant for the institutional balance, because its genesis shows some wavering around the role of the ESCB by the IGC on EMU, i.e. by the representatives of the Member States' Finance Ministries. Suggestions for a larger role for the ESCB were first taken on board and later discarded. At the same time the Finance Ministers secured a firm role for their committee in the preparations of the Ecofin Council, thus continuing the de facto role of its predecessor, the Monetary Committee, consisting of high level representatives of the Treasuries and the central banks (usually the Treasurer-General and an experienced central bank board member). For other Councils (e.g. the Foreign Affairs Council, but also the Council of Ministers of specialized ministries, like agriculture) were (and are) prepared by the so-called Committee of Permanent Representatives (Coreper),

consisting of delegates of the Ministries of Foreign Affairs with seconded staff from other ministries. In Coreper draft Commission proposals are discussed in an early stage and countries take negotiation positions.[1] The status of the EFC is strong, because it is Treaty-based.

II. GENESIS

The Committee of Governors had not dealt with the future of the Monetary Committee, as they concentrated on their own right of giving advice.[2] They wanted to avoid as being seen as trespassing on the area of the Finance Ministers, as they wanted to produce an uncontroversial report. They did however refer to the Delors Report in the last paragraph of their Introductory Report accompanying their draft ESCB Statute of 27 November 1991, as indeed the Delors Report had emphasized that 'economic union and monetary union form the integral parts of a single whole', followed by a further reference to the importance of budgetary discipline. The Delors Report had not commented on the role of the Monetary Committee, though it did mention its existence (par. 33).

The Commission's working document with drafts for a Treaty chapter on EMU repeated Art. 105 of the EEC Treaty on the establishment of a Monetary Committee with advisory status.[3] The French draft Treaty text of 26 January 1991 also referred to a Monetary Committee, with the explicit task of monitoring the foreign exchange markets and the implementation of the Community's exchange rate policy. While the Commission's text had provisionally mentioned that the Committee should be composed of two members per country and two of the Commission, the French text (Art. 4-4) explicitly mentioned that the Committee would be composed of each Member State's Treasurer-General and central bank president (or its replacement), two members of the Commission and of the Board of the ESCB.

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[1] See Art. 151-EC.

[2] Art. 4-ESCB read in its final form:

Article 4: Advisory functions
In accordance with Article 105(4) of this Treaty:
(a) the ECB shall be consulted:
- **on any proposed Community act in its field of competence;**
- **by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 42;**

(b) the ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its field of competence.

The governors had proposed the following text:
4.1 The ECB shall be consulted regarding any draft Community legislation and any envisaged international agreements in the monetary, prudential, banking or financial field. In accordance with Community legislation, the ECB shall be consulted by national authorities regarding any draft legislation in its field of competence.
4.2 The ECB may give opinions to any Community or national authority on matters within its field of competence.
4.3 [relates to exchange rate policy – see Art. 109-EC, section II.2]
4.4 The ECB may publish its opinions. [for its genesis see also Art. 109, section II.2]

[3] Commission Working Document of 10 December 1990, Art. 109a.

The German draft of 26 February 1991 just mentioned that for the purposes of coordinating economic policy the Council would be supported by 'the .... Committee.' The French draft shows their usual preference for political over expert committees, by their suggestion to defining the Treasury member as the 'suppléant du Ministre de l'Economie et des Finances' and by bringing in the president of the NCB, and not like it used to be a high-level expert member of the NCB.

The Luxembourg presidency borrowed from several sources and tabled the following text in March 1991, which would stand unchanged until the end of their presidency. Compared to the existing Art. 105-EEC on the Monetary Committee it had added the ESCB as one of the institutions which could ask for an opinion by the Committee.

"Article 109B

1. As from the date on which the ESCB begins to assume its duties (.....) an economic and financial committee shall take the place of the Monetary Committee (....); it shall have the following tasks:
   - to draw up opinions, at the request of the Council, the Commission or the ESCB, or on its own initiative, for submission to these institutions,
   - to keep under review the economic and financial situation of the Member States and of the Community and to report regularly to the Council and the Commission, in particular on financial relations with third countries and international institutions,
   - to contribute to the preparation of the work of the Council concerning EMU.
2. The Committee shall be composed of representatives from the Member States, from the Commission and from the ESCB.
   The Council, acting by a qualified majority on an opinion of the Commission, the ESCB and the Monetary Committee shall determine the composition of the Committee and approve its rules of procedure"

Luxembourg non-paper 3 April 1991 [4]

During the Deputies IGC of 2 April 1991 Germany stated that in stage three of EMU the committee should be called Financial Committee and NCB members should not participate anymore, because they cannot represent Member States anymore. While this position was supported by the Belgian delegation, the UK and Dutch delegation emphasized the need for continuing to have a non-political body of experts, that is including the central bankers. (The German position was not consistent with the assumed expert status of the committee members, and might have been inspired by the wish of the German Economics Ministry to substitute for the central bankers, while the Finance Ministry needed the support of the Economics Ministry against pressure exerted by Genscher to establish quickly an ECB.)[5]

[4] UEM/41/91. The final non-Paper of 10 June 1991 shows the same text, except for the replacement of ESCB by the ECB, where ECB stands for the Governing Council of the ECB (based on Art. 12.4 of the draft ESCB Statute of the Committee of Governors).

[5] Mentioned in report of the Nederlandsche Bank of Deputies IGC meeting (BG033, 3 April 1991).

In a chairman's paper of 25 September 1991 Maas (chairman of the deputies IGC) split the article in two, the first part relating to the Monetary Committee until the establishment of the ESCB and the second part defining its successor (an Economic and Financial Committee), basically using the text of the Luxembourg presidency, but suppressing the right of the ESCB to ask for an opinion of the committee, and changing the sentence on the composition as follows:
'The Member States, the Commission and the ECB shall each appoint members of the Committee.'
The Dutch presidency had replaced the word 'representatives' by 'members' in an effort to placate the Committee of Governors, which had expressed in a letter its wish not to be represented in the EFC, as the cooperation between the ESCB and the institutions of the Community were dealt with adequately and comprehensively in Art. 15 of the draft ESCB Statute (the predecessor of Art. 109b-EC).[6] In fact, the governors were worried that by being represented in the EFC the ESCB could be bound by the outcome of the discussions in the EFC, especially in view of the broad mandate of the EFC, which could also cover monetary-related or exchange rate matters. For this reason, some NCBs had wanted the ESCB to be present in the EFC only at staff level. In the sentence above the word 'ESCB' was changed into 'ECB', which left open that Member States could appoint NCB members à titre personnel.
The Committee of Governors' argument that the relations between the ESCB and the Community institutions had been dealt with adequately in Art. 15 of their draft Statute, might have led the Dutch presidency to drop the ESCB from paragraph 1, first indent (as quoted above). Apparently, the governors were rather concerned with the risk of others invading in their area, while they valued less the possibility of being present in a committee like the EFC, which could give them the opportunity to present expert advice to the Finance ministries on EMU-related matters. What could have played a role as well, is that in their minds the ESCB had risen to the level of the Community institutions, at which level they expected to be able to communicate effectively.
During the deputies IGC of 8 October 1991 the German delegation stated it was still not satisfied by the word 'members'. However, their proposal to state that the Member States and the Commission shall each appoint two members, while representatives of the ECB shall participate in the meetings was not adopted. A third indent was created, because the presidency decided to spell out the articles in which the EFC was entitled to contribute to preparing the work of the Ecofin, because this allowed them to delete the manyfold references to the EFC in those other articles, which was mentioned more often than the European Parliament. The article was renumbered into Art. 109C.
Article 109c also contains a third paragraph stating that Ecofin, acting by qualified majority on a proposal by the Commission and after consulting the ECB, shall lay down detailed provisions on the composition of the EFC. In 1998 Ecofin decided in favour of continued membership of the NCBs[7]. In anticipation of the enlargement of the EU, and the EFC, with ten new countries, Ecofin has more recently, i.e. in 2003, introduced restricted meetings (Finance members only) for the EFC's discussions on a number of topics, among which the discussions on Member States' stability programs and the excessive deficit procedure, thus reducing central bank presence

[6] Letter by Hoffmeyer (chairman of the Committee of Governors) to the IGC dated 5 September 1991 (CONF-UEM 1617/91). This position was repeated in the Committee's letter of 13 November 1991 to the IGC (UEM101/91).
[7] Council Decision of 21 December 1998 (98/743/EC).

during important discussions on budgetary policy to only the two members of the ECB, which is to be regretted from the point of view of EMU-wide checks and balances.

CHAPTER 5: CONCLUSIONS TO CLUSTER I

5.1 INTRODUCTION

Despite the sometimes considerable differences between the draft Treaty text of France and the Commission on the one hand and the draft ESCB Statute of the governors on the other hand, the governors' text has prevailed in almost all instances. Germany's aim was to leave the governors' text as untouched as possible. Germany could not have realized this, if the governors had not construed such a realistic and institutionally balanced text and if the central bankers had not followed to such a large extent the Bundesbank law - not so much because the Bundesbank was the most successful central bank in terms of achieving price stability, but because the Bundesbank was a proven successful example of federally structured central bank, making it especially apt to function in important respects as a model for the ESCB. Particularly useful federal elements of the Bundesbank were: (i) its combination of centralized decision-making and decentralized implementation; (ii) centralized decision-making with votes for *all* district presidents (Landeszentralbankpresidenten); (iii) such a collegial decision-making more or less implied the existence of a large degree of independence (otherwise, i.e. if the minister could overrule the central bank, collegial decision-making would be a farce)[1] ; (iv) communication with the fiscal authorities took place at the federal, not the regional level. Nonetheless, and as we have seen, the ESCB Statute does deviate from the Bundesbank law in a number of important respects: e.g. the ESCB is more transparent and the ESCB has a more narrowly defined objective. One could say though that the Bundesbank model served as a proven concept of checks and balances, although not necessarily a perfect one.[2]

An *additional* factor explaining the success of the governors might be that they started their discussions already in 1988, forced to do so by the establishment and their membership of the Delors Committee - which in retrospect was a master coup by Delors and Kohl. The governors needed time, because for them these were uncharted waters too. Once the process was set in motion, the governors took care to ensure that the Committee of Governors would be involved in case it would actually come to an IGC. [3] This allowed them to present a draft ESCB Statute to the IGC. So they managed the process very well. During this process, the governors were fortunate they could rely on the accumulated experience of the Committee of Governors; especially Pöhl, Duisenberg and de Larosière (but also their alternates) were seasoned central bankers, well-versed in the 'game' of checks and balances.

During the whole process the governors remained greatly concerned about the *economic side of EMU*. Already in the Delors Report they had emphasized the need for parallelism between monetary and economic integration, but they felt it to be outside their territory to make strong and specific recommendations in that area. Though they were able to make their case also in

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[1] Interestingly, in her biography Mrs Thatcher observes that having an independent central bank is more appropriate for federal states [than for a country like the UK]. Thatcher (1993), p. 706.

[2] We will not go into further detail, as the Bundesbank is not the subject of our study. Nonetheless we will make some comparisons between the Bundesbank and the ECB in chapter 5.3.

[3] See par. 66 of the Delors Report: '[....] The competent Community bodies should be invited to make concrete proposals on the basis of this Report concerning the second and the final stages, to be embodied in a revised Treaty.'

the Monetary Committee (through the membership of the governors' alternates in that committee), in the end they had to rely on the negotiations in the IGC, and then especially on the German delegation, which had made this parallelism into one of its negotiation priorities. France supported Germany on the need for fiscal discipline, however, they favoured different methods: the French put emphasis on Ecofin (a political body) for exerting discipline, the Germans put emphasis on automaticity based on non-negotiable pre-quantified limits. It is too early to judge whether the economic leg of EMU is strong enough. The enforceability of the budgetary discipline is a matter of concern.[4] We will come back to this in chapter 12 (in terms of the design of the economic leg of EMU seen from the perspective of checks and balances).

In section 5.2 we will briefly review each of the selected articles and assess especially how the governors dealt with the checks and balances. We will focus on the discussions in the Delors Committee, the majority of members of which were governors, and on the discussions in the Committee of Governors on the draft ESCB Statute. We will see that the governors did not try to maximize the independence of the future central bank. Already during the discussions in the Delors Committee the governors showed they were aware of the need to find a balance between independence and accountability. This positive assessment of the 'political realism' of the governors is an addition to the existing literature which usually only tries to shed light on the relative influence of Germany and France on the outcome of the negotiations. See for instance Wolf (1997); Viebig (1998); and Dyson/Featherstone (1999). At the end of section 5.2 we will draw conclusions.

In section 5.3 we will specifically compare the independence and accountability of the ESCB and the Bundesbank (to allow for a wider perspective we also compare the ESCB with the Federal Reserve and the Commission and the Court of Justice), while in chapter 5.4 we will divide the articles over the five categories of checks and balances as presented in chapter 2. This will allow us to see how the powers in the monetary area are defined, shared and limited and whether and where the System's external checks and balances should or could be improved.

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[4] German doubts about the enforceability of the budgetary rules have led to the Stability and Growth pact (concluded in Amsterdam in 1997). The pact is meant to speed up and clarify the implementation of the excessive deficit procedures of and to strengthen the surveillance procedures. The pact would come under pressure in 2003, when under pressure from Germany and France, which countries were expected to run an excessive deficit for a third consecutive year, the Council of Ministers side-stepped the pact. This action was strongly criticized by some countries and the Commission. The Commission went to the Court of Justice, which annulled the conclusions adopted by the Council in which the Council had decided to hold the excessive deficit procedure in abeyance and the Council's decision in which it had modified its previous recommendations to the excessive deficit Member States, by-passing the right of initiative of the Commission (Court Case C-27/04).

5.2 CHECKS AND BALANCES BETWEEN THE ESCB AND THE OUTSIDE WORLD

Content

5.2.1 Short reviews

Establishment (Art. 1-ESCB):

In 1985 Delors had tried, but not succeeded in endowing the European Community with a monetary capacity. Instead, the then inserted new Article 102a (drafted by Tietmeyer himself)[1] ensured that institutional changes in the monetary area, like the establishment of an eventual ECB/ESCB, would require an amendment of the Treaty. An ESCB established by way of a Regulation of the ECOFIN would of course never be sure about its status as an independent institution in a possibly highly politicized European context, partly because of its strong intergovernmental features. In short, Article 102A secured that the ESCB would get Treaty status. When discussing the position of the ESCB among its fellow Community institutions, the governors decided it would be preferable not to treat the ESCB/ECB as a genuine Community institution, as this would imply the ESCB/ECB being subject to Community provisions relating to staff, budgetary issues, auditing, secrecy, judicial control and others. Some of these provisions might have conflicted with the independent status of the ESCB. The governors opted for a separate article (Article 4A). They succeeded in getting IGC approval for this, because they included in the draft Statute specific provisions covering all areas which would otherwise have been covered by general Community provisions, thereby pre-empting any criticism as regards possible legal uncertainties of their proposal.

Article 1 should be read in conjunction with Article 9.1, which stipulates the ECB has legal personality (and not the System). The NCBs also kept their own legal personality. This makes for another difference between the Community institutions and the ESCB/ECB. The Community institutions do not have legal personality, they act on behalf of the Community.[2] In the case of the ESCB, it is different: the ESCB is not an arm or agency of the Community, nor is it established by the Community - it is established within the Community, in the same way as the Community itself was established, namely by the Member States. The constituent parts of the System (ECB, NCBs) have legal personality, the System as such does not.[3] However, the NCBs became integral parts of the System (Art. 14.3) and they are committed to the objectives and tasks assigned to the System. The decision-making bodies are attached to the ECB, but it is clear from Article 8-ESCB that the authority of the decision-making bodies extends to the System.[4]

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[1] Szász (1999), p. 94. See also SEA in Art. 7 above (section II.1A)

[2] Art. 210-E(E)C (since 1997 Art. 281-EC): 'The Community shall have legal personality.'

[3] The same is the case in the United States, where the Federal Reserve System as such does not have legal personality - see for more cluster II, Art. 12.1

[4] The System consists of the central banks of all EU Member States, even those with a derogation and a special exemptions like the UK and Denmark (together called the 'outs'). However, the central banks of the 'outs' are exempted from certain rights and obligations; for instance, they do not take part in the decision-making process

Objectives (Art. 2-ESCB):

When the Delors Committee started to meet in the second half of 1988, the governors were still used to defining the objective of their central banks in terms of 'maintaining the stability of money'. In the past this phrase had referred both to internal and external stability. However, with capital flows increasing and capital controls abolished, it had become more and more difficult to attain these two objectives simultaneously. Furthermore, exchange rate policy was a *shared* responsibility with the government, which implied that the ECB's instruments might be 'high-jacked' by the governments for the purpose of defending a certain exchange rate level. Therefore, the governors came to realize they should avoid responsibility for the external stability, or at least make sure they could give priority to internal stability. To make this clear, the mandate was slimmed down to read: 'the system shall be committed to price stability'. The Committee of Governors, when drafting the ESCB Statute, strengthened the wording of the Delors Report by changing 'commitment' (which refers to an endeavour) into an objective (which more clearly has the character of a legal obligation): 'the primary objective of the system shall be to maintain price stability'. This unequivocal formulation strengthened the accountability of the System's sought for institutional independence. By ensuring a specific mandate the governors reduced the need for control. At the same time the narrow mandate increased the system's accountability, as the narrow objective made it better possible to monitor its performance.[5] The system has no full goal independence, as it is bound (and wants to be bound) by its primary objective of price stability. The precise definition of price stability is left to the ESCB, which allows it operational flexibility without political interference. Here we see that institutional (political) independence and goal independence move in opposite directions: more goal independence will lead to less institutional independence.

Basic Tasks (Art. 3.1 and 3.2-ESCB):

The monetary and payment tasks were not contentious among the governors nor among the ministers. Problems arose with the holding of, and operations in, foreign reserve assets. See further under Article 109-EC below. Seen from the viewpoint of checks and balances it is important that the ESCB has full-scale competence for monetary policy and for the smooth operation of payment systems.

Independence (Art. 7-ESCB):

The governors have been very successful in creating an institution whose decision-making process would be shielded from political instructions and pressure. They had been 'lucky' they could borrow from the existing Treaty a very strict article defining the independence of the members of the Commission. The governors balanced this independence by choosing a clearly circumscribed, narrow mandate and by describing in detail the relations between the

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of the Governing Council, which is reserved for the central banks of the member states that have adopted the euro. See Chapter IX of the ESCB Statute.

[5] The political acceptability was enhanced by embedding the mandate in a more general obligation, *viz* to support the general economic policy of the Community, conditional on having fulfilled the mandate. Idea based on the Bundesbank (see Article 2, section II.1).

ESCB and the Community institutions. In fact, the governors succeeded in increasing both the degree of independence and the degree of accountability of the ECB relative to the Bundesbank. In retrospect, this approach must be described as a great success, as evidenced for instance by the fact that the Commission, in its Working Document of December 1990 for the IGC, hardly deviated from the governors' text as regards the formulation of independence and the inter-institutional co-operation - except for quite obvious efforts to increase the role of the Commission in the monetary area, especially in the field of exchange rate policy, efforts which were blocked by the Ministers of Finance (and *could* be blocked by them, because the Commission was not a negotiating party in the IGC).[6]

The independence extends not only to the decision-making bodies of the ECB or the System, but also to the decision-making bodies of the NCBs (and not only to their presidents), and even to the 'outs' (this was the price they had to pay for becoming a formal member of the ESCB).[7] Only the UK is exempted from this requirement. [8]

A weakness of the article is that there are no sanctions on the governments when they try to intervene - publicly or, worse, behind the scenes. This underlines how important it is for the ESCB to be endowed with unambiguous personal, functional and financial independence. One of the most important potential allies for a central bank is the public and public opinion. Therefore, it is very important that the ECB (i.e. its Governing Council) is allowed to publish its opinions (see Article 4.4-draft ESCB Statute, which became Article 34.2 of the version adopted in Maastricht).[9]

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[6] The Commission sought a more pronounced role in the following areas (all articles mentioned refer to the Commission's draft Treaty proposal of 10 December 1990: (1) The Commission's proposal reserved a right for the *Commission* to address observations to the Bank, which observations the Commission might decide to publish. (Article 109(3)-Commission's draft.) (2) The European Parliament was to hold a general debate once a year on the conduct of *economic and monetary policy at the Community level* on the basis of a report from the *Commission* and the report from the ECB. (Article 109(5)-Commission's draft.) (3) The ESCB would hold the foreign reserves of the Member States, but ownership would be transferred to the *Community*, probably also implying that a large part of the seigniorage would flow to its owner, i.e. to the Community's budget (Article 106b(2), second indent). (4) The ECOFIN, when laying down guidelines for the Community's exchange rate policy, would act solely on a proposal by the *Commission*. (Article 108-Commission's draft.) (5) The ECB Board Members would be appointed by the ECOFIN, and not by the European Council/Heads of State, thereby giving them a lower status than the *Commissioners* who are appointed by the Heads of State or Government (Article 107(3)-Commission's draft).

[7] The governors of the out-NCBs are member of the General Council. See Article 1-ESCB. The out-NCBs are also assigned a weighting in the key for subscription to the ECB's capital, though they shall not pay up their subscribed capital. See Article 48-ESCB.

[8] See Articles 5 and 8 of the Protocol nr. 11-EC. This explains why the Bank of England's inflation target can still be set by the Chancellor of the Exchequer. In contrast, the Swedish Riksbank, which also follows a policy of direct inflation targeting, announces itself the target for the inflation outcome two years later. See Houben (2000), p. 322-323.

[9] The importance of being able to publish opinions was first discussed by the Alternates of the Committee of Governors in the context of the advisory role of the ESCB in the field of exchange rate policy. At the request of André Szász, the Dutch Alternate, later supported by Tietmeyer, the draft Statute stipulated that the opinions of the ESCB, regarding intended decisions by the ECOFIN on the exchange rate regimes and parity changes, could be made public. The Commentary to Article 4.3 of the draft version of 3 July 1990 explained why: 'Some Alternates stressed the significance of publishing opinions in this context because it reinforces the authority of the System in its relationships with the other Community institutions. The provision draws on its inspiration from Dutch central bank law.' This is a reference to Article 26 of the Netherlands Bank Act 1948, which stipulates that, when the government decides to overrule the central bank when the central bank refuses to follow a governmental instruction, the arguments of the central bank for refusing will have to be published in the National Gazet, unless it is contrary to the best interest of the country. During the governors' meeting of 10 July

There will always be efforts to *de facto* invading on the central banks' independence - Treaty or no Treaty. I will give two examples. **One**: the French president Chirac tried unsuccessfully to shorten the term of office of the first ECB president (just because he was not a Frenchman).[10] The most worrisome part of the story is that he almost succeeded. Eyewitnesses tell that even Kohl had given in. He was on his way, with Waigel on his side, to tell the press that he and Chirac had agreed that Duisenberg would step down on 1 July 2002 when a diplomat told him that a German news agency was spreading the word that Kohl was ready to violate the Treaty, which would cost him votes, especially because his minister of foreign affairs (and FDP chairman) Kinkel had earlier mentioned he was considering resigning over the issue. Kohl retracted.[11] The **second** example refers to Lafontaine, finance minister of the Schröder government. Early 1999 he had put public pressure on the ECB to lower its interest rates. Because Lafontaine also made a lot of domestic enemies (among the employers) his position was weakened and he suddenly stepped down in March 1999. In retrospect this can be seen as a major watershed for the ECB, establishing its reputation as an independent institution.

An interesting topic for further research might be the way central banks ward off political pressure by mobilizing the support of public opinion and of the financial community - the essential point being that, if a central bank is able to convince the general public that the pressure of the political authorities on the bank is short-sighted (time-inconsistent), the political authorities might back off, because the electoral gains become negative. [12]

Confidentiality Minutes (Art. 10.4-ESCB):

National central banks in Europe were used to keeping their minutes confidential. At the same time they were aware of the importance of informing the markets on their intentions and priorities. For most central banks the priority was maintaining a stable exchange rate with the Dmark, which was supported by an unwavering public commitment to this goal. Internal doubts about the sustainability of the parity were treated with absolute secrecy. The Bundesbank, being the de facto anchor of the exchange rate system, did not follow an

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1990 Duisenberg remarked that the ability to publish opinions would add weight to the advice of the System. Governors then agreed to delete the proviso 'unless it is contrary to the best interest of the Community' and to mention this unrestricted ability in a separate Article 4.4: 'The System may publish it opinions.' This is an example of how important it is that persons with long experience in central banking are present during such drafting sessions.

[10] When Duisenberg had accepted to succeed Lamfalussy as president of the EMI as of July 1997, he had asked and received highest level political support for his nomination as first president of the ECB - except from the French capital. Duisenberg knew there would be a lot of pressure by Chirac for another outcome. Legend has it Duisenberg on purpose avoided meeting Chirac on a one-to-one basis, to prevent that Chirac could say they had agreed among themselves on something else than a full term.

[11] The outcome was a vague statement drafted by Duisenberg himself, according to which he might step down before the end of his term, but he would at least see his term through until the introduction of the euro. In any case he and only he himself would decide on the moment on which he will step down.

[12] The Rheingold affair is a recent example. In 1997 the German Minister of Finance Waigel wanted the Bundesbank to accelerate a pending revaluation of its gold in order to use part of the book gains to improve his budget. Waigel wanted thus to ensure Germany would meet the deficit convergence criterium in 1997 without having to take tough measures. The Bundesbank refused (because of the motive) and the conflict went into the open, with the German financial press supporting the Bundesbank.

exchange rate strategy, but could rely on a successful strategy of monetary targeting - successful in the sense of delivering the lowest inflation in Europe. There was no pressure on the Bundesbank to be more open or transparent. For the governors transparency was not a real issue and they did not spent much time on this issue. In fact, in their view publishing the records of the meetings might elicit pressure from the governments on 'their' governor. An interesting fact following from the genesis of the article is that the IGC took the position of the governors for granted, as no delegation raised the issue. Apparently, it was not considered an issue in the relations between the ESCB and the political authorities, which might have been due to their experience that sensitive informative could trigger unrest in the foreign exchange markets and due to the absence of any tradition of individual accountability which would have required the publication of votes. The more independent central banks were used to collegial decision-making.

Appointment Board members (Art. 11.2-ESCB):

This article forms an important element of the framework of checks and balances between the ESCB and the 'other' Community institutions. The governors were careful in seeking the right balance. They could have proposed that a president be chosen by the Council of the ECB from among its members, as is the case with the Court of Justice. Or they could have pursued the proposal that the other members of the Board should be appointed 'on a proposal from the Council of the System.' They opted for appointment by the highest level (Heads of State) with an advisory role for the Council of the System (the Governing Council), and only a role for the European Parliament in the appointment procedure of the president and vice-president.[13] During the IGC Waigel introduced the idea that the Board members should be appointed on a proposal of the Ecofin Council. The Committee of Governors, which reacted on two occasions to changes in its draft Statutes proposed by the IGC, never reacted to this specific proposal. It must have been acceptable to them. (Perhaps they even welcomed the proposal, because it prevented the preparation of the appointment decisions falling into the hands of the ministers of foreign affairs, who usually prepare the meetings of the European Council.) The proposed appointment procedures can be judged as being 'more democratic' than the appointment procedures for the Commission and the Court of Justice, which at that time did not provide for involvement of the European Parliament. Furthermore, the involvement of the Ecofin improved the checks and balances in the system, in the sense that it prevented a concentration of (economic) power in the hands of the Heads of State. The role of the European Parliament was nonetheless restricted to being consulted. In practice their role would be more important, because Duisenberg introduced the example that Board members do not accept their nomination unless supported by the European Parliament. This makes political appointments by the Executive branch less likely.

[13] The latter was meant to emphasize the special status of the president and vice-president. The IGC would level the appointment procedures for the (vice-)president and the other members of the board.

NCB Statutes (Art. 14.1-ESCB):

We have seen that the ESCB Statute allows for differences between the Statutes of the NCBs, though they are all bound by the objectives, tasks and procedures of the ESCB Statute. However, in some areas some further harmonization is desirable, for instance as regards the formulation of the subsidiary objective. Also differences between the terms of office of the national governors could be perceived as differences in independence. This could lead to speculation about the voting behaviour, which could harm the ECB's reputation. Though this threat is not very realistic, there are no good reasons not to harmonize their term of office.[14]

Appointment NCB governors (Art. 14.2-ESCB):

Seen from the angle of checks and balances, two issues deserve attention. **First**, in view of their responsibility as members of the Governing Council of the European Central Bank for achieving price stability in the euro area, governors should not be appointed without some sort of consultation of at least one of the European institutions. This institution could be the ECB (its president, its Executive Board or the Governing Council). This is especially relevant, because in some countries there are no national checks and balances, i.e. the government appoints without involvement of parliament or central bank. Under circumstances such a procedure could lead to political appointments of unqualified persons. **Second**, the strong protection of NCB governors against dismissal extends to their responsibility for non-System tasks. They can only be fired when there is a clear case of grave errors (serious misconduct). However, what can be done is to take the non-System task away or, more generally, the non-System mandate could be limited to tasks creating clear synergies, e.g. in the area of financial stability and the collection of statistics.[15]

Prohibition of Monetary Financing (Art. 21-ESCB):

This article is quite straightforward: monetary financing is not allowed. The option of allowing *voluntary* monetary financing was also rejected, as this option might risk giving rise to tensions, when a central bank refuses such a request by its national government. The prohibition of monetary financing not only eliminates one potential source of inflation, it also enforces fiscal discipline, as the government knows its borrowing capacity and the price against which it can borrow depends on its credibility in the financial markets.[16] This prohibition also avoids the ECB becoming an instrument for economic fine-tuning in the

[14] The term of office of the NCB's other board members could be remain as it is - see table in section I.1 of Article 11.2. According to the EMI Convergence report of March 1998, p. 294, the other board members involved in the performance of ESCB-related tasks also deserve security of tenure, but a differentiation in terms of office within an NCB's board is allowed.

[15] Non-system tasks can be attributed to the central bank by parliament (attributed powers) or by the Minister of Finance who remains responsible (delegated powers). Both decisions can be rescinded.

[16] The prohibition to lend money from the central bank is complemented by the prohibition for a government to have privileged access to financial institutions, i.e. it may not force these institutions to invest in government paper (Art. 104a-EC). The Treaty also contains a no bail-out rule, that is governments may not assume each others debts (Art. 104b-EC).

hands of the government, as would be the case if the ECB would be allowed to finance the government directly up to a certain limit, or if it could be forced to buy existing government paper on the secondary markets. The prohibition thus contributes to a clear division of responsibilities, which is an important element of the system of checks and balances. However, as an instrument to enforce budget discipline it falls short, underlining the importance of parallel introduction of effective budgetary rules preventing excessive deficits which would constrain the central bank's room for manoeuvre, or could lead to pressure on the central bank once governments are forced to take procyclical deficit reducing measures.

Auditing (Art. 27-ESCB):

The governors preferred the books of the ESCB being controlled by external auditors rather than by the European Court of Auditors. One reason might have been governors feared the ECA could be used as a political instrument. Indeed, Art. 206a, par. 4, of the EEC Treaty specified that '[t]he Court of Auditors may also, at any time, submit observations on specific questions and deliver opinions at the request of one of the institutions of the Community.' This article, if fully applicable to the ECB, would allow Ecofin to request the ECA to delve into the ECB's internal, confidential considerations regarding monetary policy and reserve management, including its intervention policy and its dealings with, and on behalf of, foreign monetary authorities. It could also be wielded as a political instrument, with ministers hoping to find elements in the ECA's reports they can use to put the central bank in a negative spotlight.[17] This would probably also change the co-operative nature of the exchange of information between the ECB and Ecofin, making it more formal and less open.
However, the ESCB not having a supervisory board and not being a Community institution and, therefore, not being scrutinized by the ECA, risked becoming unsupervised as regards the manner in which it is managed. During the IGC the solution was found to allow the ECA to check on the operational efficiency of the ECB. This outcome strengthens both its accountability and its independence, as it reduces the possibility of unsubstantiated (and possibly politically motivated) accusations that the ECB is badly run, which would form a reputation risk for the ECB.
The ECA only supervises the operational efficiency of the ECB. This leads to the question who supervises the *national* central banks as regards the efficiency with which they manage the System-related tasks? Most likely different national regimes will continue to exist in the future. There is logic in this, as long as the profits of the NCBs flow to the national coffins.[18]

ECB's Capital (Art. 28-ESCB):

There were two competing views on the issue of who should be the stockholder of the ECB. The governors saw the ECB as an institution created out of their assets, comparable to a joint venture. Others saw the ECB as a new institution, the shares of which should be owned -

[17] The effectiveness of the ECB's policy should be discussed in other fora – e.g. in the eurogroup which is attended by the president of the ECB or before the European Parliament. As credibility is one of the central bank's main assets, the risks that the discussions on the ECB's effectiveness are misused for political purposes should be minimised as much as possible.
[18] All eurosystem NCBs are nonetheless financially independent – see Art. 7-ESCB.

directly or indirectly - by the governments of the Member States. The fact that especially the French pushed for the Member States to be shareholder of the ECB made other delegations suspicious: What were their motives? Would it endanger the independence of the ECB, in one way or another? For instance, the governments could try to exert influence on issues like staff size, annual budget, personnel policy (including the possibility of introducing quotas for senior staff positions based on nationality).[19] In other words, the potential risks for the functioning and the independence of the ECB could be quite large.
A role for the Ecofin in the procedure for increasing capital is less threatening, if only because such an increase will be a rare event. The logic behind involving Ecofin is not quite clear, because other important risk transfer mechanisms within the System are not controlled by the Ecofin at all. For instance, it is up to the ESCB whether the claims NCBs receive on the ECB in exchange for foreign reserve assets transferred to the ECB are denominated in euro or foreign currency. This choice determines who carries the forex risk, the ECB or the NCBs, though again it should be noted that the ECB and NCBs not only 'share' their policy, but also their monetary income.[20] Therefore, the only reason for the Ecofin's involvement seems to be that the ministers did not want to give the System complete carte blanche. Right after the start of the third stage, the ECB prepared secondary legislation defining the limits and conditions under which a further capital increase is possible. This has been adopted by Ecofin and strengthens the status of the ECB as a financially powerful institution, which will not easily fall prey to the political authorities.[21]

Simplified Amendment Procedure (Art. 41-ESCB):

Already before the Delors Committee had it been decided that establishing a European monetary authority would require an amendment of the Treaty. The decision to give the complete Statute of the ESCB Treaty status as well, and not only its 'constitutional' provisions, first appeared in a Commission document. Any other solution would have made the ECB dependent on other European bodies (who could change their non-constitutional arrangements) and this would have reduced its independence. As the governors did not want to be dependent on the approval by each Member State for relatively small amendments to the statute, the governors (April 1991 draft) conveniently followed the suggestion made by the Commission, according to which the ECB would have the exclusive right of initiative, while the Council of Ministers would decide with qualified majority. The IGC would extend the right of initiative also to the Commission, in which case the Ecofin is to decide by unanimity. This did not significantly alter the balance between Ecofin and ECB.[22]
The balance wòuld have altered, had the possibility been created to confer new tasks upon the ESCB. If in that case too the Commission would have received a right of initiative, then the ECB might have risked becoming overburdened with tasks like reducing output variability,

[19] Even if the shareholders lacked formal competences, they could be tempted to comment on these issues in their capacity of shareholder, which comments would be especially difficult to ignore for their own governors.
[20] Both the ECB's profits and the NCBs' aggregated monetary income are shared out to the NCBs according to their shares in the ECB's capital.
[21] Council Regulation Concerning Capital Increases of the European Central Bank, adopted in June 2000, allowing the Governing Council of the ECB to increase the size of the capital with another euro 5 billion without having to resort to the Ecofin first.
[22] The Dutch presidency was keen on protecting the role and prerogatives of the Commission.

preventing deflation or tasks in the area of the exchange rate, which would all impinge on the ECB's room of manoeuvre - even though these new tasks would never override its primary objective. However, all this could not happen, because the idea of a *general* enabling clause was dropped under the Luxembourg presidency. By accepting a role for the Council of Ministers in the simplified amendment procedure, the governors made clear they did not intend to sit in the seat of the legislator.[23]

Exchange Rate Policy (Art. 109-EC):

In the area of the exchange rate, the aim of the governors was not to encroach on the turf of the ministers (who were felt to be in charge of exchange rate regimes and parity changes), but at the same time to prevent the ministers encroaching on their (monetary policy) turf. The governors were careful not to overstep their boundaries in the ESCB draft Statute, in which they only claimed an advisory role in this area. On the other hand, they had experienced that large scale interventions could disturb monetary policy. This very difficult issue, on which France and Germany took opposite views, was only solved in a very late stage of the IGC. The solution found is quite sophisticated: the ECB is its own man in the area of foreign exchange operations, provided these operations are 'consistent with the provisions of Art. 109'. Article 109 makes clear that the ECB cannot be forced to support an exchange rate of the euro which is set unilaterally by the Ecofin Council. The Ecofin can only force the ECB by bringing in another country. However, it is even questionable whether the ECB can be forced to take specific actions to support such an exchange rate system formally agreed with a third party, because the Treaty does not provide a basis for the Ecofin giving specific instructions to the ECB to conduct certain *foreign exchange operations*: the Statute only provides that the ECB may not conduct foreign exchange operations that are inconsistent with the provisions of Article 109. Therefore, the ECB will always remain in the driver's seat as regards the *size and timing* of interventions.[24] The position of the ESCB is strong, because it holds all reserves. In the **United States** the Treasury holds part of the reserves and decides on interventions, which are conducted via the Fed. Usually the Fed joins the interventions of the Treasury, but it is not obliged to do so. The Fed always sterilizes the liquidity effect. Of course, the impact of interventions is then reduced to a signalling effect, as there is no effect on the monetary stance. Under these circumstances exchange rate policy is reduced to influencing the expectations about future monetary policy or bringing back coordination among participants who lost touch with the fundamentals, which could be effective if the timing is ripe and especially if coordinated with other central banks or their monetary authorities (see also Sarno and Taylor (2001)). The pre-occupation of most European governors with exchange rate matters – compared to the relaxed attitude of the American monetary authorities – can be explained by the relative openness of most countries, which of course has become less of a factor since Monetary Union, and by the strong interventionist

[23] A specific aspect being that the Ecofin is both legislator and policy maker.

[24] The ECB could be taken to the Court of Justice for neglecting its duty to support a certain exchange rate, agreed upon in a formally concluded international exchange rate agreement. Alternatively, the ECB could decide to intervene, but at the same time sterilize the liquidity effects. The impact of interventions is then reduced to a signalling effect, as there is no effect anymore on monetary conditions. See Sarno and Taylor (2001) for the reduced role of the portfolio balance channel for sterilized interventions between the major currencies of the developed countries.

traditions of some Member States. For an area as large as the euro area a fixed exchange rate vis-à-vis another currency is less useful than for a small area, as the impact on the real economy is smaller and the likelihood of the economies being out of sync is larger. The possibilities for importing price stability from the other area are likewise smaller. The most likely situation in which exchange rate policy would come into play, is when the exchange rate is clearly over- or undervalued. Interventions could then work as a signal. Changing the monetary stance for trying to correct the exchange rate is risky, because the ECB would be seen as giving up its domestic objective, which perception might in the end be more difficult to correct than the exchange rate.
In the first five years of the ESCB interventions only took place twice, in September 2000, together with the American and Japanese authorities, and in November 2000. These interventions, which were sterilized, i.e. their liquidity impact was neutralized at the next open market operation, were intended to turn around a prolonged weakening of the euro.[25]

Interinstitutional Provisions (Art. 109b-EC):

In the area of institutional relations the Bundesbank was an important source of inspiration. The governors knew the German model had worked well in a federal system - however, there were clear differences in terms of institutional and political environment. This meant that certain elements of the German bank law, which had worked well in Germany, could imply a risk when applied at the Community level, one example being the right for the minister to suspend decision-making. This element of the Bundesbank law was not copied. Another example is that the Bundesbank had always kept away from parliament. [26] However, the governors were in search of more accountability, for which the European Parliament was a natural candidate.[27] The Delors Committee also listed the European Council as an addressee of the ECB's annual report. The IGC first dropped the European Council as an addressee, as it was not one of the official Community institutions (basically it is an intergovernmental body not accountable to another European body), later the IGC decided to reinsert the European Council as an addressee. After the ECB's establishment, links with parliament were strengthened when in 1998 Duisenberg accepted to be heard, and voted upon, by parliament before accepting his appointment as president of the ECB. He asked his colleagues board members to follow his example. They voluntarily accepted to make the acceptance of their

[25] See ECB Annual Report 2000, p.69.
[26] The Bundesbank law does not contain any provisions on the relationship between the Bundesbank and the German parliament. The most the German parliament could do was to hold its Minister of Finance accountable for its approach to the central bank.
[27] Interestingly, Nigel Lawson followed a similar train of thought, when he as Chancellor, proposed in a confidential internal memo to Thatcher to make the Bank of England independent: accountability would be achieved by making the Bank of England governor answerable to Parliament: 'We should probably need to make the Bank of England answerable to Parliament in the sense that the Governor would appear regularly before a suitable Select Committee. But we would want this to be set up in a way which did not subject the Bank to unwarranted Parliamentary pressure.' Lawson (1992), *The View From No. 11*, p. 869 and p. 1061. (A difference though is that the ESCB Statute can only be changed by the national parliaments, when these all agree (and sometimes including a plebiscite) and not by the European Parliament, which therefore has less leverage over the ECB.)

position at the ECB dependent on approval by parliament.[28] At that occasion Duisenberg also offered to appear quarterly before parliament.

Economic and Financial Committee (Art. 109C-EC):

The EFC is the successor of the Monetary Committee. The proposal to continue with such a committee, consisting of the Treasury-General and a central bank board member of each Member State, originated from the Commission's working document with a draft Treaty text. The governors showed themselves reluctant to be represented in the committee, as they feared that that representation of the ECB in the committee could be a tool for the political authorities to commit the ECB to decisions by the committee, thus detracting from the ECB's independence. However, in the end the committee was clearly defined as an advisory committee with representatives appointed by the ECB itself (and thus possibly lower than board level). The continuation of such a committee must be welcomed, as in the past it had contributed significantly to the financial integration of the European Community and the functioning of the European exchange rate mechanism, the so-called European Monetary System.[29] Also during the IGC itself the Monetary Committee would prove its worth by forming a platform for relatively informal discussions and laying the groundwork for budgetary rules in EMU. The 'secret' of the committee's succes lay in its character: a high-level technical expert committee. The present decision to change the format into a Treasuries-only club (except for the presence of the two ECB representatives) for discussions on economic and budgetary policy will turn it into a political body, thus changing its character of a committee of experts. For instance, discussions on the functioning of, or amendments to, the Stability and Growth pact would benefit from the presence of experienced central bankers; because of their small number the ECB representatives will not be able to save the expert character of the committee.

5.2.2 Accountability and independence combined

The external relations of the ESCB are often framed in terms of the opposition between independence and accountability. We will focus somewhat more on these two important elements of the checks and balances framework. (To avoid misunderstandings we emphasize that with 'independence' we refer to the meaning of that word as in Art. 7-ESCB, i.e. institutional (political) independence.) We contend that accountability and independence are not necessarily negatively correlated. Below we show a number of features which increased both the System's accountability and its independence. In all examples the checks and

[28] The website of the European Parliament states the nominees for the Executive Board have to be approved by the parliament before they can be appointed by the Council. Legally, this is an incorrect statement (see www.europarl.int).

[29] See Age F.P. Bakker (1996), *The Liberalization of Capital Movements in Europe – The Monetary Committee and Financial Integration 1958-1994*.

balances were designed by the governors (either in the Delors Committee or in the Committee of Governors).[30]

Elements which strengthened both accountability and independence

1. *A single (as opposed to a multiple) and clear mandate.* This is a plus for accountability, because it yields a better yardstick for monitoring the performance of the central bank (by parliament, ministers and public alike)[31] than a double yardstick (especially when these goals could be – temporarily – conflicting as would be the case with the mandate 'to stabilize the internal and external value of money'). At the same time a double mandate would surely have led to less independence for the ECB, as in the European context ministers would have claimed a role in prioritizing the goals of the ECB. The same would happen in case of a vague mandate (like 'promoting non-inflationary economic growth').[32] (See the genesis of Article 2-ESCB.)[33] If not formally, it would at least have led to more pressure informally and *de facto* to less independence. One could make a comparison with the European Coal and Steel Community (ECSC). The initial proposal by Schuman/Monnet had been to give the High Authority the full power to regulate within its mandate the market for coal and steel. Because of the major implications this could have on the national economies, the Dutch minister of foreign affairs proposed that the legislative and regulatory decisions of the High Authority would always need the approval of a Council of ministers. This could have happened to the ECB too, if it had been given a multiple mandate. Now only when the ECB takes decisions imposing obligations on third parties does the ECB need ministerial approval (Articles 19.2 and Article 20-ESCB). For its main instrument (setting the price of central bank money) it can act in a completely independent way. See also Havrilesky (1996, pp. 108 and 333) who points out efforts by Congress in the 1950s to allow Congress giving general directions regarding the objectives of monetary policy, without which, so it was said, there would be no accountability.[34]
2. *Reporting commitments and transparency*. The ECB is required to issue a weekly financial statement, quarterly reports and an annual report (Article 15-ESCB) and its

[30] The one exception being the non-reappointability of the ECB board members. The governors had toyed with the idea during the drafting of the ESCB Statute, but eventually dropped the idea - for unclear reasons. The idea was reinserted by the IGC.

[31] See also Issing (1999) and for critical remarks on this de Haan and Eijffinger (2000a, p.397), who express the opinion that the Statute is not precise in this respect, as it is left to the ECB to define 'price stability'. They criticize the freedom of the ECB to change its definition. The ECB's definition has by now become part of the accountability process. If the ECB were to change the definition, it would have to have good reasons for it.

[32] De Haan and Amtenbrink stress that in case of 'a clearly defined single or primary monetary objective, both politicians and the central bank are barred from abusing monetary policy for their own means.' (De Haan and Amtenbrink, July 2000, p.189.)

[33] For a further review of how the ECB affects the economy, see the introduction to the description of the genesis of Article 2-ESCB. To put it very simple: the ECB's mandate is ensuring price stability by setting the price of its assets (lending to banks) and the price of its deposit facility for absorbing liquidity surpluses. By setting minimum reserve ratios the ECB forces banks to lend its money, making its lending rate effective. The ECB cannot set production quota. The ECSC could set both production and distribution quota (Articles 58.1 and 59.4-ECSC).

[34] More generally in a democracy delegation of power should be clearly circumscribed to prevent loss of political responsibility. However, fine-tuning the goal would be counterproductive, if it would necessitate regular adjustment by the political process, undermining the authority of the delegate. One way out would be requiring the delegate to be transparent on the strategy it will follow to attain the goal.

board members appear before the relevant committees of the EP, at their own initiative or at the EP's request (Article 109b-EC). For the ECB **communication** is very important: it has started publishing Monthly Bulletins and the ECB's president appears at least four times a year before the relevant committee of the European Parliament, apart from his presentation of the Annual Report.[35] Again, reporting (a basic ingredient for accountability) is not the enemy of independence. A secretive organization is seen as less democratic and will elicit less support among the public and is more prone to behind the scenes pressure.

3. *The Executive Board members including its president are appointed by the Heads of State.*[36] Appointment by political authorities, in which more than one branch is involved, allows for a selection procedure and hearings, during which a candidate can be asked about his interpretation of the central bank's objective, which could form a reference point during his term. At the same time the independence of the central bank will be longer-lived, compared to a situation in which the national central bank would appoint its own board.
4. *Salaries of the Board members are determined by a committee, consisting of three governors (the 'shareholders') and three members of the Ecofin.* The involvement of 'elected officials' increases the accountability with respect to the use of the System's funds (especially when made public) and legitimizes the institutional independence.[37]

These examples above show that independence can benefit from more accountability (here defined in a broad sense, covering transparency, answerability, the involvement of elected officials in appointment procedures). This is in line with, for instance, Havrilesky (1996, p. 354n) and De Haan and Amtenbrink (2000, p. 189). The latter conclude, on the basis of a study of the moves towards central bank independence in the UK and France, that specific institutional features 'may at the same time support the independence of the central bank as well as it accountability in a democratic system', after which they mention the specific example of a legally-based clearly defined single or primary monetary policy objective. In this respect Art. 41-ESCB (simplified amendment procedure) presents an interesting case. The interesting feature is that any amendment (either on proposal of the Commission or the ECB) requires approval of both Ecofin and European Parliament ('assent'). Making amendments to the statute dependent on the approval of another player reduces the independence of the ESCB, but making it dependent on the approval of <u>two</u> other players makes each of them less powerful and strengthens the position of, in this case, the central bank (it makes it more difficult for the Ecofin to push through amendments against the advice

[35] By focussing on the European Parliament the ECB underlined its European call, as the EP is more supranational than the Ecofin, a body closer to the national governments. By seeking a closer relationship with the EP, the ECB strengthened its position vis-à-vis the other Community institutions.

[36] The governors preferred board members being appointed by the Heads of State, and not by the Council of Ministers, because that might make ministers feel as if they were 'the masters' of the board members. The governors wanted the board members to be able to have a dialogue with the ministers on a basis of equality. This explains why already the Delors Report (par. 32) recommended that the Executive Board members are appointed by the European Council.

[37] Art. 11.3-ESCB. The salaries of the members of the Board of Governors are specified in the Federal Reserve Act (Section 10.1-FRA). This part of the FRA has been amended numerous times.

of the ECB). On the other hand, there is the risk of overbalancing, i.e. it might also become more difficult or even impossible to effectuate desirable amendments. [38]

Below we mention three other examples, each showing that more independence does not necessarily mean less accountability - which again illustrates our main point, i.e. that independence and accountability are not each others enemies. Taken together independence and accountability form important elements of the system of checks and balances, preventing the concentration of too much power in one branch of government and even preventing the existence of absolute power for governmental branches on their own territoire, in other words the prevention of absolute dictatorship of, and within, the governmental sector.

Elements which strengthened independence and do not reduce accountability

1. Board members cannot be reappointed.[39] Being able to put pressure on someone because he wants to be reappointed, is of course not an element of accountability – on the contrary.
2. The appointments of the Executive Board members are staggered.[40] If the whole board is replaced at once, the incentive for the political authorities to go for undisguisedly political appointments would become stronger, because the reward is big. There would also be more possibilities for political deals than in the case of a single appointment. If the sitting board would see such behaviour as a realistic threat to the institution, they might not act as independent as they should
3. The system of one person, one vote.[41] This voting system stresses the *collective* responsibility of the Governing Council as a decision-making body. Governors are expected not to defend 'national' interests, but the interest of the euro area. Weighted voting would reduce independence, as it would mean that e.g. the French governor (which would have a relatively large vote) would be expected to take 'especially' his country's interests into account, in which case he would be more prone to national political pressure. One man, one vote does not reduce the accountability at the European level. Keeping the individual voting record secret is in line with this.[42] To do otherwise could especially be harmful for the national central bank governors, most of whom are reappointable.[43] Buiter[44] turns the argument around: the best protection of the NCB governors is to show openly how they voted to disapprove any suggestion of being a puppet of their government. What Buiter basically stresses is the need for individual accountability. This

[38] See also P. Moser (1999), Checks and balances, and the supply of central bank independence, *European Economic Review*, 43, pp.1569-1593). Moser first argues that almost any central bank is in fact dependent on the legislators who can change the law. However, countries with a legislation system that comprises at least two veto players with non-parallel preferences (e.g. two heterogeneously composed chambers or an executive veto) have a higher cost of withdrawing the independence and are therefore more credible in supplying a legally independent central bank. Classifying all OECD countries and using regression analysis reveals that the negative relation between inflation and legal bank independence is stronger in countries with forms of institutional checks and balances than in those without any checks and balances. (The 'assent' procedure had not been proposed by the governors (they had suggested parliament be 'consulted'), but by the Dutch presidency when it was looking for ways to upgrade the role of parliament.) See also Moser (2000).
[39] Article 11.2-ESCB.
[40] Article 50-ESCB (see under Article 11.2-ESCB).
[41] Article 10.2-ESCB.
[42] Article 10.4-ESCB.
[43] See the genesis of Article 14.2-ESCB.
[44] W.H. Buiter (1999), 'Alice in Euroland', p. 181-209.

> is not how the continental central banks have operated, which are more used to collective responsibility. This is also visible in Issing's reaction, that emphasizes the need for accountability of one institution to the other.[45] The voting balance is also kept confidential. Again, to do otherwise could lead to unwarranted speculation in the financial markets and would surely elicit political comments, especially in cases of a close call within the Governing Council.[46]

The examples illustrate that any trade-offs between independence and accountability or the conflict between independence and democratic accountability[47] should not be generalized. The impression of the existence of a trade-off is strong because of the combined criticism of a too independent ECB and an insufficiently accountable ECB.[48] Independence and accountability are not a zero-sum game,[49] there are many examples in which they reinforce each other. Together they contribute to a system of checks and balances, allowing each major (governmental) branch to play its constitutional role.

A final remark on this issue could be that though the ECB might indeed be the most independent central bank in the world, it is much more accountable than many people realize. We will illustrate this in the next section where we make a comparison with other central banks.

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[45] O. Issing (1999), p. 509-513.

[46] Until now it was never necessary to take a vote on interest rate policy. Compare Nout Wellink, president of De Nederlandsche Bank, quoted by Reuters (Frankfurt 21 June 2002): "We have never voted on monetary policy and I think we've only voted on a few occasions, on technical matters." Indeed, ECB president Duisenberg has always been able to formulate a monetary policy decision on the basis of a convergence of views within the Governing Council, even though, as will be most likely in any large board, initial preferences may deviate.

[47] See e.g. Briault c.s. (1996, p. 40), De Haan and Eijffinger (2000a, p. 395 and 397) and Eijffinger and de Haan (2000b, p.53).

[48] A trade-off exists between complete goal independence and accountability. But again, we point out that a high degree of goal independence (as complete goal independence for an agency does not, and should not, exist) does not correspond one-to-one to a high degree of institutional independence.

[49] A conclusion also drawn in Amtenbrink (1999), p. 378.

5.3 COMPARISON BETWEEN ESCB, FED, BUNDESBANK, COMMISSION AND COURT OF JUSTICE (INDEPENDENCE AND ACCOUNTABILITY)

We have seen that many elements of the institutional design of the ESCB can be traced back to the Bundesbank. Also, some elements have been borrowed from 'other' Community institutions. A comparison with these institutions might allow us to find out where the ESCB is exceptional. Because the ESCB is compared often with the Federal Reserve System, we also include the Fed.

To be able to compare our findings with the existing (empirical) literature on the comparative positions of central banks, we concentrate ourselves here on the concepts of 'independence' and 'accountability'. To this end we summarize the findings of the previous chapter into a list of indicators for accountability and independence. The order in which we list the indicators does not reflect a qualitative judgment on our side, because we more or less follow the numerical ordering of the articles of the Statute.[1] We will discover that the Statute contains many elements which enhance the accountability of the ESCB. We will compare the list with indicators used in the already existing and growing (empirical) literature on this subject. However, our purpose is not to rank institutions, but to assess the adequacy or lack of accountability and independence of the ESCB. Some of the indicators have a function both for accountability and for independence (for example, a narrow mandate). Therefore, this is a qualitative exercise. Below we list a large number of indicators for both accountability and independence. They are followed by two tables comparing the ESCB, Bundesbank (pre-EMU), Federal Reserve, Commission and Court of Justice as regards accountability and independence respectively.

Indicators for accountability of the ESCB

Accountability is a wide concept. We use it in a broad sense.[2] Where possible we use, or stay close to, the formulations used in the existing literature in order to facilitate comparison. See for instance De Haan, Amtenbrink and Eijffinger (1999), who use thirteen accountability indicators, focussing on the ultimate objectives of monetary policy, final responsibility and transparency, whereas we use twenty-four indicators. (The article numbers below refer to the articles in the ESCB Statute or, if so indicated, to the EC Treaty (Maastricht).) A question which can be answered with yes (marked by '*'), means stronger accountability. Most of these accountability indicators are neutral or even beneficial for the independence of the institution.

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[1] We discuss here only the articles of Cluster I, i.e. the articles relating to the relations between the ESCB and the outside world. That is also why we look at the ESCB, and not at the ECB. Cluster II and Cluster III deal with the relations within the System and within the Governing Council respectively.

[2] See for instance Briault, Haldane and King (1996). Being accountable means being "obliged to give a reckoning or explanation for one's actions; responsible." Responsible includes being liable to be blamed for loss or failure. This is a typical Anglosaxon approach. Briault c.s. develop a four-item central bank accountability index covering parliamentary monitoring, publication of minutes, publication of an inflation report and the existence of an override clause. The continental approach puts more emphasis on the communality: all parties are responsible together, which is of course true in the case of price stability: if wage increases are too high, the central bank is powerless, at least in the short run. Accountability also encompasses being responsible for whether or not financial resources are not spent wastefully.

1. Is the institution law-/Treaty-/Constitution-based? (Art.1)[3]
2. Does the Treaty/law stipulate a clear objective/objectives for the institution? (Art. 2)
3. Is there a clear prioritization of objectives? (Art. 2)
4. Are the objectives quantified or - where this is technically not possible - clearly defined? (Art.2)[4]
5. Does the number of instruments at least equal the number of objectives? [5]
6. Is the institution's area of responsibility properly defined? (Art. 3)
7. Must the central bank explain publicly the extent to which it has been able to reach the objective? (Art. 109b-EC)
8. Is the institution required to report on all of its activities and responsibilities? (Art. 109b-EC, Art. 15-ESCB)
9. Are minutes of the decision-making bodies disclosed within a reasonable timeframe? (Art. 10.4)
10. Are the votes disclosed?
11. Is there a provision that all its decisions must be 'reasoned decisions', when they affect third parties? (compare Article 190-EC)
12. Are the decision-makers of the institution required to appear before the Parliament? (Art. 109b-EC)
13. Has another institution (government) the right to give instructions or to suspend or override decisions? (Art. 7)
14. Is there government official present during the board meeting?
15. Is the institution allowed to publish solicited and unsolicited opinions? (Art. 34.2) [6]
16. Are the members of the decision-making bodies appointed by political/elected authorities? (Art. 11.2)
17. Is the parliament involved in the appointment procedure? (Art. 11.2)
18. Can the decision-makers be dismissed by the (European) parliament?
19. Are the salaries of the members of the decision-making body set by, or do they have to be approved by the government/external committee? (Art. 11.3)
20. Are the financial accounts examined and assessed by a national/federal Court of Auditors?
21. Are the financial accounts audited by an externally appointed, independent accountant? (Art. 27)
22. Are the acts of the institution subject to a legality review by the Court of Justice/Supreme Court? (Art. 35-ESCB, Art. 173-EC)
23. Is legal action possible against the institution's failure to act? (Art. 35-ESCB, Art. 175-EC)
24. Are there legally enshrined channels for communication with groups in society which are affected by its policy decisions?

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[3] Were the Union to be endowed with monetary capacity, the Constitution could stipulate that the Union vests the monetary competence in an independent central bank, which is governed by an annexed Statute. [This contrasts with the principal-agent relationship, with the government (or Congress) being the principal and the central bank being the agent (see Briault c.s. (1996)).]

[4] We are looking for Treaty/law-based quantification.

[5] If the number of instruments is smaller than the number of objectives, the institution can always hide behind the argument that it did not have enough instruments.

[6] The central bank should be allowed to make public opinions, also when not to the liking of the political authorities, for parliament and public opinion to be able to judge the ECB's performance.

Table 5-1: Comparison I (accountability) [7]

(* = yes; - = no; (*) = in between; ? = not known; n.a. = not applicable)

	ESCB	Bundesbank	Federal Reserve	Commission	Court of Justice
1. Treaty-/law-based	*	*	*	*	*
2. Clear objective	*	*	*	-	* (Art.164)
3. Prioritization	*	(*)	-	-	n.a.
4. Quantif/clear obj.	-	-	-	-	*
5. Instrum. > obj.	*	(*)	-	?	*
6. Resp. defined	(*)	*	(*)	(*)	*
7. Explain target hit/miss	-	-	-	-	n.a.
8. Report	*	-	(*) HH	* (Art. 156)	?
9. Minutes discl.	-	-	*	-	- [8]
10. Votes disclosed	-	-	*	-	- [9]
11.'Reasoned'	-	-	-	* (Art.190)	* [10]
12. Hearings	*	-	*	(*)	n.a.
13. Instructions?	-	(*)	-	-	-
14. Govt official present	*	*	-	-	-
15. Public Opinions	*	*	(-)	-	n.a.
16. Appointm. by politic's	*	* [11]	(*) Board	*	*
17. Role parl. in app.	(*)	* (not Dir.)	(*) Gov's	(*) as of Nice	-
18. Dismissal by parl.	-	-	-	*	-
19. Salary approval	(*)	*	*	*	*
20. Court of Aud.	(*)	-	(*)	*	*
21. Ext. auditor	(*)	(*)	(*)	-	-
22. Subject to CoJ.	*	*	*	*	n.a.
23. Failure to act	*	-	?	*	n.a.
24. Society involved	-	-	* (Adv.C's.)[12]	*	-

Explanations to table 5-1:
Line 6: The Bundesbank's responsibilities are defined in Art. 3 of the Bundesbank law. Compared to Art. 3 of the ESCB Statute, the Bundesbank's article 3 is concise: clearly no responsibility in the area of financial stability (no basis for a lender of last resort function) and

[7] The answers on lines 6, 11, 15 and 19 are explained below the table. Article numbers refer to EEC Treaty.
[8] Art. 32 Court of Justice Protocol.
[9] See Kapteijn and VerLoren van Themaat (1998), p. 251.
[10] Art. 33 Court of Justice Protocol.
[11] Landeszentralbankpresidenten are appointed on a recommendation of the Bundesrat. Direktorium members are appointed on a proposal of the Federal Government. (Bundesbank law (1957), Artt. 7(3) and 8(4).)
[12] See Board of Governors (1994), Purposes and Functions of the FRS, p. 15. These advisory committees or councils cover the banking committee and consumers, and at the FRB-level agriculture and small business. Furthermore, one-third (three persons) of the board of directors of each FRB are elected to represent the public (and not the banking interests) – FRA (1988), Section 4(11). When appointing members of the Board of Governors the US president has to give 'due regard to a fair representation of the financial, agricultural, industrial and commercial interest, and geographical divisions of the country.' (FRA (1988), Section 10(1).)

in the area of exchange rate policy: it can only contribute to safeguarding the value of the currency by regulating the note and coin circulation and the supply of credit. (Art.7–Buba mentions that the Direktorium is responsible for the implementation of decisions taken by the Zentralbankrat, among which could be 'foreign exchange transactions'.) The Commission has a wide, and therefore rather vague, area of responsibility (see Art. 155-EC). Conceptually the scope of the responsibility of the Court of Justice is quite narrow: '[it] shall ensure that in the interpretation and application of the Treaty the law is observed.' (Art. 164-EC.)
Line 11: Article 190-EC: 'Regulations, directives and decisions adopted jointly by the European Parliament and the Council, and such acts adopted by the Council or the Commission shall state the reasons on which they are based and shall refer to any proposal or opinions which were required to be obtained pursuant to this Treaty.' Art. 108a(2)-EC states that Art. 190-192 are applicable to regulations and decisions of the ECB. 'Decision' ('beschikking' in Dutch) is meant in the legal sense, as a decision addressed and binding to third parties. An interest rate decision by the Governing Council could be seen as an internal system instruction to the NCBs to offer liquidity at a certain rate to the outside world, and not as a formal 'decision'. This should be clarified. Anyhow, when formally applied to the central bank, it could be argued that a decision nòt to change the interest rate level needs to be explained as well.
Line 15: The Bundesbank law does not officially provide for the possibility of 'going public', but in practice it has not shunned issuing public statements, e.g. on EMU, see HWWA (1993), Dok. 56 and 59. See also Endler (1998), p.419: 'Für geldpolitische Streitigkeiten zwischen der Deutschen Bundesbank and der Bundesregierung sah der deutschen Gesetzgeber darin (d.h. 'Dramatisierung' des Konflikts in die Oeffentlichkeit) die alleinige Lösungsmöglichkeit, auf institutionelle Vorkehrungen wurde bewusst verzichtet.' Neither does the FRA officially provide for public opinions. The Fed uses speeches and congressional hearings (esp. by the chairman) to make its opinions known. In case of the Commission press contacts are more used than Commission approved opinions.
Line 19: The salaries of the Direktorium members of the Bundesbank are regulated in contracts concluded by the Zentralbankrat, but have to be approved by the government (Art. 7(4)). The salaries of the members of the Board of Governors of the Federal Reserve System are determined by Congress (Art. 10.1-FRA, which article has been adjusted many times). Their salaries are linked to those of cabinet officers (Stiglitz (1998)). The salaries of the presidents of the FRBs are determined by the board of directors, but are subject to approval by the Board of Governors.

Most indicators which enhance accountability would not affect the institution's independence or at least not negatively. However, the following indicators form an exception: lines 9 (disclosure of minutes), line 13 (right of instruction or override) and line 17 (dismissal by parliament).
When comparing especially the ESCB and the Bundesbank it occurs that the ESCB is more transparent, its mandate is more specific (even though its functions are more widely defined) and parliament is more involved. On the other hand the German government could postpone decision-making by the Bundesbank for two weeks.
When comparing the ECB with the Fed we note the ECB's mandate is more focussed. Also the ECB has to accept the presence of political authorities in their meetings and it has stronger reporting requirements, though it does not release its minutes, which the FOMC is obliged to do though only with a delay. The Fed seems to be better anchored in society through the

appointment procedure of the FRB presidents (who are appointed by the FRB's private shareholders (local banks), though the Board of Governors has to approve), the existence of Advisory Councils (though their influence is rather limited) and the fact that part of the Board meetings are open to the public (monetary policy parts are excluded). The appointment procedure has at the same time been criticized for being outside direct control of Congress.
Comparing the ECB with the Commission and the Court of Justice (CoJ), we note that the Commission and the CoJ are legally obliged to take reasoned decisions, while the ECB is not. We also see that the Court's mandate is fairly simple, while the Commission's mandate is very wide, but at the same time parliament could force the Commission to resign (this power has been strengthened by later Treaties).

Other studies which have compared the accountability of the ECB, the Bundesbank and the Fed are Briault c.s., (1996) and De Haan c.s. (1999). The difference with there studies is that we started from the Statute of the ESCB and its genesis. We based our list on those articles the genesis of which shows a relation with accountability. In some cases the governors preferred to be accountable not only to the political authorities, but especially to the public – i.e. they valued the relation with the public, which at crucial moments could be an ally against political pressures. Perhaps this is more important in the EU where there is no bi-cameral system like in the federal systems of the US and Germany. Our approach leads to a number of additional indicators compared to those mentioned in earlier studies. New are indicators on the relation with the public and society in general (lines 11, 15 and 24); indicators relating to the proper financial behaviour (line 20); the procedure for determining the salaries (line 19), which is relevant because one option was to have the salaries set by the shareholders, i.e. the NCBs; the appointment procedure (in casu no co-optation). The possibility for third parties to appeal to the Courts (Court of Justice), including for failure to act (line 22) would seem logical, where an override mechanism is lacking. We also included a line which relates the number of instruments to the number of objectives (giving the central bank more targets than instruments reduces the possibility to hold it accountable for reaching these targets).
Furthermore we note that actual practice can go further than requirements by law, while we also note that the choice of accountability mechanisms (i.e. accountable to whom and to which extent) seems to depend on the political environment – e.g. publishing votes endangers the position (and reappointment) of the NCB governors relatively more when their appointment is not checked at the European level; an override mechanism in the hands of only one branch or chamber can become a permanently used feature. Override mechanisms can be approximated by other features like appointment procedures, the fact that one can take recourse to the CoJ, and the possibility to amend the Statute.

Indicators for independence of the ESCB

Independence is never absolute, except in a tyranny - and even then only as long as it lasts. Complete independence is not a stable situation, because it elicits countervailing powers. Therefore, even when the ESCB could be described as the most independent central bank in the world, it will never be completely independent. Again, we will follow through the articles of the Statute and all elements of independence will be listed below. We do not delve into a

ranking exercise,[13] as we think the indicators do not capture whether the population is supportive of central bank independence or not. In this regard we point to the post-war Dutch and British central bank laws, which both provided for the possibility for the government to override the bank. In the UK this developed into a regime in which the Treasury determined monetary policy, while in the Netherlands the Bank enjoyed a de facto high degree of independence. See Eizenga (1991),[14] who also makes the point that the procedural safeguards existing in the Netherlands would not have provided the same degree of protection in the UK against Treasury involvement, because the Dutch governments are coalition governments which have relatively weak political positions.
At the end we also list an indicator not applicable to the ECB, but commonly used in other studies, i.e. the presence of procedural safeguards in case of a governmental override (to have a maximum period for suspending a decision is also such a safeguard).

1. Is the institution established by Treaty, or, if not so (and thus at a lower level of independence), does amending the bank law require the approval of *more than one* chamber or governmental branch. (Art. 1)
2. Does the institution have legal personality? (Art. 9)
3. Has the institution a clear narrow mandate? (Art. 2) [15]
4. Are the objectives quantified or - where this is technically not possible – in another way clearly defined? (Art. 2) [16]
5. Does the institution enjoy institutional independence? (Art.7)
6. Is the government not allowed to overrule or to postpone decisions? [17]
7. Is there no government official (with or without voting power) on the council, or attending the council? (Art. 10.1)
8. Does the institution enjoy personal independence (is its decision-making body protected against dismissal for political reasons)? (Art. 11.4)
9. Is each council member protected against relief from office other than for serious delicts by those who appointed them? (Art. 11.4 and 14.2)
10. Does it enjoy functional (instrument) independence? (Art. 17-24)
11. Does it enjoy financial independence? (Artt. 28, 32, 33)
12. Are decisions taken by the council as a collegial body and not just by the president? (Art. 10.2)[18]
13. Is the voting system based on one vote per voting member (i.e. not weighted)? (Art. 10.2)
14. Are the minutes kept confidential? (Art. 10.4) [19]

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[13] Compare Bade and Parkin (1988), Grilli, Masciandaro and Tabellini (1991), Alesina (1988), building on Bade and Parkin, and Eijffinger and Schaling (1993a).
[14] Eizenga (1991), 'The Bank of England and Monetary Policy', p. 4, 5 and 16.
[15] We assume no institution is completely goal independent. The alternative is that the institution's objective is formulated in the Treaty/law, either broad or narrow. A broad, multiple mandate does not make the institution more independent, because it will go hand in hand with more political control and leaves more room for interference by politicians in terms of interpretation or prioritization.
[16] One could imagine that the quantification of the objective would be in the hands of the political authorities, but this would make the central bank less independent. In case of the Court of Justice the objective is clear: to ensure that in the interpretation and application of the Treaty the law is observed. (Art. 164-EC.)
[17] The question is phrased such that an affirmative answer ('*' in the table) supports independence.
[18] This also relates to the federal character of the System. A federally composed board can be less easily put under political pressure. Cf. also Peter Loedel (1999), p. 50 on the role of the federal character of the Bundesbank.

15. May it publish its opinions, or can government silence the central bank? (Art. 34.2)
16. Do the council members have a fixed and sufficiently long tenure, i.e. longer than one electoral cycle (usually 4 yrs)? (Art. 11.2 and 14.2)
17. Does the council or president have a veto over the appointment of new members?
18. Does the appointment of new members involve more than one authority?[20] (Art. 11.2)
19. Are some council members not appointed by the government/federal authorities?[21]
20. Are the centrally appointed council members only appointable once (not reappointable)? (Art. 11.2)
21. Is there no age limit (which could de facto shorten a term of office)?
22. Are the salaries not only determined by the political authorities? (Art. 11.3)
23. Is monetary financing prohibited? (Art. 21)
24. Are the shares held by other institutions than the appointing authority? (Art. 28)
25. Do technical amendments to the Statute by Ecofin require the assent from the EP? (Art. 41)
26. Are the appointments staggered? (Art. 50)
27. In case of an override mechanism are there strong procedural safeguards?

Because we follow more or less the Statute (though for instance the different aspects of independence have been grouped) our list is much more detailed than those of most studies. Many of these studies look into the relationship between independence and low inflation. [22]
Bade and Parkin construct a (1-4) scale of central bank independence based on three institutional criteria.[23] Grilli *et al.* (1991) use eight indicators focussing on political and economic independence.[24] Cukierman (1992, p. 371-9) uses sixteen legal variables, half of which relate to various forms of lending to public authorities. Eijffinger and Schaling (1993a) use the three criteria of Bade and Parkin, but they do not weigh each attribute equally. They construct a matrix of five possible central bank independence types.
We are not so much looking into the relation between independence and inflation. We are interested in the issue of independence from the point of view of checks and balances.
A yes-answer ('*') in the table indicates a plus for independence.

[19] The emphasis is on voting. We do think the combination voting records and re-appointability does not increase independence.
[20] The idea being that strong involvement of several authorities/Community institutions that do not necessarily have the same preferences will prevent the board from turning into an instrument of the appointing authority.
[21] Borrowed from Eijffinger-Schaling (1993); see also next footnote.
[22] E.g. Bade and Parkin (1988), Grilli *et al.* (1991), Cukierman (1992).
[23] (1) Is the Bank the final authority? (2) Is there no government official on the Bank board? (3) Are more than half of the board appointments made independently of the government? See Eijffinger and Schaling (1993a, p. 52-56, and Alesina and Summers (1990), p. 153.
[24] See Eijffinger and Schaling (1993a), p. 59-62.

Table 5-2: Comparison II (independence) [25]

(* = yes; - = no; (*) = in between; ? = not known; n.a. = not applicable)

	ESCB	Bundesbank	Federal Reserve	Commission	Court of Just.
1. Treaty-based	*	- [26]	(-) [27]	*	*
2. Legal pers.	(*)	*	(*)	-	-
3. Narrow objective	*	*	(*)	-	*
4. Quantif/clear obj.	-	-	-	-	*
5. Institut. indep.	*	*	*	-	*
6. No overruling/suspend	*	-	*	n.a.	*
7. No govt. offic. present	-	-	*	*	*
8. Person. indep.	*	*	*	*/(*)	*
9. Protected ag. dismiss.	*	*	*	*	*
10. Instrum. indep.	* [28]	*	*	-	n.a.
11. Fin. indep.	*	*	*	-	-
12. Collegial dec-m	*	*	*	*	*
13. One man one vote	*	*	*	*	*
14. Minutes conf.	*	*	-	*	*
15. Public opinions	*	*	(-)	-	n.a.
16. Tenure > 5 yr	*	*	*	(*)	*
17. Appointm. veto	-	-	-	*	-
18. Shared app't resp.	- [29]	*	*	*	-
19. No centrally app.	*	*	* (FOMC)	-	-
20. App'ble once	* [30]	-	*	-	-
21. No age limit	*	* [?]	*	*	*
22. Non-political salaries	*	(*) [31]	-	-	-
23. Staggered app'ts	*	-	*	-	*
24. Mon.fin. proh.	*	(*)[32]	*	n.a.	n.a.

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[25] See also explanation under table 5-1.

[26] The Bundesbank was constituted on the basis of a law.Whether amendments to this law need approval of both the Bundestag and Bundesrat, or only of the Bundestag, is a matter of debate (see Moser (2000), p. 154-5).

[27] In the United States the president may veto Congressional legislation, e.g. legislation changing the FRA. However, Congress can override the president's veto by a two-thirds majority in both chambers (Section 7 of the Constitution of the United States of America). Therefore, in the US one branch is able to change the law. However, Senate and House can be seen as two heterogeneous bodies. (In most countries legislative proposals usually come from the government, though parliament may also take the initiative (this is for instance the case in the Netherlands and Germany).)

[28] The instrumental independence is supported by the general obligation of the ESCB to act in accordance with the principle of an open market economy, because the application of 'direct' instruments like direct credit controls usually requires government approval.

[29] The Heads of State appoint on a recommendation of their ministers, who will usually have the same preference as their masters.

[30] We note the difference between the executive board members and the governors.

[31] Salaries Directorium determined by Zentralbankrat, approved by Government (Bundesbank Law (1957), Art. 7(4)).

[32] Limited overdraft facility (Bundesbank Law (1957), Art. 20).

25. Shareholder	*	-	*	n.a.	n.a.
26. Techn. amendm: EP	*	n.a.	n.a.	n.a.	n.a.
27. Override safeguards	n.a.	*	n.a.	n.a.	n.a.

Some of the indicators enhancing independence would limit an institution's accountability. This is the case for lines 5-12, most of which apply to most institutions listed in the table, because they constitute basic elements of any institution's independence.

The table shows the ESCB's independence is better guaranteed than that of the Bundesbank, especially because (1) changing the ESCB's Statute requires ratification by all EU Member States,[33] while the Bundesbank law could be changed by a simple parliamentary majority, (2) there is no obligation for the ESCB to defend an exchange rate which it considers not to be in line with price stability, while the Bundesbank's objective to safeguard the currency also has an external dimension, [34] (3) its board members are not reappointable [35] and (4) the ESCB's decision-making cannot be suspended.[36]

When we compare the ESCB's independence with that of the Fed we note in favour of the Fed that since 1935 there is no government official present at the monetary policy meetings and that the appointment of Federal Reserve Board governors has to be approved by both the Administration and the legislature. On the other hand, the ESCB's mandate is focussed and its deliberations can be kept confidential. The Commission would not seem to be very independent as it lacks financial and institutional independence (even though it is formally protected against pressure by Member States). Only in a few areas (such as competition policy) it has far-reaching powers. The Court of Justice is quite independent, though it would seem less independent than the American Supreme Court (whose judges are appointed for life).[37]

In fact, the tables capture the notion that the ECB has clearly become both more independent and more accountable than the Bundesbank.[38] That such an outcome was possible can be readily understood from the perspective of checks and balances.

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[33] It should be pointed out though that it is not quite impossible to change the Treaty: in December 2000 the IGC of Nice amended the ESCB Statute to allow the Governing Council to put a limit on the number of voting members within the Governing Council, which will expand due to the enlargement of EMU with accession countries, while during the negotiations of the 2004 IGC last-minute efforts by the Italian presidency supported by a few big countries to make a few core articles of the Statute (Art. 10-12) more easily amendable were only just stopped by pressure from central banks and a few Member States. .

[34] In practice though the Bundesbank had secured from the government - in the context of the EMS - the right to stop interventions in support of other currencies if these interventions were threatening German monetary developments (Emminger (1986), pp. 361/2).

[35] There is no evidence that the reappointability of the Bundesbank's Direktorium members has ever led to a monetary policy stance more accommodative of the government's wishes. However, it is impossible to 'proof' this and therefore the suspicion will always remain. De Haas and van Lotringen (2003), in their biography on Duisenberg, p. 180, quote Pöhl on this issue: 'My experience at the Bundesbank has been that directors became 'soft' towards the government, when they wished to be reappointed.'

[36] See also Viebig (1999), p. 514, who especially mentions stronger institutional and personal independence.

[37] See also Kapteijn and VerLoren van Themaat (1998), p. 251-2.

[38] In this respect we side with De Haan and Amtenbrink (2000) who rate the ECB's democratic accountability higher than that of the Bundesbank. The ECB's independence is usually rated the same (e.g. in the Eijffinger-Schaling scale) or somewhat higher than the Bundesbank. (see Eijffinger-de Haan (2000b), p. 45-6).

5.4 OVERVIEW OF EXTERNAL CHECKS AND BALANCES AND ROOM FOR IMPROVEMENT

5.4.1 Overview

Below we present the articles according to how they can be divided over the categories of checks and balances mentioned in chapter 2. We have split category (a) on the protection of each party's prerogatives into (a1) for the ESCB and (a2) for the regular Community institutions. Most articles fall into one category, with a number falling into more than one. There are at least 25 articles containing 'external' checks and balances. However, as noted before, the articles do not capture everything (like for instance the tradition regarding price stability, or the existence of checks and balances within the governmental branch). Also, not all articles have the same impact. Nonetheless, an uneven distribution over the categories might point to a potential weakness or insufficiently controlled dominant position of one of the parties.

Table 5-3: Overview external checks and balances

(a1) Checks and balances **protecting** the prerogatives of the ESCB:
- Art. 1; 2; 7; 9.1; 10.2; 10.4; 11.2-4; 14.2; 17-24; 21; 28; 35.1 (second sentence); 50; 4a-EC 109b-EC

(a2) Checks and balances **protecting** the prerogatives of other EC institutions:
- Art. 2; 3; 5.1; 35.1 (first sentence)

(b) **Controlling** (blocking) mechanisms:
- Art. 25.2; 41; 42

(c) **Consultation** mechanisms:
- Art. 4; 25.1; 109(1-2)-EC; 109b-EC; 109C(2)-EC

(d) **Accountability** mechanisms:
- Art. 1; 2 [1]; 3; 11.2; 11.3; 15; 109b-EC

(e) Checks and balances allowing for intertemporal **flexibility**.
- Art. 2 [2]; 11.2; 14.2; changing the Statute (Treaty procedure) (Art. N)

Explanation: Category (a1) contains articles relating to the E(S)CB's Treaty-based establishment as a legal entity with a sui generis character, its clear institutional (political) independence, its narrow mandate, the one-man, one-vote collegial decision-making process, the confidentiality of its deliberations, appointment and dismissal procedure, the prohibition of monetary financing, its instrumental independence, its financial structure and independence, and its right to appeal to the Court of Justice. Category (a2) groups those articles which make sure that the ECB does not encroach on the prerogatives of the other institutions: the ECB's mandate is narrow, its tasks are formulated in an enumerative way, the ECB falls under the jurisdiction of the Court of Justice and the Community institutions may start infringement procedures against the ECB.[3]

[1] In the sense of a single purpose, and not a multiple objective.

[2] Monetary strategies have changed over time. There is no reason to assume we are able to define the ultimate, time-resistant monetary strategy. The Statute should offer enough flexibility. The ECB could be asked to evaluate publicly its monetary strategy. The ESCB's choice should be accounted for in public hearings with the European Parliament.

[3] This right is not reciprocal, as the ECB is not listed in Art. 230-EC, second paragraph, which makes for a peculiar asymmetry.

Where the ECB has a right of initiative, it shares this with the Commission, making it impossible for the ECB to 'blackmail' or put pressure on the Ecofin. The ECB needs the Ecofin for secondary legislation in its field, though this relates to areas where the ECB would apply powers directly affecting third parties (i.e. not through the interest rate) or technical amendments to the Statute itself. There are ample consultation mechanisms.
Accountability is ensured in several ways: the Statute is Treaty-based (i.e. adopted by national referenda or other ratification procedures), the ESCB's performance is measured against a narrow objective, it does not have more objectives than instruments, its responsibilities are well described, the appointments are made by political authorities, there are reporting requirements and (voluntary) appearances before the EP.
The flexibility is present in several ways: at regular moments new Governing Council members are appointed (board members and governors). Changing non-technical articles of the Statute is possible, but requires unanimity among the Member States' governments and national ratification by their parliaments or through referenda. On the other hand IGCs take place so frequently and take the form of package deals that the risk is always there that in the shadow of politically charged issues 'smaller' changes are taken on board without a thorough discussion.[4] The Treaty and therefore the Statute does give fewer guarantees for the System's independence than many realize. A further point of flexibility is that while the ESCB's objective is clear, its practical definition is left to the ESCB.

Table 5-3 presents the essential characteristics of any federal structure, and points in this case to a strong representation of category (a1) and a possible under-representation of categories (a2) and (e).[5] This fits with regularly ventilated criticisms by political authorities, not surprisingly often of countries with slow growth or too high budget deficits, but also by earlier academic writings. Therefore, political authorities might be tempted to counter this strong position. They could try to rein in the ESCB's mandate (a1) or they could over time try to make more use of the flexibility mechanisms (e). Alternatively, they could increase the System's accountability (d). They might also want to strengthen the checks and balances under category (a2), e.g. in the form of an *override* in order to be able to give preference to their trade-off between inflation and output (variability). However, we have seen that the reason for delegating monetary policy to a central bank is its higher ability to pre-commit to the pursuance of price stability. A truly credible central bank will also be better able to choose a credible and more gradual path towards regaining price stability (instead of immediately suppressing unexpected temporary inflationary pressures) than a central bank which risks being overruled whenever the going gets tough. (Esp. in dire times the time-horizon of politicians might get shorter.) We furthermore found it difficult to imagine that a political body which cannot be sent home by the electorate or the EP or which can act without the approval of a heterogeneous bi-cameral parliament could take such European decisions.

With this in mind, and with the benefit of section 5.2, which gave us valuable insight in the relations and the checks and balances between the ESCB and the 'other' Community

[4] We note that changing the Treaty might have become more difficult after the enlargement. At the same time we note that some parts of the Treaty, like those containing the Community's and the ESCB's federal character, probably deserve special protection against the risk of becoming part of large non-transparent IGC package deals. One could conceive of articles of the Treaty with a constitutional nature that could only be changed if individually ratified.
[5] See diagram 2 in chapter 12 for a graphical expression.

institutions, we will list elements of improvements in the next section. Below we first list the suggestions which require a change in the Treaty. Then we will deal with some suggestions made by others, to which we do not subscribe and we will explain why. Finally, we mention a number of practical suggestions which could be implemented without a Treaty change, but which would also improve the balance between the ESCB and the political institutions.
Proposals 1-4 would strengthen the accountability, while proposal 1 would also directly strengthen the System's independence. At the same time we see the ECB's independence potentially at risk through two channels, to counter these we make two proposals (nr 5 and 6). We mention our priorities at the end of section 5.4.2.

5.4.2 Further room for improvement in terms of checks and balances

Proposed Treaty changes
1. The parliamentary hearings of candidate Board members could be changed into real confirmation hearings. The accountability of the ESCB towards the European Parliament would gain a deeper significance when that parliament has been involved in the appointment of the members of the Executive Board of the ECB. At the same time this will reduce the risk of political deals by the Council of Ministers, thus strengthening the independence of the System.[6] (If the EP were to confirm their appointment, it could also be considered giving them a role in the procedure for approving the salaries.) [7] The EP could have raised this in the context of the European Convention – to our knowledge this has not happened.
2. The ECB could start publishing a *summary* of the monetary policy deliberations of the Governing Council in its Monthly Bulletin with a lag of eight weeks, showing the (non-attributed) arguments used in the Governing Council, both pro and con the decision taken. This would allow the public to check whether the ESCB was behaving consistently. More in general one could insert in the ESCB Statute the obligation that the general Treaty requirement to take 'reasoned decisions' should also apply to the ESCB's decisions on key interest rates,[8] while adding that the ECB would be allowed some *delay* in presenting an extended summary of the deliberations in case of interest rate decisions. This procedure gives a legal basis to recommendations such as by Goodfriend (2000).[9] It would increase the accountability. It would also increase the understanding of the financial markets of the ESCB's view of the working of the economy and the monetary transmission mechanism. Apart from this, the Governing Council could decide to feed information to the market about

[6] Cf. the efforts by the French president Chirac around the appointment of Duisenberg in May 1998.
[7] The role of the European Parliament in the appointment procedure of the Commission has also been strengthened since Maastricht: according to the Treaty of Nice (signed 2001 and effective as of 1 February 2003) the president of the Commission will be nominated by the Council, meeting in the composition of Heads of State or Government, by qualified majority; 'this nomination shall be approved by the European Parliament' (Treaty of Nice, Art. 214-EC).
[8] Inspired by the American Sunshine act - see Art. 10.4-ESCB, section I - and by Art. 190-EC ('Regulations, directives and decisions of the Council and of the Commission shall state the reasons on which they are based and shall refer to any proposals or opinions which were required to be obtained pursuant to this Treaty.'). It would introduce a requirement for the Governing Council to be specific on the arguments used, without prescribing in detail how this should look like. Our basic point is not to approve or disapprove of the present practice, but to find a permanent legal basis for good practice.
[9] M. Goodfriend (2000), p. 24: 'Minutes without individual attribution should be published to present opposing views clearly, to focus central bank watchers, and to guard against the potential of politically motivated policy mistakes.'

possible *future* interest rate moves – but see also our remark on the experience of the Fed with presenting a 'policy bias' in our description of Art. 10.4, section I above, which should make one very hesitant to follow such a path.

3. The Treaty could specify that the annual report of the ECB should explain - if this were to be the case - the reasons why it has not achieved price stability over the reporting period. [10] Like the previous point, this would improve the ESCB's accountability.

4. The ESCB should constitute its own dialogue with social partners and consumer organizations (to cover issues like cross-border payments and issues relating to consumer protection) in the euro area.[11] Thus the ECB would become more embedded, and effectively be perceived as being more embedded, in society, which would strengthen its support among the population. The difficulty is that the groups mentioned might not be organized on a European level. In that case one could choose to structure this dialogue nationally. One could leave the precise level on which to organize this dialogue open by inserting this as an obligation for the 'System', which could then be conducted centrally or decentrally.[12] (We would not go as far as to recommend to reserve one seat in the Executive Board for a representative of industry or commerce, as it is unlikely that such a person could vote independently from the sector he would be representing. In view of the clear mandate it makes sense to require that all board members are well-versed in financial and monetary matters.)

5. In order to keep the system of staggered appointments for the board members intact, it could be considered to allow reappointment of a board member who stepped in *during* the term of his predecessor. [13] (If some Executive Board members were to resign at the same moment, the tenures of their successors would start running parallel. This would allow the Heads of State to appoint a number of Executive Board members in one go. This would lead to political negotiations and a politically determined composition of the Governing Council, which would reduce the ESCB's credibility and thus its effectiveness vis-à-vis the financial markets.)

6. One could imagine making the appointments of national central bank presidents subject to approval by the Executive Board or by the ECB's president.[14] This would de facto eliminate the possibility of national political appointments, which, if it became widespread, would affect the System's independence.

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[10] Inspired on the Bank of England Act (see Art. 10.4-ESCB above), though we see the practical problem that the ECB's price stability objective is formulated as to be achieved over a medium-term, but this should not be an excuse for ducking such a procedure.

[11] Inspired by existing national practices and the Federal Reserve System. In some countries consumer protection is a responsibility of the national stock exchange supervisor. However, these SECs are not organised on a European scale.

[12] In this case there would be two differences with the existing so-called Macroeconomic Dialogue (see ECB Annual Report 2001, p. 97): (i) this existing dialogue is dominated by Member States (participants are representatives of the Member States, the Commission, the ECB, non-euro area central banks, and the EU level social partners and (ii) it is based on a political intention, and not a legal decision.

[13] Inspired by the rules for the Court of Justice and the FRS.

[14] Inspired by the FRA. At present there is no *European* 'check' on the appointment of the national central bank governors by their national governments. To allow the European Parliament to approve the appointment of the 'regional' members would not be in conformity with the express federal character of the ESCB (cf. A.J. Clifford (1965), p. 71/72). Therefore we choose for a 'check' by the Europeanly appointed, but a-political centre, i.e. the Executive Board. The check is meant to focus on the professional qualities and European credentials. Other governors should not be involved, as they have not been appointed by a European body.

A number of these changes could also be implemented without a Treaty change (esp. proposals two, three and four).

Treaty changes rejected

1. Some critics[15] state that it should not be left to the ECB to define price stability. It is their view that in a democracy this should be done by the political authorities. We do not support this view. It would be detrimental to the credibility of the ESCB, when the Ecofin ministers or the legislator (European Parliament) would be able on a yearly basis to reconsider the definition of price stability (or to define the circumstances under which price stability might not have to be attained).[16] This would de facto mean that the ESCB's objective would fall victim to political interference.[17] Furthermore, putting down a precise figure in the Treaty would create the risk of being too rigid. Neither does the Treaty lend itself for specifying the circumstances under which the price stability objective might be temporarily over- or undershot, to prevent being too rigid. [18] Anyhow, as long as the bias is that the Heads of State appoint relatively conservative central bankers, inflationary expectations are best anchored at a low level by allowing the central bank to specify price stability, which in the end is also a technical issue. A non-quantified objective also allows the central bank more freedom to choose its own monetary strategy (e.g. a monetary target or inflation target), best suited to circumstances.
2. We also reject the idea that the ESCB's mandate should be broadened to include the promotion of economic growth or employment, because this will increase the likelihood of political interference, it reduces the credibility of the central bank's pre-commitment to price stability, it denies that price stability (and the expectation of stable prices) is the best condition for sustainable growth (as is also recognized by the Fed), it reduces the System's accountability as it still has only one instrument (the interest rate) while having to hit two targets. The multiple objective of the Federal Reserve Act of 1913 has to be understood against the background of the early twentieth century in the United States, when bank runs happened regularly and the gold standard functioned as a credible anchor against inflation.
3. While we support the idea that the ECB should move up the ladder of transparency (see section I of Article 10.4 in Chapter 2), we do not support the publishing of individual votes and neither are we in favour of publishing the voting balance (number of votes for, against and abstaining). At the same time, we repeat that a lot is to be said for showing more of the individual debate in the form of non-attributed minutes, see our second suggestion above.[19]

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[15] E.g. Fabius, French Minister of Finance (Financial Times, 18 July 2000); more recently (2004) the new French Minister of Finance Sarkozy; J. de Haan, F. Amtenbrink and S.C.W. Eijffinger (1999).
[16] A 'double lock on the door', by requiring approval of both the Ecofin and parliament would not help, because in this respect these two branches probably share each other's preference for output stabilization over minimizing inflation.
[17] The experience of the US shows members of parliament will regularly table resolutions asking for a policy change. In other words, the central bank's pre-commitment is more credible.
[18] In the UK this is solved by requiring the governor of the Bank of England to write a letter to the Chancellor of the Exchequer explaining the reasons for any deviation. The Chancellor may not dismiss the governor. See Amtenbrink (1999), p. 214-215 and 269-270.
[19] However, it should not be overlooked that at the time of its drafting the Statute of the ESCB compared favourably in terms of transparency with the statutes of the then existing most important central banks, i.e. the Fed (decisions were not even announced), the Bundesbank (no hearings by parliament) and the Bank of England (totally controlled by the Treasury). It should also be pointed out that in terms of immediate disclosure the ECB has developed a 'best practice'.

First, publishing **individual voting behaviour** - if the members of the Governing Council were to vote regularly on monetary policy, which is not yet the case - should not to be recommended, for the following reasons. A general consideration is given by Bini Smaghi and Gros (2000): disclosure of individual opinions could contribute to shifting the real debate outside the council room. Another general argument is that disclosure might make council members reluctant to change their mind between two meetings, as such a change might sometimes be interpreted as inconsistent behaviour. This would introduce a certain (and unnecessary) degree of inertia in the individual positions. An argument related specifically to the ECB is that the governors are appointed by their national authorities. With their voting behaviour public, governors could become easy targets for national political pressure, to which they might succumb when they want to be re-appointed [20] or when they would aspire another function in public life. (A difference with the regional FOMC members and the external MPC members of the Bank of England is that these members usually return to the private sector or academia, making them less dependent on the national or federal government.) [21]

Second, there are also good arguments for not revealing the **voting balance**. As De Haan and Eijffinger[22] argue, this could undermine the credibility of a decision taken by only a slight majority, while a 'close vote' could also elicit pressure on the governors and the executive board members, if the political authorities would be tempted to influence the balance.

4. We also do not support the idea to make Walsh-type contracts, i.e. making the salary of the governor inversely linked to the inflation outcome after correcting for inflation responses to aggregate supply shocks. This line of reasoning is part of the principal-agent literature. In a standard principal-agent problem, the principal offers to its agent a contract which is designed to affect the agent's choice of action. One could think of pecuniary incentives, but in our case also to dismissal/reappointment procedures.[23] This approach suffers from two shortcomings: first, it is not realistic[24] and, second, it presupposes that monetary policy decisions are taken by one person (the governor) and not (as is usual in most central banks these days)[25] by a committee of colleagues. Decision-making by a committee is to be preferred over single-

[20] Most governors are reappointable (in some cases only once - see Article 14.2-ESCB), which strengthens our case.

[21] See also Issing c.s. (2001), p. 140: 'In the context of the ECB, the publication of voting records would, in all likelihood, be given a national connotation.'

[22] De Haan and Eijffinger (2000a), p. 400.

[23] See Carl Walsh (1995), 'Optimal Contracts for Central Bankers', *American Economic Review*. Walsh' approach differs from that taken by Rogoff's 'conservative banker' solution to the time-inconsistency problem (Rogoff (1985)), in that the government and the individual who might head the central bank could –unlike in Rogoff's model- share the *same* preferences over inflation and output fluctuations, but Walsh changes the incentive structure for the central bank by raising the marginal cost of inflation to the central banker. See also Houben (2000), p. 49.

[24] The salary is 'probably not much of a motivator for central bankers who are already voluntarily giving up a large portion of their potential earnings to do public service' (Blinder (1998), *Central Banking in Theory and Practice*, p. 45), and (in case of the dismissal procedure) it is questionable whether government would dismiss a governor for doing what it would have liked to do itself in the first place had it been allowed to do so, i.e. creating a little boom (ibidem, p. 46). The Reserve Bank Law of New Zealand tries to solve this by having a Board of purely non-executives (except for the Governor who is *qualitate qua* member of the Board) monitoring and assessing the conduct of monetary policy of the Governor.

[25] Exceptions are the central bank of New Zealand and Canada, which - probably not coincidentally - also have defined an inflation target for the central bank (adjustable for supply shocks and changes in indirect taxes).

person decision-making, because it strengthens the independence of the central bank[26] and it ensures that more information is used in the decision-making process, which is important because interest rate decisions require a fair amount of judgement. Though in theory committees could suffer from decision-making inertia, there is no evidence supporting this in practice.

Practical improvements

1. Though formally not allowed, it can not be excluded that attempts will be made to influence members of the Governing Council behind the screens. In this respect it would be worth considering that the members of the Governing Council promise to notify the others of any attempt by a government or its representative to influence his/her position. Such an arrangement, if known to the perpetrators, would work both ways: it would reduce the risk that a member would succumb, and it would reduce the risk of interference.[27]
2. The ECB has many outlets of information (press releases, introductory statements, press conferences, speeches, interviews, quarterly appearances by the president before the Monetary and Financial Committee of the European Parliament, Monthly Bulletin, Annual Report). It is a daunting task to be consistent in all these outlets. Perhaps it would be better to reduce the frequency of interviews and press conferences by the president of the ECB, because his statements tend to be overinterpreted. The most important sources of information on the ECB's current thinking would then be: the monthly introductory statement, the press conferences (on a monthly or perhaps *quarterly* basis), the Monthly Bulletin and the regular appearances for the EP.[28] This could also be combined with a voluntary publication of the summary record, mentioned above under Proposed Treaty changes, as long as a Treaty change is not realized.
3. The frequency of monetary meetings of the Governing Council (twice a month) seems to be too high: this might at occasions lead to using *artificial* arguments to motivate a decision to change the interest rate, i.e. when new information is scarce, but sentiment in the Governing Council has changed. On the other hand, a high frequency does allow the mood for change in the Governing Council to build up over several meetings even within a relatively short period. But in my view the first argument weighs heavily. Therefore, the Governing Council should schedule to discuss monetary policy only once a month[29] - with additional meetings in case of emergencies, in the form of a teleconference, not being excluded. Under Art. 10.2-ESCB, voting (decision-making) by means of a teleconference is allowed. Indeed, during the writing of this thesis the Governing Council decided to reduce the frequency of discussing monetary policy decisions to once a month, while continuing to meet twice a month, with the second meeting being devoted for the most part to non-monetary policy matters. Of course, in exceptional circumstances interest rates can always be adjusted during the second meeting or

[26] A single person is more easily put under effective pressure by the government than a committee. And it makes it more worthwhile for the government to appoint a 'cooperative', i.e. non-independent central bank governor.
[27] Such a rule could be laid down in the Rules of Procedure.
[28] The ECB is sometimes criticized for the fact that too many persons (Executive Board members and governors) express themselves on issues like the inflation outlook and interest rate policy. However, it seems difficult - and even undemocratic - to silence for instance the governors, because they have to talk to their national audiences too, and have to be able, if necessary, to point to inflationary dangers.
[29] According to Art. 10.5-ESCB '[t]he Governing Council shall meet at least 10 times a year.'

between meetings (through means of teleconferencing).[30] The lower frequency reduces the risk of noise in the ECB's communication. Another risk is that a central bank's signals are over-interpreted, or that firms assign more weight to the information provided by the central bank than to their own 'private' information on the fundamentals of the economy. When the central bank's information is less accurate than the 'private' information, this would steer expectations away from the fundamentals. This implies a central bank should only extend information on issues on which it is better informed than the private sector. This includes in any case its objectives or preferences.

4. The Rules of Procedure of the ECB (or Code of Conduct) should provide that a person resigning from the Executive Board shall not accept a position at a political function, for instance entering an administration (national government) within the first six months after the expiration of his mandate or after his resignation, because promising such function could have the same effect as promising re-appointment. An exception could be made for appointment to central bank governor. This is without harm, because it will be difficult for a government to 'promise' this with any accuracy, since the incumbent governor is protected against wilful dismissal (Article 14.2-ESCB). Other exceptions could be granted on a case by case basis by the Executive Board or Governing Council, provided that these bodies have been informed immediately of the job offer, when made, formally or informally. A similar arrangement could be made for functions at banks or other corporations which have a direct link to activities of the ESCB. Precedents for reducing the freedom of a board member in accepting a new job can be found in former Article 9-ECSC for the members of the High Authority, later Article 10 of the Merger Treaty for members of the European Commission.[31]

5. A question related to voting is whether the Governing Council should not start voting on monetary policy. Decision-making by consensus, as is the rule, might be recommendable for a young organization, because it prevents the creation of blocks (e.g. executive board versus governors, or hawks versus doves) and the confrontation of ego's. However, it also allows for hiding in the crowd, it could 'flatten' the discussion and it will probably lead to a situation in which the ECB's proposal, which at present is presented at the beginning of the discussion by a member of the Executive Board, is nearly always followed. In a more mature organization the president should formulate an interest rate proposal at the end of the discussion. One could consider decision-making by voting, one proviso being that there should be no leaks on individual votes for reasons specific to the ECB -an assumption called unrealistic by Buiter.[32] Other considerations in this respect will come to the fore in cluster III.

Priorities

The issue of voting needs further examination – see cluster III. The frequency of the regular monetary policy meetings has already been reduced, and the change in the Rules of Procedure to improve the ECB's corporate governance is desirable, but not urgent in itself. This leaves

[30] See the Introductory statement by the president during the ECB press conference following the meeting of the Governing Council on 8 November 2001. After the second meeting of the month there will be no press release on the ECB's monetary policy decision, unless - unexpectedly - interest rates are changed.

[31] Compare the Bangeman-case. In 1999 Commissioner Bangeman, responsible for industrial policy, had accepted a future position in the Board of the Spanish company Telefonica, even before the end of his term as Commissioner. He was accused of unethical behaviour, especially because Telefonica had an unresolved case running with the Commission.

[32] Buiter (1999), p. 192. For other arguments in favour of voting or against voting (i.e. in favour of decision-making by consensus), see chapter 11.3.

the practical improvements 1 and 2, and the six formal improvements respectively. The practical improvement relate to sharing information on political pressure, which should have a preventive effect, and to a more focussed way of disseminating information. The six formal improvements, requiring changes in the Treaty (and Statute), relate to an improvement in the ECB's accountability through a Treaty requirement to publish a summary record fulfilling certain minimum requirements, with the possibility of a delay as regards its monetary policy deliberations, and to improving the appointment procedures at the European and national level, increasing the role of the European Parliament in the appointment of the Executive Board and introducing the involvement of the Executive Board in the appointment of the NCB presidents. If ranked, the suggestions on the improved summary record should rank top (on a voluntary or Treaty basis), linked to this is formal improvement nr 3 (Treaty requirement to explain the reasons for not achieving price stability) and the general idea of subjecting the ESCB to the Treaty requirement of taking 'reasoned decisions'. The improvement in the appointment procedures (nr 1, 5 and 6) should be within reach too.

CLUSTER II

CHECKS AND BALANCES BETWEEN THE ECB AND THE NCBS

(the relations *within* the System)

Chapter 6: Introduction to Cluster II

In this cluster we focus our attention on the issue of checks and balances *within* the System. At an early stage major players expressed their preference for a federally construed central bank system; cf. Werner Report of 1971; Balladur's Memorandum of December 1987; Stoltenberg's reaction to Genscher's memorandum of February 1988; Pöhl's contribution to the Delors Report and the Delors Report itself.
The Werner Report mentions that 'the constitution of the Community system for the central banks could be based on organisms of the type of the Federal Reserve System operating in the United States.' Stoltenberg stressed the need for an 'ausgewogenes Verhältnis von zentralen und föderativen Elementen bei der Willensbildung.' Pöhl advocated a federal structure of the central bank system, which 'would correspond best to the existing state of national sovereignty and would additionally strengthen the independence of the central bank.' The Delors Report (par. 32) favoured '[a] federative structure, since this would correspond best to the political diversity of the Community.'
It is not surprising that the federal character of the new European central bank was relatively undisputed. Apparently, a centralized structure with no regional elements, i.e. consisting only of an ECB, was seen as an unacceptable risk to those Member States with a tradition of independent central banks and price stability. There would be no guarantee that such institution would not be taken over by politically appointed board members, whereas in a federal European central bank system power would at least partially rest with the governors of the NCBs.
The issue of a federative structure raises the question of the relative roles of the centre and the existing NCBs and the division of labour between them. A major element in this respect has been the conviction, especially expressed from the German side, that monetary decision-making should be completely centralized, though the decision-making centre should be composed of persons both from the centre and the regions, thus upholding the federal character. This relates in particular to the issue of the relative roles of the Executive Board and the governors in the decision-making process, which is dealt with in cluster III. Monetary policy making being centralized still leaves undecided **the division of labour** between the centre and the regions in the area of monetary policy operations, the focus of this chapter.

The division of labour in the operational area relates to mundane questions such as who issues and distributes banknotes, to what extent are NCBs free to conduct non-System functions, what would the ECB's balance sheet consist of, would it own foreign reserves and would it be allowed to deal directly with banks – many of these issues relating to the 'standing of the centre'. The division of labour issue played against the following background, best explained by confronting the German and French views as they came to the fore in especially the Committee of Governors meetings during the drafting of the ESCB Statute.

Throughout the negotiations within the Committee of Governors the German governor Karl-Otto **Pöhl** favoured a strong centre. Three arguments played a role. First, Germany had reasons to fear that national governments would try to influence the new central bank system, because not all countries had the same tradition of central bank independence. The best guarantee against outside political pressure would be a clearly visible and independent decision-making centre, which would be more than a token institution. Second, the example of the Bundesbank showed that a system could have a strong centre, while still being regarded as a federally organized system, one important federal element being that the presidents of the Landeszentralbanken each had a vote in the central decision-making body. Third, at occasions Pöhl had really been annoyed by the reluctance of the Landeszentralbankpresidents to vote along with the Direktorium. Pöhl may also have assumed at an early stage that the new central bank would be located in Germany anyhow.
Pöhl's Alternate, Hans **Tietmeyer**, shared Pöhl's inclination for a strong centre. Tietmeyer was especially focussed on ensuring the indivisibility of the system's monetary policy. At an early stage of the discussions Tietmeyer had objected to the recommendation of the central banks' legal experts group to substitute in the draft Statute the word 'System' by 'ECB and/or NCBs' in those cases wherever reference was made to decisions, advisory functions and operations; Tietmeyer preferred to present the system *unisono*. However, the experts' advice prevailed, as they argued that the functions referred to could only be attributed to entities with legal personality, with which the System would not be endowed.[1] Tietmeyer's position was softened, to the extent that NCBs took it for granted that they would only operate under the precise instruction of the centre, though until the end Tietmeyer would keep a preference for the centre (the Executive Board), and not the Governing Council, deciding on the degree of decentralization.
On the other side of the spectrum operated **de Larosière**, the governor of the Banque de France. He referred to the idea of *subsidiarity*, i.e. the idea that competences should be laid at the lowest possible level which still allows for effective policy-making. De Larosière borrowed this idea in order to support his point that the execution of monetary policy should take place at low levels in the organization, i.e. by the NCBs.[2] In fact, his line of reasoning was supported by most, though not all, governors as we will see when dealing with Article 12.1c.

Views of the respective committees
As regards the relative role of the NCBs, the **Delors Committee** had recommended that an ESCB should be based on a federal structure, that the governors of the central banks would be members of the ESCB Council, together with the members of the executive board, and that the NCBs 'would execute operations in accordance with the decisions taken by the ESCB Council.' [3] At an early stage therefore the choice was made for centralized decision-making

[1] See chapter 4, under Art. 1-ESCB, section II.2. This argument and the fact that he probably wanted his institution to continue to exist as a legal entity can explain why Pöhl referred to the Federal Reserve System, and not so much to the Bundesbank as an example.
[2] In fact, one should have referred to the principle of decentralization, because subsidiarity is a concept applied to the attribution of competences to higher or lower levels of decision-making and not to implementation (cf. R. Smits (1997), p. 112) - see also the box on the principle of subsidiarity at the end of our description of Art. 12.1c.
[3] Delors Report, par. 32.

and decentralized operations.[4] The **Committee of Governors**, when it started drafting the ESCB Statute, while taking this as the starting point, saw the exact degree of division of labour between the ECB and the NCBs as one of the problems it had to solve. In his capacity as chairman of the Committee of Governors Pöhl presented the issue in the following neutral fashion to the informal Ecofin on 8 September 1990: 'the System must have a strong centralised structure and organization, with monetary policy decisions being placed firmly in the hands of central decision-making bodies. However, this necessary centralization does not mean that there is not some room for a division of labour. NCBs will have their role to play in the application of the common monetary policy. However, the discussion about the scope for decentralization, which will have to be limited in any case, has not yet been concluded; it involves difficult technical issues. [....] there can be no doubt that all operational measures must be implemented strictly in accordance with instructions from the decision-making bodies. To what extent the practical execution of open-market purchases and sales of assets, rediscounting or operations on the foreign exchange market need actually be carried out from the centre or could be left to the NCBs will in good part depend on technical or market considerations which may well change over time. Irrespective of the precise form of the balance-sheet structure of the System, it must be understood that in the field of monetary policy, NCBs can act only as the operational arm of the System. In areas which are not linked to monetary policy operations, the NCBs may still have a responsibility of their own, for instance, in settling payments, performing prudential tasks, assessing risks or carrying out business on behalf of government institutions.' The governors finished a preliminary draft of the ESCB Statute containing the most important articles on 27 November 1990, though they had not solved the issue of decentralization.

The draft ESCB Statute was sent to the **IGC** before its start in December 1990.[5] In an accompanying letter the governors asked the IGC to decide on two relevant issues in this context, on which they had not been able to agree and which were still left open in the draft Statute: (1) the question of the precise division of decision-making responsibilities between the decision-making bodies (the Executive Board and the ESCB Council) and (2) the question of how strong the bias should be for the System to make use of the NCBs for the execution of its operations.[6] In both cases Germany was standing almost completely alone, supporting independent (and not only delegated) tasks for the Executive Board, placing responsibility for the execution of monetary policy in the hands of the Executive Board. In doing so, the Executive Board should make use of the NCBs to the extent possible and appropriate. The Germans opposed the alternative, which mentioned that 'to the full extent possible in the

[4] The ECB though was envisaged to have a balance sheet of its own (Delors Report, par. 32).

[5] In April 1991 the governors completed, and sent to the IGC, the final draft – now also including the article on the distribution of income of the System and the two chapters on general and transitional provisions.

[6] See the square brackets in Art. 12.1 and Art. 14.4 (later transferred to Art. 12.1c) of the governors' draft and the accompanying commentary. The Committee of Governors had failed to agree on one more issue, i.e. the issue whether part of the foreign reserve assets could remain under the full control of national governments (on which the Bank of England took a minority position - see Art. 3.1-draft ESCB Statute). On the other articles the Committee had been unanimous, though the Committee noted in its letter to the IGC that 'the Governor of the Bank of England has indicated that the authorities of the United Kingdom are unable to accept the case for a single currency and monetary policy', which was a clever formulation keeping the UK governor onboard as to the technical content of the draft Statute.

judgment of the Council the NCBs shall execute the operations arising out of the System's tasks').

The IGC would decide to give the Executive Board powers of its own, and not only delegated powers[7] and it would take a middle ground on the second issue by placing the decision on the extent to which NCBs should be used in the implementation of monetary policy in the hands of the Governing Council, with a strong, but not the strongest possible, bias towards using NCBs. Formally, this decision is placed in hands of the 'ECB'. However, such a fundamental issue would not seem to fall under 'current business' of the Executive Board, and to the extent that it could be seen as part of the 'implementation' of monetary policy, the Executive Board has to operate 'in accordance with the guidelines and decisions of the Governing Council.'

The purpose of this part of our study is to find which balance between the ECB and the NCBs the founding fathers had in mind, when they drafted the ESCB Statute, and for which reasons. We will also look into the actual division of labour as specified by the Governing Council in 1998, basing themselves inter alia on Art. 12.1, third paragraph, to prepare for the start of the ESCB in 1999. As in Cluster I, we will approach these questions by studying the genesis of the relevant articles of the ESCB Statute.[8]

Different degrees of centralization

We will focus on those articles relating to the internal structure of the ESCB which are relevant for assessing the **balance of power** between the ECB and the NCBs. While it is clear that all elements of the system have to cooperate for the system to be effective and successful, this can be achieved at different degrees of centralization at the operational level. One example of relatively strong centralization would be the **Bundesbank**, where the centre (Board of Directors) is explicitly charged with all open-market operations, foreign exchange transactions and transactions with the Federal government; the Landeszentralbanken conclude transactions with state authorities and credit institutions to the extent they do not fall under the authority of the Board; the Bundesbank has one balance-sheet, because the Landeszentralbanken are branches (administrations) of the Bundesbank. [9] At the other end of the spectrum is the **United States**, where the centre does not have operational capabilities at all. It should be added though that the United States is specific in the sense that all open-

[7] Art. 12.1, second paragraph.

[8] The articles describing the internal relations of the system were not repeated in the main body of the Treaty, i.e. they only appear in the ESCB Statute.

[9] Legally speaking the Landeszentralbanken (LZBs), which before had acted as central banks within their respective territories, merged with the Bank deutscher Länder (BdL), a joint subsidiary of the LZBs. The BdL had been responsible for banknote issuance and the coordination of policy. After the merger the LZBs lost their legal personality, but kept their name. The Bundesbank Act reserved for the LZBs transactions with their respective state authorities and transactions with banks in their area, other than banks with central functions throughout the Federal territory. (Bundesbank Act 1957, Art. 8(2); Deutsche Bundesbank (1982), *Special Series No. 7*, p. 4-7) This organizational form had been a compromise between a proposal by Schaeffer (Minister of Finance), who promoted a **decentralized** Federal system, thereby basically transferring the rights of the Allied Banking Commission which had *de jure* controlled the predecessor of the Bundesbank (Bank deutscher Länder) to the Federal **government**, and a proposal by Erhard (Minister of Economics), who favoured a **centralized** single tier system, while granting the Bank **autonomy** from the Federal government. For further references to this conflict which delayed the establishment of the Bundesbank (founded in 1957), see Amtenbrink (1999), p. 89-94, and Deutsche Bundesbank (1999), p. 111-115.

market and foreign-exchange operations are conducted by one reserve bank, namely New York. Therefore, it seems that within a federally organized central bank system different degrees of centralization are possible and effective. But even then, within each type of solution there might be an underlying tendency towards more (or less) centralization. We will draw conclusions in this regard with respect to the Federal Reserve in chapter 8.2.4.

Federal Reserve

Because of its relevance for our study we will give in this introduction some background information on the Federal Reserve and its origins, focussing on the division of labour between the centre and the regional Federal Reserve Banks. This will help us better understand the different ways in which the *checks and balances* in a federally organized central bank system can be designed and how such a system might develop. In the United States a federal central bank system was enacted in 1913. The following arguments in favour of a decentralised system had played a role: a general dislike among Congress of any concentration of economic power[10] and the fear that a dominant centre would especially protect the interests of the financial sector which was concentrated in the East, without an eye to the economic needs of the other parts of the country. At the same time there was the traditional reluctance to transfer too much power to the government. During the debate on the FRA there were coinciding forces against a powerful centre: bankers feared a politically run centre, the regions feared a centre dominated by bankers (read New York). Almost everybody had a reason to be against a strong centre.

Indeed, the outcome was a system with a (typically American) federal structure. Or as H. **Parker Willis** (first secretary of the Board) wrote in 1915: "The new act ... generally diffuses control instead of centralizing it." There would not be one central bank for all America, but twelve "district Federal Reserve Banks." [11] The envisaged system of a limited number of regional local reserve banks would substitute for the existing system of pyramiding required reserves through several levels of banks, with New York, Chicago and St. Louis at the top. That system immobilized reserves and amplified local changes in the demand for currency, e.g. during the crop selling season. [12] The Federal Reserve System allowed banks to borrow from the FRBs against commercial paper collateral, the supply of which would fluctuate elastically with local economic conditions.[13] The centre (i.e. the Federal Reserve Board) was given regulating powers, e.g. with regard to the rediscounting of eligible paper, and the power to approve or disapprove changes in an FRB's discount rate.

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[10] On the basis of hearings during 1912 and early 1913 the House Banking and Currency Committee had concluded that there was a vast and growing concentration of control of money and credit in the hands of comparatively few men. (Federal Reserve Bank of Boston (1990), *Historical Beginnings ... The Federal Reserve*, p. 19-21)

[11] Bankers had shown a strong dislike for a framework of government regulation, which they feared would be dominated by political appointees. However, when Wilson selected the candidates for the initial Federal Reserve Board, he did not aim for a Board which would work to break Wall Street's control over the nation's credit, as some had advised him. Instead, he selected men whom he hoped would win the confidence and cooperation of the banking community. The progressive wing of the Democrats were appalled by his choice, and two out of Wilson's five nominees had to withdraw, because they would not get the Senate's consent. (FRB of Boston (1990), p. 19-26 and 55-58.) (The Secretary of the Treasury and the Comptroller of the Currency were ex officio members of the Federal Reserve Board.)

[12] For a short description of the banking system and its problems before 1913, see appendix 1 at the end of cluster II. See also FRB of Boston (1990), p. 13-15 and Moore (1990), p. 4-5.

[13] The so-called **Real Bill doctrine** – see Art. 12.1c, section I.2.

The aim of the creation of the FRS was more to improve the functioning of the American banking system than to be able to control the money supply or the price level.[14] Under the then prevailing gold standard with fixed exchange rates a country's price level was related to the gold stock and the business cycle.[15]
An important development for the Fed was the increasing importance of open market operations for monetary policy, basically as of the early twenties. The Federal Reserve Act had not provided for sharing power in this respect, which initially left the Board in the cold. This changed with the Banking Act of 1935, which while maintaining the federal structure of the system centralized decision-making power on open-market operations in the System's Federal Open Market Committee, in which the Board of Governors was to have a majority of the votes. Thus the balance tipped toward shifting decision-making power to the centre.

We have captured the most important developments in the Fed's history in a separate **appendix** included at the end of this cluster. The main features in terms of division of labour are an important (but not exclusive) role for the Board of Governors in monetary policy decision-making (e.g. co-determining the federal funds rate) and an exclusive role for the FRBs in executing domestic and external monetary policy operations, open market operations and foreign exchange interventions being completely centralized in the FRB of New York and discount windows being operated locally (though since the 1920s they only play a very minor role). The Board is not empowered to hold 'monetary' assets and thus has no balance sheet of its own except for items like its premises.

We have seen that the main purpose of *checks and balances* is to prevent one party or agent coming on top and dominating all others. In the case of the Federal Reserve, the parties to be kept in check were both the commercial bankers and the central government.[16] Therefore, the balance between the FRBs and the Board was designed not so much as a balance between the regions and the centre, but between private and public interests. Nowadays the FRBs are not so much seen as representing private sector interests, but as a factor preventing the concentration of too much power in one body, the Board of Governors. One feature is very typical for the United States, that is the unique dominant role of one of the FRBs, New York. A dominant influence by New York was feared by the regions, which was one of the reasons behind designing a regional system, which worked well in the beginning.[17] Not foreseen was the development of the open market operations (OMOs) into one of the most important

[14] Friedman and Schwartz (1963), p. 195.
[15] Friedman and Schwartz (1963), p. 135-140.
[16] Early plans for establishing a more efficient banking system envisaged the creation of a central institution, the National Reserve Association, with branches all over the country and the power to issue currency and to rediscount the commercial paper of member banks. The institution would be controlled by a board of directors, the overwhelmingly majority of whom would be bankers (Aldrich plan, 1911; Aldrich was an influential conservative senator close to the eastern establishment). This plan was criticized strongly by the progressives. They protested it would not provide for adequate public control of the banking system and that it would enhance the power of the larger banks and the influence of Wall Street. But Wilson had promised financial reform without the creation of a central bank. In the end, the solution was to be a system of privately owned reserve banks, under the supervision of a public body. Also in other respects Wilson increased the public sector character of the system, inter alia by defining the reserve currency as an obligation of the United States.
[17] Opinions diverged on whether the role of New York would be diminished more by opting for many districts or instead by opting for a few, but relatively large districts, because according to some, if there were twelve (small) reserve banks, New York would undoubtedly remain the sole money centre (Warburg (1930), p.108).

monetary policy instruments – this favoured New York which had the only significant financial market in which many types of paper were traded. The FRBs agreed to coordinate their OMOs and to execute them in one spot (in practice: New York). This remained like this, until in 1935 the FOMC became the body deciding on all OMOs. In EMU, the situation is different. There are more market places, all commercial banks hold accounts with their central bank (there is no primary dealer system) and technically (thanks to IT developments) there is no need for one market place, which means the NCBs did not see each other as competitors, in their eyes the future ECB being their only new real competitor.

CHAPTER 7: SELECTED ESCB ARTICLES (CLUSTER II)

Content

Selected articles: Article 3.3 (Prudential supervision and financial stability), Article 5 (Collection of statistical information), Article 6 (International cooperation), Article 12.1, third paragraph (Decentralized execution), Article 14.3 (NCBs as integral part of ESCB), Article 14.4 (Non-System functions of NCBs), Article 16 (Banknote issuance), Art. 17-24 (Monetary functions and operations), Art. 25 (Prudential supervision), Art. 29 (Capital key), Article 30-33 and 51 (Financial articles relating to foreign reserves and the System's income allocation). [1]

Articles 9.2 (ECB) will be dealt with under Art. 12.1c, and Art. 25 (Prudential supervision) under Art. 3.3.

7.1 INTRODUCTION

For every article covered in this chapter, we will follow the structure used in Cluster I, i.e. the description of its genesis will be preceded by (i) an introductory paragraph, describing the main economic reasons (*raisons-d'être*) for including the article in the Statute and the main sensitivities regarding its precise formulation, and (ii) in most cases by a description of comparable features of the Federal Reserve System, where this is considered illuminating for the understanding of the article. We then continue with the description of the history of the article, starting with the deliberations in the **Delors Committee**, followed by a description of the drafting process of the ESCB Statute within the Committee of Governors and its Committee of Alternates and, finally, a description of the discussions in the IGC. As regards the articles treated in this cluster, most of the discussions on these articles took place within the **Committee of Governors**, as the Delors Committee focussed on the overall design of Economic and Monetary Union - and not so much on the internal structure and instruments of the ESCB.[2] Though the **IGC** did cover all articles of the draft ESCB Statute, the IGC

[1] With these articles we cover also the following articles of the EC Treaty: Article 105(5) (= Art. 3.3-ESCB); Article 105(6) (= Art. 25.2-ESCB); Article 105a(1) (= Art. 16-ESCB).

[2] The Delors Report was relatively short on the instrumentalization and governance of the ESCB, most of which can be summarized by quoting part of par. 32 of said report:
'[The ESCB] could consist of a central institution (with its own balance sheet) and the national central banks. [....]
- The policy instruments available to the System, together with a procedure for amending them, would be specified in its Statute; the instruments would enable the System to conduct central banking operations in financial and foreign exchange markets as well as to exercise regulatory powers;
- while complying with the provision not to lend to public-sector authorities, the System could buy and sell government securities on the market as a means of conducting monetary policy.
[….]

discussion on the Statute concentrated on the interinstitutional relations (treated in Cluster I), the formulation of the tasks of the ESCB and the transitional arrangements (i.e. the position of the NCBs of Member States with a derogation or opt-out), including the institute to be established during stage two (which would be called the European Monetary Institute).

Art. 3.3 on prudential supervision is dealt with in this cluster, because its genesis shows Member States were afraid of losing power to the System and NCBs were afraid of losing power to the centre of the System, while the Bundesbank objected to putting monetary and supervisory responsibilities in one hand. We will not describe the genesis of the articles containing the monetary functions and instruments (i.e. most articles of Chapter IV of the ESCB Statute ('Monetary functions and operations of the ESCB'), as these articles do not contain indications for where implementation should take place, centrally or locally - the important feature of these articles being that they allow both. Of these articles we summarize their content, and we will only refer to the genesis, when this adds to understanding the article. Section 2.3 of chapter 8 will contain a table summarizing which operational tasks befall on the ECB and which on the NCBs (as decided by the Governing Council at the start of EMU in 1999, but including the later arrangements relating to the issuing of euro banknotes, which were issued only as of 2002). The financial articles 26 to 33 will be dealt with also relatively succinctly, as their meaning for the balance of power between the ECB and the NCBs is rather limited.

- establishment of a Board (with supporting staff), which would monitor monetary developments and oversee the implementation of the common monetary policy;
- national central banks, which would execute operations in accordance with the decisions taken by the ESCB Council.'

7.2 GENESIS OF SELECTED ARTICLES (CLUSTER II)

Article 3.3:

Article 3.3-ESCB (non-basic task of the ESCB)

"In accordance with Article 105(5) of this Treaty, the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system."

Also containing the genesis of Article 25 (including enabling clause for supervisory tasks)

Article 25-ESCB (prudential supervision)

"25.1 The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system.

25.2 In accordance with any decision of the Council under Article 105(6) of this Treaty, [1] the ECB may perform specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."

(to be read in conjunction with Article 4-ESCB (Advisory functions), Art. 14.4-ESCB ('Other' functions of NCBs), Art. 22-ESCB (Sound payment systems), Art. 41-ESCB (Simplified amendment procedure), Article 105.5-EC (reflects Article 3.3-ESCB), Article 105.6-EC (reflects Article 25.2-ESCB) and Article 106.5-EC (reflects Article 41-ESCB))

I. INTRODUCTION

I.1 *General Introduction*

This article deals with prudential supervision[2] and the preservation of financial stability, which in most Member States was a responsibility of the NCB, or a shared responsibility with the national supervisory authorities. It appeared that NCBs were hesitant to endow the ECB with competences in this area, basically for one or more of the following reasons: first national supervisors have more knowledge of local circumstances and institutions (this suggested the need for continued involvement of nationally based supervisors); second,

[1] Article 105(6) specifies that the Council of Ministers can only activate this specific enabling clause by a unanimous vote. For the full text of Article 105(6), see section II.3 below.

[2] Prudential supervision is usually distinguished from conduct-of-business supervision, the former dealing with issues like capital adequacy and the level of liquidity and risk management, the latter dealing with issues like market behaviour, prevention of insider trading and misleading consumer information.

combining monetary and supervisory policy responsibility in one institution could compromise the monetary function (this argument was felt more strongly in some countries than in others); third, the transfer of national supervisory competence to an international institution could possibly concentrate too much power in one (independent) institution (instantaneously or in the future). One of the complicating factors during the design of the ESCB Statute was the diversity in national institutional arrangements relating to the supervision of credit institutions – with different degrees of involvement of NCBs. This wide diversity itself strongly suggests there is no one 'best' model, or at least that 'best' models (if they exist) are dependent on national features, like possibly the national banking structure. Nonetheless involvement in supervision enhances knowledge of the financial markets and the monetary transmission mechanism, making for better informed monetary policy decisions. The synergy also works in the other direction. Good knowledge of a bank and its linkages with other banks might be helpful when it comes to decisions such as providing liquidity support to a bank, changing its management or facilitating a rescue-take-over. A central bank is well placed to assess the risks of such decisions for the rest of the financial sector, which is especially relevant in crisis situations.
Table 7.1 provides an overview of this diversity at the time the Statute was drafted by the Committee of Governors. Subsequently we will make a few remarks on the importance of safeguarding financial stability and on the background of the position of the Bundesbank, which opposed a supervisory competence for the system. This provides appropriate background for studying the genesis of this article and the closely related article 25 of the Statute.

Table 7.1 Allocation of responsibility for the supervision of credit institutions in the Member States of the EEC (situation in 1989) [3]

Belgium:	Mainly the responsibility of the *Commission bancaire* (7 members, of which 2 proposed by NBB), the NBB providing secretariat and defraying expenses.
Denmark:	Responsibility of Banking and insurance supervisory agency.[4]
Germany:	Regulatory and supervisory powers vested with the Bundesaufsichtsamt für das Kreditwesen (BAKred), a separate Federal agency under the jurisdiction of the Federal Minister of Economics. This agency and the Bundesbank co-operate closely (a legal obligation) and exchange information.[5] The Bank participates in the definition of supervisory rules. The BAKred does not have regional offices; the regional Landeszentralbanken of the Bundesbank receive and analyse the monthly balance sheet reports submitted by the banks before sending them - if necessary with comments - to the BAKred. BAKred and Bundesbank are allowed to execute special on site inspections

[3] Sources: national central bank laws; European Commission (1990a); Hans Aufricht (1967); EMI, *Progress towards convergence*, November 1996.
[4] In Denmark regulation and supervision never belonged to the central bank. In 1988 banking and insurance supervisory agencies were merged.
[5] See Art. 7 of the Gesetz über das Kreditwesen, 10 July 1961.

	(Sonderprüfungen), usually conducted by the Landeszentralbanken, but this is not a regular feature, as they rely for their on-going supervision on the reports of the auditors; in the case of the numerous local Sparkassen and co-operative banks they rely on certifications by the Associations.
Greece:	Responsibility of the central bank.
Spain:	The central bank responsible for the inspection, supervision and control of banks, with due regard to the rules prescribed by the Minister of Finance.
France:	The central bank has no formal supervisory mandate, but is closely involved. Regulatory power is vested in the *Comité de la règlementation bancaire et financière,* which is chaired by the Treasury. The Governor of the Banque de France is ex officio chairman of the *Commission bancaire*[6] which exercises all powers of investigation (including on site), supervision and discipline. The Bank provides its secretariat. The costs of the supervision are defrayed by the banking sector. Actual approval or withdrawal of bank licenses is the responsibility of the *Comité des établissements de crédit,* which is again chaired by the Governor.
Ireland:	Responsibility for regulation and licensing and supervision of deposit taking institutions vested with the central bank since 1971, its supervisory responsibilities also covering a range of securities-related activities, including the Stock Exchange, financial futures and options exchanges, money brokers, collective investment schemes and certain investment intermediaries.
Italy:	Central bank supervising banks and other financial institutions under the overall guidance and supervision of the Interministerial Committee for Credit and Savings, chaired by the Minister of the Treasury.
Luxembourg:	The Institut Monétaire Luxembourgeois (predecessor of the present central bank) exercised prudential supervision of the financial sector.
Netherlands:	Responsibility resting with the central bank, based on the Act on the Supervision of the Credit System of 1979.
Portugal:	Banks supervised by the central bank.
UK:	Banks supervised by the central bank.

At the end of the eighties central banks felt increasingly responsible for safeguarding the stability of the **financial system** as a whole. The stock market crash in October 1987 had shown how quickly disturbances could spread among financial markets. The speed with which disturbances could spread among markets had increased considerably during the eighties due to IT developments and increased interlinkages between different financial market segments, which in themselves could also mitigate shocks by spreading the effects over more participants (increasing the absorption capacity), but under circumstances could also trigger avalanches. These developments created new kinds of responsibilities relating to prevention of system crises and the management of such crises when they occur, for instance by injecting liquidity to prevent gridlocks in the payment systems. The explicit mentioning in the ESCB Statute of some responsibility for the stability of the financial system was new, as

[6] Other members of this Banking Control Commission were the Head of the Treasury Department, a specialized member of the Council of State, a government appointed representative of the banking community and a bank staff representative nominated by trade unions.

evidenced by the fact that at that time no central bank act contained such a task, most of them focussing in this respect on guarding the solvency of individual institutions. An exception was the Banque de France law which stipulated that "*elle veille au bon fonctionnement du system bancaire."*
Some central banks stressed the importance of having under the same roof knowledge of the financial markets, payment systems and financial institutions.[7] However, the **Bundesbank** would oppose bringing supervisory responsibilities into the European central bank. It supported the German model, where the central bank is closely involved in supervision, but does not bear formal responsibility for supervisory policy. In the view of the Bundesbank combining monetary and prudential responsibilities can create a conflict of interest within the central bank, e.g. when raising interest rates would jeopardize the health of some banks. This would reduce the central bank's ability to achieve price stability. Furthermore, decisions like closing of a bank were viewed as the responsibility of the government, since the central bank's reputation could be tarnished, if one or more banks fail while it is responsible. To the extent that the government would retain ultimate responsibility for supervision, the central bank would run the risk of receiving instructions from the government, thus losing its independence. Nonetheless, because of its closeness and expertise with the banking sector, the Bundesbank always considered it had a legitimate interest in being closely **involved** in analysing the prudential reporting by the banks and in the design of general regulations in the field of banking supervision.[8] This thinking was reflected in the paper submitted by Pöhl in September 1988 to the Delors Committee: 'The European central bank should be given the right to take part in the establishment of general regulations in the field of *banking supervision*. Moreover, owing to its expertise, deriving in particular from its business relations with credit institutions, the central bank should be closely involved in day-to-day banking supervisory activities.' [9]

An important aspect in this context is the *lender of last resort function* of a central bank, which is aimed at helping solvent banks by supplying liquidity where the market temporarily is unwilling or unable to. In most countries this function is not listed explicitly in the central bank statute to prevent moral hazard among commercial banks and to prevent political pressure on the central bank for bailing out possibly insolvent banks. The border line between solvent and insolvent is sometimes thin. For an overview of the possibilities for the ECB to provide LOLR assistance, see Van den Berg and Van Oorschot (2000), [10] who conclude that the ESCB has at its disposal adequate instruments to inject at very short notice liquidity through its NCBs in the financial system ('quick tenders' have proven their value in the

[7] See in this respect for instance Annual Report 1989 of the Dutch central bank, p. 120: 'A major consideration for the central banks is that it allows banking supervision to be exercised in conjunction with other tasks, such as those pertaining to monetary policy, payment transactions, the foreign exchange, money and capital markets, and the proper functioning of the international financial system.'
[8] Traditionally, the Landeszentralbanken evaluate the monthly balance sheets, the annual reports and the statutory reports of the auditors. The Bundesaufsichtsamt does not have regional offices. The administrative jurisdiction of the state authorities in matters relating to bank supervision had only been ended in 1961 by the Banking Act of 1961, which among others established the Bundesaufsichtsamt. (See Aufricht (1967), p. 287.)
[9] Pöhl (1988), section II.B.7.
[10] Van den Berg and Van Oorschot (2000), 'Who is the lender of last resort in EMU?' *Maandschrift Economie*, Vol. 64, February 2000, p. 77-85 (only available in Dutch).

aftermath of the September 11 events in 2001)[11]. Emergency liquidity assistance (ELA) to an *individual* institution could either be defined as a system function ('bilateral transactions') or a non-system ('Article 14.4') function. In both cases decision-making can be quick, though in the first case the execution of ad hoc 'bilateral transactions' needs the approval of the Governing Council, just as the acceptance of non-listed collateral. One could very well conceive of **delegation** of the authority to approve non-listed collateral in individual emergency cases, to the Executive Board in order to ensure expediency. At the same time it is difficult to imagine the Governing Council being cut out completely from such decisions. In case ELA is defined as a non-system function, the Executive Board should be notified, because it has to be able – if desired – to consult the Governing Council on whether it wants to raise objections under Art. 14.4-ESCB.

I.2 *Relevant features of the Federal Reserve System* [12]

In the United States any group of persons that wants to establish a bank can apply for a charter either with the Office of the Comptroller of the Currency of the Department of the Treasury (OCC), in which case the bank became a *national*-chartered bank, i.e. chartered by the national authorities, or with the state's banking supervisor, in that case becoming a *state*-chartered bank. This dual system, which already existed before the establishment of the Federal Reserve in 1913, is described by some as an expression of the traditional American opposition to concentrating too much power (in this case relating to banking) in one institution, especially not a federal one. Banks are subject to periodical examination by their chartering agency, costs of which may be assessed against the bank.[13] Chartering agencies may also impose reporting requirements.

When the Federal Reserve was established in 1913, national chartered banks had to become member of the FRS, while their supervision remained in the hands of the OCC.[14] Nationally chartered banks are also member of the Federal Deposit Insurance Corporation (FDIC), established in 1933, and in 1935 endowed with supervisory responsibilities. State banks are regulated and examined by state banking authorities and by the FDIC in case they have their deposits insured by the FDIC, while uninsured non-member state banks are examined only by the state chartering agency. State banks may apply for membership of the FRS.[15] If accepted by the Federal Reserve Board, they become a so-called state member bank and are

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[11] ECB Annual Report 2001, p. 72.

[12] Based on Prochnov (ed.) (1960), *The Federal Reserve System*, p. 247-250, and Board of Governors (1994), *Purposes and Functions of the FRS* as well as Annual Reports of the Board of Governors.

[13] FRBs make no charge for their examination. This is not undisputed - see M. Mayer (2001), p. 271-272.

[14] This explains that the examination of national banks by the OCC is stipulated in the Federal Reserve Act. FRA (1988), Section 21(2): 'The Comptroller of the Currency, with the approval of Secretary of the Treasury, shall appoint examiners who shall examine every national bank as often as the Comptroller of the Currency shall deem necessary.' This was a continuation of the situation before the FRA, when banks chartered under the National Banking Act of 1863 were examined by the OCC. (FRB of Boston (1990), *Historical Beginnings ... The Federal Reserve*, p. 11.) See also the description in section I.2 of Art. 16-ESCB.

[15] See Prochnov (1960), p. 30-31, for the pro's and con's of such membership for state banks. Since the **Monetary Control Act (MCA) of 1980** (see Art. 12.1c, section I.1 and appendix 2 at the end of cluster II) advantages for state banks of membership had diminished, as the Fed has to offer its services to all depository institutions (at a cost).

subsequently examined, when practicable, jointly by teams drawn from the local FRB and the state supervisory agency, but in most cases by either one of them.[16]
Bank holding companies, which own or have controlling interest in one or more banks (member or non-member), are examined and regulated by the Federal Reserve. More recently, the Fed has been assigned the role of 'umbrella supervisor' for newly formed *financial service holding companies*. The Federal Reserve has also broad authority to supervise and regulate the U.S. activities of *foreign banks* that engage in banking and related activities in the U.S.[17]
The Board of Governors is responsible for the System's supervisory duties, it determines the System's supervisory policy and fulfils an oversight function with respect to the supervisory functions performed by the FRBs. The Board is authorized to conduct examinations,[18] but leaves this task almost completely to the twelve Federal Reserve Banks, their authority to conduct examinations being based directly on the FRA (e.g. in case of state member banks) or otherwise based on delegation by the Board, (e.g. in the case of bank holdings).[19] The Board will only conduct an examination, when it is not satisfied with the FRB's work. This is the exception, in fact leaving the bulk of the supervisory work to the FRBs. This also becomes more clear when one looks at the number of people at the Board employed in the supervisory area, *viz*. 220 (2000-figure), of which 40 responsible for oversight supervision and the others for more general tasks, like training Reserve bank staff, risk assessments programs and examination procedures. It should be clear however that *supervisory policy* as such is made by the centre, and not made by the FRBs. [20] The FRS and the FDIC receive copies of the examination reports of the OCC, because national banks are members of the FRS and the FDIC.[21]

[16] The obligation of state member banks to accept supervision by the Federal Reserve is explicitly mentioned since 1917 in Section 9(7)-FRA (1988). Examinations may be performed by direction of the FRBs, but the examiners must be selected or approved by the Board (Section 9(7)-FRA (1988). Section 21(5)-FRA (1988) provides that '[i]n addition to the examinations made and conducted by the OCC, every Federal Reserve may, with the approval of the Federal reserve agent or the Federal Reserve Board, provide for special examination of member banks within its district.'
[17] At year-end 2001 there were more than 2100 national banks (oversight by OCC) and 970 state member banks, 6318 US bank holding companies, 259 foreign banks with state-licensed or federally licensed (OCC) branches. (OCC-publication; Board of Governors Annual Report 2001, p. 143/4 and 150/1.) And there are many more non-member state communal banks, like local savings banks etc.
[18] An examiner tries to determine whether the auditing procedures are adequate and he also appraises the loans and the lending policy, and the investment and investment policy of the bank. He can reclassify loans, leading to higher capital requirements or even write-offs.
[19] The Bank Holding Company Act of 1956 authorizes the **Board** to examine such companies; the International Banking Act of 1978 idem. Under Section 11(k) of the FRA (introduced in 1966), the Board of Governors is authorized to **delegate** any of its functions, other than those relating to rulemaking and monetary policy decisions, to Federal Reserve banks.
[20] During 2001, the Reserve Banks conducted 534 examinations of state member banks (some of them jointly with the state agencies; state banking departments conducted 264 independent examinations of state member banks); Reserve Bank examiners conducted 1212 bank holding company inspections and they conducted or participated with state and federal regulatory authorities (like the FDIC) in 289 examinations of state-licensed or federally licensed branches of foreign banks. In addition, the Federal Reserve conducted 119 special examinations of banking organizations with special clearing or broking functions. (Board of Governors, Annual Report 2001, p. 143-151.)
[21] The banking supervisors developed a Uniform Bank Performance Report to allow for aggregation and comparison.

To be able to fulfil its statutory tasks the Board of Governors is entitled 'to require from each member bank such statements and reports as it may deem necessary', and, since 1980, to receive from *depository institutions*[22] all data on their assets and liabilities the Board may prescribe 'to enable the Board to discharge its responsibility to monitor and control monetary and credit aggregates'.[23] Moreover '[e]xcept as otherwise required by law, any data provided [by a depository institution] to any department, agency, or instrumentality of the United States pursuant to other reporting requirements shall be made available to the Board. The Board may classify depository institutions for the purposes of this paragraph and may impose different requirements on each such class.'[24]

The FRA does not contain a direct reference to safeguarding the stability of the financial system (or the stability of financial markets). On the contrary, the Fed allowed a large number of banks to go bust in the run up to, as well as during, the Great Depression (1929-1933). Today the Fed interprets its mandate much broader. According to the Fed publication 'Purposes and Functions of the Federal Reserve System' (1994) the Fed's duties fall into four general areas, one of which relates to 'maintaining the stability of the financial system and containing systemic risk that may arise in financial markets'.[25] Prudential information is seen as instrumental for the Fed in solving potentially systemic problems: 'In the past decade, the experience and knowledge of examiners and supervisory staff provided instrumental in the Federal Reserve's responsiveness to the Mexican debt crisis of 1982, the collapse in 1985 of privately insured thrift institutions in Ohio and Maryland, the stock market crash of 1987,[26] and the failure of the Drexel-Burnham investment firm.' [27] These observations were made in 1994. To this list can now be added the response to the LTCM crisis of 1998 and the terrorist attacks of 11 September 2001. The Fed could not have handled the fall-out of these crises as efficient as it had without the knowledge about the financial system and the linkages within the financial system derived from its supervisory functions.
Congress has assigned the Federal Reserve the duty of implementing specific federal consumer protection laws[28] to ensure that consumers receive comprehensive information and fair treatment.[29] In these efforts, the Federal Reserve is advised by a Consumer Advisory Council, whose members represent the interests of consumers, community groups, and

[22] This category encompasses more than member banks.
[23] FRA (1988), Section 11(a)(1) and 11(a)(2). Reporting requirements had also existed before 1913. Under the **National Banking Act of 1863** nationally-chartered banks had been required to report on their reserve ratios to the newly-established Office of the Comptroller of the Currency, which was an agency of the Treasury. This OCC also conducted bank examinations. (FRB of Boston (1990), p. 11.)
[24] FRA (1988), Section 11(a)(2).
[25] The other three general areas are: conducting the nation's monetary policy; supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers; and providing certain financial services to the U.S. government, to the public, to financial institutions, and to foreign official institutions, including playing a major in operating the nation's payments system.
[26] In response to this crash the Fed issued a one-sentence statement before the start of trading on 20 October: 'The Federal Reserve, consistent with its responsibilities as the nation's central bank, affirmed today its readiness to serve as a source of liquidity to support the economic and financial system.'
[27] Quote taken from Fed publication *Purposes and Functions of the Federal Reserve System* (1994), p. 72.
[28] Examples are the Consumer Lease Act of 1976 and the Fair Credit and Charge Disclosure Act of 1988.
[29] Board of Governors of the FRS (1994), *Purposes and Functions of the Federal Reserve System*, chapter 6.

creditors nationwide. Meetings of the Council, which take place three times a year, are open to the public.

II.1 HISTORY: DELORS COMMITTEE

Already in the Delors Committee an effort was made to find a compromise between the different traditions of the central banks in the area of supervision. The discussion in the Delors Committee centered on the role of the ECB or the system in general. It did not discuss the pro's and con's of supervisory functions for national central banks. In September 1988 Pöhl had submitted a paper to the Delors Committee, covering many aspects of EMU, among which supervision, for which he promoted a model clearly akin to the German model – see the quote from this paper given in section I.1 above.
One of the first drafts versions of the Delors Report[30] gave the ESCB a macro-prudential role, i.e. a role relating to the financial markets and deriving from that role an undefined role in actual supervision:
"- in accordance with the traditional and generally accepted task of central banks to ensure the safety and balanced development of the financial system, the European system of central banks would have to oversee the functioning of financial markets in the Community. In order to play this macro-prudential role the system would have to exercise supervisory functions in the field of banking supervision and should at least take part in the process of establishing general regulations in this field."

During the meeting of the Delors Committee on 10 January 1989, Duisenberg submitted a proposal for formulating the mandate of the ESCB. This mandate included wording on a supervisory role for the system of central banks:
"-The system will be responsible for the formulation of banking supervisory policy at the Community level and co-ordination of banking supervisory policies of the national supervisory authorities."
This text was integrated in the next version of Part II of the Report.[31] However, the apparent differences between member states in this respect resulted in a final version which would see a far more limited role for the ESCB, far weaker than the text cited above:[32]

> "- the System would participate in the coordination of banking supervision policies of the supervisory authorities."
>
> Delors Report, par. 32

II.2 HISTORY: COMMITTEE OF GOVERNORS

The first draft of the ESCB Statutes, drafted by the secretariat of the Committee of Governors under the guidance of the chairman of the Alternates Jean-Jacques Rey, contained both the idea of some task relating to the area of financial markets and of (micro) prudential

[30] CSEMU/5/88, 2 December 1988, Part II.4.
[31] CSEMU/10/89, 31 January 1989.
[32] No documentation available which explains the difference.

supervision. The tasks appeared under the heading of 'basic tasks':

"2.2 The basic task of the ESCB shall be:
-
- to contribute to the smooth operation of the payment systems and the financial markets;
- to participate in the co-ordination of the banking supervision policies of the supervisory authorities."

draft 11 June 1990

After a first round of discussion among the Alternates, the last but one indent was split into two indents:

"3.1 The basic tasks of the ESCB shall be: [33]
- (....)
- to promote the smooth operation of the payment systems;
- to promote the stability of the financial markets;
- [to participate as necessary in the formulation and execution of policies relating to banking supervision].[34] "

draft 22 June 1990

In the Alternates meeting of 29 June 1990 Crockett proposed to add to Article 2 (Objectives): 'A further objective of the ESCB will be to preserve the integrity of the financial system.' Tietmeyer objected: preserving the integrity was a *task*, not an objective of the system. Crockett's wording was used to reformulate the last but one indent of Art. 3.1 (i.e. 'to promote the stability of the financial markets') into:

'- to preserve the integrity of the financial system;
- ..... '

draft 3 July 1990

During their meeting of 10 July 1990, the governors agreed that any role for the System in rescuing individual banks should be avoided. On the other hand, they also recognized that measures might have to be taken in order to cope with sudden developments in the financial markets. They changed the words 'preserve the integrity' into:

'[- to support the stability of the financial system;]
- ..... '

draft 13 July 1990

[33] Article 2.2 had been renumbered into Article 3.1. Article 2 now only contained the system's objective.

[34] The last indent was put between square brackets for a while, awaiting the report of the Banking Supervisory Sub-Committee (BSSC), one of the three sub-committees of the Committee of Governors. The membership of the BSSC included non-NCB banking supervisors, like the German Bundesaufsichtsamt. In a note dated 5 July the BSSC argued as follows: 'The Sub-Committee considers it important to acknowledge that the primary objective of price stability can effectively be pursued and maintained only in the context of a stable banking system and that an ESCB has a role to play in securing these conditions. Furthermore, the process towards EMU is likely to lead to greater integration of banking and financial systems within the Community with consequences for the structure and activities of banks therein. The Sub-Committee therefore sees a role for the proposed ESCB in the area of banking supervision.' On 10 July 1990 the governors would delete the square brackets around the last indent.

The indent was bracketed at German request, reflecting German scepticism (Pöhl kept warning against conveying the idea there would be any kind of guarantee for *individual* financial institutions). It was agreed that the issue should be discussed further. In the last indent the word 'banking supervision' was changed into 'prudential supervision', 'as NCBs and other supervisory authorities were becoming increasingly involved in other areas of supervision, such as insurance and securities operations':

'- to participate as necessary in the formulation and execution of policies relating to prudential supervision.'

draft 13 July 1990

During their September meeting the French governor, de Larosière, said he regarded banking supervision as a principal function of a central bank and a pillar of monetary policy supervision. During the Governors' meeting on 13 November de Larosière earmarked the bracketed indent as a fundamental role of a central bank, though at the same time he admitted that the word 'support' might indeed be too strong.[35] As a compromise it was decided to combine this indent with the subsequent indent relating to prudential supervision (while adding, at the request of the French governor, the word co-ordination to this indent). In the final draft the last indent of Article 3 read:

"- to participate as necessary in the formulation, co-ordination and execution of policies relating to prudential supervision and the stability of the financial system."

draft 27 November 1990

At a more general level, it was felt to be important that the ESCB could submit opinions on matters pertaining to supervision of banks and financial markets in the Community to the appropriate regulatory bodies. This advisory function of the ESCB was to be covered in Article 4-ESCB. This article limits the advisory function of the ECB to its fields of competence. These fields are not defined in Article 4 itself, but are derived from other articles of the Statute.

Article 25

The BSSC had noted in a report to the Committee of Governors dated 5 July 1990 that the system of banking supervision follows or shadows developments in the markets, rather than leading them. Therefore, it was considered prudent to insert in the Treaty a procedure by which the ESCB could be endowed with new responsibilities in the field of supervision if deemed necessary to keep up with developments in the financial markets. Initially this was accommodated by a general *enabling clause*, enabling the Council of Ministers to confer other tasks to the System on a proposal from the System. The BSSC identified the following examples of activities in which the ESCB might (want to) participate: the prudential aspects of policies concerning inter-EC cross-border mergers and acquisitions, policies concerning the supervision of pan-EC financial conglomerates, systemic risks in the payment and banking systems and the provision of financial support to the banking system. The idea of a general *enabling clause* was to be dropped only later.[36] At that time the BSSC however still

[35] Minutes of meeting of Committee of Governors on 13 November 1990.

[36] What survived was the idea of simplified amendment procedure for articles of a more technical nature. See Article 41-ESCB.

assumed the Treaty would provide for the possibility of a transfer of competence to the ECB, to the extent (and in those areas) provided for in the draft articles. (This explains the formulation of Art. 25.2, which is not so much an enabling clause itself, but assumes one.) In October 1990, following a request of the governors, the BSSC produced a proposal for a supervisory chapter of the draft Statute. The BSSC presented two articles, each containing two sub-sections, to the Committee of Alternates:[37]

> " Article 25.1
>
> The ECB shall be entitled to offer advice and to be consulted on the interpretation and implementation of Community legislation relating to the prudential supervision of credit and other financial institutions and financial markets.
>
> Article 25.2
>
> The ECB may formulate, interpret and implement policies relating to the prudential supervision of credit and other financial institutions for which it is designated as competent authority.
>
> Article 26 bis 1
>
> The System shall be entitled to offer advice to Community bodies and national authorities on measures which it considers desirable for the purpose of maintaining the stability of the banking and financial systems.
>
> Article 26 bis 2
>
> The ECB may itself determine policies and take measures within its competence necessary for the purpose of maintaining the stability of the banking and financial systems."
>
> BSSC 11 October 1990

Some Alternates considered Article 26.1 to be superfluous, as it was already covered by Article 4, while Article 26.2 was considered to be adequately dealt with by Article 3, last indent ('to participate as necessary in the formulation and execution of policies relating to prudential supervision.'). Therefore, before being presented to the governors, Article 25.2 and 26.1 and 26.2 were put between square brackets (at the same time Article 26.1 and 26.2 were renumbered into 25.3 and 25.4).

During the Governors' meeting on 13 November Pöhl said he felt that the decision as to whether supervision was a central banking function should be left to the political authorities. De Larosière said there was no need for a vast supervisory organization at the ECB. However, he would find it entirely appropriate for the ECB to co-ordinate such supervisory functions. (It was then agreed to add 'co-ordination' to Article 3, last indent.) According to Pöhl, the Bundesbank had serious misgivings about Articles 25.3 and 25.4, which would create a moral hazard situation. Duisenberg and Ciampi were willing - in a spirit of compromise - to drop these two Articles. Leigh-Pemberton however was reluctant to delete them. Ravasio (director-general DG II), representing the Commission, stated general reservations by the Commission as regards Article 25, because it tended to assign to the ECB some regulatory and legislative powers which were regarded as falling within the competence of the Commission, the Council

[37] Opinion of the BSSC of 11 October 1990. The Bundesaufsichtsamt had entered a general reservation concerning Article 25.2. In an earlier report the BSSC had assigned all tasks to the System (Report to the Committee of Governors on the Role of the ESCB in Banking Supervision, dated 5 July 1990, and a chairman's report to the Committee of Governors, dated 29 August 1990). In its report of 11 October the BSSC had replaced 'System' with 'ECB' in most cases, except in Art. 26 bis 1 where advice to national authorities was involved.

and the Parliament.[38] In the end the governors agreed to retain the first two sub-sections and delete the last two, implying **Article 25** read as follows (the predecessor of the specific *enabling clause* being captured in paragraph 2):

> "Article 25 - Supervisory Tasks
> 25.1. The ECB shall be entitled to offer advice and to be consulted on the interpretation and implementation of Community legislation relating to the prudential supervision of credit and other financial institutions and financial markets.
> 25.2. The ECB may formulate, interpret and implement policies relating to the prudential supervision of credit and other financial institutions for which it is designated as competent authority."
>
> draft 27 November 1990

As regards the division of labour between the ECB and the NCBs, the article thus formulated leaves little room for interpretation. In Art. 25.1 it is clear that for ECB one should read 'Governing Council of the ECB', like is done in Art. 4-ESCB, and the Governing Council stands for the System as a whole. Art. 25.2 is hybrid: it encompasses decisions related to policy-making (formulating and interpreting policies), which belong to the Governing Council and it encompasses implementation, which could have been assigned to both the ECB and the NCBs. It should be remarked that the Statute does not provide for the possibility that the ECB or the Governing Council could delegate functions, attributed to the ECB, to NCBs.[39] The Governing Council can only delegate to the Executive Board (see Art. 12.1-ESCB, second paragraph). The wording probably reflected the wish to avoid any impression of trespassing on national arrangements for prudential supervision (as assigning a competence to the System (or to 'the ECB and the NCBs') would have implied a role for the NCBs, even where that did not exist nationally thus far). This still left open the issue of which supervisory competences to give to the ECB.

II.3 HISTORY: IGC

During the IGC the supervisory task of the System, as proposed by the Committee of Governors, was much debated, mostly at the level of deputies of the Ministers of Finance. Views were split. The main arguments used by the opponents of a 'supervisory task' for the

[38] In his view the ECB should only coordinate supervision where necessary for the conduct of monetary policy. More specifically, the Commission representative objected to giving the ECB the right to interpret Community legislation. This was the Commission's responsibility. He also pointed out that the Statute should make clear that the term 'other financial institutions' would be interpreted in the (restrictive) sense of the Second Banking Directive of 1989 - which would exclude *inter alia* insurance companies and pension funds. Responsibility for formulating Community-wide legislative proposals in the supervisory field lies with the EC Commission - assisted by the Banking Advisory Committee, members of which are central bank supervisors (whether central banks or governmental agencies) and the Finance Ministries of the EU Member States. The BAC does not concern itself with problems relating to individual institutions. (The so-called Groupe de Contact is an informal body consisting of representatives from national supervisory authorities of the EU Member States, who regularly meet to exchange information on aspects largely of a practical and technical nature.)

[39] Delegation should anyhow be limited to operational or secondary functions and should be known to the public. Compare section 11(k) of the Federal Reserve Act, cited in section I.2 above. See also Art. 12.1, second paragraph, which will be dealt with in cluster III.

ESCB were: possible conflict of interest between the prudential and the monetary objectives (Germany, France); the lack of accountability (France and UK); the risk of moral hazard (Portugal). Quite clearly, the Trésor took another position than the Banque de France, presumably because the Trésor had only reluctantly accepted the independence of the ECB and now the aim was to give the ECB no more powers than necessary. And the Trésor wanted to continue its working relationship with the Banque de France.[40] The UK (and France) wanted their supervisors to be accountable to their national parliaments: they should not be able to hide behind the back of the ECB. The UK position was influenced by the experience with the BCCI scandal. Not every argument came to the fore. For instance, it was known that some Finance Ministries were afraid that the central banks would take away tasks from (non-NCB) supervisors. For instance, when the Dutch Finance Ministry took over the presidency of the IGC, it would limit 'prudential supervision' to 'prudential supervision on credit institutions'.

In its final non-paper the **Luxembourg** presidency put both Article 3, last indent, and Chapter V of the draft Statute (i.e. Article 25) between square brackets.[41] At the same time Art. 3, including the last indent, appeared in a slightly revised fashion[42] in the draft Treaty text of the Luxembourg presidency:

> "Article 105
> 1. [....]
> It [the ESCB] shall take part, as required, in the definition, co-ordination and execution of policies relating to the prudential control and stability of the financial system."
>
> non-paper 12 June 1991

Over the summer the Committee of Governors prepared a reaction to the Luxembourg non-paper of 6 June 1991. This resulted in a letter sent to the IGC on 5 September,[43] one paragraph of which dealt with prudential supervision: "The relevant [supervisory] provisions were introduced into the Statute with three considerations in mind: firstly, the System, even though operating strictly at the macro-economic level, will have a broad oversight of developments in financial markets and institutions and, therefore, should possess a detailed working knowledge which would be of value to the exercise of supervisory functions. Secondly, the ESCB's primary objective of price stability will be supported by the stability and soundness of the banking system in the Community as it evolves. Thirdly, measures to deal with fragility or disturbance in the banking system must take account of their effect on monetary objectives and policies."

The Dutch presidency, which took over in July, did not like the wording of Article 105, last paragraph. Especially the words 'as required' gave the central banks too much room for

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[40] See Viebig (1999), p. 503-505.

[41] UEM/52/91, dated 12 June 1991. The text of Article 25 was left unchanged, with the exception of the word 'interpretation' which was replaced by 'scope' in Art. 25.1 and the word 'interpret' which was deleted altogether in Art. 25.2 - the argument probably being that 'interpretation' (in a legal sense) is the provenance of the Court of Justice.

[42] The difference in wording might be due to translation from French to English. The bracketed indent of Art. 3 of the Statute reads: '[- to participate as necessary in the formulation, co-ordination and execution of policies relating to prudential supervision and the stability of the financial system].'

[43] CONF-UEM 1617/91.

initiative. Relevant in this regard was that the Dutch Minister of Finance, Wim Kok, had expressed himself during a meeting with a parliamentary sub-committee against concentrating all supervisory tasks in one institution, read the ECB ('who will supervise the supervisor'?). On 25 September 1991, the Dutch presidency issued a chairman's paper covering i.a. Article 105-108.[44] In this paper they had dropped the last paragraph of Art. 105.1, explaining this in an explanatory footnote (in the meantime Art. 105.1 had been renumbered into Art. 105.2):
"In paragraph 2 [of Article 105] the task as regards prudential supervision has been deleted, because it seems proper to leave prudential supervision in principle for the time being in national hands and not in all Member States this is the central bank. Therefore, it is not necessary to lay down explicitly in the Treaty a task for the ESCB in this field. Nevertheless, it would be useful that in the new Treaty provisions are incorporated so that the Council could designate the ECB as coordinating competent supervisory authority in future times. This is dealt with in Article 108.4." [45]

Following several inconclusive discussions at deputies' level, the Dutch presidency re-inserted a supervisory task in Article 105.2 of the Treaty and Article 3.1 of the Statute, but now in more opaque form and limiting prudential supervision to 'credit institutions' (where the Committee of Governors nor the Luxembourg presidency had left open the reach of supervision):[46]

"Article 3 – Tasks
3.1 As set out in Article 105 paragraph 2 of this Treaty, the basic tasks to be carried out through the ESCB shall be:
- […]
- to contribute to a smooth conduct of policies relating to the prudential supervision on credit institutions and the stability of the financial system." [47]

presidency's proposal, 28 October 1991

In the eyes of the drafters of the Dutch Ministry of Finance, this formulation ensured a role for the ECB, while at the same time supervision would remain primarily in national hands. The Committee of Governors decided not react on this text, because Article 3 (last indent) and, especially, Article 25.2 (see below) appeared to them to be sufficiently flexible. Indeed, though the text was more restrictive, it kept open the door for future involvement of the ECB beyond the advisory role foreseen in Article 25.1.
In the end, this text would be accepted with only two amendments. First, the word 'policies' was changed into 'policies pursued by the competent authorities' at the request of the UK. The reference to 'competent authorities' was meant to reflect the existing differences between the institutional arrangements in the area of supervision. Second, the indent was placed in a new sub-paragraph of Article 3, thereby 'degrading' this task to 'a' task of the System; the tasks listed in paragraph 1 of Article 3 were as of then called the 'basic' tasks of the System.[48]

[44] UEM/66/91 of 25 September 1991.
[45] In line with this the Dutch presidency retained Article 25. For Art. 108.4-EC, see the further genesis of Art. 25-ESCB hereafter.
[46] The officials of the Ministry of Finance in charge of preparing the IGC were of the opinion that the door for broader responsibilities for the ECB should not be closed entirely, though other parts of the Ministry were afraid the ECB would claim supervisory responsibility over other financial institutions as well.
[47] Article 3.1-ESCB was changed in the same vein.
[48] Suggested i.a. by France during the EMU working group session of 6 November 1991.

Article 25
As regards Art. 25.1 the Dutch presidency specified which authorities have to consult the ECB (capturing also the national legislative authorities) and they continued, as proposed by the Luxembourg presidency, to replace the word 'interpretation' by 'scope'. As regards the remit of prudential supervision, the Dutch presidency deleted the reference to 'other financial institutions and financial markets' in Art. 25.1. This reference was replaced by introducing in Art. 25.1 a concept mentioned in the (at that moment suppressed) last indent of Art. 3.1, i.e. the stability of the financial system. The presidency did not drop the reference to 'other financial institutions' in Art. 25.2 (the 'enabling clause'), in order to keep the door open for unexpected developments. Compared to the Luxembourg non-paper of 12 June the Dutch presidency also added the word 'coordinate' in Art. 25.2.

"Article 25 - Prudential supervision

25.1 The ECB shall be entitled to offer advice to and to be consulted by the Council of Ministers, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and relating to the stability of the financial system.

25.2 Subject to Article 108, paragraph 4 of the Treaty the ECB may coordinate, formulate and implement policies relating to the prudential supervision of credit and other financial institutions."

chairman's paper 25 September 1991

During the IGC deputies meeting of 13 November 1991 the German delegate Haller requested to replace 'credit institutions' in Art. 25.1 by 'credit institutions and security houses'. He feared British security houses would benefit from the restriction of this article to credit institutions, because in the UK these houses were non-banks, while in Germany securities are mostly traded by banks (Universalbanken).[49] When the UK objected, Chairman Maas replied to Haller the addition was superfluous, because the subsequent part of the sentence ('and (relating) to the stability of the financial system') could be interpreted sufficiently broad.[50]

As mentioned above, the Dutch presidency specified the procedure for activating the enabling clause of Art. 25.2. Neither the draft Statute produced by the Committee of Governors nor the Luxembourg's presidency's paper had specified the procedure for designating the ESCB as 'competent authority' for the purpose of Art. 25.2. The Dutch presidency introduced an article

[49] For the same reason this concern was shared by the Danish delegation.
[50] Report by the Nederlandsche Bank of deputies IGC meeting of 13 November 1991. Therefore, the term 'financial system' should be seen as encompassing more than the banking system. This should also apply to Art. 3.3-ESCB and Art. 105.5-EC. This explains why the term 'credit institutions' was maintained (even though an interim version of the EMU texts presented to the deputies IGC by the chairman of the EMU Working Group (UEM112/91, dated 22 November 1991) used the term 'banking institutions' instead of 'credit institutions'.

to fill this legal void:

> "Article 108(4)
> The Council may, acting by qualified majority on a proposal of the Commission, [in co-operation with the European Parliament] and after consulting the ECB, designate the ECB as competent supervisory authority concerning the coordination, formulation and/or implementation of policies relating to the prudential supervision of credit institutions. According to the same procedure the ECB can be given supervisory authority over other financial institutions."
>
> chairman's paper 25 September 1991 [51]

In the presidency's first consolidated version of EMU texts Art. 108(4) was rephrased as follows:

> Art. 108(5)
> "The Council may, acting by qualified majority on a proposal from the Commission and after consulting the EMI or the ECB and [in co-operation with] the European Parliament, confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions."
>
> presidency's draft 28 October 1991 [52]

In two respects this text was more restrictive than the previous one, trying to appease the opponents: first, the new text spoke of conferring 'specific tasks' instead of designating the ECB in more general terms as competent authority, though at the same time by dropping the reference to 'coordination' it was achieved that a coordinating role for the ECB was not depending anymore on designation, but could be exercised right from the start of EMU. Second, the sentence referring to 'other financial institutions', i.e. other than credit institutions, was deleted. This text was discussed by the EMU Working Group on 6 November 1991. Views were split.[53] The only way out was to require *unanimity* for a decision to confer specific tasks upon the ECB - after which only the UK made a reservation. The presidency also changed 'credit institutions' into 'banking institutions'.[54] During the EMU Working Group meeting on 26-28 November it was decided to replace 'banking institutions' by 'credit institutions and other financial institutions with the exception of insurance companies'. With this formulation the presidency sought a middle course between the worries expressed by Haller (see immediately above), its own wish to keep open the door for future developments, and the fear of other parts of the Dutch Ministry of Finance that this was a secret plot to facilitate in the future the creation of a single big supervisor (i.e. the ECB). [55]
Art. 25.2 was revised accordingly (see page 263).

[51] UEM/66/91, dated 25 September 1991.
[52] UEM/82/91, dated 28 October 1991.
[53] France, Germany, the UK and Luxembourg favoured deleting Art. 108(5), while Portugal, Italy, Spain and Denmark wanted to retain it or to strengthen it.
[54] UEM112/91, dated 22 November 1991 (consolidated EMU texts as presented to the deputies IGC by the chairman of the EMU Working Group).
[55] In legal terms it was an improvement, as the term 'banking institution' was not defined in existing Community legislation, whereas 'credit institutions' and 'insurance undertakings' were, though 'financial institutions' are defined in various ways – see Smits (1997), p. 358.

After the legal nettoyage the article was renumbered into Art. 105(6) and read as follows:

Art. 105(6)
"The Council may, acting unanimously on a proposal from the Commission and after consulting the ECB and after receiving the assent of the European Parliament, confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."

Two additional observations can be made. First, a French request for generalizing the enabling clause was rejected.[56] Second, the procedure for activating the enabling clause requires the assent of the European Parliament (instead of the co-operation or consultation procedure).[57]

[56] Deputies meeting of 6 November 1991. See also Art. 41-ESCB, section II.3.

[57] According to then existing Community procedures a unanimous Council decision requires either consultation or assent of the Parliament. Early December 1991 the ministers opted, in this case, for the assent procedure.

Article 5:

"Article 5 (Collection of statistical information)
5.1 In order to undertake the tasks of the ESCB, the ECB, assisted by the NCBs, shall collect the necessary statistical information either from the competent national authorities or directly from economic agents. For these purposes it shall cooperate with the Community institutions or bodies and with the competent authorities of the Member States or third countries and with international organizations.
5.2 The NCBs shall carry out, to the extent possible, the tasks described in Article 5.1
5.3 The ECB shall contribute to the harmonization, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its fields of competence.
5.4 The Council [of Ministers], in accordance with the procedure laid down in Article 42, shall define the natural and legal persons subject to reporting requirements, the confidentiality regime and the appropriate provisions for enforcement."

(to be read in conjunction with Art. 12.1c-ESCB (Division of labour between ECB and NCBs), Art. 34.3-ESCB (Legal acts))

I. INTRODUCTION

I.1 *General introduction*

Central banks need statistical information on monetary and credit aggregates and the economy in general. They usually collect the monetary and banking information at source, that is directly from credit institutions or, in the case of balance-of-payment statistics, directly from companies. For other information on the economy, central banks usually rely on the publications of the national statistical bureaus.[1] This is an important task for central banks, also in terms of resources. As regards the division of labour within the System, Art. 5.1 mentions that the ECB shall be assisted by the NCBs, while Art. 5.2 adds that the NCBs shall carry out these tasks to the extent possible, which is stronger than the decentralization principle as formulated in Art. 12.1c (which uses the words 'to the extent deemed possible and appropriate, the ECB shall have recourse to the NCBs'). This division of labour makes sense, not only because of the closeness of NCBs to the reporting agents, but also because of the language aspect.

Reporting puts a burden on the reporting agencies, for which they are not compensated. The ESCB is authorized to put a burden on a selected group of economic agents and to enforce compliance, but only within the confounds of secondary legislation (i.e. legislation by the Council of Ministers). Indeed, wherever the ESCB puts an obligation on third parties, Council legislation is required. Such is therefore also the case for the imposition of minimum

[1] Likewise Eurostat, the statistical agency of the Commission, does not collect information at source, but receives its information through the national statistical bureaus. The same is true for the BIS, which does not collect at source, but receives its information from central banks and data vendors.

reserves,[2] the imposition of financial sanctions on agents failing to comply with obligations under its regulations and decisions,[3] the requirement for the lawmakers to consult the ECB on any proposed Community act or draft legislative provision 'in its fields of competence' [4] and for the definition of persons subject to reporting requirements (the reporting population). The content and the timing of the reporting of statistical data (the ESCB needs precise and timely information to be able to fulfil its tasks) is set by the ESCB. Agents not obliging to the ECB regulations can be subjected to fines or daily penalty payments.[5]

In order to use possible synergies and reduce the costs for the reporting agencies, the article requires the System to co-operate with existing collectors of statistical information. The cost awareness of the drafters of the Statute though was not as high as in the case of the Federal Reserve. In the meantime the ECB has introduced, following requests from several NCBs, a cost-benefit analysis procedure for each introduction of new statistical demands by the system, in order to prevent the imposition of too many reporting obligations by the centre, which does not feel the collection costs borne by the NCBs nor the reporting costs borne by the reporting agents. Apparently, thinking on this evolved. When the Ecofin Council introduced an article relating to its own competence to collect (economic) statistical data in the Treaty of Amsterdam of 1997, it included the following line (Art. 213a(2)): 'The production of Community statistics […..] shall not entail excessive burdens on economic operators'. And the 1998 Ecofin Council regulation ex Art. 5.4 of the statute defining the reporting population called on the ECB to "minimize the reporting burden involved, including by using existing statistics as far as possible".[6]

I.2 *Relevant features of the Federal Reserve*

The Federal Reserve Act defines both the right of the Fed to collect information and the reporting population (i.e. depository institutions). In most cases the statistical information is reported directly to the Board of Governors - only very small non-member depository institutions which are subject to less overall reporting requirements report through specified federal agencies.[7]
We note that the FRA stresses the importance of minimizing the reporting burden, as can be seen from section 11(a)(2) of the FRA (1988): " [.....] The Board shall endeavour to avoid the imposition of unnecessary burdens on reporting institutions and the duplication of other reporting requirements. Except as otherwise required by law, any data provided to any department, agency, or instrumentality of the United States pursuant to other reporting requirements shall be made available to the Board. The Board may classify depository

[2] Art. 19-ESCB. The secondary legislation puts limits on the minimum reserve ratio and lays down the rules for calculating the basis over which the ratio is to be applied.
[3] Art. 34.3-ESCB. This article determines that the only sanctions the ECB may impose are of a pecuniary nature, i.e. fines and periodic (e.g. daily) penalty payments, for as long as the obligation is not fulfilled. The secondary legislation defines maximum amounts.
[4] Art. 4(a)-ESCB. Secondary legislation determines the fields of competence.
[5] Council Regulation EC/2533/98 of 23 November 1998 defines the reporting population and sets limits on the sanction the ECB may impose in case of non-compliance. These limits fall within the framework defined by Council Regulation 2532/98 of 23 November 1998 concerning the sanctioning power of the ECB.
[6] Council Regulation/2533/98 of 23 November 1998, Art. 3.
[7] FRA (1988), Section 11(a)(2).

institutions for the purposes of this paragraph and may impose different requirements on each such class."

II.1 HISTORY: COMMITTEE OF GOVERNORS

The *Delors Committee* did not deal with the statistical reporting requirements. The *Committee of Governors* was very quick in formulating and agreeing on a text. The following, preliminary text appeared in the first draft of the Secretariat:

> 'Article 5 - Task of collecting information and compiling statistics
>
> The ESCB shall collect the information it requires either from the competent national authorities or directly from economic operators.
>
> For the purposes, the ECB shall co-operate with the competent authorities of the Community, the Member States or non-member States and with international organisations. It shall be responsible for harmonising the conditions governing the collection, compilation and distribution of statistics in the area of its field of competence.'
>
> draft 11 June 1990

The draft version of 22 June was already close to the final outcome:

> " 5.1 In order to perform its functions, the ESCB shall collect the necessary information either from the competent national authorities or directly from economic agents. For these purposes, it shall co-operate with the competent authorities of the Community, the Member States or non-member States and with international organisations.
>
> 5.2 The NCBs shall carry out, to the extent possible, the tasks described in Art. 5.1. The central body shall be responsible for harmonising, where necessary, the conditions governing the collection, compilation and distribution of statistics in the areas within its field of competence.
>
> 5.3 The ESCB shall respect the confidentiality of information it receives in accordance with the relevant provisions of Community law."
>
> draft 22 June 1990

The description of 'to the extent possible' went further, i.e. it was clearer in its unequivocal bias in favour of involving NCBs in the execution of this task, than the more general formulation at that moment chosen for (the predecessor of) Art. 12.1c, which read in the draft version of 22 June: 'The Council may entrust the execution of certain tasks to NCBs on the terms it shall lay down.' (Art. 13.2 (fourth paragraph), draft 22 June 1990.) Art. 5.2 meant NCBs did not have to share their contacts with national reporting agencies with the ECB.
Following the advice of the legal experts not to give legal personality to the System, it was necessary to replace 'ESCB' in the first sentence of Art. 5.1. A new draft by the Secretariat of 8 October, to be looked at by the legal experts, suggested to replace in Art. 5.1 'ESCB' by 'ECB'. The Secretariat also proposed to add after 'to the extent possible' in Art. 5.2 the words: 'and following instructions from the ECB'.[8] The suggested amendments apparently elicited some comments, because the version of 19 October showed Art. 5.2 in its original, unchanged form, while in Art. 5.1. 'ECB' was replaced by 'ECB, assisted by the NCBs,'. The version of 19 October would stand to be the final version sent to the IGC - which is quoted

[8] Taken from draft version dated 8 October 1990.

below. (The version of 8 October would have shifted the power almost completely to the ECB.)

Article 5 (Collection of statistical information) 5.1 In order to undertake the tasks of the System, the ECB, assisted by the NCBs, shall collect the necessary statistical information either from the competent national authorities or directly from economic agents. For these purposes, it shall co-operate with the competent authorities of the Community, the Member States or third countries and with international organizations. 5.2 The NCBs shall carry out, to the extent possible, the tasks described in Article 5.1. 5.3 The ECB shall promote the harmonization, where necessary, of the conditions governing the collection, compilation and distribution of statistics in the areas within its field of competence. Community legislation shall define the natural and legal persons subject to reporting requirements, the confidentiality regime and the appropriate provisions for enforcement. draft 27 November 1990

We note that changing the federal concept 'ESCB' into 'ECB' was observed with some suspicion by the NCBs, especially where this was related to the *implementation* of System tasks. Indeed, in these instances 'ECB' could be read as the central institution, i.e. to the exclusion of the NCBs, whereas in case of decision-making by the ECB 'ECB' could still be read as the 'decision-making body of the ECB', in casu its federally composed Governing Council.

The *IGC* would only add some editorial changes.

Article 6:

"Article 6: International cooperation
6.1 In the field of international cooperation involving the tasks entrusted to the ESCB, the ECB shall decide how the ESCB shall be represented.
6.2 The ECB and, subject to its approval, the NCBs may participate in international monetary institutions.
6.3 Articles 6.1 and 6.2 shall be without prejudice to Article 109(4) of this Treaty."

(to be read in conjunction with Art. 1-ESCB (Establishment), Art. 12.5-ESCB (Decision-making authority regarding Art. 6 in hands of Governing Council), Art. 13.2-ESCB (President's authority to represent the ECB externally), Art. 14.4-ESCB (Non-System tasks NCBs), Art. 23-ESCB (External operations), Art. 31.1-ESCB (NCB obligations towards international organizations), Art. 39-ESCB (Signatories), Art. 109.4-EC (External competences Community))

I. INTRODUCTION

I.1 *General introduction*

The article provides a framework for the involvement and participation of the System in any form of international cooperation involving somehow the ESCB's field of competence. These issues should be separated from the establishment of relations and accounts with central banks and international organizations, which is allowed for without the need for approval by the Governing Council under Art. 23-ESCB. [1]
Article 6.1 determines that in case the System needs to be represented, the ECB (i.e. the Governing Council) decides on the representation (by whomever the System is represented) to ensure the System 'speaks with one voice' (see Commentary with Art. 6 of the draft Statute of 27 November 1990). In some cases the Governing Council will have to decide first whether a certain topic is part of the System's tasks or not. For instance, is assisting the Brazilian central bank in managing its dollar-real exchange rate part of the playing field of the ESCB, or should NCBs be free to extend a dollar credit line to the Brazilian central bank, provided the amounts involved do not exceed certain thresholds stipulated ex Art. 31.3-ESCB? And are discussions on the international monetary architecture ESCB competences, or could NCBs continue to operate in G7 working groups related to such areas? It is possible that both NCBs and the ECB participate in an international meeting or organization, but if so they are bound to the System's common view, when System related tasks are involved.
Cooperation sometimes involves the participation in the capital or membership of international bodies. An example is participation in the capital of the Bank for International Settlements (BIS, erected and owned by central banks in 1930).[2] Where membership requires

[1] These accounts are used to conduct foreign exchange operations, e.g. necessary for the management of their foreign reserves. See also Smits (1997), p. 307.
[2] The BIS performs banking and statistical functions for central banks and sometimes participates in international lending operations to a country facing external financial problems, with the bulk of the loan usually being provided directly by other national governments/central banks. The financial risk of participation by the ECB is

legal personality, only the ECB and/or NCBs qualify, as the System lacks legal personality. The framework of Art. 6 determines that not only the ECB, but also NCBs may participate in such institutions. This is relevant for the NCBs, because conceivably all non-operational external relations can be handled by just the centre. This could come about anyhow in practice, for it is difficult to see how the Executive Board once present in international meetings would not start to dominate the System's representation. On the other hand, many international fora deal with both System and non-System tasks. As long as the NCBs perform non-System tasks (e.g. in the field of payment systems (though in this field the ESCB could assume all-regulating power – see Art. 22 - or banking supervision) NCBs can be member "à titre personel". Art. 6.2 allows NCBs to participate in international monetary institutions without interference by their governments, but at the same time acts as a System-internal approval (control) mechanism.
As regards the IMF, the Committee of Governors and the IGC assumed that euro area Member States would continue to be member of the IMF, as the IMF only allows sovereign countries (and not central banks) as members.[3] This would only change, not with the introduction of a single currency, but only with the advent of European political union. This raises the question how the System could be involved when the IMF discusses issues which are relevant to the ESCB (or perhaps even belonging to the exclusive competence of the ESCB, like international transparency guidelines for foreign reserve holdings). This has been 'solved' by allowing the ESCB an observership in the IMF. At the same time NCBs continue to be advisor of their own governments, relating to issues like extending IMF credits to countries with external financing problems.[4]

Art. 6.2 seems to suggest a hierarchy, with the ECB being able to decide itself on participation, and the NCBs being subject to its approval. However, in both cases the decision is up to the Governing Council. (This view is supported by Art. 12.5-ESCB. See also Art. 12.1, second paragraph, for the limited 'own' powers of the Executive Board.) Therefore, 'ECB' in Art. 6.2 has a double meaning: it refers to the decision-making ànd to the participating body.

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ultimately covered by its shareholders (the NCBs), the risks for the NCBs by their shareholders (usually the Member States).

[3] The five largest countries (in terms of IMF quota) have a chair of their own in the 23 member IMF Board, while the other countries form separate constituencies.

[4] On issues pertaining purely to the System (like reactions on IMF comments on the ESCB's monetary policy) the ECB coordinates the input of the euro area NCBs, which is sent to the Executive Director at the IMF representing the Member State which at that moment has the presidency of the EU, while the ECB's observer at the IMF is also kept informed.

I.2 *Relevant features of the Federal Reserve*

In the United States the FRBs were put on a tight leash in 1935 when a new paragraph g of section 14 (Open Market Operations) of the amended FRA stipulated the following:
'*Relationships and Transactions with Foreign Banks and Bankers*
(g) The Board of Governors of the FRS shall exercise special supervision over all relationships and transactions of any kind entered into by any Federal reserve bank with any foreign bank or banker, or with any group of foreign banks or bankers, and all such relationships and transactions shall be subject to such regulations, conditions, and limitations as the Board may prescribe. No officer or other representative of any Federal reserve bank shall conduct negotiations of any kind with the officers or representatives of any foreign bank or banker without first obtaining the permission of the Board of Governors of the FRS. The Board of Governors of the FRS shall have the right, in its discretion, to be represented in any conference or negotiations by such representative or representatives as the Board may designate. A full report of all conferences or negotiations, and all understandings and agreements arrived at or transactions agreed upon, and all other material facts appertaining to such conferences or negotiations, shall be filed with the Board in writing by a duly authorized officer of each Federal reserve bank which shall have participated in such conferences or negotiations.'
This very firm text suggests a lot of distrust existed on the side of the Board. According to Kettl (1986), this was meant as 'a slap in the face' of the New York Fed, which under the leadership of Benjamin Strong (until 1928), had more or less confiscated the external relations of the system.[5]
Section 14(e) (on Foreign Agents and Correspondents) was also amended by adding that the Board could not only approve, but also order a FRB to open and maintain accounts in foreign countries and that, once an FRB had opened a certain account abroad, other FRBs would be allowed, with the consent of the Board, to conduct transactions through that account. The establishment of banking accounts abroad had already been subject to the consent of the Board under the FRA of 1913, but it should be remembered that the Board itself could not open such accounts.
In practice, the New York Fed has been allowed to play an important role in the international contacts of the Fed, with the approval of the Board. For instance, the two delegates to the monthly BIS meetings are the chairman of the Board and the president of the New York Fed. The other FRBs do not play an international role, except in the area of research.[6]

Comparing the Fed and the ESCB
In 1913 the Federal Reserve had been designed with relatively independent roles for the FRBs. New York with the largest financial market had been treated by the Bank of England and the Banque de France and other central banks as their counterpart.[7] Therefore, New York quite naturally dominated the system's external relations. When participating in international credits New York would act on behalf of all FRBs. An example of a large credit was the one to the UK in 1925 ($200 mln). Another significant transaction was undertaken in 1931, when the FRBs participated in international central bank credits to the UK, Austria, Germany and

[5] Kettl (1986), p. 46.
[6] See Art. 12.1c, section I.2 (specialization).
[7] Friedman and Schwartz (1963), p. 380.

Hungary.[8] In 1933 the centre took advantage of the weakened status of the Federal Reserve in the wake of the Great Depression and took complete control of the external relations in 1933.[9] (The fact that the president of the New York Fed joins the chairman of the Fed to the BIS meetings is due to the fact that New York is the operational arm of the Fed.)
The U.S. model cannot be an example for Europe, as long as the EU *Member States* want to be able to decide individually on loans to, for instance, the central banks of Mexico or Brazil, or on participation in the GAB and the design and implementation of the Basle capital accords, which are topics discussed in and around the BIS meetings. In case of the IMF, the role of the NCBs as the fiscal/financial agent handling on behalf of their Member State is closely related to the fact that only countries can be member of the IMF, and not institutions. Probably Member States could appoint the ECB as their agent, but that would seem to require pooling of all reserves at the ECB.

II.1 HISTORY: DELORS COMMITTEE AND COMMITTEE OF GOVERNORS

The *Delors Committee* paid some limited attention to the question of international policy coordination. Par. 38 of the Delors Report observes that '[....] With the establishment of the ESCB the Community would also have created an institution through which it could participate in all aspects of international monetary management.'

The *Committee of Governors* would pay a lot more attention to this issue. A first draft by the Secretariat of the Committee of Governors (which had not yet been discussed by the Alternates) was discussed by the governors on their meeting of 10 July 1990.

'Article 6 - International cooperation
[6.1 The ESCB shall participate in actions and institutions involving international monetary or central bank co-operation.]
[6.2 The modalities of this participation shall be in accordance with decisions to be taken by the Council of the ESCB which shall specify in each case the respective roles of the NCBs and the central body.]
[6.3 When representing the ESCB, the NCBs act in accordance with the view of the Council and the Executive Board.]'
draft 3 July 1990

De Larosière made a remark on IMF membership, of which he said that one quota for the single currency area would seem logical under a single currency system. However, the matter was complicated, as it was the national governments which were members of the IMF and not the central banks. No other remarks were made and one decided to await further discussion among the Alternates.
In their meeting of 20 July the Alternates discussed an earlier note by Szász on the implication of EMU for participants' IMF membership. This note had concluded that only if the Community were 'to transfer itself into a genuine political union as a complement to

[8] Prochnov (1960), p. 278.
[9] New York had also been accused of bending domestic conditions, not for domestic reasons, but to help pound sterling, sometimes leading to a too accommodative stance in the late twenties. Kettl (1986), p. 33-34.

EMU, then it seems likely that within international organizations it would be represented at the Community level.' The opinion expressed by de Larosière had been in line with this. The Alternates also discussed the relative roles of the System and the NCBs and concluded that in cases of international cooperation between central banks relating to the tasks entrusted to the System the System would represent the NCBs, while the System itself could also participate in international organizations. This gave rise to the following draft by the Secretariat:

'Article 6 - International cooperation
In the field of international co-operation where it relates to the tasks entrusted to the System, the NCBs shall be represented by the System. The Council shall decide the methods of this representation. The System may participate in international monetary institutions.'
draft 24 July 1990

The matter of IMF membership would not be discussed anymore. Apparently all subscribed to the opinion that despite the complication of continued membership of the euro area countries for issues like the formula to calculate their quotas and the conduct of IMF Art. IV consultations, these countries would remain member of the IMF, implying the IMF could put a call on their reserves for IMF transactions. Such transactions, which would follow from a Member State's obligations under the IMF Articles of Agreement, would be exempted from the ESCB guidelines for the management of the Member States' and NCBs' foreign reserves.[10]

During the summer the legal experts discussed the question of the legal personality of the System and its components. They opted for extending legal personality only to the central body and the NCBs. This meant the 'System', being a concept and not a legal entity, could not externally represent the system.[11]
During the governors' meeting on 11 September 1990, the Irish governor Doyle pointed to an inconsistency between the July version of Art. 6 and Art. 7.3. Until then Art. 7 had read:

'Article 7 - Decision-making bodies of the System
7.1 The decision-making bodies of the System shall be the Council and the Executive Board.
7.2 The President, or in his absence, the Vice-President shall chair these bodies.
7.3 The President or his nominee shall represent the System externally.'
draft 3 July 1990

[10] See Art. 31.1-ESCB.
[11] The legal experts had also proposed to include that 'It [the central institution] may represent the Community and the Member States.' This was not taken up in the draft Statute. The possibility that the ESCB may represent the Community – outside the area where it is already exclusively competent – is covered by Art. 109.3-4-EC. See on the relation between Art. 6-ESCB and Art. 109.4-EC Smits (1997), p. 409-410.

In order to take away any inconsistency the words 'the NCB shall be represented by the System' in Art. 6 (July version) were changed into (in fact reversing subject and object):

' ....., the System would be represented by the ECB or the NCBs.'
draft 14 September 1990

At the same time the word 'System' in Art. 7.3 was changed into 'Council'. (Art. 7.2 and 7.3 would later turn into a separate Art. 13 relating to the role of the President, while Art. 7.1 would be inserted in Art. 9.3 on the ECB, with the word 'System' replaced by 'ECB' - see also Art. 1-ESCB, section II.2. The reason for linking the decision-making bodies, including the Governing Council, to the ECB was to protect the status of the Governing Council by attaching it to an independent institution. Because the System would not have legal personality it would give less protection against political interfering.)

When the Secretariat produced a new draft it also replaced 'System' into 'ECB and the NCBs' in the second sentence of Art. 6, adding that the participation should be subject 'to approval by the Council'.

'Article 6 - International co-operation 6.1 In the field of international co-operation involving the tasks entrusted to the System, the System shall be represented by the ECB or the NCBs. The Council shall decide the methods of this representation. 6.2 Subject to approval by the Council, the ECB and the NCBs may participate in international monetary institutions.'
draft 14 September 1990

We add the Secretariat's Commentary:
'Comments: Given the complexity of this matter, Article 6.2 would permit the ECB or the NCBs to participate in international monetary institutions. This flexibility would allow, for instance, NCBs to remain members of the Bank for International Settlements.'

During the governors meeting on 13 November 1990 Doyle observed the two sentences of Art. 6.1 were in his view contradictory, referring to the word 'or' in Art. 6.1 and 'and' in Art. 6.2. It was decided to adapt Art. 6.1 as shown below, while adding that Art. 12 should specify that the decisions referred to in this Article should be taken by the Council of the ECB (and not by the Executive Board). The new formulation seems to give an edge to the ECB, because apparently the right of the ECB is less restricted than that of the NCBs. One should note though, as mentioned already in section I.1 above, that in Art. 6.2 'ECB' refers to the organization, while 'its' (in 'its approval') can only refer to a decision-making body (in casu the Governing Council).

Article 6 - International cooperation 6.1 In the field of international co-operation involving the tasks entrusted to the System, the ECB shall decide whether the System shall be represented by the ECB and/or the NCBs. 6.2 The ECB and, subject to its approval, the NCBs may participate in international monetary institutions.

Article 12 - Responsibilities of the decision-making bodies .... 12.5 The Council shall take the decisions referred to in Article 6. draft 27 November 1990

The following extensive *Commentary* was added:
'Article 6 recognises the need for the System to play an active role in international monetary co-operation and to participate in international organizations. This Article provides a considerable degree of flexibility: it enables the ECB and/or NCBs to conclude agreements with central banks of third countries and to participate in international monetary institutions, thus allowing, for instance, NCBs to remain member of the BIS.
Decisions relating to the System's international representation are to be taken by the Council (Article 12.5). This ensures that the System "speaks with one voice".
If the ECB is to represent the Community in international monetary institutions and if it is to be enabled to conclude agreements on behalf of the Community, a provision to this effect would need to be introduced into the Treaty.'

II.2 HISTORY: IGC

During the IGC the words 'whether the ESCB shall be represented by the ECB and/or the NCBs' would be replaced by 'how the ESCB shall be represented'.[12] Also, a new Article 6.3 would be added, with the aim to make clear that these articles would have to yield to Art. 109(4) of the Treaty:

'6.3 Articles 6.1 and 6.3 shall be without prejudice to Article 109(4) of this Treaty.' presidency text 28 October 1991

Art. 109(4) would read, in its final form:

'109(4) Subject to paragraph 1 [relating to procedures to conclude exchange rate agreements], the Council shall, on a proposal from the Commission and after consulting the ECB, acting by a qualified majority decide on the position of the Community at international level as regards issues of particular relevance to economic and monetary union and, acting unanimously, decide its representation in compliance with the allocation of powers laid down in Articles 103 and 105.' [13]

This makes clear that the central bank (ECB) does not have the automatic mandate to represent the Community. On the other hand, the Community, however represented, has to

[12] Summary of Commission staff of EMU Working Group of 20 November 1991. Probably just intended as an editorial improvement.
[13] Art. 103 refers to procedures in the area of multilateral surveillance of economic policies and Art. 105 refers to the basic tasks of the ESCB.

respect Art. 105, implying it may not trespass those areas for which the ESCB is independently competent.

Article 12.1, third paragraph (Art. 12.1c):

Article 12.1-ESCB, third paragraph (Decentralization principle):
"To the extent deemed possible and appropriate and without prejudice to the provisions of this Article, the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB."

(to be read in conjunction with Article 1-ESCB (Legal structure ESCB); Article 5.2-ESCB (Collection of statistics); Article 9.2-ESCB (Implementation either through ECB or NCBs); Article 10.2-ESCB (Voting); Article 12.1-ESCB, first and second paragraph (Responsibilities decision-making bodies) ; Article 16-ESCB (Banknotes); Articles 17 to 24-ESCB (Monetary and external operations); Article 27-ESCB (Auditing); Article 3b-EC (Subsidiarity))

I. INTRODUCTION

I.1 *General introduction*

This article can be seen as the guiding principle for the allocation by the Governing Council of operational responsibilities within the System, which would consist of a new institution (the ECB) and the existing NCBs. The two possible extremes were not realistic, i.e. (1) to give the centre no operational responsibility (like the Board of Governors of the Federal Reserve), because the centre would be endowed with foreign reserves anyhow, or (2) to give the centre all operational responsibilities, i.e. to centralize operations completely, because that would negate the federal character, which was strived for from the beginning. A high degree of decentralization seemed logical, because the infrastructure was there, because it would prevent the creation of one dominant financial centre and because of the principle of subsidiarity. This principle was especially promoted by the French – for them it was a 'constitutional idea' that executive responsibilities should not be given to the centre, in case these could be handled equally effectively for the benefit of the 'ensemble' by national institutions. Also, giving an operational role to the centre could attract business to the city of its location, thus giving it an edge as financial centre.[1] Art. 12.1c itself is a procedural article, the operational tasks themselves are contained in other articles, esp. Art. 16-24. It is important to note that these articles empower both the ECB and the NCBs to execute these tasks, not making a choice (and in fact allowing for flexibility as regards future developments).

Article 12.1c played an important role, when the predecessor of the ECB, the European Monetary Institute, prepared the so-called 'General Documentation on ESCB monetary policy instruments and procedures', containing a description of the ESCB's monetary policy instruments, the procedures to be followed and the relative roles played by the NCBs and the ECB.[2] Examples are the design of the standing facilities and the modalities of the open market procedures. According to the General Documentation the standing facilities are

[1] The decision on the seat required unanimity among the Heads of State (Art. 37). In 1992 they decided after strong pressure by Helmut Kohl in favour of Frankfurt, which is also the location of the German central bank.
[2] The General Documentation (a public document) also contains lists of eligible collateral and counterparties, and other details relevant for counterparties of the ESCB.

offered by NCBs, and not by the ECB; the tender operations are conducted through NCBs. Banks hold (payment) accounts at NCBs and they receive central bank liquidity only from their 'own' NCB. Only in exceptional circumstances will the ECB seek contact with market participants in order to initiate monetary operations. Even in these cases the transactions are executed through the books of one of the NCBs.[3] These exceptional circumstances can only be defined by the Governing Council.) In the end, the ECB's only real operational presence is in the area of foreign reserves (managing the pooled reserves and where appropriate using them for interventions), thus not going beyond the Delors Report!

The ESCB Statute allows for *specialization among NCBs*. To evaluate the prospects of specialization we will also look at the developments in the Federal Reserve System. We will come back to this issue in appendix 2. Here we concentrate on the genesis of the article itself. As usual we pay some attention to the division of labour in the FRS, not in the least because the FRS was often referred to as a possible example, among others by Pöhl.

I.2 *Relevant features of the Federal Reserve System*

If the Federal Reserve System was used as a reference during the discussions on the design of the operational features of the future ESCB, it was to stress the roles of the regional Federal Reserve banks (FRBs). The operational capacities of the FRS rest with the **Federal Reserve Banks** (FRBs). This is clear from the Federal Reserve Act (FRA), which does not extend operational capabilities to the Board of Governors, but bestows them on the FRBs.
The operational powers of the FRBs are described in Section 13 (FRBs may receive lawful money and deposits and may discount eligible paper), Section 14 (FRBs may buy and sell on the open market, may open accounts abroad and may open accounts for foreign correspondents), Section 15 (FRBs may hold Treasury funds and provide fiscal agency functions), Section 16 (FRBs may issue notes,[4] have to clear checks[5] and may be required by the Board to act as a clearing house for depository institutions for the transfer of funds[6]),

[3] See General Documentation (1999), par. 5.2, and Art. 17-24-ESCB.
[4] FRBs also circulate coins (which they buy from the Treasury). Coins are a direct obligation of the Treasury.
[5] FRA (1988), Section 16(3). An amendment of the FRA in June 1917 allowed non-member banks to become clearing members of the FRBs as well. While checks are cleared at par, collection fees, fixed by the Board (Section 16(13)), were and are defrayed upon the clearing members. This legislative development shows that the FRA of 1913 did not state clearly a Congressional intent as to the role of the Fed in the payments system. Though already soon, and supported by president Wilson, its facilitating role (and the importance of that role for the economy) was recognised and enhanced. See also R.A. Gilbert (1998), 'Did the Fed's Founding Improve the Efficiency of the U.S. Payments System', *FRB of St. Louis Review* May/June 1998.
[6] FRA (1988), Section 16(4). Section 16(14)-FRA authorizes the Board of Governors to designate one of the FRBs to run clearing house for the transfer of funds between the FRBs. The Board is authorized to exercise the functions of the clearing house itself, making this a rare example of an operational function the Board is allowed to exercise, though, as formulated, it is an intra-system function and not a function vis-à-vis the banks. Indeed, in the first years the Gold Settlement Fund, located at the Board, fulfilled this function of clearing positions between FRBs (e.g. due to nationwide check clearance), for which it was necessary to use the normal commercial telegraphic system. In 1918 the function of the Fund was taken over by a leased wire system, operated by the FRB of Chicago, and these services were offered to banks as well. (FRB of Chicago, Annual Report 1988, p. 16.) Until 1980 this service (Fedwire) was only for member banks and free of charge. After passage of the **Monetary Control Act** in 1980 the service was open to all depository institutions at a charge (see FRB of St. Louis Annual Report 1997; see also appendix 2 at the end of this cluster). Fedwire operates alongside private sector transfer systems. Offering and developing payment services as such is seen as falling mostly in the realm of the FRBs. This is reflected in the Annual Report of the Board which reports on payment system

Section 19(c)(1) (FRBs may offer accounts for holding required reserves), Section 21 (FRBs may subject member banks to special examinations) and Section 9(7) (State banks which become member of the FRS are subsequently subject to examinations by the state chartering authority and the Board of Governors or the local FRB). Many of the functions are subject to regulations such as the Federal Reserve Board (in 1935 renamed into Board of Governors) may impose. FRBs may also perform functions delegated by the Board of Governors (FRA (1988), Section 11(k)). For instance, examination and on-site inspections of bank holding companies which are supervised by the Board of Governors is delegated to the FRBs (see Art. 3.3-ESCB), the Board remaining responsible for regulation and policy.

A special characteristic of the FRS is that the open market operations (OMOs) are concentrated in one place, **New York**. This does not follow from the FRA, but followed from the fact that when OMOs became important some reserve districts lacked an organized market in the relevant securities, while the only significant market in US government securities was that in New York. For its domestic open market operations the New York Fed deals these days with less than 30 counterparties, so-called primary dealers which channel the liquidity further down the banking system. Most commercial banks in the rest of the country maintain correspondent relations with New York banks. [7] FRBs maintain a discount facility for local banks, but this has not been not an important channel for monetary policy.[8] Like the OMOs, foreign exchange interventions are conducted solely by New York (see appendix 1 at the end of cluster II). The services for foreign central banks and international institutions are generally provided by New York as well. The New York Fed also holds in its vaults vast amounts of gold owned by foreign official institutions.[9]

For the first two decades after the adoption of the Federal Reserve Act in 1913, the main tasks of the **Board of Governors** were, apart from its analytical and secretarial functions, to

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developments under the heading of the FRBs. The Board may require each FRB to offer local clearing facilities. The Board of Governors has taken responsibility for issues in the area of payment system risk, to which end the Board has issued a Policy Statement on Payment Systems Risk (see e.g. the Board's Annual Report 2001, p. 207-208).

[7] In the eurosystem's weekly refinancing operations the euro area NCBs deal with around 500 counterparties. The total number of counterparties for the deposit facility of the eurosystem is around 3400 (the total number of registered counterparties is more than 7100, but this number also includes many members of cooperative banks which have a separate banking license, but operate and report through their mother banks).

[8] After a period in the early years of the Fed during which member bank borrowing exceeded their reserve balances, continuous borrowing became objectionable to the System. It considered itself as a 'lender of last resort', and not as a source of continuous financing. It could have raised the discount rate to make rediscounting unattractive. Instead it adopted the policy that 'continuous indebtedness at the reserve banks, except under unusual circumstances, is an abuse of reserve bank facilities,' that 'the proper occasion for borrowing at the reserve bank is for the purpose of meeting temporary and seasonal needs.' (Quotations come from *Annual Report* of the Federal Reserve Board for 1928, and are quoted by Friedman & Schwartz (1963), p. 268.) But even the seasonal use of the discount window is limited in the US, as this use is seen as a distress signal of the bank using the window. As of 1980 discount window credit is also available to other depository institutions (non-member banks) (**Monetary Control Act** 1980, see appendix 2). The discount window proved very important in the first few days after the terrorist attacks on 11 September 2001, which had created communication and connectivity problems in the nation's payment system infrastructure. Depository institutions that were affected borrowed heavily from the windows for a few days. (See Annual Report of the Board of Governors 2001, p. 174/5.)

[9] Board of Governors of the FRS (1994), p. 110-111.

coordinate discount rate changes proposed by the regional banks and to modify reserve requirements. This was hardly enough to assure a minimal authority vis à vis the 12 regional Federal Reserve Banks who did most of operational tasks, in particular open market operations. Lack of first-hand contact with financial markets has, until at least the restructuring of the Fed in the 1930's, been a handicap for the Board. This situation changed when in 1935 the Board became member of the FOMC. As of 1935 the FRA stipulated that "[n]o Federal Reserve bank shall engage or decline in open-market operations under section 14 of this Act except in accordance with the direction of and regulation adopted by the Committee [FOMC]."[10] At the same time the Board also took control of the System's external representation.[11] The Board has only a few 'operational' responsibilities, *viz*. in the areas of collection and analysis of statistical information and supervision.[12] The Board's supervisory responsibilities extend to the roughly 1000 state banks that are member of the FRS, all bank holding companies, the foreign activities of member banks, the U.S. activities of foreign banks, and Edge Act and agreement corporations. Even though the Board is authorized to conduct examinations, it leaves this task almost completely to the FRBs. The Board's other responsibilities cover supervising and regulating the operations of the FRBs, exercising broad responsibility in the nation's payments system and administering most of the nation's laws regarding consumer credit protection.

The FRBs spend the largest part of their resources on payments processing (including processing of checks), roughly half of the 23,000 people employed by all FRBs.[13] In terms of operational expenses of the FRBs around a third is generated by commercial check collection.[14] The costs for services to the private sector (banknotes printing and issuing are excluded) are recovered from the private sector through pricing (obligation of the **MCA (1980)**, see appendix 2).[15] Other (non-priced) operational expenses relate to FRB functions such as offering banking services to the Treasury (for which they are reimbursed)[16] and banking examinations.[17] The income of the System derives primarily from the interest on the System's holdings of domestic and foreign assets (more than 30 billion dollar in 2001). This income is allocated according to each FRB's share in the total capital of the System. The costs of the Board of Governors are covered by a yearly 'assessment' against the income of the FRBs. The FRBs pays out 6 per cent dividend over the capital paid in by its member banks. Net profits flow to the Treasury.

For an overview of the development in the relationship between the FRBs and the centre, the Federal Reserve Board, in the early years of the Fed, see ***appendix 1*** *at the end of this cluster, covering the developments in the Fed's early years (1913-1935). The appendix also*

[10] FRA (1988), Section 12A(b). Before 1933 coordination of OMOs between the FRBs took place on a voluntary basis. The FOMC, in which the Board has a majority of the votes (see Art. 10.2-ESCB, section I.2), decides on the desired level of the federal funds rate, which is the rate commercial banks use when they lend federal reserve funds to each other. The FOMC instructs the New York Fed to conduct open market operations necessary to achieve the desired funds rate.

[11] See Art. 6-ESCB, section I.2.

[12] See Art. 3.3-ESCB, section I.2, and Art. 5-ESCB, section I.2, respectively.

[13] Santomero (2002).

[14] Board of Governors, Annual Report over 2001, p. 185-187.

[15] Half of the operating expenses of FRBs relate to 'priced services' and are thus recovered.

[16] Board of Governors of the FRS (1994), p. 108.

[17] See Art. 3.3-ESCB, section I.2.

contains a box summarizing the contents of the Banking Acts of 1933 and 1935, which affected the structure of the Fed, basically strengthening the authority of the centre, i.e. the Board of Governors.

Specialization
Apart from the well-known example of the FRB of New York, which is specialised in open market operations and foreign currency interventions and which manages of the System's domestic and foreign assets, **specialization** is limited. The basic principle of the division of labour within the FRS seems to be non-specialized **decentralization**. Every District Bank is involved in banknotes and coins, payment systems (including check collection), research, preparation of the contribution of its president to the FOMC meetings, Treasury functions and banking supervision (though the intensity varies, especially depending on the number of bank holding companies located in the district). Within this context specialization has developed in three areas: research, financial services and banking supervision, and the most important of these is research. This is described in more detail in **appendix 2** at the end of this cluster. The specialization in research has an informal character and is usually related to an FRB's geographic location or recognized expertise in a specific field. Specialization in financial services refers not so much to their provision (which is a local affair), but to the provision of leadership in the development of certain kinds of services. This form of specialization is more formalized and is made possible by the fact that the services are highly uniform. Specialization in banking supervision is limited and is linked to the fact that some districts gained more expertise in supervising certain kinds of institutions than other districts, because more of these institutions are located in their district.

Comparing the Federal Reserve and the ESCB
There are some clear similarities between the Federal Reserve System and the European System of Central Banks. In both systems policy-making is centralized, while implementation is not. An important difference however is that the central element of the FRS, the Board of Governors, does not have operational capabilities, whereas the ECB is able to perform typical central banking functions itself. In the United States there had been strong populist tendencies against creating a centralized system. This was reflected in the design of the system, which consisted in fact of a substantial number of local central banks. For a good many years the System was dominated by the very gifted governor of the New York Fed, Benjamin Strong. In the years after Strong, who resigned (and died) in 1928, there was a clear lack of leadership, which might also have contributed to the too passive attitude of the Fed during the big contraction (which a number of Federal Reserve Board members initially viewed as a purging operation after the speculative years of the late twenties).[18] The banking community had disliked a centralized system for other reasons: they feared the system would then be controlled by a Board dominated by 'political' (Democrat) appointees.[19] In line herewith the drafters of the FRA had seen no need to endow the Board with other features than a staff of its own. In Europe other forces were at work. At least from the French side there had been the wish to establish already in *stage two* an institution endowed with the capacity to intervene in

[18] See also Meltzer (2003), p. 400 and 408-409.
[19] In practice, however, control would shift to the open-market committees, consisting of (until 1935) only FRB governors (see appendix 1 below). At the time the FRA was drafted, open-market operations had not been seen as a major monetary policy instrument.

the foreign exchange markets[20] - the idea to endow the ECB (or its predecessor) with reserves was in line with this.
Remarkably, it were the French who would most ardently oppose the idea of operations executed by the centre in *stage three*. We will be able to follow this debate in section II.2 below. In chapter 8 we will present how the ESCB tasks have actually been divided over the ECB and NCBs.

II.1 HISTORY: DELORS COMMITTEE

Already in the very first stages of the debate leading to the establishment of the EMU it became clear that the leading actors were thinking of a federal system, that is a system which would keep the existing national central banks intact. Stoltenberg's memorandum of March 15 1988 spoke of a European central bank system (last paragraph).[21] Pöhl's contribution to the Delors Committee submitted in September 1989 mentioned the following in section II.B.4: "A federal structure of the central bank system - according to the pattern of the Federal Reserve System, for instance - would correspond best to the existing state of national sovereignty [nationaalstaatlichen Souveränität] and would additionally strengthen the independence of the central bank. (Before the final stage involving the introduction of a uniform currency, only a federally structured central bank system is conceivable in any case.[22])" The comparison with the Fed was repeated in a speech by Pöhl held in Paris on 16 January 1990 ("Basic features of a European monetary order", reprinted in the Bundesbank Presseauszüge 1990, nr. 4), which - quite unusually - was sent by Pöhl to the ministers of finance of the EU. In this speech Pöhl said: " [....] the ESCB could function with a comparatively small staff, say, a number similar to that of the Board of Governors of the Federal Reserve System, as executive functions could largely be transferred to the well-established systems of the NCBs which would then act on behalf of the Community [in Gemeinschaftsauftrag]. The settlement of payments, open market operations with the banks, business on behalf of government institutions and the like could well be taken care of by the NCBs - according to the guidelines and instructions of the ESCB."
The Delors Committee would opt for a federal system. It did not explicitly deal with the question whether the centre of the system (i.e. the ECB) should perform (some) operational tasks, or whether these should be left completely to the existing national central banks, being under the instruction of the centre. Below we list a number of arguments which were developed in those days on the optimal degree of (de)centralization.

Arguments mentioned in favour of giving the ECB operational tasks of its own: [23]
- it would increase the visibility of the ECB and thereby its profile;

[20] The difference between the US in 1913 and Europe in 1990 could also be described in terms of currencies: in the US there had been one currency - though banknotes issued by far-away (less-known) banks circulated at a discount and checks might move for weeks from bank to bank before arriving at the bank at which it was drawn; in Europe there were more than ten different currencies, which had adjustable exchange rates between them.
[21] HWWA (1993), p. 310.
[22] The original German sounds even stronger: 'Ohnehin ist vor dem Endstadium einer Einheitswährung nur ein föderatives Zentralbanksystem denkbar.'
[23] Partly based on a paper by prof Thygesen (member of the Delors Committee), distributed to the other members of the committee on 'A European central banking system - some institutional considerations' (29 October 1988, p. 8-9; not included in the annex of the Delors Report). Some arguments were developed later on.

- it prevents possible conflicts of interest for an individual NCB which might occur when they have to undertake operations both on its own account and in a European role in the same market;
- for an adequate policy preparation the ECB should be able to benefit from close contacts with the markets, therefore it should have operational tasks.

Arguments mentioned in favour of a decentralized execution:
- intuitively appealing and no technical barriers (as regards foreign exchange interventions, these could be delegated to one of the financial centres);
- the NCBs have most of the required experience;[24]
- as long as there will be several financial centres, there will be a need for interventions and operations in each of these centres;
- NCBs were expected to continue their task as fiscal agent (cashier) for their government, therefore they would be well informed about one of the most important factors influencing the liquidity situation in the local money market;[25] more in general, NCBs were expected to be better placed to understand local circumstances.[26]

A more strategic argument in favour of decentralization was that concentrating operational tasks with the ECB would aggravate the discussion on the seat of the ECB, because the seat would be seen to benefit from centralization to the expense of other financial centres.

The Delors Committee formulated its preference for a *federal* structure in the following way:[27]
"Considering the political structure of the Community and the advantage of making existing central banks part of a new system, the domestic and international monetary policy-making of the Community should be organized in a federal form, in what might be called a *European System of Central Banks* (ESCB). ..... The national central banks would be entrusted with the implementation of policies in conformity with guidelines established by the Council of the ESCB and in accordance with instructions from the central institution."
The last indent of the sub-paragraph of par. 32 of the Delors Report on the **Structure and organization** of the ESCB is also worth quoting here (the first indents mentioning the federative structure and the establishment of an ESCB Council and a Board):
"- .....
- establishment of a Board (with supporting staff), which would monitor monetary developments and oversee the implementation of the common monetary policy;
- national central banks, which would execute operations in accordance with the decisions taken by the ESCB Council."

[24] Based on the same argument Thygesen also envisaged the possibility of **specialization** among NCBs, e.g. the responsibility for interventions in third currencies could be delegated to the major reserve currency or financial market centre, i.e. the Bundesbank.
[25] Ideally Treasuries should bank with commercial banks, in which case fluctuations in their balances would not affect the liquidity of the money market anymore. At present, almost all euro area Treasuries, while using their NCB as payment hub, place their end-of-day surpluses above a certain amount back in the market.
[26] This argument was based on the idea that financial markets could – at least for a while – remain segmented, which in practice would not be the case, however.
[27] Part of section 32 of the Delors Report.

The first quoted indent leaves open the possibility of a non-executive centre; the second however should then have used the words 'would execute the operations', which would have implied all operations; now it reads as 'some' operations. Furthermore, the Delors Committee proposed that the central institution would have its own balance sheet. However, this was aimed at allowing the ESCB (to be established according to the Delors Report at the start of Stage Two) to hold foreign reserve assets for the purpose of creating a 'training ground' for the future role of the system and for conducting concerted interventions. So the idea to give the system its own balance sheet was not necessarily aimed at creating the possibility for the central institution to conduct *domestic monetary policy* operations.[28] In this respect par. 32 and 60 of the Delors report have to be read in conjunction. Par. 32, first paragraph, states:
"At the final stage the ESCB - acting through its Council - would be responsible for formulating and implementing monetary policy as well as managing the Community's exchange rate policy *vis-à-vis* third currencies. The national central banks would be entrusted with the implementation of policies in conformity with guidelines established by the Council of the ESCB and in accordance with instructions from the central institution."
Par. 60 (relating to the principle steps in stage three), second indent, reads:
"- ....; the execution of interventions [i.e. exchange market interventions] would be entrusted either to national central banks or to the European System of Central Banks."

These considerations, i.e. an important role for the NCBs in carrying out monetary policy operations and possibly also foreign exchange operations and a balance sheet for the centre, constituted the background for the ensuing discussion in the Committee of Governors on the draft ESCB Statute.
Between the publication of the Delors Report in April 1989 and the start of the drafting of the ESCB Statute by the Committee of Governors early summer of 1990, Pöhl held an important speech on the outline of a European monetary framework.[29] Part of the speech was devoted to the role of NCBs in a possible European central bank system. The relevant parts of the speech are printed in annex 3 of this study. In it Pöhl first emphasized that in EMU interest rate and intervention decisions should be taken at Community level. Then he continued that "[i]n spite of these far-reaching powers, the ESCB could function with a comparatively small staff, say, a number similar to that of the Board of Governors of the Federal Reserve System, as executive functions could largely be transferred to the well-established systems of the NCBs which would then act on behalf of the Community. The settlement of payments, open market operations with banks, business on behalf of government institutions and the like could well be taken care of by the NCBs – according to the guidelines and instructions of the ESCB. In addition, the NCBs should, in my opinion, be responsible for bank and stock exchange

[28] This view is supported by the fact that according to the Skeleton Report of December 2 (CSEMU/5/88), page 28, the central institution would only hold foreign reserve assets and claims on and liabilities to the participating central banks. The idea of pooling reserves at the centre had been strongly promoted by the French governor. The German and Dutch were opposed to the idea of centralizing intervention tasks in Stage Two, because they feared that in Stage Two interventions in Dmark - even if taken by majority vote in the ESCB Council - could dilute the monetary autonomy of the Bundesbank. (According to the Delors Report (par. 57) the ESCB was to established (early) in Stage Two.) Pooling of part of the reserves in stage three was not contested, because non-pooling would not have been credible. Regarding stage three the Dutch were more worried that some reserves would remain in the hands of some governments, which would also mean trouble.
[29] Pöhl (1990a), *'Grundzüge einer europäischer Geldordnung'*, speech, Paris, 16 January 1990; printed in Bundesbank Presseauszüge 1990, nr. 4.

supervision where this is not yet the case as, for example, in the Federal Republic of Germany. This means that the NCBs would play a role similar to that of the Federal Reserve Banks in the United States or the Land Central Banks in Germany."

Clearly Pöhl was leaning towards a small centre, with operational tasks to a large extent being entrusted to the NCBs.

II.2 HISTORY: COMMITTEE OF GOVERNORS [30]

The Alternates discussed the concept of a decentralized central bank system during their meeting on 29 May 1990 (this was before any draft text was written). They assumed NCBs would continue to exist. However, in such a scenario NCBs would have to act on the basis of daily instructions 'extrèmement strictes' - words used by the French delegate Lagayette to counter German worries that the system would be too loose. (At the beginning of the meeting the German delegate Rieke had put on the table the suggestion that NCBs would become agencies of the System. Rieke had initially even favored the creation of a single balance sheet for the system, but he seemed to accept that it mattered that the day-to-day operations would be decided centrally.) And, also according to Lagayette, commercial banks would hold their accounts with an NCB, and not with the centre. The idea of endowing the central institution with a balance sheet of its own was not disputed, not even by the Dutch, who on the contrary were keen to bring the management of all foreign reserves within the realm of the System in order to prevent foreign reserves remaining in the hands of Member States, who could then frustrate the monetary and exchange rate policy of the system. A very first internal draft version of the draft Statute of June 11, 1990 (prepared by the Secretariat of the Committee of Governors) included a reference to the role of NCBs in Article 13, which dealt with the role, place, obligations and rights of the national central banks within the System:

"13.2 (fourth paragraph) The ECB may entrust the execution of certain tasks to the national central banks, or to some of them, on the terms it shall lay down."

11 June 1990

During the meeting of the Alternates on 18 June Lagayette remarked he favoured a system

[30] In the draft ESCB Statute of 27 November 1990 this article would be part of Article 14 on the National Central Banks. During the IGC Article 14.4 would be transferred to Article 12 on the Responsibilities of the decision-making bodies.

which would be as decentralized as possible, in order to ensure the continued existence of several financial centres, while Rieke had proposed to remain flexible as regards the centralization or decentralization of the execution of operations. In the Secretariat's version of 22 June, Art. 13.2 was changed into:

"13.2 (fourth paragraph) The Council may entrust the execution of certain tasks to national central banks on the terms it shall lay down." [31]
22 June 1990

However, views among the Alternates differed concerning the degree to which execution of operations may be decentralized without impairing the indivisibility of monetary policy. This was reflected in the version of July 3:

"[13.3 The Executive Board [may] [shall usually] entrust the execution of its tasks to national central banks on the terms it shall lay down.]"
3 July 1990

On 10 July 1990 the Governors discussed the draft Statute. De Larosière referred to the principle of subsidiarity. He said that the execution of some tasks of the System should be entrusted to national central banks on terms the System shall lay down. The Governors should avoid creating a 'super central bank' that would perform every function. The British governor supported this view. Chairman Pöhl agreed and said this implied a Council and Executive Board without a large number of operational and supporting staff and with national central banks acting as an operational arm of the Council.[32]
The Secretariat tried to reflect this in a new draft of (renumbered) Article 13.4 (dated 13 July), reading:

"13.4 The tasks of the Executive Board[33] shall normally be executed by the[34] national central banks. The execution of these tasks shall be in accordance with the terms laid down by the Executive Board."
13 July 1990

[31] The Commentary accompanying Chapter IV (Monetary functions and operations) shows an interesting parallel with Article 12.1c. The General comments at the beginning of this chapter read as follows (draft version of 22 June 1990): "As drafted, the text does not prejudge the question of whether operations are carried out at the level of the central institution or at the level of the national central banks. The precise distribution of tasks may evolve over time with due regard to the principle of subsidiarity. Some of the Alternates were firmly of the opinion that virtually all operations should be executed by national central banks. The operating procedures would be harmonized to the extent necessary; full harmonization being neither necessary nor appropriate."
[32] Minutes of Committee of Governors' meeting of July 10, 1990. Pöhl had already expressed a similar view on the role of the NCBs in a speech held in Paris on 16 January 1990, quoted in section I.1 above.
[33] Probably one should read here 'tasks of the System'.
[34] The addition of the word 'the' is significant, as it points to the involvement of all NCBs. Documentation does not show whether this was at the particular request of a Governor, or whether it resulted from the Secretariat.

The version of July 24, after discussion by the Alternates, showed that disagreement still existed:

"13.4 The tasks of the System [may] [shall normally] be executed by the national central banks. The execution of these tasks shall be in accordance with the terms laid down by the Executive Board."
24 July 1990

The discussion lingered on, also because a clear view on how the system could operate was lacking. For instance, in a paper by the French central bank of 23 July it was proposed that the monetary operations should be decentralized, while the external transactions (interventions and reserve management) should be centralized.[35] Views differed concerning the extent to which segmentation would prevail in the Community financial markets, at the beginning of Stage Three, thereby justifying the greater involvement of NCBs in the local supply of liquidity. This conundrum would continue for a long time. Only during the preparations under the EMI of the monetary policy instruments for Stage Three it became possible to square the circle: a single monetary policy would be defined by the existence of uniform money market conditions throughout the whole euro area. This required that banks should be able to transfer sums of money from one country to another within the same day. To this end all national payment systems operated by the NCBs would be connected on a real time basis (see Art. 17-24 below). Under that condition it would not matter that banks could do business only with their local central bank (their central bank being the socket where they would plug in to receive liquidity provided by and at the conditions determined by the 'system').

The Alternates discussed this topic on September 3 1990 and again on September 9. They could not decide on the degree of decentralization of the System's operations. Lagayette referred again to the principle of subsidiarity: decentralized implementation is desirable, even when financial markets would become strongly integrated. He was supported by Crockett, Szász and Mikkelsen (the UK, Dutch and Danish Alternates respectively). Tietmeyer, who still feared monetary policy would not be of one making, distinguished rediscount window operations, which called for a decentralized approach, and open-market operations, for which he could only envisage a 'back-office' model (in which the front-office function including the allotment of the accepted bids would be centralized and the NCBs would act as back-office). Italian Alternate Dini also favoured predominantly centralized execution of monetary policy for reasons of efficiency and external clarity.
Chairman Rey reported to the governors' meeting on 11 September 1990 that the Alternates, while not agreeing on the degree of decentralization, had agreed on some overriding principles: the System should operate credibly and efficiently in a market-friendly way but leave no uncertainty as to the indivisibility of monetary policy. Moreover, given the principle of subsidiarity, the NCBs should be involved, to the extent possible, in the execution of the System's operations.[36] This discussion had led to a reconsideration of Article 13.4; two

[35] This was in line with the French view of a decentralized system, while at the same time borrowing the international strength of the Bundesbank in the area of exchange rate policy.
[36] As regards operations on the foreign exchange market, there was more agreement among the Alternates: all of them considered it necessary to centralize foreign exchange interventions, which should be entrusted to the central institution. This led them to conclude that all or part of the reserves would have to be pooled (there would be debate on the size and on the rules for the remaining non-pooled reserves - see Art. 30-ESCB)

alternative suggestions had been drafted (the first alternative representing the 'German' view):

(1) "The operation of the System shall be executed by the central institution or the national central banks, as appropriate for the efficient conduct of monetary policy, in accordance with the terms laid down by the Executive Board."
or
(2) "The Council shall normally rely on the national central banks for the execution of the tasks of the System. The execution of these tasks shall be in accordance with the terms laid down by the Executive Board."

oral presentation J-J Rey 11 September 1990

The governors took up this issue in their meeting of 11 September 1990. De Larosière said that, according to the principle of subsidiarity, the System should rely as much as possible on national central banks for the execution of tasks. Leigh-Pemberton agreed that, wherever possible and appropriate, partly to avoid confusion and partly to reduce expenses, the existing national central banks and their operating procedures should be used. Pöhl was less intrigued by the question whether decentralization should be a possibility or the norm. He could live with decentralization 'to the extent possible and appropriate'.[37] The governors decided that the text should read:

"13.4 The Executive Board shall, to the extent possible and appropriate, make use of the national central banks in the execution of the System's operations."

14 September 1990

Until September the draft Statute had always referred to the System (and not to specifically NCBs and/or the ECB). Over the summer the NCBs' legal experts had met. They had concluded that not the System, but the ECB (and the NCBs) should have legal personality. This implied that operational, advisory, decision-making and regulatory functions had to attributed to elements of the System. They advised to mention in case of operational functions indiscriminately both the ECB and the NCBs. According to Rey this did not alter the 'balance of power within the System nor the relationship between the central institution and the NCBs'[38] Psychologically it did alter the balance, bringing the ECB more at level with the NCBs.

The authority of the ECB to execute functions itself was also reflected in a new **Article 9** on the ECB, first appearing in a draft version of 8 October 1990 meant to be discussed further by the legal experts. The article grouped together previous and new sections of articles on the ECB. Art. 9.4 thereof read: "The function of the ECB shall be to ensure that the tasks conferred upon the System under Article 3 shall be implemented either by its own activities

[37] 'Appropriate' refers especially to being compatible with a single monetary policy, according to an internal report on of this meeting by De Nederlandsche Bank.
[38] Presentation to the Committee of Governors' meeting of 13 November 1990.

pursuant to this Statute or through the NCBs pursuant to Art. 13." This article would remain basically unchanged (later renumbered into Art. 9.2 of the Treaty signed in Maastricht).[39]

A new, interesting exchange of views took place in the meeting of the governors on 13 November, when they had a final round on each article of the draft Statute and the accompanying Commentary. The draft contained the above mentioned version (the article had been renumbered into Article 14, due to a re-arrangement of some articles). Also tabled was a new alternative version, supported by the French:

"to the extent possible, the national central banks shall execute operations arising out of the System's tasks."

proposal Banque de France, 13 November 1990 [40]

The German chairman considered the (French) suggestion non-workable in practice. Furthermore, he considered this again a question of the 'conceptual interpretation of the role and powers of the Council and the Executive Board'. De Larosière said to his defence that the Statute contained only a limited number of instances where the principle of subsidiarity was specifically apparent.[41] Since this principle was, in his eyes, a cornerstone of the Delors Report, he strongly supported the new alternative. In his view this was a constitutional matter. It was essential not to create an organization at the centre which would duplicate or assume the existing functions of the national central banks. De Larosière said that the principle of subsidiarity should be permanent and that it should not be left to the governing bodies of the System to determine what should or should not be delegated to the national level; the national central banks should be the executive arms of the System. This view was fully endorsed by Leigh-Pemberton. Since no agreement was reached, the Committee decided to place the alternative version (amended by the words "full" and "in the judgement of the Council of Governors") alongside the original clause.[42] This version would be sent to the IGC.

"14.4 [To the full extent possible in the judgement of the Council, the national central banks shall execute the operations arising out of the System's tasks.] [The Executive Board shall, to the extent possible and appropriate, make use of the national central banks in the execution of the operations arising out of the System's tasks.]

27 November 1990

According to the 'Commentary' of November 27, 1990 'most' governors supported the first of these bracketed options (the French' alternative), which put stronger emphasis on

[39] The reference in the final version to Art. 14 is probably a remnant from the earlier version, when Art. 12.1 was part of Art. 13 (later 14) before being moved to Art. 12. The need to refer to Art. 12.1 was only discovered in the EMU Working Group of 26-28 November 1990.

[40] The formulation first appeared in the draft version of 19 October 1990 (that text had been prepared by Lagayette of the Banque de France, arguing that the wording of September 11 did not adequately reflect the implementation of the principle of subsidiarity).

[41] De Larosière could have had in mind Art. 5.2 - see Art. 5-ESCB.

[42] Minutes of CdG meeting on 13 November 1990.

decentralization. This Commentary read:

" All Community central banks endorse the adherence to the principle of subsidiarity in the implementation of operations undertaken on behalf of the System, i.e. to make use of the national central banks to the extent possible. However, views differ as to how this principle should be embodied in the Statute. Most Community central banks agree on the formulation that to the full extent possible in the judgment of the Council [of the ECB] the national central banks shall execute operations arising out of the System's tasks. Some [43] Community central banks prefer the formulation that the Executive Board shall make use of the national central banks, to the extent possible and appropriate, in the execution of such operations."[44]

The topic was not discussed anymore by the governors. The updated version of the draft Statute dated 26 April, 1991 contained the same text and the same bracketed alternatives.

II.3 HISTORY: IGC

The Commission draft Treaty did not deal with the issue of decentralization, neither did the German or French drafts. On 12 March the deputies discussed the issue and reached a compromise after Rieke (the Bundesbank delegate) had indicated that in his view the differences should not be exaggerated. Köhler (German Finance Ministry) expressed the view that de-central execution should be an option, not on obligation. Conthe (Spanish Finance Ministry) said he could live with these articles as long as they referred to 'the' national central banks, to make clear <u>all</u> central banks would participate in the execution of the System's operations. Then Wicks (HM Treasury) formulated a text which did not give rise to objection at the meeting and to which Trichet (Trésor), Köhler and Italy explicitly agreed:[45]

"14.4 To the full extent possible and appropriate and without prejudice to Article 12.2,[46] the ECB shall make use of the national central banks in the execution of the operations arising out of the System's tasks."

deputies IGC meeting 12 March 1990

[43] The French had proposed to use the word 'one', but had offered as an alternative to use the word 'some'.

[44] This position was echoed in the General comments at the beginning of Chapter IV (Monetary Functions and Operations) of the 'Commentary' on the draft Statute of 27 November - see also the footnote at the beginning of section II.2 for a quote of an earlier version of this part of the Commentary. These comments read: "This Chapter describes the monetary functions and operations that may be undertaken by the ECB and national central banks. The relevant Articles recognise that both are the operational arms of the System and do not prejudge as to how the execution of monetary operations will be distributed among them in line with the principle of subsidiarity (see comment on Article 14). Although national central banks are already authorised under their present statutes to perform many of the operational functions mentioned in this Chapter, reference is made to them in this Chapter [instead of just referring to 'the System may ....'] in order to reaffirm that they have the necessary operational powers for executing the System's tasks, and to indicate the areas in which operational procedures may need to be harmonised." See further the quote taken from the Introductory Report accompanying the draft Statute, as quoted at the end of paragraph II.2 of the section dealing with Article 1.

[45] Wicks formulated a compromise, taking elements from both alternatives of the draft Statute of 27 November 1990: starting from the more centralized, second alternative, he took out 'Executive Board', which he replaced by 'ECB' (where the governors would have a majority) and inserted 'full' in 'to the extent possible', which then came to read 'to the full extent possible'.

[46] Article 12.2 stipulates that the Executive Board may instruct the NCBs.

The Luxembourg presidency decided to 'formulate a compromise' based on the input received during the meeting. It also decided to lift this topic into Article 108(5) of the draft Treaty text.

The text of Article 108(5) of the Luxembourg presidency (non-paper of 13 March 1991, UEM/34/91) would read:

> "108(5) To the extent deemed possible and appropriate, and without prejudice to the provisions of paragraph 4,[47] the European Central Bank shall have recourse to the central banks of the Member States to carry out operations which form part of the system's tasks."
>
> non-paper March 13 1991 [48]

A substantial change relative to Wicks' proposal was the deletion of the word '*full'* in 'to the full extent'. The text of the draft Statute was left untouched for the moment. The issue of the organization of the ESCB was discussed among ministers on 18 March 1991. Only a few ministers touched upon the issue of the future role of the NCBs. Solchaga (Spain) remarked that money market interventions decided upon by the ECB should be divided over all national markets - in the initial years the ECB should not discriminate in favour of one market and should make use of the expertise and services of all NCBs. Such a provision could in his eyes be waived after the ESCB had gained some operational experience. According to Maude (deputy minister UK) implementation of policy should be delegated as much as possible to the NCBs. According to Wim Kok of the Netherlands decentralization of implementation was imperative. The text of Article 108(5) remained unchanged. On 10 May the deputies discussed the ESCB Statute and they decided to shift Article 14.4 which now followed the wording of Art. 108(5) to Article 12.1 of the ESCB Statute. Article 12 deals with the 'Responsibilities of the decision-making bodies'.
From that moment on, the text would remain untouched except for a minor editorial change. The Dutch presidency decided to take the article out of the draft Treaty text and to retain it only in the Statute,[49] because of its largely System-internal nature.[50]

So the final version approved at Maastricht would read:

> **Article 12.1-ESCB (Responsibilities of the decision-making bodies), third paragraph:**
>
> **"To the extent deemed possible and appropriate and without prejudice to the provisions of this Article, the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB."**

[47] See previous footnote.
[48] UEM/34/91 would appear in Europe daily, No. 5458 of 23 March 1991, in slightly different wording (probably due to translation from a French version): '5. To an extent which is considered possible and adequate, and without prejudice to the provisions of the above paragraph, the European Central Bank has recourse to the central banks of Member States for the execution of operations arising from the system's assignments.'
[49] The Statute also having Treaty status.
[50] See footnote 3 of UEM/66/91, dated 25 September 1991.

Box 3: ***Subsidiarity and decentralization***

The fact that the concept of subsidiarity has been used to argue in favour of a model with decentralized operations, i.e. involving as much as possible the NCBs, has been criticized from legal side. Indeed, subsidiarity relates to the question of surrendering sovereignty to higher political/bureaucratic levels and not to the execution of tasks. Therefore, Art. 12.1c does not have a legal basis, rather it is the outcome of political negotiations. However, the way the principle has been used could be seen as a welcome addition to the principle of subsidiarity, though it should be renamed for instance into the principle that the responsibility for the execution of public tasks should preferably be vested in persons/institutions as closely as possible to those concerned. In this case 'those concerned' are the nationals banks, payment systems and reporting agencies, while the 'NCB' would be one of the 'institutions' close to those concerned.

The principle of subsidiarity had been mentioned in the Delors Report (1989), par. 20, as an essential element in defining the appropriate balance of power within the Community:
"20. An essential element in defining the appropriate balance of power within the Community would be adherence to the 'principle of subsidiarity', according to which the functions of higher levels of government should be as limited as possible and should be subsidiary to those of lower levels. Thus, the attribution of competences to the Community would have to be confined specifically to those areas in which collective decision-making was necessary. All policy functions which could be *carried out* [emphasis by the author] at national (and regional and local) levels without adverse repercussions on the cohesion and functioning of the economic and monetary union would remain within the competence of the member states."
Indeed, the wording 'carrying out functions' could easily be misinterpreted.

During the process of drafting the ESCB Statute the Banque de France repeatedly referred to the principle of subsidiarity as an important argument for decentralizing as much as possible the implementation of monetary policy (and more in general: implementation of the System's policies).
The Commentary accompanying the governors' draft ESCB Statute of 27 November 1990 (Introductory report, p.5) followed this reasoning: 'The federative structure of the System is also reflected in the execution of operations arising out of the System's tasks, which, as mentioned above, rests firmly on the application of the principle of subsidiarity.'
Subsidiarity gained an official place in the Treaty of Maastricht in Article 3b-EC, second paragraph, which had been developed in the parallel IGC on Political Union: "In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community." [51]

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[51] Kapteyn/VerLoren van Themaat (1999), p. 139, observe that this is a typical political principle: it can be invoked as a justification for Community action, but also in opposition to it.

The subsidiarity principle as defined in Article 3b logically does not apply to areas that fall within the exclusive competence of the Community. Therefore it does not apply to the ESCB, because the tasks of the ESCB (monetary policy) are within the exclusive competence of a supranational body.[52] Neither does the concept as defined in Art. 3b refer to the execution of policies. (The definition used by the Delors Report is close to that of Art. 3b, but is more ambiguous, as it also refers to the execution ('carry out') of policy functions.)
For the Banque de France (and others with her) subsidiarity meant that tasks should preferably be performed by national institutions as opposed to 'central' institutions. The objective was to defend the executive prerogatives of the NCBs. This point was appropriately noted by Horst Köhler during the deputies IGC meeting of 12 March 1990, when he observed it would be better to use the concept of decentralization instead of subsidiarity.[53]
Finally we note that the Statute as such does not refer to subsidiarity.

[52] This issue is discussed in the same vein in R. Smits (1997), p. 111/112.
[53] Taken from report of said meeting by the Dutch Ministry of Finance (IMZ/nr. 91-500).

Articles 14.3 and 14.4:

Article 14 (National central banks)
"14.3 The national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB. The Governing Council shall take the necessary steps to ensure compliance with the guidelines and instructions of the ECB, and shall require that any necessary information be given to it.

14.4 National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB."

(to be read in conjunction with: Art.1-ESCB (Constitution of ESCB), Art. 6-ESCB (International cooperation), Art. 12.1c-ESCB (Decentralization), Art. 14.1 (NCB statutes), Art. 21.2-ESCB (Allows NCBs to act as fiscal agent), Art. 22-ESCB (Payment systems oversight); Art. 27-ESCB (Auditing); Art. 28-ESCB (ECB's capital); Art. 31.1 (NCB obligations towards international organizations))

I. INTRODUCTION

I.1 *General introduction*

The focus here is on Article 14.4, according to which NCBs may also perform non-System functions. However, we will see that Art. 14.4 gave rise to Art. 14.3, which is why we treat them together. Unlike NCBs the ECB is not allowed to perform non-System functions. This fact might strengthen the position of NCBs, as they might have wider competences than the ECB. The genesis shows that Art. 14.4 was basically a 'defensive' article, in the sense that NCBs sought assurance they would not have to 'sell off' those functions not covered by the ESCB Statute. Though the non-System functions of NCBs differ per NCB,[1] they include in most cases the collection of non-monetary statistical information and the rendering of services to the government. On the other hand, supervision of the banking system, banknote printing,[2] rating the quality of loans and companies, distribution of coins and monitoring consumer credit activities are examples of non-System tasks not performed by all euro area NCBs. The non-System functions sometimes involve large contingents of employment. Roughly half of the euro area NCB staff is employed in non-System related functions. Therefore and because the synergies involved the NCBs strongly favoured retaining their existing non-System tasks, even though part of these non-System functions might bring them in a more dependent position vis-à-vis their domestic political authorities – at least informally.

[1] This is understandable as each of them had its own 'personal' history, some central banks existing already for centuries.
[2] 'Issuing' banknotes is a System function, but does not necessarily entail their production, as can be readily derived from that fact that a number of NCBs buy their banknotes from private sector printing houses.

As a safeguard the Governing Council was given the right to forbid functions when they interfere with the functioning of the System. An example might be a central bank becoming active as a lender to certain industrial sectors, or starting to act as an international lender of last resort for certain regions in the world. This could lead to conflicts of interest with the monetary policy function. Another example might be a central bank becoming market maker in certain financial market segments, because such would seemingly create a second monetary policy decision-maker with discretionary powers.
Because governors were not sure how restrictive the future Governing Council would use this provision, they proposed to install a high threshold for activating this provision, by requiring a qualified majority for any such decision. The alternative, i.e. to list all their current non-System functions, was not considered. That approach (using a 'positive' list) would have entailed a more restrictive regime for the NCBs and might have precluded taking new tasks on board, e.g. in the supervisory area.[3]

I.2 *Relevant features of the Federal Reserve*

Unlike the NCBs in the ESCB, the Federal Reserve Banks do not have functions outside the Federal Reserve System (FRS). This is understandable as their only reason for being is being part of a federal central bank system. They only perform System tasks. Their main operational functions are in the area of payment systems, banking supervision and research, while the contacts with the markets and the market operations are concentrated in New York. They are an integral part of the FRS, even in stronger measure than it is the case for the NCBs in the euro system. In fact, the Board approves the appointment of the president of each FRB, it may suspend or remove from office FRB officers and directors, it approves the salaries of the directors and the officers (among which the FRB's president), it may examine the books and affairs of each FRB, it 'exercises general supervision' over the FRBs,[4] the budgets of the FRBs (including the headcount) are submitted to Board of Governors for approval,[5] it may suspend – for the violation of any of the provisions of the FRA - the operations or even liquidate and FRB.[6] In general the euro area NCBs enjoy much more budgetary freedom than the FRBs. This is related to the fact that NCBs traditionally had, and still have) close relations with national authorities (shareholders; NCBs also are part of different national legislative regimes), while FRBs do not have an institutional relation with individual States and were established under one uniform national legal regime.

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[3] For an example of a non-System tasks performed by an NCB, see J. B. Jansen (2001), *The position of the Nederlandsche Bank N.V. under the Bank Act 1998*, Bankjuridische Reeks of NIBE-SVV, appendix C (only available in Dutch). Jansen provides a complete overview of all non-System tasks of the Netherlandsche Bank. Although the System and non-System tasks are difficult to separate, roughly one-half of the employment of the Netherlands Bank is related to System and one-half to non-System tasks.

[4] The Board's general supervisory authority over the FRBs includes all facets of Reserve Bank activities (Akhtar and Howe (1991), p. 347.)

[5] The budgets of the FRBs are reviewed by a committee of two governors and then presented to the Board of Governors for final action (see Board of Governors (2000), Annual Report Budget Review, p. 3). In the case of the ESCB the NCBs have full control over their own budgets, while the Governing Council supervises the budget of the ECB.

[6] Examples taken from FRA (1988), Sections 4(4), 4(22), 11(a)(1), 11(f), 11(h), 11(j), 12A and 14(d).

The table below shows the number of staff of the FRBs, with special mentioning of New York, and of the Board of Governors. We include figures for the eurosystem.

Table 7-2 Staff size FRS and eurosystem 1999/2000

Number of staff [7]	
FRBs	23458
(of which New York Fed	*3654)* [8]
Board of Governors	1729
Federal Reserve System	25187
Euro area NCBs	23903 [9]
(including non-System related tasks	*53400)*
ECB	737 [10]
Eurosystem	24640

II.1 HISTORY: DELORS COMMITTEE AND COMMITTEE OF GOVERNORS

The *Delors Committee* had taken on board the idea, first expressed by Stoltenberg (see Art. 7) that the ESCB should be of a federal nature. For instance, in section 32 one can read: 'Considering the political structure of the Community and the advantages of making existing central banks part of a new system, the domestic and international monetary policy-making of the Community should be organized in a federal form, in what might be called a European System of Central Banks.' The Delors Committee proposed the governors should be part of the decision-making body of the ESCB and that the NCBs 'would execute operations in accordance with the decisions taken by the ESCB Council.'

When the *Committee of Governors* asked the Alternates to start drafting the Statute, they were aware of the need to integrate their central banks into the System and of the fact that their central banks were substantially different from each other. For instance, some central banks were banking supervisors, others were not; some printed their banknotes, other did not. An effort was necessary to find a workable construction. The initial formulation by the secretariat

[7] 2000/2001 figures for FRS; figures are relatively stable over time. 1999-figures for ESCB, including Greece (numbers for NCBs are declining, number for ECB is increasing (1265 in 2003)).
[8] The size of the other FRBs ranges from 1270 to 2762 staff.
[9] Estimated number for System-related tasks (e.g. excluding prudential supervision by NCB's).
[10] To allow for a comparison with the Board of Governors one should reduce the number of staff of the Board of Governors that work in areas not covered by the ECB, i.e. banking supervision and regulation (220) and consumer protection affairs (78).

focussed on stating that the statutes of the NCBs should be 'compatible' with these of the System and that:

"13.2 The NCBs should act in accordance with the policies of the ESCB to the extent necessary for the latter to exercise its powers. In this regard, the Council may require the NCBs to seek prior approval of acts which are relevant to the objectives and functioning of the ESCB."

22 June 1990

This text, which was in fact describing a very loose system, was discussed by the Alternates on 29 June. Lagayette (Banque de France) and Crockett (Bank of England) indicated they wanted NCBs to be able to continue performing historically established tasks outside the framework of the System. Tietmeyer warned this could imply political interference through the backdoor. This discussion led to a new text by the Secretariat, for the governors' meeting on 10 July:

Article 13 - National central banks

13.1 The statutes of the NCBs must be compatible with this Statute. [followed by sentence on the minimal term of office of ncb governors]

13.2 The NCBs shall act in accordance with the policies of the ESCB to the extent necessary for the latter to exercise its powers.

The Council shall take the necessary steps to ensure compliance by the NCBs with the obligations incumbent on them and in this respect it shall be given all relevant information.

13.4 NBCs may continue to perform tasks other than those described in the Statute of the ESCB provided they are not in contradiction with the objectives and functioning of the ESCB. These actvities shall not be regarded as being part of the ESCB. The NCBs may undertake new tasks subject to the prior approval of the Council of the ESCB.

3 July 1990

Subsequently Tietmeyer formulated an alternative text for 13.1, introducing the concept of the NCBs being 'an integral part' of the new system and rearranging the text to make clear that the requirement of compatible statutes meant more than avoiding inconsistencies between them. This text (see below) was discussed during the governors' meeting on 10 July.

13.1 The statutes of the NCBs must be [made compatible with] [adapted to] this Statute so as to ensure that they are an integral part of the ESCB. The NCBs shall act in accordance with the policy guidelines and instructions of the Council or Executive Board.

The Council shall take the necessary steps to ensure compliance with its policy guidelines and instructions, and shall require that any necessary information be given to it.

Tietmeyer 10 July 1990

Pöhl supported Tietmeyer's text, emphasizing the importance of using the concept of compatibility. Tietmeyer's text would be accepted (and one would opt for the words 'compatible with' over the words 'adapt to' in order to strengthen the text).

On 24 July the Secretariat's text would read as follows:

> 13.3 Subject to Article 13.5, the NCBs are an integral part of the System and shall act in accordance with the policy guidelines and instructions of the Council or the Executive Board.
>
> The Council shall take the necessary steps to ensure compliance with its policy guidelines and instructions, and shall require that any necessary information be given to it.'
>
> 13.5 NCBs may continue to perform functions other than those described in the Statute of the System unless the Council finds, by an [appropriate] majority that these interfere with the objectives and tasks of the System. Such functions shall not be regarded as being part of the System. The NCBs may assume new functions subject to the prior approval of the Council of the System.
>
> draft 24 July 1990 [11]

This version of Art. 13.5 (the predecessor of Art. 14.4) was close to the final text of the governors. Following advice of the legal experts of the central banks, a reference to liability was included (see below). During their meeting on 13 November 1990 the governors decided - with a view to simplifying and clarifying the text - to delete the words 'continue' and to delete the last sentence of Art. 13.5, while the word 'prescribed' was changed into 'specified'. In Art. 13.3 (later Art. 14.3) 'Council or Executive Board' would be replaced by 'ECB'.[12] The governors confirmed that the 'appropriate' majority would have to be a qualified (*ergo* not a simple) majority, thus protecting the position of the NCBs.

This led to the following final text:

> '14.3 Subject to Article 14.5, the NCBs are an integral part of the System and shall act in accordance with the guidelines and instructions of the ECB.
>
> The Council shall take the necessary steps to ensure compliance with the guidelines and instructions of the ECB, and shall require that any necessary information be given to it.
>
> 14.5 NCBs may perform on their responsibility and liability functions other than those specified in this Statute unless the Council finds, by a qualified majority of two-thirds of the votes cast, that these interfere with the objectives and tasks of the System. Such functions shall not be regarded as being part of the System.'
>
> draft 27 November 1990

II.3 HISTORY: IGC

During the IGC Art. 14.3 remained as it was, though the Dutch presidency dropped the subjugation to Art. 14.5 by dropping the words 'subject to Art. 14.5.[13] Art. 14.5 would become Art. 14.4, with the words 'responsibility and liability' being moved from the first sentence to the second. Apparently all participants agreed that NCBs would be more than

[11] The requirement to ensure compatibility of the national legislation including the NCB Statutes with the Treaty and the ESCB Statute would henceforth be part of Art. 13.1 (later 14.1).
[12] Possibly as a result of the remark of the German legal expert who pointed out that according to Art. 12.2 'policy guidelines' are an instrument of the Council and 'instructions' an instrument of the ECB.
[13] UEM/82/91, 28 October 1991.

mere agencies of the centre, this allowed not only for a continued existence, but also for a continued presence in the domestic economic field as an independent expert institution.

14.4 NCBs may perform functions other than those specified in this statute unless the Governing Council finds, by a majority of two-thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of NCBs and shall not be regarded as being part of the ESCB. December 1991

However, during the legal nettoyage it was pointed out that the last sentence of Art. 14.4 was grammatically incorrect. To solve this the last six words were replaced 'as being part <u>of the functions</u> of the ESCB'. This would seem to bring Art. 14.4 more in line with Art. 14.3 ('integral part').

Article 16:

Article 16: Banknotes

"In accordance with Article 105a(1) of this Treaty, the Governing Council shall have the exclusive right to authorize the issue of banknotes within the Community.
The ECB and the national central banks may issue such notes.
The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community.

The ECB shall respect as far as possible existing practices regarding the issue and design of banknotes."

(to be read in conjunction with Article 1-ESCB (Legal structure of the System); Article 52-ESCB (Exchange of national banknotes); Article 4A-EC (Establishment of ESCB); Article 105a(1)-EC (replica of this article) and Article 105a(2)-EC (Coins))

I. INTRODUCTION

I.1 *General introduction*

In the area of note issuance by central banks, many different traditions existed and continue to exist, also within the European Community. In most countries the central bank is the sole bank issuing fiduciary currency. An exception is the UK where some regional commercial banks still issue banknotes, though these notes are not legal tender, while in Belgium Parliament, prior to the introduction of the euro, had the power to confer the right of issue upon other banks. Also in the Netherlands, government authorization was necessary for calling in any series of banknotes issued by the central bank. In France the creation or issue of notes needed approval of the two governmentally appointed censors (usually the highest officials of the Ministry of Finance).[1] Despite these different traditions, the article regulating banknote issuance in EMU is of relatively simple design: it bestows all legal capacities in this area on the Governing Council of the ECB. It does neither set limits, nor does it oblige the central bank to hold a minimum ratio of specified assets (e.g. gold) against issued banknotes. The article bestows legal tender on the System's banknotes, without the need for further legislation.[2]

[1] Examples taken from BIS (1963), *Eight European Central Banks - a descriptive study* and De Nederlandsche Bank, *Bank Act 1948* (Edition 1991).

[2] The only legislation required relates to the arrangements for legal tender during the period in which national banknotes would still exist. Euro banknotes (and euro coins) were only introduced as of 1 January 2002, that is three years after the start of the third stage of EMU. These three years, during which national banknotes continued to be issued and to circulate, were necessary to design and print a large amount of banknotes (and strike coins) and to prepare the logistics - in practical and legal terms - of the changeover. The legal framework for the changeover is contained in two Council Regulations, *viz* EC/1103/97 of 17 June 1997 and EC/974/98 of 3 May 1998. During these first three years of EMU the money, financial and foreign exchange markets had already adopted the euro as their unit of account, but in daily life national currencies were still used, the national currency officially being sub-denominations of the euro as of 1 January 1999. Banknotes and coins denominated in national currency retained their status as legal tender within, and confined to, their territorial limits, until the

The article needs close reading for a full understanding. More specifically, the **first sentence** establishes that the Governing Council has the monopoly to authorize the issuance of banknotes within the Community.[3] The **second and third sentences** state that both the ECB and the NCBs may issue banknotes and that these banknotes will be the only ones with legal tender status within the Community. The formulation implies that the Governing Council may authorize other institutions, e.g. commercial banks, to issue banknotes. However, these would not have legal tender status.[4] This formulation was chosen to allow the Governing Council to authorize the continuation of the British tradition, according to which three banks in Scotland and four in Northern Ireland issue their own banknotes.[5] UK law obliges these banks to cover their banknotes, except for a *de minimis* part, by gold, silver or banknotes of and held at the Bank of England. In this way their banknotes can be considered as just another appearance of pound sterling notes. However, they are not legal tender.[6] Once the UK joins monetary union, the Governing Council of the ECB will have to decide whether it allows this tradition to continue. The **last sentence** can be read in different ways: it is an admonition to the ECB to accept continued issuing of banknotes by some commercial banks, but it also allows the ECB to reject this, because the words 'as far as possible' can be interpreted in several ways. If the Governing Council were to consider that the issuing of these banknotes were to undermine the ECB's monetary policy or the euro's credibility, it could put an end to this private issuing. The last sentence also allows for the possibility of banknotes with a uniform and a national side. This reference to the design was again added at British request. The UK delegation to the IGC insisted that British Parliament would only surrender its currency, if allowed to keep the Queen's head on one side of the banknote (the other side being a uniform European side). Also here the decision is in the hands of the Governing Council. Right after the establishment of the ECB in July 1998, the Governing Council decided to go for a uniform design without national features,[7] in order not to confuse the public and to present the risk that people could start refusing banknotes of countries with relatively frequent falsifications - if not for other

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first few months of 2002. Each central bank though stood ready during this period, through one or more of its offices, to exchange banknotes of other euro area countries at par. After this transitional period remaining *national* banknotes can be exchanged for euro banknotes at the central bank's head office in the country of issuance, for periods which vary per country (varying from 10 years to indefinite).

[3] See R. Smits (1997, p. 206) for a discussion on the expression "to authorize the issue". The authorization relates to all instances of bringing into circulation, withdrawing or re-issuing banknotes including "decisions as to cancellation, compensation for loss and other acts relating to the circulation, for all of which the ECB's Governing Council [and not the NCBs] is exclusively competent."

[4] 'Legal tender' denotes money a creditor is obliged to receive in payment of a debt. See *The New Palgrave Dictionary of Money and Finance*, edited by Newman and others, Macmillan, London, 1994. See for legal tender also R. Smits (1997), p. 207-208.

[5] ECB (1999), *Report on the legal protection of banknotes in the European Union Member States*, November 1999, p. 35-36.

[6] These notes held are included in UK banknote circulation figures. In 1999 they represented some 10 percent of the total amount of Bank of England banknotes in circulation. (Ibidem, p. 35.) These banknotes are not legal tender (also not in Scotland or Northern Ireland), but act as an authorized currency and in effect enjoy a status comparable to that of English banknotes. (Information received from the Bank of England.)

[7] Decision of the European Central Bank of 7 July 1998 on the denominations, specifications, reproduction, exchange and withdrawal of euro banknotes (ECB/1998/6) as amended by ECB Decision of 26 August 1999 (ECB/1999/2), published in the Official Journal of the European Communities No. L 8 of 14 January 1999, p.36, and the OJ L 258 of 5 October 1999, p.29 respectively.)

reasons, like possibly large fiscal or political problems in these countries. Such actions would hamper the economy and could be a threat to EMU.

The word 'issue' in the **second sentence** refers to the legal step of *bringing them into circulation as a means of payment and carrying them as liabilities on the balance sheet* (we will refer to this as being the 'legal issuer') [8] and to the operational handling and distribution of banknotes. Banknotes are typically delivered to banks, that want to satisfy the demand for banknotes by their clients, against debiting the (minimum reserve) account of these banks at the central bank (these accounts are built up when banks borrow central bank money from the central bank or when the central bank buys domestic assets or foreign exchange from the banks). The central bank that carries the banknotes on its balance sheet will also collect the *seigniorage* involved.[9] The drafters of the Statute had to decide who would carry these banknotes on its balance sheet: the NCBs and/or the ECB. They decided that both should be able to do so. It follows from the first sentence that this is up to the Governing Council to decide on this.

In theory it is possible to make the **ECB** the sole legal issuer, while the NCBs handle the physical circulation. Taking away the distribution function from the NCBs, would be more difficult to imagine in view of Article 12.1, third paragraph, which puts strong emphasis on using the NCBs 'to carry out operations which form part of the tasks of the ESCB.' A decision to designate the ECB as the only issuer of euro banknotes would have important psychological consequences (as such a decision would take away one of the oldest functions of NCBs) and unexpected practical complications, which would need due consideration. For instance, in Belgium the right of the NCB to retain seigniorage is linked to the central bank being issuer of banknotes. A decision, on the other hand, to designate the **NCBs** as the sole issuers of euro banknotes would reflect the situation in the United States, where banknotes are issued by the Federal Reserve Banks (see section I.2 below).

In practice, the Governing Council has decided for a combination, i.e. the issuing of banknotes is for 92 per cent allocated to the NCBs according to their paid-up share in the ECB's capital and for 8 per cent of the total to the ECB, with the distribution and handling remaining entirely in the hands of the NCBs.[10] The outcome was a compromise, as a number of NCBs considered it unnecessary to make the ECB legal issuer, while the Executive Board of the ECB even envisaged that the ECB could be the sole issuer. The Board argued that the euro banknotes only showed the name of the ECB (and not of the NCBs) and the signature of the president of the ECB. It also disputed whether the NCBs' euro banknotes were **fungible**, as was assumed by the NCBs. Indeed, banknotes can be distinguished as to their origin of

[8] The two qualities of issuing, i.e. the legal aspect and the physical distribution, can be separated (if central bank X circulates legal tender notes issued by central bank Y, NCB Y receives a claim on NCB X). While 'legal tender' is a quality of the banknote itself, 'legal issuer' refers to the issuing institution. While a commercial is 'legal issuer' of its own banknotes, these notes need not have legal tender status.

[9] Seigniorage is defined here as the *income* generated by the assets which are held against the issued *non-remunerated* banknotes (some authors define seigniorage as the nominal value of the issued banknotes). Monetary income of NCBs is pooled and reallocated over all the NCBs participating in the euro area.

[10] ECB's Annual Report 2001, p. 119: 'In accordance with the principle of decentralization in the execution of Eurosystem operations, the 12 NCBs of the euro area will put into and withdraw from circulation, and will physically process, all euro banknotes, including those issued by the ECB.' The banknotes are printed under the aegis of the NCBs, either in-house or at private sector companies. Production volumes and desired stock levels are coordinated centrally.

issuance, because they contain a country code in the serial number on the banknote. However, NCBs do not repatriate notes to the country of origin. Making the System legal issuer was no way out, because the System does not have legal personality and thus no balance sheet. The compromise found comes close to making the System legal issuer.
Of course, fungibility exists de facto and is supported by the fact that each NCB's balance sheet shows an 'allocated' number of euro banknotes in circulation (i.e. based on its share in the ECB's capital, and not on the number of banknotes actually issued). Fungibility could legally be expressed by stating that euro banknotes constitute a joint and several liability of the components of the system. (Such a text could also imply the need for stronger control over each others balance sheets.)[11] Because banknotes are not repatriated, the banknotes in circulation will over the years tend to get mixed more and more (probably up to a certain steady-state mix).

Finally it could be remarked that Article 16 does not refer to the name of the currency. This name is mentioned in Art. 2-EC and several other places, most people taking it for granted that the name would be 'ecu'. However, in 1995 German Finance Minister Waigel, backed by Kohl, would insist on another name than 'ecu', inter alia because the ecu had been nicknamed esperanto money by German journals and was associated with a currency basket, whose value had depreciated over the years vis-à-vis the Dmark since the start of the EMS. Germany argued that the name 'ecu' was a mere acronym for 'European Currency Unit', for which a name still had to be found.[12] This led to the adoption of the name 'euro' by the Heads of State in 1995.[13] The name 'euro' had been favoured by Germany.[14]

In the operational area therefore, NCBs (and not the ECB) *distribute* the banknotes. *Printing* is a related issue. Some NCBs print banknotes in-house, while other NCBs order their banknotes from private sector printing companies, making for the case that printing is not an exclusive System function. In all these cases (distribution, printing volume, but also *design and security features*) the Governing Council issues detailed guidelines with minimum sets of rules. The Governing Council took a difficult decision as to who would carry the euro banknotes on its balance sheet. The System, not having legal personality, did not qualify. The decision to allocate part of the 'issued banknotes' to the ECB was considered important by the Executive Board for symbolical reasons. The solution found also gives the ECB a first-hand claim on the accompanying part of the System's seigniorage. This seigniorage income of the ECB is distributed separately to the NCBs in the form of an interim distribution of profit.

[11] An implicit recognition of fungibility is contained in article 3 of ECB Decision ECB/1998/6 of 7 July 1998 which obliges NCBs "upon request, to exchange mutilated or damaged legal tender euro banknotes in the following cases: (a) when more than 50% of the banknote is presented: (b) when 50% or less of the banknote is presented if the applicant proves that the missing parts have been destroyed" – i.e. irrespective of their origin.
[12] écu was also the name of an old French gold coin. When the ecu was introduced as a basket currency at the inception of the EMS, Giscard d'Estaing had pointed out the double way ecu could be read. In the German versions of the Treaty ecu was consequently spelt with capitals (ECU).
[13] See Smits (1997), p. 490-491, for a critical legal assessment of this ex post interpretation of the name ECU as an abbreviation. According to Grosche (member of the German negotiating team in 1991) the name 'euro' had circulated even then, so there is no clear originator of the name.
[14] The starting value of the currency was fixed, as Art. 109L(4) stipulated that the substitution of the ecu for the national currencies 'shall by itself not modify the external value of the Ecu'. (Art. 109g had confirmed the basket currency character of the existing ecu.) The quoted sentence was inserted to prevent that the starting point could become a nasty negotiation element.

Independent of the method of profit distribution, the ECB's budget always needs to be approved by the Governing Council.

I.2 *Relevant features of the Federal Reserve System*

In 1836 the charter of the Second Bank of the United States was not renewed. This was followed by the so-called Free Banking Era from 1837 to 1863,[15] during which state-chartered banks could issue banknotes, which varied in quality from relatively good to very low and therefore often traded at discounts. The National Banking Act of 1863 provided for the creation of nationally-chartered (note-issuing) banks and effectively taxed the issuing of banknotes by state-chartered banks out of existence.[16] The legislation provided for stringent capital requirements and mandated that the circulating banknotes be backed by holdings of specific United States government securities. If a bank failed, its notes could be redeemed at the Treasury. Nonetheless, banking problems persisted, as abundance and lack of liquidity were regular phenomena (due to the so-called inelasticity of the currency). The establishment of a system of local Federal reserve banks was aimed at breaking this pattern.[17]
The 1913 Federal Reserve draft bill brought to Congress provided for banknotes to be issued only by the FRBs. The FRBs were (and are) privately-owned, their shares being held by local member banks.[18] However, important Democrats believed the currency should be issued by the government. As a way out President Wilson insisted upon exclusive government control of the Federal Reserve Board (only governmental appointees) and by making the Federal Reserve notes an obligation of the United States. Both elements became part of the law.[19] The Federal Reserve notes had to be fully collateralized by *commercial* paper,[20] while at the same time the FRBs had to keep a gold reserve of not less than 40 percent of its Federal reserve notes in circulation. (This rather curious double requirement was changed in 1917, when the security against Federal Reserve notes was changed to at least 40 per cent in gold and the

[15] After the closing of the Second Bank of the United States many states started to reform their (until then very cumbersome) bank chartering systems, so that entry into the banking industry would be easier. (The Second Bank had branched out through the country having established 25 branches by 1836 and had been an extensive provider of banking services, which void had to be filled after its closing.) Most free banking laws allowed anyone to operate a bank as long as two requirements were met: all notes the bank issued had to be backed by state bonds deposited at the state auditor's office; and all notes had to be redeemable on demand at par, or face, value. Otherwise, the auditor would close the bank, sell the bonds and pay off the noteholders. According to a study by Rolnick and Weber (1982) the relatively high rate of bank failures in that period was caused not so much by fraud (so-called Wildcat Banking), but by periods of steep bond price declines, which would instigate runs on banks.
This period was called free Banking Era, because there was no federal regulation (but only state regulation). Many banks were established, by private persons, or state-owned. Relatively many banks failed. The Second Bank of the United States had helped promoting the soundness of the banking system by regularly presenting for payment the currency of state banks it suspected of over-issuing.
[16] The state banks survived, because demand deposits (checking accounts) had become the most important source of funds to the banks (FRB of Boston (1990), p. 9-12). In other words, banks issued checking accounts instead of banknotes.
[17] See also Art. 12.1c (section I.2) above.
[18] FRA (1988), Section 2(3).
[19] FRB of Boston (1990), p. 24. For the struggle to establish the FRA see chapter 6 above under the paragraph 'Federal Reserve' and Studenski and Krooss (1963), *Financial History of the United States,* p. 225-260.
[20] This reflected the so-called Real Bills doctrine. Eligible commercial securities were defined as the commercial notes and bonds eligible for rediscount under Section 13 of the FRA.

remainder in commercial paper, instead of another 100 per cent. In the early thirties a constant decline in commercial paper was considered a potential threat to the continued expansion of the currency, and in February 1932 Congress passed the Glass-Steagall Act of 1932, which among others authorized the FRBs to use not only commercial paper, but also government obligations as collateral for note issues. Nowadays collateral exists primarily of government obligations.

The above is reflected in Section 16 of the FRA, which authorizes the issuance of Federal reserve notes: 'Federal reserve notes, to be issued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal reserve banks through the Federal reserve agents[21] [...] and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs, and all other public dues. They shall be redeemed in gold on demand at the Treasury Department of the United States, in the city of Washington, D.C., or in gold or lawful money at any Federal reserve bank.' [22]
Until 1933 people could still require that debts incurred must be paid in gold, not paper currency. This changed in 1933, when through a Public Resolution of Congress it was ordained that Federal reserve notes had to be accepted in payment 'as coin or currency of the United States' instead of gold in contracts that called for payment in gold. The same was applied to gold clauses in securities in 1935. Federal reserve notes formally received legal tender status only under the Coinage Act of 1965.[23] It is only since then that the notes show the following print: 'this note is legal tender for all debt, public and private'.

Federal Reserve notes show up as a liability in the books of the FRB that issued these notes. Each note shows the seal of the Federal Reserve Bank through which the note was issued and a letter-number combination which is unique for each of the twelve FRBs.[24] The notes also

[21] One of the nine directors of each FRB (to be exact: one of the class C directors) is appointed *Federal reserve agent* by the Board of Governors. (FRA (1988), Section 4(20)) Federal reserve banks apply for Federal reserve notes through the Federal reserve agent, who checks whether these notes are backed by sufficient collateral. (FRA (1988), Section 16(2).)

[22] Formulation of FRA of 1913. In March 1933 the United States abandoned the gold standard, with the purpose of allowing the dollar to depreciate. In January 1934 Congress passed the Gold Reserve Act, placing the United States on a *gold-bullion* standard internationally and on an irredeemable paper standard domestically. The 'gold clauses' in domestic contracts were voided by Congress and the reference to redemption in gold was dropped from Section 16 of the FRA. The last sentence of Section 16 would henceforth read: '[Said notes] shall be redeemed in lawful money on demand at the Treasury Department [in Washington D.C.] or at any Federal reserve bank.' Lawful money was defined as gold and silver coin, greenbacks, gold certificates, silver certificates and Treasury notes of 1890 (Studenski and Krooss (1963), p. 259.) Right after passage of the Gold Reserve Act president Roosevelt, by proclamation, set the gold content of the dollar at 59 percent below its former value. (Studenski and Krooss (1963), p. 383-390.) Congress appropriated $ 2 billion of the valuation gain resulting from the dollar depreciation to the Exchange Stabilisation Fund (ESF); $ 1.8 bln of that was later used to fulfil the (national currency part of the) initial U.S. quota subscription to the IMF.

[23] M. Mayer (2001), p. 73-74. Congress still hesitated to impose 'paper money' on the public.

[24] The letter-number combination is an obligation following from Section 16(3) of the FRA. The seal of the individual Federal Reserve Banks has disappeared from the design of the new 5, 10, 20, 50 and 100 Federal Reserve notes. It is replaced by a seal of the "Federal Reserve System" (which is remarkable because the FRS is not a legal entity). **(One could envisage the same for a future design of euro banknotes, showing the name not of the ECB, but of the eurosystem, especially if the eurosystem would be given a formal legal basis by being defined and mentioned in the Treaty. At present the term eurosystem is only defined in the Glossary of the ECB's Annual Report.)**

show the seal of the Treasury, and carry on both sides the words THE UNITED STATES OF AMERICA. Banknotes are circulating freely through the system. When taken in by an FRB, they are not shipped back to the FRB of issuance. They remain an outstanding liability of the issuing bank (though in the balance sheet presentations cash held in their vaults is deducted from the circulation figures). The Reserve Banks package the fit notes for recirculation and destroy the unfit ones in their processing offices. The original requirement of sorting by bank of issue and returning the banknotes to the FRB of issue was eliminated by act of Congress July 19, 1954. In the words of former Federal Reserve Bank vice president Moore[25]: 'After all, they were all Federal Reserve notes, and the Reserve banks were in sufficient financial condition that the question of note liability was not critical to any one bank. At least in practice they were all liabilities of all of the Fed banks.' Therefore, these notes are *de facto* **fungible**.[26] A formula based on the Reserve Bank distribution of outstanding notes is used to update the balance sheet so that the notes destroyed are accounted for in the same proportion as issued notes.[27]

Comparing the Fed and the ESCB

Though the eurosystem is in many respects comparable to the FRS, one striking difference is that in the FRS the System's assets (or at least a large part of them) are apportioned over the balance sheets of the FRBs, but not the banknotes; in the eurosystem it is the other way round: the banknotes are apportioned and not the assets. The fact that the eurosystem assets are not apportioned is due to the decentralized execution of monetary policy, while the apportioning of banknotes has been triggered by the wish to allocate part of the issued banknotes to the ECB (a factor not into play in the US, where in contrast the Board of Governors is not empowered to 'own' monetary assets or liabilities). On the operational side the differences in the area of banknotes are minimal though: both the FRBs and the NCBs circulate banknotes, fulfilling the demands of the banks and the public. Printing is in government hands in the US and partly public sector, partly private sector organized in the eurosystem. In both the FRS and the eurosystem fungibility of banknotes issued by the different local central banks follows from practical arrangements.

II.1 HISTORY: DELORS COMMITTEE

The Delors Committee did not discuss the issue of banknotes, probably because it was considered to be self-evident that issuing banknotes would be one of the tasks of the central bank system. However, there was some discussion on the timing of the appearance of the new currency. First, the Delors Committee had discussed and rejected the idea of a parallel currency. A parallel currency co-exists with other national currencies. However, such a road was considered to be full of pitfalls. See the contribution of Duisenberg in the Appendix with the Delors Report. To make this absolutely clear the Committee started using the word *single currency*. The term 'common currency' was considered too ambiguous, because a common

[25] C. Moore (1990), *The Federal Reserve System: a history of the first 75 years*, p. 37.
[26] **Fungibility** between banknotes issued by different FRBs would anyhow seem to be an ephemeral problem in practice, as the notes can be redeemed at the Treasury Department (see footnote 22).
[27] FRA (1988), Section 16(3), second and third sentence.

currency can also be used to refer to a parallel currency. The Treaty would also use the word 'single currency' - see for example Article 3a(2) and Article 109L(4).
Second, the Delors Committee defined the irrevocable locking of the parities as the real start of monetary union. A draft version of January 1989 of the Delors Report[28] stated the introduction of a single currency would be possible 'only some time after exchange rates had been locked and when market forces had fostered a spreading use of the ECU in commercial and financial transactions'. A later draft[29] stated that 'the replacement of national currencies by a single currency would take a certain time.'
Leigh-Pemberton then proposed to insert the notion of replacing the national currencies 'as soon as possible', the main reason being it would lend greater international credibility to the new currency (by clearly showing the irrevocability of the process), while at the same it would reduce transaction costs. The proposal of the UK governor was readily accepted, because it made even more clear that the purpose was not to create a parallel currency, but to start a new, single currency. Section 23 of the final Delors Report was redrafted to read that 'the replacement of national currencies by a single currency should therefore take place as soon as possible after the locking of parities'.
However, section 58 in the final Report remained unchanged, stating that 'In the course of the final stage the national currencies would eventually be replaced by a single Community currency.' This left the timing of the revocation of national currencies once the euro was introduced somewhat in the open.

II.2 HISTORY: COMMITTEE OF GOVERNORS

A first reference to banknotes appeared in the second version of the draft ESCB Statute dated 22 June 1990, which at that stage was only being discussed at the level of the Alternates of the
Committee of Governors. Banknotes were referred to in Article 3.1, first indent and in Article 15:

"Article 3 (Basic Tasks)
3.1. The basic tasks of the ESCB shall be:
- to issue notes [and coins] which shall circulate as means of payment within the Community;
- ..... "

"Article 15 (Notes [and coins])
15.1. As provided by the Treaty, the ESCB shall have the exclusive right within the union to issue notes [and coins] in the Community.
15.2. Except for a transitional period during which notes [and coins] denominated in national currency can circulate alongside the Community currency, the latter shall be the only legal tender."

draft 22 June 1990

[28] CSEMU/10/89, 31 January 1989, section 6.
[29] CSEMU/14/89, 31 March 1989, section 24.

The issuance of coins was put between brackets, because this competence traditionally belongs to the government, but at least some central banks felt the need to control the volume of coin circulation. Apart from this, the UK side had expressed the wish to retain the right for some commercial banks in the UK to issue bank notes.

During the governors' meeting of 10 July 1990, de Larosière sought confirmation that Article 3.1[30] would allow for the possibility that banknotes could be issued by national central banks for some time at the beginning of Stage Three, before a single currency was available. In his view progress towards the issue of single currency banknotes would take time. Chairman Pöhl said he could conceive of such a system, but added the amount of cash in circulation would have to be under the control of the central institution. Other governors pointed out that the amount of notes in circulation would always be demand determined (and not supply determined) and would not necessarily be the same throughout the Member States. According to Leigh-Pemberton the purpose of the provision was only to 'enable' the System to issue banknotes, whereas the extent to which the System could do so would be governed by the primary objective of price stability. Irish governor Doyle suggested note issuance could best be discussed only under Art. 15 (then the first article of chapter IV of the Statute on Monetary Functions and Operations), after which the governors decided to drop the reference to note issuance from Article 3.1. (The second indent was dropped all together.)

The version of 13 July 1990 of the draft ESCB Statute would read:

"Article 15 - Notes

15.1. As provided by the Treaty, the System shall have the exclusive right to issue notes in the Community.

15.2. Except for a transitional period during which notes denominated in national currency circulate alongside the Community currency, the latter shall be the only legal tender."

draft 13 July 1990

The reference to coins was dropped, but would reappear in the version of 5 September 1990. In August 1990 the legal experts of the NCBs were asked for an opinion on a variety of issues, among which the legal status of national currencies at the beginning of Stage Three. Their report contained the following text on bank note issuance:[31]
'[The (central institution) shall have the exclusive right to issue notes in the Community which shall be the only legal tender. Any transitional provisions concerning the legal tender status of national currencies shall be regulated according to the Community legislation.]'

The Secretariat of the Committee of Governors produced a new draft version of the ESCB Statute, dated 5 September 1991, which read as follows:

"<u>Article 15</u> - <u>Notes and coins</u>
15.1 The Council [of the ECB] shall have the exclusive right to authorise the issue of notes in the System which shall be the only legal tender. ./.

[30] Version of 3 July, see p.78 above.
[31] Report by the Legal Experts, 31 August 1990.

15.2 Provisions concerning the legal tender status of Community currencies shall be regulated according to Community legislation. The Council [of the ECB] shall make the necessary arrangements for the exchange of notes denominated in Community currencies by the national central banks at par value.
15.3 The volume and denomination of coins issued within the Community shall be subject to approval of the Council of the System. The coins [shall] [may] be put into circulation by the System."

draft 5 September 1990

We see that in paragraph 1 the words 'to authorise' were added. These words were meant to protect the System against indiscriminate issuance of notes by an NCB. (At the same time the sentence seemed to leave the right to authorize non-legal tender to others.) The introductory paragraph to chapter IV of the Statute (called 'Monetary Functions and Operations'), of which Art. 15 was the first article, shed light on the question as to who the drafters considered should distribute the notes (and coins). This introduction read: 'As drafted, the text does not prejudge the question of whether operations are carried out at the level of the central institution or at the level of the NCBs. The precise distribution of tasks may evolve over time with due regard to the principle of subsidiarity.'
The second paragraph refers to the situation when national currencies continue to exist. The arrangements for the exchange of notes by national central banks at par value and without any cost are designed to ensure full substitutability between the national currencies.[32] On coins the Committee of Governors did not claim the right to issue them, as this was traditionally a competence of Finance Ministries, instead it claimed that both the volume and denomination of coins issued within the Community, to be decided upon by the Council of Finance Ministers, should be subject to approval by the ECB. [33] Paragraph 1, relating as it does only to banknotes, does not exclude the possibility of giving legal tender status to (a limited amount of) coins.

Interesting changes, from our point of view, took place after 25 September 1990. During the summer the legal experts had concluded that 'decisions, advisory functions and operations' could not be attributed to the System, because the System would not have legal personality.[34] Where relevant 'System' was to be replaced by 'ECB and NCBs'.[35] (This led de Larosière, the French governor, to emphasize even more strongly than before the principle of subsidiarity - see Art. 12.1c, section II.2.) These changes were introduced in the draft version of 8 October. Art. 15.1 did not contain a reference to the System as an actor, but only in terms of geography ('the issue of notes in the System'). This was replaced by 'the issue of notes **within the Community'**. (The article was also renumbered into Art. 16.) In the version of 25 October a new sentence appeared, which according to the commentary added by the Secretariat aimed to clarify that the notes issued by the ECB and the NCBs would be the only

[32] Commercial banks would be free to charge commissions to cover transaction costs but it was expected that competition would reduce these to a level not significantly higher than that for transactions in a single currency. See Commentary accompanying the draft ESCB Statute of 27 November 1990.
[33] Complementary legislation under Art. 104-EC would limit coin-holding by the ECB and the NCBs in order to avoid significant lending to the issuers of such coins (which would amount to monetary financing).
[34] See Art. 1-ESCB, section II.2, especially footnote 41.
[35] See Art. 1, section II.2.

legal tender with unlimited legal tender status. This was a complex way of saying that coins (the other legal tender) would not have unlimited tender.[36] However, the sentence also attributed note-issuing competence to the ECB.[37] And by taking out the reference to legal tender in the first sentence it gave the ECB Council full authority over the issuance of also non-legal tender notes, which had been unclear in the version of 5 September.

The draft version of 25 October read (new sentence underlined):

"Article 16 - Notes and coins
16.1 The Council shall have the exclusive right to authorise the issue of notes within the Community. The notes issued by the ECB and the national central banks shall be the only legal tender for any amount.
16.2 [unchanged]
16.3 [unchanged]

draft 25 October 1990

During the Governors' meeting on 13 November Duisenberg pointed out that in the Netherlands current accounts with commercial banks ('book money') were legal tender as well.[38] As a result, it was agreed that the second sentence of Article 16.1 were to be replaced by:

"16.1, second sentence
The notes issued by the ECB and the national central banks shall be the only notes
to have legal tender status."

draft 15 November 1990

At the same time the (confusing) reference to 'unlimited' legal tender was dropped.

In the end Article 16 on Notes and coins of the final draft ESCB Statute of 27 November 1990 would read:

" 16.1 The Council shall have the exclusive right to authorize the issue of notes within the Community. The notes issued by the ECB and the national central banks shall be the only notes to have legal tender status.

./.

[36] Money usually is unlimited legal tender, but there are exceptions with regard to 'small change' (usually there is a limit up to which one has to accept payment in the form of coins) and with regard the large denomination banknotes. For instance in the Netherlands many gas stations depicted a note on the door expressing they do not accept 1000 guilder banknotes. It would force them to keep too large cash balances, which would create a security risk.

[37] According to Hans-Peter Scheller, a leading member of the Secretariat, the formulation was deemed necessary to prevent possible legal battles or even the need for a Treaty change in case one were to decide that the ECB would issue banknotes. Source: Oral information by Hans-Peter Scheller, April 2000. At stake was not the note-issuing capacity of NCBs, as most governors had in mind that the System would probably start with the NCBs still issuing their national banknotes. See also Art. 52-ESCB for the exchange of banknotes in Community currencies during the transitional period and Council Regulation (EC) No 947/98 of 3 May 1998 on the introduction of the euro.

[38] Section 6:114 of the Netherlands Civil Code holds that payment through the banking system is a valid means of discharge of a monetary debt unless the creditor has validly excluded this method of payment.

16.2 Provisions concerning the legal tender status of Community currencies shall be established according to the Community legislation. The Council [of the ECB] shall make the necessary arrangements for the exchange of notes denominated in Community currencies by the central banks at par value.[39]

16.3 The volume and denomination of coins issued within the Community shall be subject to approval of the Council [of the ECB]. The coins shall be put into circulation by the ECB and/or the NCBs.“ [40]

draft 27 November 1990

During the IGC the Commentary was not discussed, because the Commentary is not part of the Treaty text.

II.3 HISTORY: IGC

Under the Luxembourg presidency banknote issuance was discussed at several occasions. During the deputies meeting of 23 April the French (Trichet), Belgian (Snoy) and Irish delegates expressed the view - which did not raise objections - that in stage three in each country both ecu banknotes and its national banknotes should be legal tender, while only banks (and for instance not shopkeepers) would have to accept (and change for free) the banknotes of other MU countries. The draft ESCB Statute, including Art. 16, was discussed during the deputies' meeting on 10 May 1991.[41] Chairman Yves Mersch decided to delete Art. 16.2, relating to the legal tender status of *Community currencies*, from the Statute, because this could be dealt with in the Treaty or in the chapter on transitional provisions (see Art. 52-ESCB on the terms for exchanging notes denominated in Community currencies by the NCBs). The Spanish delegate Conthe argued that there was no need at all, also not in the Treaty, for provisions concerning the legal tender status for the single currency, for Spain had done a long time without. Conthe also stressed that any transitional period during which national currencies would continue to circulate alongside the single currency should be kept short, at most two years, to ensure in the eyes of the public the irreversibility of the process. According to the French Treasurer-General Trichet the Treaty should clarify that the competence to issue coins should lie with the Ecofin Council.

[39] Second sentence of Article 16.2 later to become Article 52 ESCB-Statute. The first sentence would be deleted by the IGC.

[40] This last sentence of Article 16, relating to coin distribution, would not survive the IGC.

[41] The Commission's draft Treaty text of December 1990 served as a guide for the discussion in the deputies IGC under the Luxembourg IGC presidency, but was not discussed in detail. The Commission's draft had mentioned banknotes in two places: Article 106b.1 ("For the purpose of the preceding Article [a reference to the system's objective, i.e. price stability], Eurofed's tasks shall be: - ...; - to issue notes and coins denominated in ecus as the only legal tender throughout the Community, subject to the provisions of Article 109h(2);") and Article 109h.2 ("The Council, acting in accordance with the procedure provided for in paragraph 3, shall adopt, in so far as is necessary, the technical arrangements under which Member States' currencies may provisionally remain legal tender."). As regards banknotes, the French draft Treaty (Projet de Traité, 25 janvier 1991) contained exactly the same wording.

The non-paper of 12 June of the Luxembourg presidency of the IGC showed the following article on notes and coins in the Treaty text (Article 105(2), following on Article 105(1) containing the so-called basic tasks of the ESCB):[42]

"Article 105(2):
The ESCB shall regulate the issue and circulation of notes and coins, which alone shall be legal tender."

non-paper 12 June 1991 [43]

The Luxembourg non-paper also contained a replica of the whole ESCB Statute with only few minor amendments to make the articles consistent with their proposed Treaty language.[44] Art. 16 read:

"Article 16 - Notes and coins

16.1 The Council of the ECB shall have the exclusive right to authorize the issue of notes within the Community. The notes issued by the ECB and the NCBs shall be the only notes to have legal tender status.

16.2 The volume and denomination of coins issued within the Community shall be subject to approval by the Council of the ECB. The coins shall be put into circulation by the ECB and/or NCBs."

annex to non-paper 12 June 1991

Article 105(2) did not take into account that in the Netherlands payment with money on bank accounts is also accepted as legal tender. This was corrected in the first draft texts of the Dutch presidency which took over in the second half of 1991.

On 25 September the Dutch presidency presented a new draft text on Articles 105-108. Article 105(2), containing all the basic tasks of the ESCB mentioned in Article 3 of the draft ESCB Statute, now also included the issuing of banknotes.

Article 105(2), fourth indent, read:

" <u>Article 105</u>
2. The ESCB shall
- .....
- have the exclusive right to issue and circulate notes within the Member States; the notes issued by the ECB and the national central banks shall be the only notes to have legal tender status;"[45]

Dutch presidency 25 September 1991 [46]

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[42] An earlier version had appeared in UEM/34/91 of 13 March 1991 (Luxembourg non-paper containing draft versions of Art. 105-108).

[43] UEM/52/91.

[44] For instance the term 'Council' had been replaced by 'Council of the ECB' to avoid any confusion with the Council of Ministers.

[45] Article 105(2) mentioned the ECB has the right to 'issue notes', while Article 16-ESCB Statute mentions the right 'to authorise the issue of notes'. This is probably due to an oversight and would be corrected in the next official draft version.

[46] UEM/66/91.

Article 105(2) mentioned the ECB has the right to 'issue notes', while Article 16-ESCB Statute mentions the right 'to authorise the issue of notes'. This was probably due to an oversight and would be corrected in the next official draft version.
In order to be consistent the Dutch presidency's version of Article 16 of the draft ESCB Statutes included a cross-reference to Article 105(2)-EC:

"Article 16 - Notes
In conformity with Article 105 par. 2 of the Treaty, the Governing Council shall have the exclusive right to authorise the issue of notes within the Member States. The notes issued by the ECB and the national central banks shall be the only notes to have legal tender status."

Dutch presidency 26 September 1991 [47]

Unlike Art. 16-ESCB, Art. 105 does not specify that it is the Governing Council which authorizes the banknote issuance, because the monetary chapter of the Treaty follows a generic approach, i.e. referring to the ESCB and ECB (of which the Governing Council is the highest decision-making body).[48] The Dutch presidency dropped the reference to coins, arguing that the issuance of coins should be, in line with the existing procedures in most of the Member States, a responsibility of the Council of Ministers rather than of the ECB and coins were of minor monetary importance anyhow. This view would be validated by a majority in the IGC. Henceforth coins would be dealt with in Art. 108, par. 4 (later par. 3). For the final version of Art. 108(3), see footnote at the end of this section.[49]
During the summer the Dutch Finance Ministry had experimented with replacing all articles of the Statute which were also mentioned in the Treaty by a simple cross-reference to the relevant Treaty article, without specifics on the content.[50] This experiment was - among others after urgent request from the Dutch central bank - not pursued, but in the process Art. 16 had slipped back - unnoticed by anybody - as the last article of Chapter III of the ESCB Statute (Organization of the System), instead of the first of Chapter IV on Monetary Functions and Operations.
During the meeting of the EMU Working Group on 17 October 1991 the relevant provisions were also discussed. France, supported by Portugal, proposed that a ceiling for the issuance of banknotes should be provided for in secondary legislation (i.e. at the level of the Ecofin). Other delegates rejected this as not making any economic sense (the volume of banknotes being demand determined) and as conflicting with the ECB's monetary autonomy.

[47] UEM/67/91, dated 26 September 1991.
[48] See Art. 12.1-ESCB, second and third paragraph, in cluster III for the division of labour between the Executive Board and the Governing Council.
[49] The Dutch presidency had thus also suppressed the approval by the ECB of the volume of coin issuance. However, this requirement would reappear in the consolidated draft Treaty version of 22 November 1991 (UEM/112/91).
[50] For instance, Art. 7-ESCB had read: 'The independence of the System is set out in Art. 107 of the Treaty.'

An important document is the Dutch draft Treaty text of 28 October 1991 (UEM/82/91). The banknote task had been taken out of the list of *basic* tasks (Art. 105(2)) and was now referred to in a separate paragraph 4 of Article 105:[51]

"105.4 The ECB shall have the exclusive right to authorise the issue of notes within the Member States. The ECB and the national central banks may issue notes. The notes issued by the ECB and the national central banks shall be the only legal tender notes within the Member States."

Dutch presidency 28 October 1991

The second sentence is new. According to an internal document of the Dutch presidency this sentence was added, because the right of the ECB to issue banknotes 'had not been specified elsewhere in the Treaty.'[52] The words 'within the Member States' had been added to the third sentence to indicate the banknotes would have legal tender status in all Member States. (This had raised problems with the Spanish delegation during an earlier meeting.) These changes were also copied into Art. 16 of the ESCB Statute. In subsequent drafting, 'notes' was to be changed into 'bank-notes' and 'Member States' was changed into 'Community'.[53]
During the meeting of the Working Group EMU on 27 November 1991 the presidency made a concession[54] to the UK, by adding to Article 16-ESCB and Article 105(4)-EC the following sentence:

"105.4 (last sentence) In carrying out these functions, the ECB shall respect as far as possible regional traditions." [55]

Dutch presidency 28 November 1991[56]

During the same meeting the Working Group rejected the UK request to introduce the explicit freedom for Member States/central banks to determine the effigies on the banknotes. That would have allowed the British authorities to tell their population that entering Monetary Union would not necessarily imply that the portrait of the Queen would disappear from the notes and coins issued by the British authorities. This matter was referred to the meeting of the deputies IGC, which met on 30 November. Again, a majority opposed the British requests. A majority of delegations also proposed to refer the sentence on respecting regional traditions to a (non-binding) Declaration.[57] This forced British Finance Minister Lamont to raise the

[51] Paragraph 3 contained a derogation to paragraph 2, allowing governments to hold a small amount of foreign exchange in the form of working balances.
[52] Internal note of the Dutch Ministry of Finance (IMZ/nr. 91-1976), dated 16 October 1991.
[53] The problem of derogation countries (which are part of the Community) was to be solved through a special article for derogation countries.
[54] This concession however would subsequently be contested at the deputies' meeting of 30 November 1991 where a majority of delegations favoured putting this sentence into a Declaration. However, the UK insisted on having this in the Treaty.
[55] The British delegation would have liked the following, stronger formulation: 'In doing so, the ECB shall respect as far as possible regional and national rights and traditions.'
[56] UEM/118/91.
[57] 'The ECB shall respect as far as possible existing practices regarding the issuing of bank-notes within the United Kingdom.' (Revision to UEM/118/91 - Conclusions of the meetings on 30 November 1991.)

issue again during the ministerial IGC of early December. During these final negotiations the UK succeeded in having the following sentence inserted in the Treaty:

"105.4 (last sentence)
The ECB shall respect as far as possible existing practices regarding the issuing and design of bank-notes."

early December 1991

In the end this particular sentence was not included in Article 105a, for being too specific for a main Treaty text. Instead it was added to Art. 16 of the Statute. Furthermore, the phrase 'the only notes to have legal tender status' would be changed into 'the only such notes to have legal tender status'.[58]

The full final texts read as follows:

Article 105(4)-EC:
"The ECB shall have the exclusive right to authorize the issue of bank-notes within the Community. The ECB and the national central banks may issue such notes. The bank-notes issued by the ECB and the national central banks shall be the only such notes to have legal tender status within the Community."

Article 16-ESCB:
"In accordance with Article 105 paragraph 4 of this Treaty, the Governing Council shall have the exclusive right to authorize the issue of bank-notes within the Community. The ECB and national central banks may issue such notes. The bank-notes issued by the ECB and the national central banks shall be the only such notes to have legal tender status within the Community.

The ECB shall respect as far as possible existing practices regarding the issuing and design of bank-notes."

10 December 1991

This was the text approved at Maastricht. During the nettoyage juridique early 1992 paragraph 4 of Article 105, relating to banknotes, and paragraph 3 of Article 108,[59] relating to coins, were put together to form a new Article 105a.

One could wonder why the UK was so successful on this issue at the last moment. One possible explanation is that the Dutch chairmanship wanted to minimise the risk that John Major would refuse to sign the whole Treaty. The item was probably considered small change for getting an overall agreement, which in the end was not reached, because the UK negotiated an opt-out clause. On the other hand, the UK did not block the other countries to

[58] UEM/118/91, late November 1991.
[59] Article 108(3), relating to coin issuance, as approved in Maastricht read: "Member States may issue coins subject to ECB approval of the volume of the issue. The Council may, acting by a qualified majority on a proposal from the Commission and after consulting the ECB and in cooperation with the European Parliament, adopt such measures to harmonize the denominations and technical specifications of all coins to the extent necessary to permit a smooth circulation of coins within the Community."

go ahead, which had been feared as a possible outcome until the very last moment by the Dutch presidency.

Articles 17-24 (Chapter IV):

Chapter IV: Monetary Functions and Operations [1]

(to be read in conjunction with Art. 1-ESCB (Constitution); Art. 2-ESCB (Objectives); Art. 3.1-ESCB (Basic tasks); Art. 12.1c-ESCB (Decentralized execution))

I. INTRODUCTION

I.1 *General introduction and history*

Chapter IV, containing articles 17 to 24, of the ESCB Statute describes the instruments available to the System in a relatively generic way. The articles are formulated in such a way, as to leave open who should conduct the transactions. Chapter IV should therefore be read in conjunction with Art. 12.1c dealt above, which imposes a strong bias in favour of operating through the NCBs. The articles of chapter IV cover the following topics: Accounts with the ECB and the NCBs (Art. 17), Open market and credit transactions (Art. 18), Minimum reserves (Art. 19), Other instruments of monetary control (Art. 20), Operations with public entities (Art. 21),[2] Clearing and payment systems (Art. 22), External operations (Art. 23), Other operations (Art. 24).

As regards the **history** of the articles the following could be noted. The Delors Committee did not pay attention to specific instruments of the System, the Committee of Governors did. This Committee described the instruments only in a generic fashion, because 'the precise distribution of tasks [= execution of operations] may evolve over time' (words used in the draft version 3 July 1990). The same draft Statute already contained the notion of decentralization, which was referred to as the principle of subsidiarity.[3] This principle was captured in Art. 13 of the draft Statute – which was later developed into Art. 12.1c – and was also mentioned in the general comments applicable to chapter IV. In their first drafts the governors had attached the instruments to the System. However, after the summer the governors decided not to attach legal personality to the System, but only to its constituent parts (i.e. the ECB and the NCBs). Following this and for legal reasons they replaced the word 'System' by ECB and/or NCBs in many places, inter alia in chapter IV. The articles now referred explicitly to the NCBs, which made some governors feel uneasy, as this stated the obvious and in fact weakened the position of the NCBs, in the sense that ECB and NCBs were now put at par. Or in the words of the draft Statute of 3 July 1990:[4] 'Although NCBs are already authorized under their present statutes to perform many of the operational functions mentioned in this chapter, reference is made to them [and not only to the ECB] in this chapter in order to reaffirm that they have the necessary operational powers for executing the

[1] We refer to the annex for the text of the articles of Chapter IV of the ESCB Statute.
[2] Art. 21 is dealt with in cluster I, as this article is relevant for the relation between the ESCB and the political (fiscal) authorities.
[3] General comments with chapter IV.
[4] Comments to chapter IV of the Commentary to the final draft Statute of 27 November 1990.

System's tasks, and to indicate the areas in which operational procedures may need to be harmonized.' This led to increased efforts to strengthen the wording of the decentralization article – see Art. 12.1c, section II.2. The instruments were defined in a generic way, because (1) the future circumstances under which the System would operate were unknown and (2) a generic definition increased the independence of the ESCB vis-à-vis the political authorities, because the System does not have to revert to the political authorities for getting approval for new instruments, the need for which might develop over time. See also the EMI's Annual Report over 1992 (p. 58): 'The manner in which the single monetary policy is to be conducted is not defined in the Statute of the ESCB. A large margin of discretion is left to the ECB, which will allow it considerable flexibility to adjust its methods to the prevailing circumstances, as the conditions under which it will operate cannot yet be fully ascertained.'

In general we note that the governors had postponed the decision to allocate the operational tasks over the ECB and the NCBs. At the same time they clearly left that decision to themselves (i.e. the Governing Council), and not to the political authorities or to the Executive Board, as they knew they would have a majority in the future Council of the ECB. It should finally be noted that Art. 18.2 of the Statute allows the ESCB to specify the procedures – including the division of labour – for the System's monetary operations. This has resulted in the so-called 'General Documentation on the ESCB monetary policy instruments and procedures'. The governors have translated the principle of decentralization into the rule that banks were not allowed to have accounts with the ECB, but only with NCBs, while they also decided that banks would only be allowed to borrow liquidity from their own NCB – thus ensuring a continuation of the existing operational roles of the NCBs as much as possible, while at the same time providing for an effective way to execute monetary policy.[5] (Banks are allowed to hold *payment accounts* with other NCBs.) The fact that the ECB holds foreign exchange reserves means it has to hold foreign currency with (usually foreign) banks. The euro leg of forex transactions (e.g. buying dollars against selling euros) will by necessity take place through the books of one of the (euro area) NCB. Local events, like tax payments to the Treasury or other country specific events, could in theory cause interest rates diverge between countries. To prevent this, the central banks decided in 1993 to build TARGET, the Trans-european Automated Real-time Gross settlement Express Transfer system, allowing for real-time cross-border fund transfer, the equivalent of the American Fedwire.[6] This cross-border real-time interbank payment system ensures equal interest rates levels in the interbank market, i.e. . the market where cash balances held at the central bank are traded between banks and the interest rate the central banks are best able to influence directly.[7]

[5] See chapter 8.3 for an overview of the division of labour between the ECB and the NCBs and section II below.
[6] For Fedwire, see Art. 12.1c, section I.2, footnote 6.
[7] Back in 1990 central banks were not convinced that interest rates would be equalized through arbitrage by banks. One idea not outright rejected these days and supporting an indispensable role for the NCBs in the execution of monetary policy was to share out the global amount of central bank money, decided upon by the centre, among the NCBs on the basis of perceived local needs. The NCBs would distribute this liquidity over their local banks (through tender procedures). However, it was not clear that this would guarantee a continuous single monetary policy stance. Report by the Monetary Policy Sub-Committee of the Committee of Governors (MON/90/02, August 1990).

I.2 *Relevant features of the Federal Reserve System*

The operational functions of the Federal Reserve System rest with the Federal Reserve Banks. These functions are described in Sections 13-16 and 19 of the Federal Reserve Act.[8] Many of these functions though are subject to 'such restrictions, limitations and regulations as may be imposed by the Board of Governors.' [9] All decisions on open market policy, including the location of these operations, are taken by the FOMC. The local discount window was initially considered the main monetary policy (liquidity) channel, but was soon overtaken by the open market operations (OMOs). In fact, the use of the discount window was soon discouraged – see [Art. 12.1c, section I.2]. This development had not been foreseen by Congress in 1913, while the Board had some say over the discount rate, but it had no formal say over the size of the OMOs. [10] Only in 1933 and 1935 would the FRA be amended to take full account of this development, primarily by giving the Board of Governors a formal role in the steering of the OMOs through their membership of the FOMC – see appendix 1. OMOs had de facto already been concentrated in New York – the FOMC followed this practice by selecting (every year) New York as the location for conducting OMOs.[11] The Fed uses *outright* and increasingly also *reverse* open market transactions, i.e. with a buy- or sell-back obligation. In both cases auctions are used among 30 specialized dealers (both banks and non-bank security firms). These dealers are mostly located in New York, a network of telephones and wire services linking them to customers regardless of their location, thus forming a nationwide market. The Fed has also specific responsibilities in the area of payment services – see appendix 2.

Comparing the Fed and the ESCB

In theory the ESCB Statute could accommodate the same division of labour and operating procedures as within the FRS, including the concentration of operations at one NCB (with even the ECB carrying out its forex transactions as much as possible through this NCB). However, this is unlikely to happen. In Europe there is no tradition of primary dealer systems; NCBs used to deal directly with all their banks. This practise was continued in EMU, with OMOs being directed from the centre, but conducted locally. As a result the ESCB conducts OMOs with many more counterparties than is the case in the US.[12] An important difference between the Fed and the ESCB is that in the FRS the division of labour is determined in the law (the FRA), which allows no operational role for the centre. In the ESCB the decision as to the division of labour is taken not by the Statute, but by the Governing Council. And in

[8] See also Art. 12.1c, section I.2 above. For a general description of the Fed's monetary policy instruments and procedures, see Board of Governors (1994), p. 94-111. For an overview of the services provided by the FRBs, see the Board's *Annual report* 2001, p. 181 and M. Mayer (2001), chapter 12.
[9] Example taken from FRA (1988), Section 13(10).
[10] Kettl (1986), p. 45.
[11] To be precise, the New York Fed is appointed manager of the System Open Market Account (**SOMA**) The assets contained in SOMA are owned by the FRBs. This is reflected by the fact that these assets show up on the balance sheets of the FRBs, to which they are apportioned according to a certain key. This does not have income consequences, because the net profits of the FRBs flow to the Treasury anyhow. In the ESCB there is no 'need' for only one open market account – this also means there is no need to apportion the assets. However, in order to prevent monetary policy decision-making in the Governing Council becoming polluted with possible income considerations the seigniorage of the NCBs is reallocated over them under Art. 32-ESCB. See also Art. 16-ESCB, section I.2 above.
[12] See Art. 12.1c, section I.2, footnote 7.

contrast to the U.S. the centre is potentially allowed to execute each typical central bank transaction itself. The Governing Council decides on this. The Governing Council also decides on the operational procedures, in the US this is commissioned to the Board of Governors.

The **ESCB** also provides most of its liquidity through open market operations (mostly on reverse transactions based on tender (auction) procedures with a weekly frequency).[13] Outright transactions, which are the exception, are also conducted by NCBs, or in exceptional circumstances by the ECB, which then seeks contact with one or a few counterparties which are listed as counterparties eligible for fine-tuning operations. Foreign reserve interventions are conducted by the ECB, though the 'euro leg' of the transactions is settled by necessity through the books of NCBs, because banks do not hold accounts at the ECB.

II.1 Description of the articles

Below we describe the content of each article (together forming the ESCB's 'toolkit') and the operational procedures laid down in the General Documentation, showing the current division of labour between the NCBs and the ECB. We will see that the ECB has in practice no role in the execution of 'daily' monetary policy. Banks do not have accounts with the ECB, but only with NCBs. The ECB's operational role is limited: the ECB has an operational ('front-office') role in the monetary area only in exceptional circumstances (in the form of bilateral fine-tuning operations) (see Art. 18); it offers settlement facilities to two private sector organizations (Art. 17 and 22); it has a role in the payment systems oversight of these two organizations; and it conducts the System's foreign exchange interventions (Art. 23 and 30). In this section we focus on the present, and less on the genesis, though we will touch upon some specific issues that were discussed during the drafting process and that had a bearing on the division of labour.

Article 17 allows the ECB and the NCBs to open accounts for credit institutions, public entities and other market participants and to accept assets as collateral. A central bank that offers a financial service, like offering a payment account, to a bank from its own country has to offer such account to banks from other EU countries as well, Community legislation prohibits them to discriminate. However, banks can only obtain credit from their own central bank; in other words **remote access (read: cross-border access) to central bank credit** is not allowed. This is based on a decision of the Governing Council, contained in the ECB's *General Documentation*.[14] Most NCBs feared that otherwise all monetary transactions might flow to one or two of the large financial centres, if remote access to monetary credit would be allowed. NCBs would then lose contact with important parts of the market, which would be detrimental to their other functions, like effectively preparing the Governing Council's monetary policy discussion for their president, as well. The Governing Council also decides

[13] For a thorough overview of the ESCB's instruments and how they function in practice, see Hans Peter Scheller (2000), chapter 7.

[14] Section 2.1 of the *General Documentation* reads: 'Institutions may access the ESCB standing facilities and open market operations based on standard tenders only through the national central bank of the Member State in which the institution is established.'

which services the **ECB** may offer to market participants. The basic line is that the ECB only offers non-standardised services which are not already offered by other euro area NCBs. An example is the settlement account for the EBA Euro Clearing System (a transfer and netting system of a number of commercial banks).

Article 18 allows the ECB and the NCBs to conduct all the typical central bank transactions with other parties. A distinction is made between open-market (either outright or under repurchase agreements) operations and lending activities. Lending has to be based on 'adequate collateral'. The *IGC* decided in favour of a collateral requirement, after the *Committee of Governors* had been unable to agree on this issue, most of the governors valuing flexibility in case of emergencies, while some were less lenient (wishing to protect the System against credit risk). The decision also implies NCBs cannot be 'forced' into lending of whatever kind without adequate security. For domestic monetary policy operations 'eligible' collateral has been defined in a limitative sense in the *General Documentation*.[15] This also means that a central bank when extending emergency liquidity assistance (ELA) to one or more individual institutions does not need the approval of its shareholder (usual the Minister of Finance), because their lending to the institution(s) with liquidity problems does not put the NCB's capital at risk.[16]

Art. 18.2 requires the ECB to publish its main rules of the game: 'The ECB shall establish general principles for open market and credit operations carried out by itself or the NCB[….]'[17] This led to the publication of the *General Documentation on the ESCB's monetary instruments and operations*, which was prepared by the EMI and approved by the Governing Council in 1998. [18]

This General Documentation provides that reverse transactions[19] are the main instrument to provide liquidity to the banking system. These regular open-market refinancing transactions are conducted using system-wide tender procedures. Subscriptions are collected through the NCBs, the allotment decision is made at the ECB (Executive Board) and the liquidity is provided to the banks by the NCBs. The interest rate is decided by the Governing Council at their two-weekly meetings, one of which (*viz.* the first meeting of the month) is devoted to monetary policy, though the other meeting can also be used to change interest rates. All transactions are executed in a *decentralized* manner, the only possible exception being bilateral fine-tuning reverse transactions, which under exceptional circumstances (to be decided by the Governing Council) may be engaged upon by the **ECB** - in which case the ECB contacts a counterparty for the purpose of engaging in a transaction, the settlement of which would still take place through the books of an NCB. NCBs offer two standing facilities, which are permanently available for eligible counterparties, *viz*. a deposit facility and a marginal lending facility, at rates respectively below and over the main refinancing operations (MROs) rate). These rates constitute a corridor for the short-term interest rates. Only strong

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[15] *General Documentation*, sections 6.1-3. See also under Art. 3.1, section I.1, above.

[16] Here ELA is defined as a System function.

[17] Like in Art. 6 we see an example of 'ECB' used in two meanings: the ECB as decision-maker (= Governing Council) and the ECB as operational arm of the System.

[18] *General Documentation*, section 1.6: 'The Governing Council of the ECB may, at any time, change the instruments, conditions, criteria and procedures for the execution of ESCB monetary policy operations.'

[19] Reverse transactions refer to operations where the ESCB buys or sells eligible assets under repurchase agreements or conducts credit operations against eligible assets as collateral.

expectations of imminent changes in the rates for refinancing operations (refi-rates) could lead interest rates to move outside this corridor.

Article 19 empowers the ECB (read Governing Council) to impose minimum reserves which *credit institutions* have to hold on accounts with the ECB and NCBs. The Governing Council determines both the level of reserves (up to a maximum determined by the Council of Ministers)[20] and the level of remuneration (which could be below the prevailing market rate). In line with the foregoing the *General Documentation* determines that each credit institution must hold its minimum reserves on one or more reserve accounts with the NCB in the Member State in which it is established.[21] Shortly after the establishment of the ECB in July 1998, the Governing Council announced it would apply a minimum reserve ratio of 2 per cent over the predetermined liability base, which reserves would be remunerated at the rate of the ESCB's main refinancing operations. The ESCB's minimum reserve system enables counterparties to make use of averaging provisions, because compliance with the reserve requirements is determined on the basis of the average end-of-day daily balances on the counterparty's reserve account over the one-month maintenance period.[22] For this reason reserve accounts are well suited to be used as payment account. The averaging provisions have a smoothing effect on the interest rate development, because they act as a shock absorber.

Article 20 allows the Governing Council to introduce 'other operational methods of monetary control'. It is not clear which methods the drafters had in mind. Nonetheless, given the restriction imposed by the last sentence of Art. 2-ESCB, which obliges the System to respect the principle of an open market economy with free competition, it would seem very unlikely that this article could be used to introduce direct controls (e.g. quantitative credit limits).[23] In any case, if any 'other operational method' were to impose obligations on third parties, Council regulation (secondary legislation) will be necessary. The article does not pre-specify who should operate such a possible new tool, the ECB and/or the NCBs, but also here Art. 12.1c would apply.

Article 21 has been treated in cluster I, because of its relevance for the independence of the System. However, Art. 21.2 relates more to this cluster, dealing with the roles of the ECB and the NCBs. In line with the other operational articles, Art. 21.2 allows both the ECB and the NCBs to act as fiscal agents for the entities mentioned in Art. 21.1. In view of the line taken by the Governing Council, as mentioned under Art. 17 above, it would seem unlikely that the **ECB** would offer fiscal agent services to national (or regional) authorities. This limits the range of possible ECB clients to institutions like the Commission and the IMF.

[20] Ecofin legislation is necessary to specify the basis over which minimum reserves are calculated and the ceiling for the ratio to be applied over that basis (Council Decision 2531/98 of 23 November 1998).
[21] *General Documentation*, section 7.4.b.
[22] *General Documentation*, section 7.1.
[23] Cf. also commentary with Art. 2 contained in the Commentary accompanying the draft ESCB Statute of 27 November 1990 of the Committee of Governors.

According to **Article 22**[24] 'the ECB and NCBs may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries.' Since monetary policy operations are transmitted through the payment systems, of which the central banks form the 'hub' and because failures in payment systems can have major consequences for financial stability, it is appropriate that the ESCB has been given competences in respect of payment systems.[25] The first draft of the Secretariat of the Committee of Governors had read '[t]he ESCB may provide facilities to ensure efficient clearing and payment systems inside the Community and with third countries.'[26] The Committee of Governors added, as suggested by their Monetary Policy Sub-Committee,[27] the word 'sound' ('efficient and sound'). The **ECB** 'may make regulations' to ensure systems are efficient and sound.[28] The reference to 'sound' together with the Governing Council's regulatory power constitute an *oversight function* for the ESCB, which relates not only to the System's own facilities, but potentially to all (national or multinational) payment and clearing systems in the euro area.[29] The exercise of this oversight function (including its regulatory element) does not require secondary legislation.[30]

In practice, all EU NCBs offer real-time gross settlement systems. The RTGS systems of the euro area NCBs are interconnected by common procedures (Interlinking mechanism). They allow for real-time transfer of funds between banks in different Member States.[31] Together these systems form TARGET (Trans-European Automated Real-Time Gross settlement Express Transfer system). The **ECB** disposes over a small ECB payment mechanism (EPM), which is connected to, and forms part of, TARGET. This EPM is for instance used for the transfer of funds to and from NCBs related to foreign exchange market interventions conducted by the ECB. The **ECB** does not provide payment facilities, except for a few special cases, mentioned under Art. 17 above.

As regards the exercise of *oversight*, we quote from a statement of the ECB of June 2000 on this issue: 'In line with the principle of decentralization the enforcement of the policy stance

[24] See also Art. 3.1, fourth indent, dealt with above under Art. 3.1, sections II.2 and II.3.
[25] See R. Smits (1997), p. 297.
[26] Draft version of ESCB Statute of 11 June 1990.
[27] MPSC Report of 14 August 1990.
[28] Regulations are binding and directly applicable - see Art. 34 and 43-ESCB. They are decided upon by the Governing Council.
[29] ECB regulations have primacy over national regulations – like Community law has primacy over national law. While in the area of monetary policy the powers conferred on the ESCB are by nature 'exclusive' (see Kapteyn/VerLoren van Themaat (1999), p. 139), this does not seem to apply to this function of the System. For instance, NCBs may – if authorized to do so by their national central bank law - define policies in areas not specifically covered by the common oversight policy, but these policies have to apply within the framework defined at the Eurosystem level, while the Governing Council always may decide to extend [read: detail] its framework, thus creating a *de facto* 'exclusive' function (see Barents and Brinkhorst (1994), p. 125). From the genesis of the article it follows that during the IGC the UK, supported by France, did not agree with the unrestrained regulatory powers for the ECB, being in their eyes an unnecessary inroad to private sector (read: domestic) competences. In the EMU Working Group the UK proposed to make this regulatory power subject to secondary (i.e. Council of Ministers') legislation, which proposal was not supported.
[30] Article 23 is not listed in Art. 42-ESCB. Cf. R. Smits (1997), p. 304.
[31] TARGET does not include the Real-Time Gross Settlement (RTGS) systems of the out-NCBs. However, their systems are connected to TARGET through bilateral 'private sector' contracts between these NCBs and the ECB representing the owners of TARGET, an important difference being that out-NCBs are not allowed to have at any moment in time a negative position within TARGET vis-à-vis the euro area.

[in the area of common oversight] is, as a rule, entrusted to the NCB of the country where the system is legally incorporated.' In case of cross-border participation a local NCB should act as lead overseer. For systems which have no clear domestic anchorage the Governing Council could decide to entrust *oversight* responsibilities to the **ECB**. This is done in the case of EBA Clearing Company and would also apply to the case of the Continuous Linked Settlement (CLS) Bank.

Art. 23 enables the ECB and NCBs 'to perform all operations necessary for the conduct of the exchange rate policy of the Community and the management of the foreign exchange reserves.'[32] The **ECB** holds a large amount of foreign reserves,[33] the management of which – at least for the time being – remains with the NCBs [34]in proportion to their share in the transfer of the reserves to the ECB. The strategic management of these reserves is coordinated centrally by the Governing Council and the tactical management by the Executive Board.[35] The NCBs also manage their own reserves; small part of the reserves may remain in the hands of the Member States. Transactions above certain limits need approval of the ECB (GovC) in order to ensure consistency with the exchange rate and monetary policies of the Community.[36] The **ECB** conducts the System's foreign exchange interventions, in which case it operates a front office and directly contacts market participants.[37] Art. 23 also enables both the NCBs and the ECB to extend loans to the central bank of third countries and international organizations. [38]
Art. 23 'authorizes' the NCBs and the ECB to establish external relations and conduct related transactions. However, policy is made by the GovC, with two exceptions: transactions following from IMF obligations (Art. 31.1-ESCB); Art. 14.4 transactions (we mentioned before the example of an NCB opening a credit line in euro for a befriended central bank), in which case the GovC can veto the transaction with a two-third majority. All transactions (except the Art. 31.1-type) need to respect the rule that forex transactions over a certain maximum size need ex ante approval by the ECB (otherwise only notification).

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[32] Words taken from the Committee of Governors' Commentary with the draft ESCB Statute of 27 November 1990.
[33] 45 billion euro in foreign currency and 8 billion euro in gold at the end of 2001 (ECB Annual Report over 2001, p. 184).
[34] Decided by the EMI Council, before the establishment of the ECB, at a moment when the immunities of the EMI/ECB in the United States were legally not fully completed and it made sense to have the dollar reserves managed by existing NCBs. The decision on who should manage the ECB's foreign reserves should be seen as part of the ECB's current business, and would thus be a competence of the Executive Board - see also Art. 12.1b in cluster III.
[35] Hans-Peter Scheller (2000), chapter 7.3.
[36] Art. 31.2- and 31.3-ESCB.
[37] See also under Art. 30-ESCB.
[38] The collateral requirement of Art. 18 would seem to extend to the lending operations mentioned under Art. 23, fourth indent, as Art. 18 seems to have a general character, exemplified by the fact that its second indent also refers to non-Community currencies. It would seem that a governmental guarantee could constitute 'adequate collateral' depending on the credit rating of that government. The fact that governmental guarantees are not listed as eligible collateral in the General Documentation is not relevant, as the GD applies only to domestic monetary policy operations.

Art. 24 allows the ECB and NCBs to establish their own infrastructure for their administrative purposes and their staff.

II.2 General observations regarding chapter IV and the General Documentation

It is clear that the governors, when they started drafting the Statute, had in mind a continued role for their own NCBs (the 'federal' character already expressed in the Delors Report) and an as yet unspecified role for the centre. Their main concern however was the relation with the outside world, and their first drafts basically conferred tasks and functions to the ESCB/System. These first drafts also mentioned the 'possibility' for the Council of the ECB to entrust the execution of tasks to the NCBs, later evolving in the possibility for the Executive Board to entrust the execution of its tasks to the NCBs. While many NCBs worried about the continued existence of several financial centres, the Bundesbank was concerned the centre, and especially the Executive Board, would be too weak to conduct a forceful policy. When the decision was taken to mention ECB and/or NCBs instead of System, the perceived natural lead of the NCBs over the ECB as regards the execution of tasks diminished and the discussion on the division of labour became more intense. The strongest statement in this respect was by de Larosière who saw no need to create new operational devices, because one should rely as much as possible on the NCBs for the execution of the tasks of the System. But no one proposed to blank out the ECB, possibly because it had been accepted that the centre should be allowed to carry out foreign exchange operations. This discussion is reflected in the open-ended character of the Statute in this respect. A second stage was reached when the central banks gathered in the EMI had to determine the operating procedures of the future ESCB. They endorsed the rule that banks would not be allowed to hold accounts with the ECB and only in their country of establishment, as being a straight-forward translation of the decentralization principle. This rule also ensured the central banks would not start competing for business as a way to gain status and influence.[39]

Despite the limited operational role of the ECB, the ECB is in full charge of preparing all guidelines and policy developments in the area of monetary policy implementation and in the areas of payment system and oversight and reserve management. In this sense it has a role comparable to that of the Federal Reserve's Board of Governors, be it that in the euro area the decision-making body of the centre is extended with the presidents of the local NCBs, while in Washington it is confined to the Board members only.

[39] There are direct gains (i.e. financial) and indirect gains (e.g. employment and profits in the banking sector) of being a financial centre. Art. 32-ESCB only covered the possibility of direct competition for seigniorage.

Articles 26-33 and 51 (Chapter VI): [1]

Chapter VI: Financial provisions of the ESCB [2]

(to be read in conjunction with Art. 1-ESCB (Establishment); Art. 10.3-ESCB (Weighted voting); Art. 15-ESCB (Reporting commitments))

I. INTRODUCTION

I.1 *General introduction and history*

We treat the articles of this chapter on the ECB's and ESCB's financial provisions as a group. We describe their content, but not their individual genesis. Because the ECB is owned by the NCBs all articles relate to intra-System financial issues, i.e. issues like sharing foreign reserves and monetary income and distributing the System's profits. [3] To be more precise, some articles deal with the relation between NCBs, like Art. 29 (Capital key) and Art. 32 (Definition and allocation of monetary income), while other articles touch upon the relation between the NCBs and the ECB, like Art. 30 (Foreign reserve transfer to the ECB), Art. 31 (Foreign reserve assets remaining with NCBs) and Art. 33 (Allocation of the ECB's profits). In this respect it is important to note that it was decided relatively early (Delors Committee 1988) to endow the ECB with its own balance sheet, containing at least foreign reserves, and in line herewith some capital of its own (early draftings by the Committee of Governors). Some issues were left to be decided by the IGC, like the size of the ECB's capital (euro 5 billion) and the ECB's foreign reserves (euro 50 billion). Many details of the financial arrangements were left to be decided by the future Governing Council, e.g. where and how revaluation losses and profits would materialize within the System, i.e. with the ECB or the NCBs.[4] The ECB's losses and profits are shared over its shareholders, i.e. the NCBs. The Governing Council adopts the ECB's budget, which is prepared by the Executive Board.[5] The NCBs generate substantial amounts of seigniorage. This so-called monetary income is pooled and reallocate over the euro area NCBs according to the capital key (Art. 29). The NCBs' profits will flow to the national coffins according to the provisions contained in their own statutes.
An important characteristic of the financial provisions is that there is no role for the political authorities (thus substantiating the System's financial independence) – except through the ex post check on the System's operational efficiency by the European Court of Auditors (Art. 27) - and that the ECB does not control the NCBs' budgets.

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[1] Chapter V (containing Art. 25) has been dealt with under Art. 3.3-ESCB above.
[2] We refer to the annex for the text of the articles of Chapter VI of the ESCB Statute.
[3] Art. 27 (Auditing) and Art. 28 (Capital of the ECB) have already been dealt with in cluster I, because they also relate to the System's external relations (i.e. relations with the political authorities).
[4] The Governing Council decides on the use and design of revaluation accounts (Art. 26) and on the denomination of and remuneration on the claims the NCBs receive against the reserves they transfer to the ECB (Art. 31.3).
[5] Art. 15 of the Rules of Procedures.

I.2 *Relevant features of the Federal Reserve System*

The situation in the U.S. is different, because the budgets of the FRBs are de facto controlled by the Board of Governors (see Art. 14.3, section I.2, above). Therefore, one could say that while there is a balance between the Board and the FRBs as regards policy decisions, there is no balance as regards the operational tasks (completely in hands of the FRBs), though the Board has a strong leverage over the functioning of the FRBs through a strong grip on their budgets – even though the FRBs are owned by private banks. The way the Board of Governors runs the Board and supervises the FRBs is under the scrutiny of the GAO (see Art. 27, section I.2). Any net profits of the System flow to the Treasury.

II DESCRIPTION OF THE ARTICLES [6]

Art. 26 allows the Governing Council to determine the accounting rules necessary to draw up a consolidated balance sheet of the ESCB. Such a balance sheet contains important information for the financial markets and is a necessary ingredient for the ECB's accountability. NCBs follow basically the same accounting rules for the presentation of their balance sheets. Part of these accounting rules is that revaluation (book) profits flow into revaluation accounts. These accounts may not be negative, in which case revaluation losses will bear directly on the profit and loss account.

Art. 29 defines the key for subscription by the NCBs of the ECB's capital. This key is based on the share of each NCB's Member State in the Community's GDP and population. The capital key is also used for determining each NCB's share in weighted voting (Art. 10.3), in the transfer of foreign reserves to the ECB (Art. 30), in the NCBs' monetary income (Art. 32) and the ECB's profit (or loss) distribution (Art. 33).

Art. 30 determines the amount of foreign reserves to be transferred by the NCBs to the ECB. The Governing Council decides on the denomination and remuneration of the resulting claims of the NCBs on the ECB.[7] The ECB has full authority 'to hold and manage' these foreign reserves and to use them for the purposes set out in the Statute.[8] The ECB is also authorized to act as agent for a Member State to handle its financial affairs with the IMF, if requested to do so. In view of the history of the Delors Report and the Statute (and especially the fact that pooling of reserves was not disputed) it would seem that Art. 12.1c has limited relevance for the management of, and transactions (interventions) in, foreign currencies.[9] The fact that the

[6] As mentioned before Art. 27 and 28 are dealt with in cluster I.

[7] In fact, the Governing Council has decided that the NCBs received claims (equivalent to the amount transferred) denominated in euro, over which the ECB has to pay a euro money market interest rate.

[8] See also Art. 11.6 in Cluster III. The last sentence of Art. 30.1, containing the words 'the ECB shall have the full right to hold and manage the [pooled] reserves', was added by the Dutch IGC presidency when it became clear that the question whether the ECB would have full ownership of the reserves could not be answered (Presidency's internal summary of meeting of EMU Working Group of 17 October), though in fact this question is less relevant because economic ownership is completely transferred to the holder (Smits (1997), p. 198-199).

[9] Art. 12.1c gives guidance especially for those tasks which are endowed on the System without making any differentiation as to who should carry out which tasks. However, foreign reserves were singled out for being transferred to the centre. The fact that the Commentary to the draft ESCB Statute of 27 November 1990 states that 'Article 30 does not prejudge the possible role of NCBs in the management of foreign reserve assets transferred to the ECB and in the execution of foreign exchange operations' is consistent with the view that Art. 12.1c is less relevant for Art. 30, because the comments to Art. 30 (which is part of chapter VI) do not invoke the subsidiarity principle, while the comments to chapter IV do invoke this principle. The idea of nonetheless

ECB's foreign reserves are managed by the NCBs does not contradict this, because it made sense to do as long as the ECB did not have full immunity in the U.S. as an international organization (the relevant Executive Order was only signed by president Bush in May 2003). We submit that the ECB should at least be at par with the NCBs in being able to manage its own reserves (while respecting the guidelines approved by the Governing Council), i.e. the ECB does not manage the NCBs' reserves and the NCBs do not manage the ECB's reserves. When the Governing Council decides to intervene, it uses the ECB's reserves. Further calls on foreign reserves of the NCBs are possible, however such decision requires the involvement of the Ecofin Council. The Governing Council has approved a list with possible counterparties for foreign interventions, at least one per Member State. In case of actual interventions the ECB takes the initiative, while the euro leg of the transaction takes place in the books of the NCB of the Member State, in which the contacted counterparty resides. The ECB could also call a few of the NCBs with the request to contact eligible counterparties themselves, but it would not be efficient to involve them all.[10]

Art. 31.1 makes clear that NCBs are authorized to continue to carry out transactions 'in fulfilment with their obligations' with international organizations. What is meant here is that NCBs do not need approval of the System for financial transactions to which their Member States have committed themselves towards international organizations and for which purpose Member States have appointed their NCBs as financial agent.[11] It is submitted that this is meant to relate to *monetary* institutions only, first and foremost the IMF.[12] In other words, the purpose of Art. 31.1 is the transfer of the management of the Member States' reserves should not hinder Member States fulfilling an independent role in *monetary* international organizations. This will probably only change when there will be European Political Union. Other transactions are subject to prior approval (or prior notification in case of transactions below the threshold) by the ECB (read: by the Executive Board, which to this end acts according to rules set by the Governing Council).

Art. 32 reallocates the NCBs' monetary income to the NCBs in order to protect their income position against the effect of any possible concentration of financial operations in one or some financial centre. It was also meant to prevent income considerations from becoming an issue themselves in the taking of monetary policy decisions. The definition of monetary income is a complicated matter. It is 'proxied' by multiplying an NCB's monetary liabilities with the main refi-rate.[13] This technique avoids the need of having to measure the precise income of each asset category which would run into difficulties as NCBs hold different assets and, more importantly, which in the end would make detailed guidelines on the management of these

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involving the NCBs in the management of the reserves could be traced back to the NCBs managing the dollars and gold they had formally swapped into official Ecu's under the former EMS arrangement.

[10] It could happen that a bank is called both by the ECB and its NCB. The NCB has to indicate it intervenes on behalf of the eurosystem. The ECB decides on the tactics.

[11] Taken to the letter the words 'their obligation' relates only to the NCBs themselves, and not to obligations in their capacity as agent for another institution, though one could argue that obligations as fiscal agent should be included, because according to Art. 21.2-ESCB NCBs are allowed to conduct fiscal agent functions.

[12] Smits (1997), p. 200, footnote 208. Indeed, it would not be appropriate, if a Member State would ask his NCB to finance the Member State's capital contribution to an international development bank.

[13] See for instance De Nederlandsche Bank, Annual Report 2002, p. 170 (Notes to the profit and loss account).

assets almost unavoidable. Such guidelines would reduce an NCB's freedom and would concentrate power in the centre, as the centre would take charge in defining these guidelines.
Art. 33 puts a limit on the size of the general reserve fund the ECB is allowed to build up. If the general reserve fund is not large enough to cover the losses in a particular year, the Governing Council could decide to earmark part of the NCBs' monetary income to cover the loss.[14] If this does not suffice, the capital of the ECB will shrink. However, Art. 28 allows the ECB (Governing Council) to raise the capital contributions from the NCBs under conditions set by the Ecofin.[15] Here we note that the cap on the ECB's reserve fund does not pose a threat to the ECB's financial strength, as the ECB is backed up by the system's monetary income; this is different for the NCBs themselves, which without a strong financial position could be forced to turn to its shareholder (the State) to supplement its capital. As the State is required to promote, and not thwart, the NCB's financial independence NCBs should be in the position to build up adequate reserves and provisions, that is NCB laws should provide for such a possibility. An additional source of income for the ECB is the monetary income over the ECB's share (eight per cent) in the System's banknote circulation, basically transferring seigniorage from the NCBs to the ECB, increasing the ECB's profits (or reducing its losses). The ECB's net profits are distributed to the ECB's shareholders.
Art. 51 allowed for a transitional period of at most five years after the start of the third stage of EMU during which any significant changes due the reallocation of monetary income on NCBs' relative income positions could be smoothed in a linear way. In November 1998, i.e. before the start of Monetary Union, the Governing Council decided not to apply Article 32 to the income generated by the circulation of national currency banknotes by not earmarking them as monetary liabilities. This meant that monetary income as defined under Art. 32 was practically zero for the first three years, as banknotes make up the largest share of the monetary liabilities and euro banknotes only started circulating in 2002, i.e. three years after the start of EMU. Because such a long period of national banknotes-only had not been foreseen at the time the Statute was drafted, it was decided to apply the smoothing period of Art. 51 only as of the moment of introduction of the euro banknotes (2002). Such a material interpretation of this article opens the way for the Governing Council to apply a similar 5-year smoothing period also to countries adopting the euro at a later date.

All financial decisions with repercussions on the relative share of NCBs in the System's income are taken by the Governing Council under Art. 10.3, i.e. with weighted votes (and zero weight for the Executive Board members).

[14] ECB Annual Report 1999, p. 159.
[15] See Council Regulation (EC) No. 7651/00 of 8 May 2000 and the accompanying statement of the ECB, which allows the Governing Council to increase the ECB's capital by an additional amount up to euro 5 billion without further conditions by the Ecofin.

CHAPTER 8: CONCLUSIONS TO CLUSTER II

8.1 INTRODUCTION

This cluster has dealt with the articles determining the System's operational functions and the division of labour between the ECB and the NCBs. There might be some tension between the ECB and the NCBs as regards this division of labour. It would increase the ECB's position considerably, if it were conducting large part of the System's operations with the banks and in the markets. A complete centralization (in all areas, e.g., open market operations, domestic facilities, foreign exchange operations, payment services, banknote issuance) would be unlikely, as this would be tantamount to merging all balance sheets, thus ending the federal character of the System. Complete decentralization, on the other hand, would not seem to be incompatible with a federal central bank system. Complete decentralization allows for concentration of activities with one of the central banks. Mixed systems are possible too. The centre could act as one of the central banks, offering all central bank services or conducting only a few types of transactions. To understand the way the Statute has been drafted we need to know what the drafters were aiming for when designing the Statute.

Some of the contours of the system though date from **before the Delors Committee**, because Germany had indicated (and France had supported this)[1] that the system should be federal, i.e. with a clear role for the existing NCBs. Taking the Bundesbank as an example, NCBs could be expected to participate in the highest decision-making body and to have local operational functions. The **Delors Committee** did not go into details as regards the internal division of labour – this was not the core of their report. Nonetheless, already at this stage the Delors Committee agreed on pooling of reserves at the centre – some had in mind the final stage, others (among whom Delors and the French central bank) already the intermediate stage.
The **Committee of Governors** concentrated on the final stage: they agreed to pool a substantial part of the reserves and to make the management of the remaining reserves subject to central guidelines. Pooling would create a pool of directly available foreign reserve assets, lending credibility to the System's exchange rate policy, and indirectly contributing to creating a 'strong' centre. A strong centre was considered desirable, because the System would probably have to operate – at least in its formative years - in a difficult environment, in a political sense. While the governors clearly had in mind that monetary policy would be implemented using the NCBs and that the System itself should decide on the division of labour within the System, they could not agree on the degree of decentralization (i.e. *strong* or *very strong*) and neither on which body should ultimately have the final say as regards the actual division of labour (the Executive Board or the Governing Council). Most of the governors wanted the Governing Council to decide, a small minority (mainly the Bundesbank) favored the Executive Board. Behind this was the fear that NCBs could undermine the singleness of monetary policy. The governors did agree though that in order to ensure the singleness of policy the Governing Council should be able to adopt guidelines,

[1] See e.g. Memorandum-Balladur (29 December 1987), in which Balladur mentions the possibility of a single currency and 'a common central bank and 'Bundes'banken in each country.' (HWWA (1993), p. 338.)

upon which the Executive Board could base instructions to NCBs, which NCBs were required to obey (see Art. 12.1, first and second paragraph and Art. 14.3).

The **IGC** quickly found a compromise, choosing for the *strong* option (and not the *very strong* option) and placing the decision in the hands of the Governing Council (and not the Executive Board). The IGC did not express a specific opinion on the desired degree of centralization or decentralization of the System's operations. The IGC devoted some time to the topic of banknote issuance, basically to accommodate peculiarities of a few countries (relating to the issuing of banknotes by a few private banks and to the issuance of coins).
Overall, the governors made a considerable mark on the final design of the System.

Taking the procedure used in chapter 5, we will first present a short summary of the articles of which we studied the genesis in chapter 7. We will highlight the specific interests at stake for the NCBs and/or the centre. After this we will analyse the checks and balances by focussing on the elements in the Statute which 'protect' the positions of the NCBs and which elements protect the role of the ECB (section 8.2.2). In section 8.2.3 we will show the 'outcome' in practice, i.e. how have the operational functions been allocated at the start of the ESCB in 1999. To put this in perspective we will ask ourselves which other 'models' are possible (section 8.2.4). This may shed light on the possible future trends in the allocation of operational powers. Finally, we use the categorization of checks and balances developed in chapter 2, which allows us to detect possible unevenness in the checks and balances between the ECB and the NCBs. This allows us to present some suggestions for improving the checks and balances relating to the internal division of labour (section 8.3).

8.2 CHECKS AND BALANCES BETWEEN THE ECB AND THE NCBS

Content

8.2.1 Short reviews (with emphasis on checks and balances)

Supervision (Article 3.3- and 25-ESCB):

Discussion on this article on prudential supervision and financial stability was complicated because the existing national arrangements differed. Some central banks were responsible for supervision; others (in fact most of them) were only 'involved' through cooperation with or membership of their governor of a separate supervisory body. In practical terms, though, all central banks, except the Danish, were actively involved in the supervisory process. Financial stability, i.e. the stability of the financial system, was increasingly seen as an area calling for active central bank involvement, though this had as yet not been reflected in the mandates of the NCBs.

The reluctance of the German central bank to be made responsible for supervision combined with the reluctance of other NCBs/countries to share their supervisory responsibilities, which had always been a closely guarded functional area, with other countries/central banks. This reluctance was also felt vis-à-vis the ECB, which was a new potentially powerful institution, which might start encroaching on the supervisors' territory. In retrospect, there was no willingness to make optimal use of the opportunity to create synergy in the field of supervision; the national roles could adequately have been safeguarded by explicitly putting down on paper the (minimum) involvement of NCBs in supervision, e.g. in the area of on-site inspections. However, what happened was that the NCBs, and also the Finance Ministries, seeing the ECB as a potential supervisory competitor, marginalised the supervisory role of the System and the ECB, though a potential role was not excluded.

This brings us to the following general observation leading to two suggestions for improvement. Protecting financial stability in the euro area requires an effective network of cooperation and information sharing between national supervisory authorities.[1] What is true at the national level, i.e. that there is potential synergy between being monetary authority and being involved in supervisory tasks, is also true at the European level. At the same time, the problems Germany had (and has) with a possible conflict of interest between monetary and supervision at the European level should be coped with. This could be achieved by copying the German-style involvement of the ECB in supervision, through a Treaty article explicitly obliging central banks and supervisors to inform the ECB of relevant developments (first improvement) and by making the ECB for instance co-supervisor for large foreign banks or

[1] The argument that financial stability is an issue covering more than one geographical area (e.g. the European Union or the G10 countries), while true, should not be an argument not to improve regional cooperation.

large bank holdings (second improvement).[2] The tasks of the ECB need to be spelt out quite clearly. The requirement to inform and be informed would also allow the ECB to make most of its role as contributor to financial stability. The ECB is uniquely placed to oversee financial stability issues on a daily basis for two reasons: it has a European scope and it has daily contacts with the financial markets. This makes a difference with other supervisors: *national* supervisors only have a national scope and *European* regulatory bodies only meet infrequently.[3] The institutional balance between the NCBs and the ECB, if considered important in this respect, would not be disturbed, because the ECB would only be co-supervising with the relevant national supervisors (i.e. the ECB would not substitute for supervision by national supervisors), but at the same time it would enable the system to acquit itself more effectively of one of its tasks. [4] The appointment as co-supervisor could be enacted through activation of Art. 25.2, which could possibly be confined to specific supervisory issues. The Executive Board would be informed on a continuous basis and the Governing Council would be informed regularly, or when deemed necessary, while regular reporting should also take place in relevant European fora.

Collection of statistics (Article 5-ESCB):

Though the collection of statistical data does not have the mystique of monetary policy making, it involves large contingents of people to collect, analyse and report these data, which are indispensable for informed policy-making. The drafters of the Statute introduced a logical split between policy-making by the central body (e.g. cooperating with other bodies, contributing to harmonization) and decentralized execution (NCBs collect 'to the extent possible'). Decentralized execution makes sense from the point of view of effectiveness and efficiency (i.a. language problems and national peculiarities), but it increases the distance between the institution asking for information (basically the ECB) and the persons/agents carrying the reporting burden, thus possibly introducing a bias towards 'over-asking'. The ESCB now applies a cost-benefit analysis to each new information demand, but it would not have been wrong to state the 'obvious' ('thou shalt not unnecessarily burden reporting agencies') in the Statute, following the example of the Federal Reserve. The article only relates to the collection and not the reporting of information. Practice has it that the ECB only reports euro area aggregates, while NCBs publish relevant national data. NCBs should not publish sensitive national monetary data (e.g. a national money growth figure) before the aggregate is published, as this would make monetary policy making more difficult.

[2] We do not see advantages of the ECB as sole supervisor, or as co-supervisor of purely local banks, as in those cases the existing information asymmetry (i.e. the fact that local supervisors have better access to relevant local information) is not outweighed by other benefits, like increasing returns of scale or information of system-wide relevance.

[3] This suggestion relates to regular information sharing, which contributes to *crisis prevention*. In times of an actual crisis supervisory authorities and NCBs should be (and in fact are) authorized to share confidential information relevant for *crisis resolution*.

[4] An effective functioning of the ECB in this respect also requires that NCBs inform the ECB on a continuous basis or any unusual large access to their local marginal financing facility, other organized lender-of-last-resort assistance and large interbank (including cross-border) exposures – see Van den Berg and van Oorschot (2000).

International cooperation (Article 6-ESCB):

It was considered very important that the System would represent itself to the outside world as a unity. Art. 6 allows the Governing Council to decide on the System's representation, but also on the System's position or common language, e.g. in case the System is represented by both the ECB and NCB representatives. A binding approach is possible in areas where the System is competent. It is not possible where the System has an interest, but lacks authority, because then NCBs cannot be bound. Then there can only be voluntary coordination of opinions. Coordination strengthens the 'expert' opinion of the System. In these areas the president of the ECB should make clear whether he speaks for the Board or the System. Art. 6 does not prejudge the way the System should be represented in international meetings. It allows NCBs and ECB to participate alongside each other, which makes sense anyhow because most gatherings also relate to non-System responsibilities of NCBs. In theory, the Governing Council could decide that the System is represented by an Executive Board member together with a representative of the NCBs with a special kind of expertise, to the analogy of the Federal Reserve, which in international meetings usually is represented both by someone from the Board and from New York.
It should be noted that were NCBs to lose their international contacts, their presidents would lose influence in the Governing Council and the quality of the monetary policy debate could stand to lose too, because well-informed people are better able to take the best possible decision than non-informed people, especially when they receive their information from a plurality of sources (and not only from one staff presentation).[5] Here we see a reflection of the general idea that the division of operational competences is of direct relevance for the quality of monetary policy making.

Decentralization of operations (Article 12.1c-ESCB):

There is an analogy with Art. 6: if NCBs would lose their contact with the markets their presidents would be less well informed and would contribute less to the discussions in the Governing Council. The article can best be understood by looking at its origin: the first draft showed a relatively centralized system. The Germans had wanted this to ensure uniformity; the Dutch wanted this too, because they thought this to be supportive of the independence of the System. The Delors Report had recommended the centre to have its own balance sheet (read: holding foreign reserves), making it already more than the Board of Governors, which is a decision-maker, regulator and overseer, but does not execute operations. However, the French had no wish to centralize the domestic monetary assets. To this end they successfully introduced a strong bias towards decentralized implementation. They argued this would not undermine the unity of the System, because the NCBs should be under very strict operating guidelines.[6] This was supported by most other central banks. Arguments used in favour of decentralized operations were: (1) the *subsidiarity* principle (though it was used out of context – see box in section II.3 of Art. 12.1c in chapter 7 –, it had strong appeal and was an effective argument), (2) *cost efficiency* (existing infrastructures could be used), (3) the argument that *several financial centres* should co-exist (the alternative being the development of a European

[5] See also Art. 10.2-ESCB in cluster III.
[6] This last idea was captured in the second paragraph of Art. 12.1 and in Art. 14.3 of the ESCB Statute.

equivalent of New York with shrunken provincial financial centres in the regions, while the creation of one financial centre would probably also give more clout and political influence to the financial sector),[7] (4) *continuity* - it would allow most commercial banks to continue to participate in the money market operations of the central bank. And more in general it enhances the federal character of the system. Apart from this, there are synergies when monetary authorities are also involved in supervision (in terms of knowledge of the financial markets and institutions, which would of course dry up when the monetary function becomes non-existent). The IGC was asked to decide on the exact formulation of the bias favouring decentralization (basically a choice between a very strong and an even stronger bias). The IGC took a middle position, but – and this is at least as important - it accepted that the precise balance could be determined in practice by the System itself.
The ECB would seem to suffer less from an informational disadvantage, because it is informed daily by the NCBs of market developments, while it is also responsible for ensuring that monetary policy is implemented and for the conduct of possible foreign exchange interventions. This implies the ECB is in regular contact with the markets and is well-informed.

NCBs and the System (Article 14.3 and 14.4-ESCB):

It was not contested that NCBs would be more than mere agencies of the ESCB. They were allowed to perform independent tasks, thus preserving their domestic profile[8] and strengthening the position of the System (because it allows for synergies), and the position of those governors with important non-System tasks. It does not seem to harm the ECB, because it does not take away tasks of the ECB, though it affects the balance between the ECB and the NCBs to the extent that it strengthens the NCB's identity and their independent right to exist. The attribution of non-System tasks to an NCB might though, under circumstances, give the national political authorities unwanted leverage over the NCB's board (see also Art. 7, footnote 12). Art. 14.4 was balanced by a text drafted by Tietmeyer entailing complete subjugation of NCBs to the objectives of the System, as evidenced by the fact that the Governing Council may forbid functions which are detrimental to, or even just interfere with, the System's objectives and tasks. (Because such a fundamental decision should not be taken lightly, a two-thirds majority is required.) The formulation of Art. 14.3 could be said to transcend Art. 14.4: it has a high federal content. The obligation for NCBs to provide the Governing Council with information provides a form of accountability vis-à-vis the Governing Council.
It follows that non-System tasks should also not lead to the possibility for political authorities to dismiss NCB board members for failing to please the authorities in fulfilling these non-System functions, as this could be misused to dismiss a board member for monetary policy reasons. Of course, the general clause of being unfit to fulfil a board function would still apply, while alternatively non-System tasks could be taken out of the NCB by the national authorities.

[7] Compare the perceived influence of Wall Street in the United States and of the 'City' in Britain.
[8] In some cases this has led to complicated institutional–legal frameworks, e.g. in the case of the Irish central bank, because one has to bring Treaty-based functions and attributed (or delegated) national functions under one governance structure.

Banknote issuance (Article 16-ESCB):

The article looks innocent, but its innocence hides a very long story. For our purpose the following is relevant: policy-decisions were laid in the hands of the Governing Council. Banknote issuance is possible both by the ECB and the NCBs. The drafters did not distinguish between legal and physical issuing. Elsewhere, however, Art. 12.1c leaves no doubt that the physical part (the distribution) should be carried out by the NCBs. Art. 12.1c does not give guidance as to who should be the legal issuer, i.e. who should carry the banknotes as liabilities on its balance sheet. After a long discussion the Governing Council would decide to *separate* the physical and legal aspect of issuing by allocating the banknotes in circulation over the ECB (fixed share) and the NCBs (using NCBs' shares in the capital key), thus supporting the assumption that banknotes by different euro area NCBs are fungible. Sensitivities ran high, because NCBs view banknote issuance as a core NCB function – losing this would take away a very visible function, a function that makes their existence self-evident to the general public. Sharing the note issuance with the ECB took away a feature of uniqueness and indispensability of the NCBs. Distribution was laid with the NCBs. Production does not seem to be an exclusive System function, because some NCBs have their notes printed by private sector companies (of course, the System is responsible for their design and safety features and for having sufficient banknotes printed and in stock). In the area of production the ECB has taken the role of co-ordinator (this could have been an example for specialization among the NCBs, but in practice they are not keen in allowing the lead to a colleague NCB).

Monetary functions and operations (Article 17 - 24-ESCB):

These articles describe the System's monetary instruments and other 'allowed' functions in generic terms. Details of the monetary instruments and procedures are provided in the General Documentation, as approved by the Governing Council ex Art. 18.2-ESCB. A backbone for the decentralized execution of monetary policy is TARGET, a real-time gross settlement payment system connecting all NCBs and accessible for all financial institutions. TARGET allows for a continuous uniform money market rate throughout the euro area.
The Statute allows both the ECB and NCBs to perform the execution of the System's monetary and payment system functions. The first versions of the draft Statute prepared by the Committee of Governors referred to the 'System' as operator. When the legal experts of the NCBs advised not to give legal personality to the System, but only to its components, they also advised to attribute operational functions to both the ECB and the NCBs, because this would allow for development in the operational methods of the System without the need to amend the Statute. This was meant as an enabling mechanism and was not meant to prejudge the outcome. Nonetheless, it put the ECB completely *ex aequo* with the NCBs, which was not what the governors initially had had in mind. In theory, the chosen formulation allows both for complete centralization as complete decentralization. The only guiding principle is laid down in Art. 12.1c, favouring decentralized operations. Although that principle is strongly worded, two uncertainties remain: first, the words 'to the extent deemed possible and appropriate' need to be interpreted, and second, though the interpreter is known (i.e. the Governing Council), its composition is not. Indeed the Governing Council's composition could be changed, though this requires an amendment of the Treaty. A reduced presence of

the NCB presidents in the Governing Council (or reduced voting rights) could lead to an interpretation more in favour of centralization. The opposite, i.e. a reduced role for the Executive Board, seems unlikely. That is, the position of the Executive Board seems more secure. In other words, a change in the governance structure of the ESCB (e.g. the composition of the Governing Council) may affect the checks and balances also in the operational sphere. The System's instrumental independence is based on the Statute providing an extended set of instruments, which can be used without ministerial involvement.

The System's financial provisions (Article Art. 26 - 33-ESCB):[9]

The intra-System financial relations do not give rise to one-sided dependencies. The centre does not control the NCB budgets, neither is the opposite true: decisions on the ECB's budget are not taken by the NCBs (the shareholders), but by the Governing Council, in which the Executive Board is represented with a (large) minority (six out of fifteen votes). In fact, if budgetary decisions are prepared and supported by all Board members, they only need the support of a few governors to have their proposals approved. On the other hand, until now most Governing Council decisions have been taken by consensus, and one would expect that, except in urgent matters or monetary policy decisions, vote taking will be the exception. These budget decisions allow the Governing Council to decide on the staff size of the ECB.

8.2.2 Factors influencing the division of operational powers

We have condensed the key elements of the articles of cluster II in the previous pages. In this part we will try to answer the question whether the design is balanced as to the relative operational roles for the NCBs and the centre (ECB). If one party is considerably less protected than the other we have a system which in the long run is potentially unbalanced. A difference with the full definition of checks and balances developed in chapter 2 is that the ECB and the NCBs cannot decide themselves to encroach on the area of the other – this requires a decision by the Governing Council. Nonetheless, the threat is there and furthermore the ECB and NCBs need each other and there is some kind of accountability in the form of Governing Council approval for the ECB's budget and the requirement for NCBs to provide the ECB with any information the ECB considers necessary for it to ensure compliance with its guidelines and instructions.

Below we make a short inventory of which articles, or elements thereof, offer protection for the operational position of the ECB and NCBs respectively. We then confront this with a description of how the operational powers have been attributed in practice, basing ourselves on the General Documentation. We compare this 'ESCB' model with that of the Federal Reserve and the Bundesbank. This will allow us to draw some conclusions as to the stability of the design and possible future trends.

[9] Art. 27 and 28 have been dealt with in cluster I because of their relevance for the System's financial independence vis-à-vis the outside world. Art. 29 is less relevant for cluster II; it is a technical article determining each NCB's share in the ECB's capital. It is thus more relevant for the relation between NCBs than between the NCBs on the one hand and the ECB on the other.

Table 8-1: Inventory of protecting factors

Factors protecting the operational position of the ECB

1. The ECB has initially been endowed with euro 50 billion euro in foreign assets. Further transfers of reserves from the NCBs to the ECB are possible, according to a procedure involving the Council of Ministers (Art. 30).
2. Foreign exchange interventions are the prerogative of the ECB. This follows from Art. 30.1, last sentence, and Art. 31.2. In this area decentralization is an option, but not required and also not practical.
3. The article on international cooperation (Art. 6) allows the Governing Council to give the function of external representation completely to the ECB (read: Executive Board). The other extreme, i.e. placing this responsibility completely with NCBs, seems unimaginable, also because Art. 6.2 seems to suggest a natural right for the ECB. It would have to be mandated by the Governing Council (which could be a broad mandate).[10] Allowing the Executive Board the monopoly on international economic and monetary information would substantially increase their leverage over Governing Council meetings.

Factors protecting the operational position of the NCBs

1. In the statistical area the NCBs would seem to have an indisputed, strong legal base for continuation of their role as collector of necessary data from *local* reporting agents (Art. 5).
2. NCBs are allowed to continue to perform transactions in fulfilment of their obligations towards international organizations (Art. 31.1), e.g. transactions with the IMF on behalf of their Member State for which they act as 'fiscal agent'. This presupposes that some reserves will remain with the NCBs. The situation would change when the EU would become member of the IMF.
3. The fact that NCBs may perform other non-System functions, e.g. in the area of supervision, gives them an edge over the ECB.
4. If there is financial leverage from one group over the other, then it is from the NCBs over the ECB. The Governing Council, in which the governors form a majority,[11] has to approve the ECB's budget, and decides indirectly on issues like the size of the ECB staff and whether or not to set up a dealing room at the ECB.
5. Pièce de resistance however for the NCBs is Art. 12.1c. This article introduces a strong bias towards decentralized operations. The article covers each of the System's tasks, like open market operations, banknote distribution, payment system facilities, fiscal agent functions (but not so much the holding of the ECB's own foreign reserves and their use for interventions)[12]. The article, however, is a procedural one: it does not give basic rights to the NCBs, but it provides a guiding principle for the decision-making bodies of the ECB. Again, the fact the NCB governors have a majority in the Governing Council is relevant. Until now it has not been deemed appropriate to deviate from this principle – see next sub-section.

[10] In the US the FRA authorizes the Board of Governors of the Federal Reserve to prepare policy positions.

[11] The relation between the governors and the Executive Board will be dealt with in cluster III.

[12] The genesis of the Delors Report and Art. 30-ESCB show the transfer to the ECB was meant to create a visible centre with a significant amount of foreign reserves to ensure the credibility of the System's exchange rate policy.

We did not mention the issue of banknotes issuance. The practical aspects (distribution) fall under Art. 12.1c. The decisions taken as regards legal issuership have disconnected distribution from legal issuership. As long as most of the System's assets remain on the NCBs' balance sheets, it would seem natural that banknotes appear on the NCBs' balance sheets as well, apart from a symbolic share for the ECB. Though symbolic, it means part of the System's seigniorage is generated on the balance sheet of the ECB.[13] That does not change the fact that the ECB's expenditures need Governing Council approval. Furthermore, the ECB's net profits flow to the NCBs. By allowing both the ECB and the NCBs to act as legal issuer, the drafters of the Statute have created in theory the possibility of a complete substitution of the NCBs by the ECB.

From the list we conclude that the ECB is especially 'strong' in the international area. It would seem difficult for the ECB to take away operational tasks from the NCBs, as this is determined by the Governing Council. The NCBs seem to have fewer basic rights than the ECB. Art. 12.1c does not provide a right, but only a direction. Nonetheless, the direction is loud and clear, *viz*. execution of tasks as much as possible through local NCBs.
We will now proceed with showing the actual outcome, basing ourselves largely on the ECB's *General Documentation* on ESCB monetary policy instruments and procedures, approved by the Governing Council in September 1998.

8.2.3 Actual situation

Below we present a table summarizing the operational roles of the ECB and the NCBs.

Table 8-2: Summary table on division of labour with respect to ESCB operations and functions

	ECB	NCBs
Minimum reserve/payment accounts	-	x
Standing facilities	-	x
Open market operations:[14]		
- Refinancing operations	-	x
- Fine-tuning operations		
- reverse transactions	-	x
- outright	x[15]	x
- Structural operations		
- reverse transactions	-	x
- outright	x[16]	x

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[13] Strictly speaking this depends on the remuneration of the concomitant claim of the ECB on the NCBs.
[14] Reverse transactions are executed through (standard or quick) tenders. Tenders are announced by the ECB, bids are collected through the NCBs, allocations are decided by the ECB. Outright transactions are executed through bilateral procedures. See ECB General Documentation on ESCB monetary policy instruments and procedures.
[15] Only in exceptional circumstances (as defined by Governing Council).
[16] Only in exceptional circumstances (as defined by Governing Council).

Holding foreign reserves	x	x
Managing ECB's foreign reserves	-	x[17]
Managing non-pooled foreign reserves	-	x
Forex interventions	x[18]	-
Managing euro denominated assets	-[19]	x
Legal issuer euro banknotes	x	x
Distribution and intake banknotes	-	x
Collecting statistics at source	-	x
Providing payment services	-[20]	x
Payment systems oversight	x	x
International cooperation	x[21]	x
Member of BIS	x	x
Fiscal agent	-	x
Fiscal agent for national authorities in IMF	-[22]	x
Represented at the IMF	(x)[23]	-

The table shows an overwhelming majority of functions being performed by the NCBs. At the same time, all operations in the monetary field are conducted under strict rules determined by the General Documentation. NCBs have more room for manoeuvre when managing domestic (euro) asset portfolio's, though even then NCBs have to respect the maximum size of operations, above which they need ex ante approval by the ECB, to prevent interference with monetary policy objectives. Management of the ECB's foreign reserve assets has for the time been delegated to NCBs, but this could be reversed.[24] An area where NCBs are dominant is the provision of financial services: this includes the offering of payment accounts, payment services and securities handling. Also coin and currency distribution is an NCB affair.[25] Not

[17] Each NCB manages a portion of the foreign reserves of the ECB corresponding to its share in the transfer of reserves to the ECB, on the basis of an agency construction. The ECB (Governing Council) issues detailed guidelines (including benchmarks) for the management of these reserves. Size end 2002: euro 44.8 billion (excluding euro 7.8 billion gold).

[18] The ECB contacts the counterparties in the financial markets. Foreign currency is moved to/from account liquid account of the ECB held at the NY Fed. The euro leg of the transaction is settled through the books of an NCB. (This gives rise to intra-eurosystem claims/liabilities in the books of the ECB and the NCB involved.)

[19] The ECB manages a euro securities portfolio, the size of which corresponds more or less to the size of its capital and reserves (euro 4.4 billion end 2001).

[20] Only for a few international organizations.

[21] The ECB has an advantage, because for instance in the context of G7 meetings the ECB's president or an Executive Board is invited to be present, and not an NCB president (though the G7 governors might be present in their own capacity).

[22] ECB has observer status at the IMF. The IMF is an intergovernmental organization, of which only countries can be a member. The ECB is entitled to hold IMF reserve positions and SDRs (Art. 30.5)

[23] Unlike the NCBs, the ECB has an observership at the IMF. NCBs are usually represented through secondment of staff to their country's or constituency's Executive Director's office.

[24] Of the consolidated eurosystem balance sheet of ultimo 2001 claims on credit institutions arising from monetary policy operations constitute 25%, total forex holdings (including gold) 51% (of which 7 percentage point is held by the ECB), and NCB held domestic euro denominated assets 11%, on a total balance of euro 814 billion (ECB Annual Report 2001, p. 200).

[25] European NCBs are not involved in check collection, like their American counterparts.

mentioned in the table are the non-system functions, such as actual banking supervision. The actual division of labour as presented in the table clearly reflects the drafters' intention, i.e. that the System's policies (to be decided centrally) should be executed as much as possible by the NCBs.

8.2.4 Alternative models and possible future trends

One could ask the question whether the present division of labour is stable, or whether a movement away from decentralization is likely to occur. To investigate this, we look into developments that took place in the FRS and the other major country with a federal central bank system, Germany. There are no studies in this respect focussing explicitly on this question. We begin with a factual description of the *present* situation in the US and Germany.
In case of the **Fed** the Board of Governors would only have a cross in table 8.2 on the lines 'payment systems oversight' (and then only in the regulatory sense), 'international cooperation' and 'member of BIS'.[26] The external relations are completely in the domain of the Board, except for the operational side, which rests completely with the New York Fed as the yearly elected manager of the **SOMA**. The operational tasks rest with the FRBs, of which the following are localized in New York: open market operations, foreign reserve related activities (there would be no line on non-pooled reserves), managing domestic currency denominated assets, fiscal agent in IMF and member of the BIS. Therefore the ECB looks more like a central bank than the Board of Governors, which is a regulatory organ, though of course very important.
In case of the **Bundesbank** the table would be more complex than for the Fed. The Bundesbank Head Office deals with banks which have a federal significance. To be more precise: the Head Office handles in particular 'transactions with the Federal Administration and its Special Funds, transactions with credit institutions which have central functions for the whole of the Federal territory, foreign exchange transactions and other transactions with foreign countries, and open-market operations.' [27] On the other hand, the following business is reserved for the Landeszentralbanks (LZBs):[28] 'transactions with the Land and public administrations and transactions with credit institutions within their area of competence, except transactions with credit institutions which have central functions for the whole of the Federal territory.' [29] In doing so, 'the LZBs are subject to the decisions taken by the Central Bank Council in matters of credit and monetary policy and to the general directives issued by

[26] On the basis of a 1994 Board of Governors decision the chairman is the *ex-officio* director on behalf of the FRS and the president of the New York Fed is the appointed second American member of the BIS Board. The American shares in the BIS were owned by commercial banks.
[27] This and the following quotes are taken from BIS (1963), *Eight European Central Banks*, p. 60ff. This division of labour still applies to the present Bundesbank, though the number of LZBs has become smaller and monetary policy is formulated by the ECB's Governing Council.
[28] The Landeszentralbanken are branches of the Bundesbank. Although they do not have there own balance sheet, they are allocated specific tasks according to the Bundesbank Law. Despite losing their legal independence, when the Bank deutscher Länder was being replaced by the Bundesbank, the LZBs retained their organizational independence. The LZBs conduct on their own responsibility all transactions and administrative business within the area for which they are competent. See also appendix on the Bank deutscher Länder in cluster III.
[29] The LZBs collect the bids of small banks for participation in the refinancing operations of the Bundesbank sometimes even through their branch offices.

the Central Bank Council, which may be supplemented in individual cases – if special circumstances should warrant it – by particular instructions.' Then the study we quote from, written by a former LZB president, refers to the principle of decentralization: 'Even in the case of decisions, instructions and measures of the central authority that are generally binding on the whole system the principle of decentralization is indirectly safeguarded by the fact that the Landeszentralbanken participate through their Presidents in the formulation of policy by the Central Bank Council.' Here we see a much larger degree of centralization than in the US, but still a backbone of operational responsibilities for the local central banks. But again the international side is completely in the hands of the centre.

We conclude from the above that a decentralized system is not inherently unstable, *it is workable and has proven to be effective*. This does not preclude changes from occurring. Comparing the ECB with the Fed and the Bundesbank we see three areas in which changes might occur, all of them going in the direction of more centralization. We will treat them successively, after which we will make a few general observations relating to the longer term.
First, one could think of changes entailing a further or even complete **centralization of external contacts and business**. Thus the ECB would move in the direction of the Fed and the Bundesbank. However, what makes for an important difference with both the Fed and the Bundesbank is the existence of other, non-System functions of the euro area NCBs. This creates an independent reason for them to stay internationally active. Not being able to participate actively in international circles and fora would reduce the NCBs' influence vis-à-vis the ECB.
A second development could be more **centralization of open market operations**. This could take two forms: (i) banks could be allowed to *open accounts with the ECB*. This implies the ECB would have to open accounts for thousands of European banks,[30] including for very small ones. Though practically not impossible, it is an unlikely development, because it offers little benefits over the present system and it would violate the decentralization principle. A disadvantage for NCBs is that they would lose contacts with important players in national payment systems and they would lose the synergies resulting from their being both monetary authority and supervisor (or co-supervisor). (ii) An alternative could be the introduction of a *primary dealer system* (or clearing bank system), the essence of which is that it is two- or more layered (liquidity would reach banks via a limited number of specialized banks or financial houses that deal directly with the central bank). In case of a primary dealer system one would need one point of communication with the primary dealers. There will be problems both with respect to the choice of the primary dealers as the central point of entry. As regards the primary dealer system, if one would opt for one primary dealer per country, the selection of them will be fraught with 'political sensitivities', e.g. should the biggest bank from a small country with low transaction volumes be included and much larger banks, but not being the largest in their country, be excluded? The logic alternative is working with those primary dealers which can guarantee large volumes. This option would probably lead to a concentration of open market operations in one (or a few) financial centres. This leads to severe political problems, as the other financial centres would stand to lose, if not in terms of direct business, then in prestige (translating in indirect loss of business). As regards the single point of entry, one could decide to periodically elect one central bank that is authorized to

[30] See footnote with Art. 12.1c, section I.2.

manage the system's open market account; compare the New York Fed which manages the Fed's **SOMA**. Such a function could rotate, but that is highly impractical. Therefore, such a procedure will in practice lead to **specialization**. Art. 12.1c refers to the ECB being obliged to take recourse to the extent possible and appropriate to the NCBs, this implies the ECB cannot 'impose' specialization in the operational field – therefore, all NCBs would have to agree. (If the NCBs would agree to interpret Art. 12.1c in such a flexible manner, they could opt for the ECB as well.) In a primary dealer system the number of regular contacts of the System with banks would shrink, making for less synergy, though banks would still manage their reserve accounts with their local NCB. This is a disadvantage for central banks that appreciate direct contacts with their banks, inter alia because they usually are prudential supervisor, or at least are actively involved in supervisory work.[31] Furthermore, practical changes would become necessary: for instance, banks now also use *local* collateral (so-called tier-two assets), e.g. bank loans, in refinancing operations with their central bank. It remains to be seen whether primary dealers would accept that kind of collateral too. We conclude that while a primary dealer system would technically be conceivable too in the euro area, *there is no technical need to change* the present system; moreover, a change to a primary dealer system would trigger a number of issues difficult to solve and would increase the distance between the ESCB and many banks. We conclude from the above that centralization or specialization in this area is unlikely to be proposed by the ESCB. If nonetheless centralization at the ECB were to happen, it would reduce the influence of NCBs and increase the influence of the ECB. Specialization would probably lead to intensified contacts between the ECB and the NCB responsible for (most) OMOs, like in the U.S. between the Board and the New York Fed.[32] The ECB would probably gain from this development in terms of influence over the System's operations and decisions.

A third development one could think of is the general **abolishment of the prohibition of remote access** to central bank credit (see description of Art. 17). This would have a cascade of consequences, because a commercial bank would want to hold its payment account which serves as we have seen also as its minimum reserve account at the central bank from which it receives its central bank liquidity (which is credited to its payment account). Therefore, this could affect almost all business areas of the central banks, depending on how many commercial banks would opt for another central bank. In this respect is relevant that domestic transactions between banks which are handled through their central bank RTGS systems would become cross-border payments, if one of the banks changed its central bank account to another central bank. Cross-border transactions through TARGET are more expensive than domestic RTGS transactions. It is possible that only a few commercial banks with large international transactions volumes would actively search for the cheapest payment services, but the system would get more complicated to handle. At the same time we see that the central banks themselves strive for as much harmonized payment services as possible. We contend that a development in the direction of harmonization is more likely than towards

[31] In a primary dealer system there would be less need for NCBs feeding the centre with projections of local factors affecting the euro area's overall liquidity system. In such a world the centre would probably rely more on information contained in market prices and forward rates, assuming the markets would make sure they are well-informed about important local tax pay days and other technical factors. A difference with the Fed would be that the eurosystem relies to a larger extent on the buffer function of the minimum reserve accounts and mostly relies on weekly (and not daily) refinancing operations.

[32] See appendix 2 for specialization within the Federal Reserve System.

centralization (towards the centre) or specialization (towards one or a few NCBs). In this process of harmonization the ECB could play a proactive role. Such a role is within its competence. One could even say the centre has a duty to enable and facilitate decentralization of operations. Remote access would probably lead to some specialization, but the difference with the specialization in the preceding paragraph is that there would not be a primary dealer system, but all banks would still receive their liquidity directly from a central bank.
We have now dealt with possible developments towards more centralization. Theoretically, the opposite, i.e. a development towards less centralization, is possible too, but that is quite unlikely in view of the already very high degree of decentralization.

The above relates in first instance to the short-term and to developments which can take place within the context of the present Statute. In the short-run we do not think it is likely that major changes will take place. In the longer run though major changes could happen. Major changes have occurred in the **Federal Reserve Act** and in the set up of the **Bundesbank**. However, in these cases major changes were triggered by major external developments, as we will see below. The number of Landeszentralbanken (which threatened to increase from eleven to sixteen at the occasion of the German unification) was instead reduced to nine, by creating state-overlapping State central banks.[33] In the United States major changes occurred in 1933 and 1935,[34] after the dramatic event of the Depression. FRBs were forbidden to make their own arrangements with foreign central banks. Open market operations were completely centralized in New York (this process had already started in 1922 – see appendix 1 below) and they came under complete control of the FOMC. At the same time, the Board of Governors, formerly only a supervisor over the FOMC, became member of the FOMC and gained a majority of the votes. This is sometimes seen as a major step towards **centralization**.[35] However, it is more appropriate to describe this development as a reaction to the increased importance of open market operations, which had not been foreseen by the drafters of the FRA, and which thus called for 'reparation' of the FRA to restore the original balance. The reparation had become urgent, because the Fed had not functioned effectively in the years before and during the Depression. Making the appointment of FRB presidents by their boards of directors subject to approval by the Board of Governors was part of this reform.[36] The Federal Reserve remained nonetheless still a federal system. Its federal character is engrained in the Federal Reserve Act, the first words of which are: 'To provide for the establishment of Federal reserve banks'. The federal character of the ESCB is also reflected in the first article of the Statute of ESCB and the ECB: 'The ESCB and the ECB shall be established …..'. In contrast the Bundesbank had a less federal character: the State central banks are branches of the Bundesbank and the Head Office conducts open market operations directly with major banks.
Therefore, we see that major external shocks, both political (re-unification) and market-related (growing importance of OMOs), can lead to changes in the structure of federally designed central bank systems. In the cases mentioned above these changes, though being major, did not undermine the federal character of the Systems; in fact, one could say they were meant to prevent or correct a weakening of the centre. Nonetheless, in the long run

[33] Amtenbrink (1999), p. 94.
[34] See **box 4** in appendix 1.
[35] Friedman & Schwartz (1963), p. 445).
[36] Eccles (1951), p. 167-174.

major elements of the system are not excluded. In case such changes are proposed, one should carefully consider what the motives are for doing so, before one allows for a change in the balance between central and decentral elements, one side-risk being that a scaling back of the operational roles of NCBs will in the end undermine their presence in the Governing Council. The operational knowledge of the centre would seem to be adequately safeguarded by the fact that the centre prepares all implementation decisions and the fact that the centre is responsible for foreign exchange management and policy. To make an analogy with the Fed, the Board of Governors never seems insufficiently informed about the markets, although it does not carry out market operations itself. The presence of NCB governors in the Governing Council, in other words the federal composition thereof, also strengthens one of the other anchors of the ESCB, i.e. its independence as a monetary policy maker. Furthermore, direct operational knowledge benefits the discussion on monetary policy. Potential efficiency gains, when central bank operations would be carried out by the ECB, would have to be weighed against advantages of continued decentralized operations. In this respect we refer to Goodfriend (2000),[37] who concludes that a regional presence facilitates surveillance of the economy and helps a central bank to communicate with the public. Competition among regional central banks stimulates innovative thinking on policy, research and operational questions. We add that many central bank tasks also benefit from proximity to the banks, like payment services, standing facilities, banknote distribution, supporting supervisory activities. This leaves uncontested that cost considerations could enter the equation. It will be clear that the combination of decentralized implementation and the transfer of profits to the national Treasuries does not make for cost awareness being given high priority by the System. At the same time, more cost efficiency does not necessarily mean centralization of monetary operations. Harmonization and sharing of RTGS systems would reduce costs though.

[37] M. Goodfriend (2000).

8.3 OVERVIEW OF CHECKS AND BALANCES BETWEEN EXECUTIVE BOARD AND GOVERNORS AND POSSIBLE IMPROVEMENTS

8.3.1 Overview

In this section we apply the system of checks and balances of chapter 2 on the European System of Central Banks (ESCB), seen as a federally designed system in which separate bodies (the ECB and NCBs) are united within an overarching structure, in which each body, while maintaining its individuality, shares in the operational tasks of the system. To this end we divide the articles of this cluster over the categories of checks and balances mentioned in chapter 2. We follow the presentation used in chapter 5.4, but this time related to the 'internal' checks and balances between the ECB and the NCBs. There are at least fifteen articles and sub-articles containing 'internal' (ECB-NCB) checks and balances (not counting chapter IV).

Table 8-3: Overview 'internal' checks and balances (between ECB and NCBs)

(a1) Checks and balances protecting the prerogatives of the ECB:
- Art. 6; 9.2; 30.1; 30.5

(a2) Checks and balances protecting the prerogatives of the NCBs:
- Art. 3.3;[1] 5; 12.1c; 14.4; 31.1; 32;[2] 33;[3]

(b) Controlling (or blocking) mechanisms:
- Art. 6; 14.3; 14.4; 31

(c) Consultation mechanisms:
- (see Art. 12.3 of cluster III on the role of ESCB committees)

(d) Accountability mechanisms:
- Art. 12.3; 14.3 (last sentence); 26

(e) Checks and balances allowing for intertemporal flexibility
- Art. 5.2; 6; 12.1c; 16; 17-24; 25.2

Explanation: Categories (a1) and (a2) contain the articles defining operational tasks which cannot be taken away. Line a1 contains the task for the ECB of seeing to it that the System performs its tasks and of being in control of the pooled foreign reserves, while the ECB is also allowed to accept invitations to participate in (the capital of) international monetary institutions. Line a2 contains the rights of the NCBs, though some of the articles mentioned relate to non-System tasks (Art. 3.3 and 14.4), while Art. 5 and 12.1c contain the decentralization principle. Art. 12.1c applies to the typical central bank functions contained in Art. 16 (issuance and distribution of banknotes) and Art. 17-24 (monetary functions and procedures).[4] Art. 31-33 protect the NCBs' financial rights.[5]

[1] Art. 3.3 indirectly protects NCBs with supervisory responsibilities, because it stops short giving the ECB responsibilities of its own in the area of prudential supervision.

[2] Art. 32 stipulates that the monetary income flows to the NCBs (and not to the ECB).

[3] Art. 33 determines that the surplus profits flow to the NCBs. Losses of the ECB can be covered by NCBs, but only when the Governors so decide (weighted voting). The ECB may build reserves, but it is not free to spend, its budget requiring approval by the Governing Council.

[4] There is a link with cluster III, because the actual division of labour is laid down in the General Documentation (GD), which is approved by the Governing Council, the composition of which is determined in Art. 10.1-ESCB (see cluster III). The GD is prepared by ESCB committees, comprising both ECB and NCB representatives.

The blocking mechanisms (category b) mostly refer to possibilities for the centre (ECB, but read: Governing Council) to impose restrictions on or guidelines for NCBs (Art. 6; 14.3; 14.4; 31). There are no examples of blocking power of NCBs vis-à-vis the ECB.[6] Category (c) is empty. Indeed, formally the ECB and NCBs do not consult each other, but in practice their officials consult almost continuously, because they 'meet' in (advisory and technical) ESCB committees and in the Governing Council. The accountability mechanisms (category d) relate to information requirements. The ECB (Governing Council) may require from the NCBs all information necessary for it to be able to check whether the NCBs act according to and within the guidelines and instructions of the ECB (Art. 14.3). One would assume though that this information requirement also applies to the ECB. The annual accounts of the ECB, but also its annual budget (and with it the headcount), have to be presented to and be approved by the Governing Council.[7]
A number of articles allows for flexibility (category e). They open the possibility to share out operational tasks over the ECB and NCBs and the possibility to give the ECB specific tasks in the supervisory area.

Table 8-3 captures the checks and balances of the functioning of the federally designed ESCB, these checks and balances determine the relative roles of the NCBs and the ECB within a flexible framework. They determine the inalienable rights, the way the components of the System depend on each other and the way their powers are limited (e.g. by guidelines) and the elements of flexibility.
Table 8-3 shows two specific features, see also diagram 2 in chapter 12. First, the table shows that the number of articles allowing for flexibility (category e) is remarkably high, which allows for a high adaptability but also creates a relatively high uncertainty as to the division of labour. In fact, category (e) contains the System's core operational tasks (Art. 16, 17-24). Strictly speaking both extremes are possible, i.e. that only the NCBs perform these tasks or only the ECB. Neither is ensured of a continued operational role. The division of labour is relatively undetermined.
Second, the ECB has relatively few basic operational prerogatives, its edge seems to lie in the external area (international representation and being responsible for managing the pooled reserves).[8] In contrast, category (a2), which is supportive of the position of NCBs, seems very well represented. However line a2 basically contains no more than procedural, financial and non-System related articles. We also note that Art. 5.2 and 12, though containing strongly formulated decentralization principles, do not give *absolute* certainty.

At the same time the NCBs are under pressure to reduce their size. Political authorities are taking a new look at their NCBs, because the NCBs stopped being extensions of the

[5] Art. 16 has been used to give the ECB more 'own' funds, though the NCBs remain the ECB's shareholders and the ECB's budget needs to be approved by the Governing Council.
[6] The patrimonial decisions (in which the votes of the Executive Board members have zero weight – see Art. 10.3-ESCB in cluster III) do not count as such as they are aimed at decisions which affect the NCBs' relative financial positions, though there can be side-effects for the ECB's income position (esp. Art. 30.3).
[7] Art. 26-ESCB and Art. 15 of Rules of Procedure respectively – see under Art. 12.3-ESCB for Rules of Procedure. (External auditors examine the books of the ECB – see Art. 27-ESCB.)
[8] Apart from making sense for practical reasons, this division of labour is the product of the efforts by some Member States to give the ECB a visible role in the area of exchange rate policy, while other Member States wanted to prevent any remaining national influences over exchange rate policies.

government or, where they were independent or important for anchoring low inflationary expectations or stabilizing the exchange rate, they lost importance to the ECB. Furthermore, a number of European central banks are relatively quite large consuming a lot of resources. Especially the Banque de France and the Bundesbank, which have a high number of local branches, have announced, or are engaged in, plans to reduce size. The (research) output of the NCBs is also scrutinized by studies, like the one from Eijffinger (2002).
Another development is the EU's enlargement, implying increased importance of the ECB because not all new NCBs will perform all tasks (for instance some NCBs are too small to have their own RTGS (payments system) platform), and because the ECB will increasingly become the System's external face, as the System will in the end come to encompass twenty-five or more central banks, of which none has the standing or unique position of New York. This pleads for less open-endedness of the division of labour between the ECB and the NCBs, and a higher and more visible cost-awareness of the System's efficiency. In fact, this will be mutually beneficial, because NCBs which are sure of a minimum operational role are probably more co-operative as regards the System's efficiency.[9]

From the foregoing it follows that there are several areas in which the checks and balances in the operational field could be improved. In section 8.3.2 we will mention several improvements, some of which would require a change in the Treaty or the Statute; other improvements have a more practical nature and can be implemented without a Treaty change. Finally we mention a few suggestions which would allow the ECB to play a more meaningful role in the preservation of financial stability, while preserving supervisory responsibility as a national affair (though implying sharing information or even tasks with the ECB).
Apart from this, major improvements would not seem necessary, because we have concluded in the previous section (section 8.2.4) that the System is effective, that is it is capable of an effective implementation of monetary policy, including the effective realization of a uniform monetary policy stance in all parts of the euro area. There is a single money market rate and volatility is small, also thanks to the averaging facility built in the minimum reserve system.

8.3.2 Possible improvements in terms of checks and balances

Possible Treaty changes

1. We note that **Art. 12.1c** (decentralization of operations) while clearly showing a bias in favour of decentralization, is in fact open-ended. In theory both extremes are possible: complete centralization and complete decentralization. It would have been possible to introduce some permanent elements in the division of labour without giving up flexibility. While *too much* flexibility leads to too much uncertainty (and inefficiencies resulting from that) and to NCBs and the ECB seeing each other as competitors (possibly leading to sub-optimal cooperation, because of the fear of 'winner takes all'), *too little* flexibility would lead to a situation in which the System could be unable to adapt the division of labour in response to changes in the external environment. The following might introduce some more certainty. One could have laid down in the Statute that NCBs are allowed to offer standing facilities to local banks according to rules and guidelines of the Governing Council. One could also lay down that central banks are always allowed to offer payment

[9] We repeat that a continued operational role for the NCBs is also essential for the input of their governors in the Governing Council.

services related to monetary policy operations to their banks. This formulation would leave open developments towards, e.g., a primary dealer system or other market led forms of organization among commercial banks (provided these banks continue to fulfil their minimum reserve obligations). At the same time, it could be clarified that the ECB may hold and manage its own foreign reserves without having to take recourse to the NCBs as an agent, or – alternatively – it should be allowed to use one or a few of the existing NCBs, in which case it could rely exclusively on this NCB (or these NCBs) for being informed of market developments on a continuous basis in the same way as the Board of Governors of the Federal Reserve System is informed by the New York Fed.

2. While the distribution of banknotes is covered by Art. 12.1c, the issuance of banknotes is not, at least this is less clear. In this respect Art. 16-ESCB is open-ended, as it allows for both extremes, i.e. that banknotes are issued only by the NCBs or only by the ECB. On top of this, while the fungibility (interchangeability) of banknotes is generally accepted and de facto a reality, a single legal basis is missing. One way of expressing that banknotes are legally fungible is to insert a text, possibly in secondary legislation, stating that the banknotes issued by any component of the System belonging to the euro area are a 'joint and several liability'. An alternative, or possibly a combination, is to insert in the Treaty the commonly used term '**eurosystem'**,[10] encompassing the ECB and the NCBs of the Member States without a derogation or opt-out and to print the name 'eurosystem' on the banknotes possibly in the form of a multilingual seal, instead of printing 'ECB'. This would leave **Art. 16-ESCB** unchanged, but it would make this article less open-ended by eliminating the possibility that the euro banknotes are only issued by either the ECB or the NCBs and it would clearly anchor the seigniorage to the System (reducing the risk that the System's monetary income would be claimed by the Commission, which would reduce the System's financial independence).

Practical improvements

1. In the area of international representation (**Art. 6**) we have noted a possible bias in favour of the ECB. Indeed, when international fora invite the ESCB to a meeting, only sending NCB representatives would not contribute to the System's unity. This however does not imply that in some cases the Governing Council could not decide to nominate a representative of both the Executive Board and of one of the NCBs, preferably someone with a special position covering international relations or the markets, or with special expertise. Sharing such position with NCBs will win the ECB a cooperative attitude by NCBs.
2. In a federal system committees are an efficient tool for exchanging ideas among the regional central banks and the centre for fostering convergence of views. The present committee structure of the ECB according to which all NCBs participate in each committee might lose some of its present effectiveness when the euro area is enlarged with ten or more new (accession) countries. One improvement might be to replace a number of these committees by **small committees** composed of a limited number of NCBs (level, e.g., vice-presidents) suppleted with an ECB member of equal ranking, thus following the example of the Federal Reserve (see appendix 2, following this cluster).

[10] In the meantime in the draft Constitutional Treaty, as signed by the Heads of State and Government on 29 October 2004, but still to be ratified, the term 'eurosystem' has been defined in Art. 1 of the ESCB-Statute and will have formal Treaty-status, once the Constitution becomes effective.

Membership of these committees could rotate and should preferably be linked to expertise. Decision-making should be retained for the Governing Council. These small high-level *advisory* committees should discuss strategic matters and issues relating to the cohesion of the system. The advantage of small committees over the existing committees, in which all NCBs are represented, is that members of small committees are less inclined to defend 'national' positions and therefore are more apt to follow innovative lines of thought (bottom-up innovation). In large committees delegates will be more inclined to defend the interest of their NCB, because they expect others to do the same. Such group dynamics are less likely to occur in small committees. The aim of smaller committees is to mobilize ideas without immobilizing decision-making. The high-level committees are an instrument for keeping the federal character alive and make best possible use of it. They could also lead to forms of **specialization**, as NCBs could start focussing on the development of operational tasks in only a limited number of functional areas of the System and they could become more willing to follow the example of a few leading NCBs. This is a natural way to reduce the main disadvantage (i.e. possible cost inefficiencies) of decentralized implementation, which has merits of its own. One could make an exception for committees covering areas where national authorities are also major players (e.g. international relations, supervision and oversight) or for core business like monetary strategy evaluation or amendments to the General Documentation of ESCB monetary policy instruments and procedures. These committees could retain full composition. The other, small committees could establish, following the example of the Federal Reserve, sub-committees of varying size, when necessary including all NCBs (though the introduction of liaison officers in the high level committees should make this less necessary). An alternative would be to retain the present committees, even when growing to twenty-five members or more, while working with small-sized task forces. A disadvantage of that model would be that each proposal by a task force would still need to pass both the full-sized committee and the Governing Council, which for important non-monetary issues might want to stick to consensus decision-making, thus not solving our problem. Another aspect is that in very large sized committees the chairperson collects automatically a dominant position, while according to current practice the chairperson is usually a person from the ECB. Smaller committees allow for chairmanships to be more evenly spread over the ECB and NCBs, thus increasing the awareness that one is part of a system (a 'team').

Other improvements (not related to checks and balances)

Finally we want to recall we made a few suggestions for strengthening the contribution the ESCB could make to **financial stability**. We made suggestions for improved exchange of information between prudential and financial stability supervisors and to allow for some limited co-involvement of the ECB in the supervision of system-relevant banks (see section 8.2.1). Article 7 of the German Banking Law (Gesetz ueber das Kreditwesen) provides an example in this respect: 'The Deutsche Bundesbank and the Banking Supervisory Office shall exchange observations and findings which may be of importance for the performance of their respective functions.' Designating the ECB co-supervisor in a limited number of cases would make sure the ECB (in this case specifically the Executive Board) has the best possible knowledge of the positions of the largest financial players and their interlinkages. It would not imply the ECB taking over final supervisory responsibility, which would and should remain national.

Priorities

We have noted that the Statute could have been phrased in such a way as to leave the division of operational functions in a less open-ended way. The Statute could be improved in this respect only through an amendment of the Treaty. Central banks might view this as opening the box of Pandora, but it is a possibility. It is not urgent as the System is functioning well, though the likely accession of up to ten new Member States to the euro area over the period 2007-2012 might make this issue more urgent later this decade. The common (shared) issuance of banknotes could be addressed as of the moment the present draft Constitution Treaty becomes effective. For the short term priority should lie with the improvements of a more practical nature. In this regards we think the spirit of co-operation is best served by introducing a workable committee structure which does not give a leadership's role automatically to the ECB.

Furthermore, we recall our suggestion to increase the efficiency and effectiveness of the arrangements in the area of preserving financial stability by making better use of the ECB (by making the ECB co-supervisor for large banks) without taking away responsibility from national supervisors, a number of which are central banks.[11] This could be implemented at very short notice.

[11] See chapter 8.2.1 (Art. 3.3-ESCB) and sections I.1 and I.2 of Art. 3.3-ESCB.

APPENDIX 1: Developments in the Fed's early years (1913-1935) [1]

The federal design of the Federal Reserve System can be explained by both technical and political factors, which are described below. We will see that in some respects the design was not perfect. This led to an initial domination by the FRBs, which was corrected by the Banking Act of 1933 (which tried to improve the coordination among the FRBs) by the Banking Act of 1935, which gave the Board a stronger grip on the conduct of open market operations (OMOs). The contents of the Banking Acts are described in a separate box at the end of this appendix.

The Federal Reserve Act of 1913 should be seen against the central-bank-less situation of these days (the charter of the Second Bank of the United States had expired and had not been renewed in 1836). The National Banking Act of 1863 had provided for the creation of nationally-chartered banks, which were effectively handed the monopoly on issuing banknotes.[2] However, bank runs kept recurring, even in times of prosperity. And interest rates showed large seasonal swings because of the following mechanism: after the harvest season surplus funds held by banks in the agricultural areas would be sent to money centre banks in the large cities (mainly New York), where they earned money. The money centre banks often lend funds out to speculators in the stock market. When country banks needed currency, they would draw down their reserve accounts with their reserve city banks. Those banks, now with less vault cash, were compelled to draw down their own reserve accounts with their central reserve city banks, multiplying the effects. The money centre banks called in their loans and money panics could occur, which could not be assuaged by the lack of a lender of last resort. Also, national bank note issuance was inelastic, as these notes had to be secured by government bonds, bank holdings of which showed even a countercyclical pattern. When interest rates rose, existing bond holdings became less attractive and were sold, thus reducing their basis for issuing banknotes. Another problem prior to the FRA involved the collection of checks, which could take weeks.[3]

A solution was found by allowing bank to borrow liquidity by discounting commercial bills to a Federal Reserve Bank, while the dominance of the New York financial markets was reduced by creating a number of FRBs over the country – implying the unavoidable waves in liquidity needs in the country were not amplified anymore in the New York with their spill-over effects to other parts of the country. The political advantage of creating a system of FRBs, instead of one central bank, was that it allowed for a mixture of private-public governance, with the FRBs owned by private banks (a wish from the financial community, supported by the Republicans in Congress), while the rule-setting Board had the character of a governmental, though independent, agency (a strong wish of president Wilson's Democratic Party). We describe the features of the FRA in more detail below.

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[1] This appendix is based for the most part on Friedman & Schwartz (1963), *A Monetary History of the United States, 1867-1960*, p. 251-253; 362-391; 411-420; 445-449; Wheelock (2002), 'Conducting Monetary Policy Without Government Debt: The Fed's Early Years', in: *The Federal Reserve Bank of St. Louis Review*, May/June 2002, p. 1-14; Federal Reserve Bank of Chicago (1988), Annual Report 1988, 'Historical Perspectives: The Bank at 75'. For a discussion of the checks and balances involved see chapter 6 above (section on the Federal Reserve).

[2] See Art. 16-ESCB, section I.2.

[3] Moore (1990), *The Federal Reserve System - A History of the First 75 years*, p. 4-5; FRB of Boston (1990), p. 13-15.

The Federal Reserve Act of 1913 provided for several major innovations: commercial bills could be discounted at the Federal Reserve Banks (thus providing for an 'elastic currency'); member banks were required to hold their reserves at their FRB (thus ending the pyramidization of reserves in New York); a par collection system for check clearance was set up (thus ending the practice of discounting checks drawn on peripheral banks) and FRBs would be owned by its member banks. Rediscounting, or making loans to member banks, was seen as the chief means of affecting credit. The **founders** of the Fed had placed limits on the type of securities eligible for rediscount: eligible were discount notes, drafts and bills of exchange issued or drawn for agricultural, industrial or commercial purposes, and bank acceptances.[4] The FRA explicitly prohibited the rediscount of notes, drafts or bills for speculative purposes, defined as notes, drafts or bills issued or drawn for the purpose of carrying or trading stocks, bonds, or other investment securities.[5] In this way they hoped to prevent Federal Reserve credit from being used for speculative purposes. The founders expected the Fed to supply a sufficient volume of credit to accommodate growth and fluctuations in the real activity.[6] The FRA also allowed banks to issue bankers acceptances to finance foreign trade, and it encouraged the development of a U.S. acceptance market by permitting FRBs to acquire acceptances by discount or open market purchase. The FRA also authorized FRBs to buy and sell U.S. government bonds and notes (federal, state and communal). This provision was intended to allow them a source of income in the case the income from rediscounts and the provision of services was insufficient to meet expenses.[7] In other words, open market operations were not seen as a monetary policy instrument, but rather as creating commercial opportunities for the FRBs.

It was not until 1921, that the Reserve Banks (that had ample liquidity due to the massive gold inflow during the First World War and the 1920 downturn) began to buy and sell government securities on a significant scale. Discount window loan volume had dropped sharply in 1921-1922, when the FRBs had raised their discount rates - which had reduced their income.

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[4] FRA (1913), Section 13 (as amended in 1916 for the purpose of including a wider array of bankers acceptances).

[5] FRA (1913), Section 13. An exception was made for bills drawn for the purpose of trading bonds and notes of the Government of the United States.

[6] This thinking reflects the so-called the **Real Bills Doctrine**. Friedman is critical of the Real Bill Doctrine. It did not work symmetrical, because commercial paper was abundant (so currency did not necessarily move down with the volume of commercial paper). Furthermore, in practice the doctrine was not pure, because not only commercial paper was accepted, but indirectly also government paper (because government paper was used as collateral for 15-day notes issued by banks, which itself was accepted as commercial paper. Finally the doctrine overlooked the need to take into account other sources of money creation. We quote F&S on this (Friedman & Schwartz (1963), p. 191-193): 'The road to elasticity of the money stock, it was believed, was paved with commercial paper that member banks would present for rediscounting. [....] Conflicting monetary policies were sometimes pursued, because it was not clear to the Federal Reserve that the rediscounting of any security, open market purchases, and gold inflows, all had precisely the same effects on the money stock as the rediscounting of eligible paper.' The risk of bank runs though was effectively reduced, because banks to generate cash quickly in times of need by discounting paper at an FRB. A further reflection of the Real Bills doctrine was that the FRBs had to set discount rates 'with a view to accommodating commerce and business' (FRA, Section 14(d)). For the Real Bills doctrine, see also section I.2 of Art. 12.1c-ESCB.

[7] Wheelock (2002), p. 5. Section 14 of the FRA (1913) allowed open market transactions in securities eligible for rediscount, gold and all kinds of government paper.

Only then policy-makers started to realize that the potential effect of open market operations *as a monetary policy tool*. The possibilities for such a policy were especially recognized by Benjamin Strong, the powerful governor of the New York FRB.[8]

According to Wheelock (2002) the accompanying change in the composition of Federal Reserve credit (assets) during the 1920s reflects the evolution from the self-regulating, selective *credit* policy envisioned by the Fed's founders toward a modern *monetary* policy.[9] To take an example, the volume of discount borrowing and advances of the FRB of New York came down from dollar 871 million in 1920 to dollar 164 million in 1924. In contrast, its volume of holdings of U.S. government securities rose from dollar 47 million in 1923 to dollar 742 million in 1935.[10]

Strong saw a need to coordinate the operations of the Reserve Banks, but he also argued they should be undertaken by the New York Fed, since the market for government securities was located in New York. In May **1922**, at the request of the Federal Reserve Board, the governors of the four eastern districts (New York, Chicago, Boston and Philadelphia - later extended with Cleveland)[11] organized among themselves a committee 'to execute joint purchases and sales and to avoid conflicts with orders for Treasury account'. In March **1923** the Board reinserted its influence by disbanding the governors' committee and re-establishing it as a committee under the aegis of the Board.[12] Operating in accordance with principles and regulations set forth by, and under the general supervision of, the Board, this Open Market Investment Committee (OMIC) of the Federal Reserve System was given 'the duty ... to devise and recommend plans' for open-market operations. The Board's resolution establishing the OMIC provided that open-market purchases and sales should be made with the primary regard for the accommodation of commerce and business and to the effect of these purchases and sales on the general credit situation. [13] The wording made clear that open market operations in government securities fell under the umbrella of monetary policy

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[8] Strong directed two major monetary policy operations during the 1920s involving substantial open market purchases in 1924 and 1927. Scholars disagree whether his primary motivation had been to ease money market conditions or to redirect the international gold flow away from the United States toward the United Kingdom, in an effort to help Britain restore, and then preserve, gold convertibility of the pound. His initiative irritated members of the Federal Reserve Board, who believed the committee of governors (see below) had overstepped its authority. They also believed that credit should be provided to banks for selective purposes, i.e. through discounting commercial and agricultural loans. Otherwise, the Fed risked contributing to speculative attacks. The stock market was roaring, but most Board members were reluctant to constrain this by raising the discount rate, because this would not only punish investment brokers, but also businesses. However, the FRBs believed it neither practical nor desirable for the Fed to affect the private allocation of credit. In 1928 the Federal Reserve's open market committee decided to implement a more restrictive monetary policy. The FRBs also began to increase discount rates – and for the most part these actions were supported by the Board. Despite this, credit continued to flow to the stock market. Some officials recommended that banks be required to liquidate speculative loans before being permitted to rediscount eligible paper. When the stock market declined sharply in October 1929 and after, the Fed did not respond aggressively, one reason being that some FRB governors were of the view that open market operations constituted artificial easing and would lead to a dangerous misallocation of credit. They were not able to prevent open market operations altogether, but their attitude slowed the Fed's response to the Great Depression. (Wheelock (2002), p. 6-11.)

[9] Wheelock (2002), p. 6.

[10] Federal Reserve Bank of New York, Annual Reports over 1920, 1923 and 1935.

[11] Prochnov (1960), p. 119.

[12] See Dykes and Whitehouse, 'The Establishment and Evolution of the Federal Reserve Board: 1913- 1923', in: *Federal Reserve Bulletin*, April 1989, p. 24.

[13] FRA (1988), Section 12A(c). See also Marriner Eccles (1951), *Beckoning Frontiers*, p. 169.

making.[14] Beginning December 1923, a System account (then called Federal Open Market Investment Account)[15] was established, in which every FRB had a share, based on its share in the FRS's total capital subscription by member banks. Individual banks still engaged in independent operations which the Committee executed on their behalf, but they were generally small in amount.[16] The System account was operated by the New York Reserve Bank.

Until 1928, 'the New York Bank was the prime mover in Federal Reserve Policy both at home and abroad, and Benjamin Strong, its governor from its inception, was the dominant figure in the Federal Reserve System'. After his resignation (and death) in 1928 there was a vacuum in leadership. 'The Banks outside New York, seeking a larger share in the determination of open market policy, obtained the diffusion of power through the broadening of the membership of the OMIC in March **1930** to include the governors of all the Banks.' [17] Open market operations now depended upon a majority of twelve rather than of five governors and the twelve "came instructed by their directors" rather than ready to follow the leadership of New York as the five had been when Strong was governor. These new other Banks were, unlike New York which was accustomed to regard itself as shaping conditions in the credit market, more likely to believe that the Reserve System must *adjust* to other forces. They had no background of leadership and national responsibility, and 'tended to be jealous of New York and predisposed to question what New York proposed.' Most of the Reserve Banks were also reluctant to follow the leadership of the Board, partly because of the Board's personnel, partly because they still thought of it primarily as a supervisory and review body.[18]

Early **1932** great pressure from Congressional critics had induced the System to undertake large-scale securities purchases it should have made much earlier. When the operation failed to bring immediate dramatic improvements, the System promptly relapsed into its earlier

[14] Dykes and Whitehouse (1989), p. 241. The wording seems to have been borrowed partly from the last part of **Section 14(d)**-FRA (1913): "[Every Federal reserve bank shall have the power:] (d) To establish from time to time, subject to review and determination by the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business."

[15] Later called System Open Market Account (**SOMA**).

[16] Friedman & Schwartz (1963), p.251n. They also mention that Strong and the other Bank governors regarded the coordination of open market operations as a *voluntary* agreement. Reserve Banks could refuse to participate in operations recommended by the committee. The issue was never pressed to a final decision and became irrelevant after the Banking Act of 1935, which would lead to new decision-making rules in the FOMC, the committee which had been established by the Banking Act of 1933. The voluntary character of the arrangements had been criticized by Eccles who, when asked by president Roosevelt to become the chairman of the Board, had produced a critical memorandum which would lead to the Banking Act of 1935 (see Eccles (1951), *p. 165-176).* Another issue never pressed to its end was how much leeway an FRB had in maintaining an unchanged discount rate, while the rest of the FRBs with the approval of the Board wanted to change their rates. In 1927 Strong was leading an effort to reduce the rates, basically for international reasons. Chicago resisted and was ordered by the Board to reduce its rate. Chicago complied, but announced at the same time it would seek an opinion from the U.S. Attorney General, as to the legality of the Board's action. In the end Chicago did not pursue this legal course. FRB of Chicago, Annual Report 1988, p. 18.

[17] See also Prochnov (1960), p. 121. The OMIC was redesignated as the Open Market Policy Conference.

[18] See Friedman & Schwartz (1963), p. 414-416. Strong's successor at New York (Harrison) did advocate a strong reaction to the unfolding liquidity crisis, but he failed to convince the others.

passivity.[19] The apparent failure of monetary policy to stem the depression led in the New Deal era to the relegation of money to a minor role in effecting the course of economic events. On the other hand, action was taken to strengthen the foundations of the American financial structure. The collapse of the banking system produced a demand for remedial legislation that led to the enactment of federal deposit insurance, to changes in the powers of the Federal Reserve system (see following paragraph and box 4) and to closer regulation of banks and other financial institutions. Other measures were that banks were restricted from engaging in securities activities (Glass-Steagall Act of 1933) and prohibited from offering interest on demand deposits.[20]

The battle of power between the New York Fed and the Board and the apparent failure of the Federal Reserve to get its act together led to changes in the FRA, incorporated in the Banking Acts of 1933 and 1935. The **1933** Banking Act eliminated the power of Banks to buy and sell government securities for their own account except with the explicit permission or at the direction of the Federal Open Market Committee (**FOMC**), which replaced the Open Market Policy Conference, and consisted of the twelve heads of the Banks.[21] The Banking Act of **1935** further centralized the authority and responsibility for open market policy by changing the composition of the **FOMC**: it would be composed of the *seven* members of the Board and *five* representatives from the FRBs, each to be selected annually by the board of directors of stipulated groups of Reserve Banks.[22] New York has a permanent vote,[23] the other eleven FRBs share four votes. The Banking Act of 1935 did more: it changed the name of the Federal Reserve Board to the 'Board of Governors of the Federal Reserve System'; [24] reconstituted the Board by eliminating ex officio members; and strengthened the control of the FOMC over open market operations.

[19] Friedman & Schwartz (1963), p. 419.
[20] FRB of Chicago, Annual Report over 1988, p. 20.
[21] Friedman & Schwartz (1963), p. 446n. Banks were still allowed to purchases government securities for their own account, subject to certain restrictions, in an emergency involving individual banking institutions. This possibility would be scrapped by the Banking Act of 1935.
[22] Prochnov (1960), p. 121.
[23] Formally only since 1942, see footnote 39 below and Art. 10.2, section I.2 in cluster III.
[24] Before, only the executive head of the Board also had been a governor and addressed as such. The other members were simply members of the Board and were addressed without title. The chief executive officers of the Banks had been governors too, but henceforth became 'president' of their Banks. It was through this new name (Board of Governors of the Federal Reserve System) that the term 'Federal Reserve System' appeared in the FRA. The system as such was not a legal entity and the FRA had described the components of the system, their powers and the way they relate. In fact, the recital of the FRA does not refer to the establishment of a system, but to the establishment of Federal reserve banks: "An Act. To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." See also section I.2 under Article 1-ESCB of Cluster I.

Box 4: Banking Acts of 1933 and 1935

These acts are of special relevance for the institutional design of the Federal Reserve.[25]

Banking Act of 1933 [26]
- Establishment of the **FOMC** (composed of one representative of each Reserve Bank), placing the open market operations under the control of the FOMC.
- Introduction of a provision forbidding Reserve Banks from engaging in **negotiations** with foreign banks except as authorized by the Board.[27]
- Introduction of a provision stating that the Board's funds 'shall not be construed to be Government funds or **appropriated moneys**.[28]
- The Banking Act of 1933 also provided for the establishment of the Federal Deposit Insurance Corporation (**FDIC**) to protect small depositors against loss due to bank failure, the obligation for member banks to become member of the FDIC and a prohibition for commercial banks to engage in **securities activities**.

Banking Act of 1935 [29]
- **Reorganization** of the Federal Reserve **Board**: the name was changed into the Board of Governors of the Federal Reserve System. Ex officio membership (of the Secretary of the

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[25] Another famous act from this era is the **McFadden Act** of 1927 which prohibited interstate banking. The **Riegle-Neal Act** of 1994 again permitted (adequately capitalized and managed) bank holding companies to acquire banks in any state.

[26] The Banking Act of 1933 is sometimes referred to as the **Glass-Steagall Act** of 1933. In practice, the Glass-Steagall Act of 1933 has come to mean only those sections of the Banking Act of 1933 that refer to banks' securities operations - sections 16, 20, 21 and 32 -, which establish a separation between the banking and securities businesses. The Glass-Steagall Act was de facto repealed when in 1999 **Gramm-Leach-Bliley Act** was passed. The GLB Act also allowed affiliation between banks and insurance underwriters, thus reversing part of the Bank Holding Act of 1956 The GLB Act allows banks (financial holding companies) to offer a menu of financial services, including investment banking and insurance sales..

[27] See FRA (1988), Section 14(g). According to Kettl (1986), p. 46, this was an undisguised slap at the extensive negotiations Strong had with Norman, the governor of the Bank of England. Though, German Länder may, in their field of competence, conclude public international law agreements with third countries, subject to approval by the Federal Government, this does not apply to the Landeszentralbanken. (Zilioli and Selmayer (1999a), p. 278.)

[28] In the wake of the Depression, Congress wanted to strengthen the Fed, and the committee report on the bill noted Congress's intent to allow the Fed to set its own management policies. This clause ended GAO's audit of the Fed. (Kettl (1986), p. 154.) In 1978 the GAO audit would be restored, be it with a limited mandate - see Article 27-ESCB.

[29] This content of this part of the box follows closely Eccles (1951), p. 222 - 229. Eccles was chairman of the Federal Reserve from 1934 to 1948. In September 1934 Eccles was sounded by president Roosevelt about the post of chairman (Governor) of the Federal Reserve Board. Eccles replied that the post would be an appealing one only if fundamental changes were made in the Federal Reserve system. He elaborated his ideas in a memorandum, presented to and discussed with president Roosevelt on 4 November 1934. Roosevelt supported his ideas. Subsequently Roosevelt set up an Interdepartmental Banking Committee, consisting of the heads of agencies involved in banking operations and chaired by Treasury Secretary Morgenthau (Eccles (1951), p. 165-176 and p. 194).

Treasury and the Comptroller of the Currency) was scrapped,[30] implying the U.S. President would appoint henceforth not five, but seven members of the Board. Their tenure was increased from ten to fourteen years[31] (thus restoring the rule that the president appoints one new member only every two years, which rule had been established at the start of the Fed in order to prevent the president from being able to appoint too many new members within one presidential term of four year.)[32]

- **Chief Executive Officers** at the Federal Reserve Banks: the name 'governor' had, until then, been reserved for the person was designated by the President from among the five presidential appointees to the Federal Reserve Board to be the Board's active executive officer. [33] The chief executive officers of the FRBs had started to use the title of 'governor' as well, a title generally assigned to the operative head of central banks. The Banking Act of 1935 stipulated that the chief executive officers of the Federal Reserve Banks should henceforth be called **presidents**, the title 'governor' being reserved for each member of the Board of Governors. The appointment of the presidents by the board of directors of their FRB would henceforth be **subject to approval** by the Board of Governors.[34] [35] They would be appointed for **five-year** terms. Before, their term had not been fixed and they could have been dismissed 'at pleasure' by their boards.[36] The Board of Governors would be chaired by the 'Chairman', designated from among the governors by the President of the United States, by and with the consent of the Senate.[37]

- **New Federal Open Market Committee**: Eccles wished to take away the power over open-market operations from the privately run FRBs, acting through their governors. He wished the power to be concentrated in an Open Market Committee of the *Federal Reserve Board* in Washington D.C.[38] In the House version of the bill the Open Market Committee was formed of Board members alone. The governors of the FRBs (renamed presidents - see previous indent) would annually chose **five** of their number to act in an advisory capacity to the

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[30] According to Eccles (1951), p. 216 and 222, it was at the insistence of Senator Glass, himself a former Secretary of the Treasury, that the ex officio membership of Treasury Secretaries was dropped, as Glass knew by experience he had had too much influence on the Board's decisions. Treasury Secretary Morgenthau then insisted that the other ex officio membership, i.e. that of the Comptroller of the Currency (a subordinate in the Treasury Department), should also be dropped.

[31] FRA (1988), Section 10(1) and 10(2).

[32] The first group of governors would be appointed for periods from two to fourteen years, so that not more than one would expire in any two-year period.

[33] The 'governor' of the Federal Reserve Board did not act as chairman. Section 10 of the FRA of 1913 stipulated that '[t]he Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Board.'

[34] The same applies to the first vice president.

[35] Eccles had promoted the idea of making the appointment of the FRB's governor subject to approval by the Board in Washington, because in the day-to-day operations the governor, being the FRB's ceo, was more important than the FRB's chairman (one of the class C directors). According to Eccles the ceo was 'the creation of the private interests which supplied a majority of the board of directors and who hired and fired the governor without let or hindrance of the Reserve Board in Washington.' The importance of the governors of the FRBs had increased with the increased importance of the open market operations, which was coordinated by a committee consisting of governors. (Eccles (1951), p. 168/9.)

[36] FRA (1913), Section 4. FRA (1988), Section 4, seems to apply only to 'other' officers and employees.

[37] The same procedure applies to the designation of the Vice Chairman.

[38] Eccles (1951), p. 174.

committee. In the final version they (i.e. five FRB presidents) had become full voting members of the committee.[39] Eccles still valued the outcome because it established the principle that open market operations would be initiated in Washington. Also no FRB would be permitted to engage, *nor decline to engage,* in open-market operations without approval by the committee.[40] Eccles also valued that 'records were to be taken and kept of each vote on open-market policy questions, and with a full account of such actions being submitted annually to Congress, there could no longer be any buck-passing.' [41]

- The Board's powers to alter **reserve requirements** were enlarged. It was given the authority to change member banks' reserve requirements between the minimum percentages specified in the act of June 1917 and twice those percentages.[42] Thus the Board of Governors was given authority to use the reserve requirements as a monetary instrument without approval by the President.[43]

[39] Section 205 of the Banking Act of 1935 stipulated that the five representatives (together with one alternate for each) are to be selected annually by the boards of directors of the FRBs according to the following schedule: 'one by Boston and New York; one by Philadelphia and Cleveland; one by Richmond, Atlanta and Dallas; one by Chicago and St. Louis; and one by Minneapolis, Kansas City, and San Francisco.' This was changed in 1942 (amendment to Section 12A FRA, 7 July 1942, 56 Stat 647) defining the following groups: '(1) **New York**, (2) Boston, Philadelphia, and Richmond, (3) Cleveland and Chicago, (4) Atlanta, Dallas, and St. Louis, (5) Minneapolis, Kansas City, and San Francisco. According to the Annual Report of the Board of Governors of the FRS of 1942 (p. 56) '[t]his arrangement makes provision for continuous representation of the FRB of New York on the FOMC. This is for the reason that the New York Bank is in the principal capital market and acts as the agent for the FOMC in the operation of the System open-market account.' Before 1942, New York had always had a vote, implying Boston never had one. In 1942 Boston was shifted to one of the other groups, while at the same time some reshuffling took place, each group still consisting of geographically neighbouring districts. See also Article 10.2-ESCB in Cluster III. Most publications of the Federal Reserve contain a map showing the districts.

[40] According to Friedman & Schwartz, the change in name of the Federal Reserve Board into the Board of Governors was the final seal on the transfer of effective power from the Banks to the Board. (Friedman & Schwartz (1963), p. 445-447.)

[41] Eccles (1951), p. 224/6. FRA (1988), Section 10(b); see also Art. 10.4-ESCB, section I.2.

[42] Since 1933 the Board had been able to increase or decrease reserve balances member banks were required to maintain against their demand and time deposits, during special circumstances and only with the President's approval. Before 1933 the Board had only been allowed to suspend reserve ratios for limited periods. It could not change them. This would only have been possible through amending the FRA, Section 19. See Friedman & Schwartz (1963), p. 447, also for some later amendments of Article 19-FRA.

[43] Eccles (1951), p. 226.

APPENDIX 2: Specialization within the Federal Reserve System

This appendix describes the specialization within the FRS existing in the following areas: research, financial services and banking supervision. (The role of New York in the field of operations is described in appendix 1 and p. 337-8.)

Specialization is quite prominent in the field of *research*. Some district banks have a strong academic reputation, but reputations have varied - and still vary - over time. Others have specialized - clearly for geographic reasons - in certain commodities or regions, e.g. Kansas in agriculture, Dallas in energy, San Francisco in the Pacific rim, while the Philadelphia Fed concentrates on researching expectations using survey data. This could be called *informal specialization* - it is not the result of Systemwide decision-making, but rather the result of individual Reserve Bank decisions and strategic plans. Competition in analytical fields like research is healthy, because it stimulates good research and avoids a monoculture of research in which only the centre determines the research agenda.[1]

Specialization also exists - to a limited extent - in the area of *financial services*.[2] Specialization in this area dates from relatively recent times. In 1994 the Conference of (Reserve Bank) Presidents[3] created a special Financial Services Policy Committee **(FSPC)** to set out the strategic direction of the Fed's financial services and related support functions nationwide and to provide leadership for the evolving U.S. payments system. The FSPC is formed by the presidents or first vice-presidents of six FRBs[4] and is chaired by the president of an FRB. With a view to better coordinating the FRBs' development and implementation of financial services under the FSPC umbrella, certain Reserve Banks serve as product and function offices for the entire Fed System. The chairman of each 'product group' is chosen on the basis of a competition between two or three FRBs. These assignments are generally for 5

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[1] See M. Goodfriend (2000), 'The Role of Regional Banks in a System of Central Banks', *FRB of Richmond Economic Quarterly*, Winter 2000, Vol. 86, No. 1. For a further description of the specialization of the FRBs' research departments, see Fase and Vanthoor (2000), The Federal Reserve System discussed: a comparative analysis, *DNB Staff Reports*, No. 56.

[2] All FRBs are connected to **Fedwire**, the funds transfer system of the FRS, and they all offer the whole range of payment services, among which are settlement services to approximately 90 local and national private-sector clearing and settlement arrangements. This explains the presence of local expertise in the area of payment systems in all FRBs.

[3] The **Conference of Presidents** meets periodically and has established six *standing* committees (Steering Committee; Committee on Credit, Reserves and Risk Management; Committee on Management Systems, Budgets and Planning; Committee on Personnel; Committee on Regulations, Bank Supervision and Legislation; and the Committee on Research, Public Information and Community Affairs), each committee consisting of three presidents, and nine subcommittees, in which Board of Governors staff may participate. Six of the nine subcommittees have representation of all FRBs. Two of the other subcommittees have liaison members from the Reserve Banks not actually represented. In one subcommittee eight FRBs are represented. This network of committees increases the cohesion within the System and stimulates bottom-up innovation and also specialization. In addition, a **Conference of First Vice Presidents** (CFVP), established in 1969, meets periodically dealing primarily with operational matters (not policies) and focussing particularly on the implementation of operational policies. This Conference has currently one committee (Steering Committee) and one subcommittee. Apart from this a few System committees exist, the Board member of which is assigned by the chairman of the Board of Governors and the FRB members (four to five) by the chairman of the Conference of Presidents. These System committees are mostly chaired by the Board member. They cover issues like employment benefits and investment performance.

[4] The Board of Governors is represented through a liaison officer.

to 7 years, but due to more consolidation and centralization of operations, product office locations may not rotate, or rotate less frequently in the future. These 'product offices' are typically chaired by the first vice president of the FRB that won the assignment. This 'product director' is allowed an additional staff of 5 to 10 persons. A 'product office' typically tries to enhance existing services.[5] Today, the provision of most payment services is managed by a 'product office', located in one of the FRBs. Examples are: the Wholesale Payments Office[6] is situated in the New York Fed, the Retail Payments Office in Atlanta, Cash Services in San Francisco, and customer support in Chicago. Some FRBs are also specialised in the area of *financial services support* functions: e.g. providing accounting services, automation services,[7] payroll processing, etc.[8]

Two developments made an impact on the organization of payment services by the FRBs. First, the Depository Institutions Deregulation and Monetary Control Act (**MCA**) of 1980 forced the Fed to price its financial services competitively against the private sector, i.e. to use prices allowing for full recuperation of costs, while also using a mark-up for implied costs (i.e., taxes and borrowing costs, which are made by the private sector, but not by the Fed – see FRA (1988), Section 11A). This act has been criticized, because unlike private sector providers, the FRBs cannot distinguish between small and big clients (i.e. the FRBs cannot negotiate volume deals). The MCA introduced market discipline on the FRBs. [9] The Board of Governors establishes fees for FRB services, pursuant to section 11A-FRA. The Board has delegated some of these decisions to an internal division director or to the FSPC. Second, the FRBs received a strong incentive to coordinate their payment services after the repeal of the 61 years-old prohibition on interstate banking in 1994 with the adoption of the **Riegle-Neal Act**. This repeal allowed commercial banks to use and compare the services of the Fed in different districts. The MCA and the Riegle-Neal Act led to the creation in 1994 of the FPSC, which sets the strategic direction for Fed financial services nationwide.[10]

The Board of Governors, assisted by its staff, is responsible for the development of *policies and regulations* to foster efficiency and integrity of the U.S. payment system, and it works with other central banks and international organizations to improve the payment system more broadly.[11] The Federal Reserve has established five System committees, in which Board

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[5] Source: A.F.P. Bakker (1996), *Report of a visit to the Federal Reserve System*, De Nederlandsche Bank, December 1996, p. 32-37. (Only available in Dutch.)

[6] Includes Fedwire (the Fed's funds and securities transfer system) and net settlement services involving institutions within a single Federal reserve district.

[7] One FRB (Richmond) is responsible for **FRIT** [name change a couple of years ago](Federal Reserve Information Technology). FRIT operates the consolidated network of Reserve Bank mainframe data processing systems and data communications, which are crucial for Fedwire (the Fed's funds and securities transfer system) and the ACH operated by the Fed (Automated Clearing House, used for small-value, usually consumer-related electronic payments). Back-ups for critical information technology services are located at different sites.

[8] See FRB of St. Louis, Annual Report 1997, for a list with specializations in the area of payment services.

[9] According to Greider (1987), p. 154-157, the MCA was created as a way to put an end to the shrinking of Fed membership, which would - if continued - reduce the Fed's leverage over the economy. Chairman Miller had proposed to remunerate the required reserves of the member banks. Congress refused, but were asked to find another solution. The Act opened services to all depository institutions, including the discount window, and required all depository institutions, member banks and non-member banks alike, savings and loan associations and even credit institutions, to maintain reserves with the Fed. At the same time old-fashioned regulations capping interest rates were abolished or forbidden.

[10] See FRB of St. Louis, Annual Report 1997.

[11] Board of Governors web site → Payments systems → Glossary.

members and FRB presidents participate. In the Payments System Policy Advisory Committee (**PSPAC**) participate three Board members and three FRB presidents.
In the area of *banking supervision* specialization is increasing, as it is very difficult to maintain the highest level of knowledge, e.g., in specialised fields like risk management in insurance business, in all FRBs.[12]

Outsourcing is a common practice in non-core-functions (cleaning/catering, shipment of cash, some IT developments).[13]

[12] In this specific field Boston is developing a knowledge centre. And other FRBs have more *expertise* than others in certain areas. For instance New York, Chicago, San Francisco and Atlanta have expertise in supervising branches of foreign banks.
[13] Based on Bakker (1996).

CLUSTER III

CHECKS AND BALANCES BETWEEN THE GOVERNORS AND THE EXECUTIVE BOARD
(relations *within* the decision-making bodies)

CHAPTER 9: INTRODUCTION TO CLUSTER III

In this cluster we will look for checks and balances within the System's highest decision-making body, the Governing Council. In fact what we have in mind is the relation between the representatives of the NCBs (the governors) and the representatives of the central body, the Executive Board. While both share the same objective, i.e. achieving price stability for the euro area, there are many issues, like organizational issues and issues how to react to political pressure, where the interests of the governors and the board members do not necessarily run parallel. This is reflected in the fact that in the preparation of the Statute there has indeed been an extensive debate on the composition, the voting system and the own (i.e. non-delegated) powers of the Executive Board. Questions were posed like should only the president of the Executive Board be member of the highest decision-making body or all Board members?; should the votes of the NCB presidents (the governors) be weighted and what would that mean for the vote of the Executive Board?; should the Executive Board be a secretariat or an executive arm of the Governing Council, or should it have 'own powers'? Behind these questions lay the ultimate question on how powerful the Executive Board should be.
For our study we take as a starting point an executive board, and a council in which the federal elements of the System are represented, i.e. the governors. In this council the executive board could be represented, or not. What we will be looking for is whether the drafters envisaged a role for both governors and executive board members, and how they envisaged this role could be protected against intrusion by the other party. In other words, did they design a stable system of checks and balances? [1]

The drafters intended to find a middle ground, i.e. rejecting the extreme of giving all powers to the governors or to the central body. A supranational element was considered important, because it increased the level of accountability (as the board members were to be appointed by European authorities), it helped giving the system a 'face' (important vis-à-vis the political authorities and the financial markets), it would provide leadership and help create unity within

[1] We should also mention the existence of a third decision-making body, the **General Council**, which includes the governors of the NCBs of EU Member States that have not yet entered the euro area and the members of the Governing Council; however, in order to ensure that this Council could not start to act as an enlarged Governing Council, it was decided by the drafters of the Statute that not all Executive Board members should be member of the General Council - in fact only the president and vice-president. The body acts as a forum for exchange of information. In the General Council responses may be coordinated in areas where the ESCB has an interest in a common position by the EU Member States, but no competence of its own, like issues relating to the role of the IMF in preventing financial crises. The General Council has a role in administering credit and debit positions resulting from foreign exchange interventions conducted in the context of ERM-II. The functions of the General Council are formally listed in Art. 44 and 47-ESCB.

the System. There were also arguments against putting *all* decision-making powers in the hand of the new board. These were partly **political**, partly **technical** by nature. For instance, it was considered unacceptable to the German electorate to hand over the monetary powers of the mighty Bundesbank to an unknown body, while not retaining a presence in that new institution.[2] But also countries that feared a t*oo independent* ECB had reason to propose strong federal elements, which could contain the power of a possibly too independent centre. **Technically** it made sense to use the expertise of the incumbent governors, supported by their staff. Another point usually overlooked is that the Governing Council does not only decide on monetary policy, but also on issues like the external positioning of the System, the degree of decentralization, the annual budget of the ECB, legal opinions, the ordering of new banknotes, payment system regulations. Here the active involvement of the governors is called for. More arguments in favour of a regional presence in the decision-making body of a federal bank are mentioned by Goodfriend (2000): it facilitates surveillance of the economy and helps a central bank to communicate with the public. Furthermore, a federal build-up enhances competition in research and innovative thinking. The above arguments do not indicate whether the governors should have a majority of the votes in the council, or not. One could point to two different, both successful examples: the Bundesbank (with a majority for the LZB-presidents) and the FOMC (with five of the twelve votes reserved for the FRB presidents). In either case, it takes special skills of the ECB president to chair these meetings with central and regional members, because he should both stimulate debate and be able to achieve consensus.

Both the Executive Board and the Governing Council are attached to the ECB and the System is governed by these decision-making bodies of the ECB. The reason for attaching the Governing Council to the ECB was that the System itself would not receive legal personality, which would make the Governing Council, if attached to the System, resemble an agency of the Community.[3] This explains why in many documents, including the ECB's Annual Report, the words 'the ECB' are used as short for the ECB's highest decision-making body, the Governing Council.

Relative roles of the committees and the IGC

The *Delors Committee* already laid the ground for a central bank system with strong federal elements, with NCBs continuing to exist and with both the members of the Board of the central institution and the presidents of the NCBs being member of the ESCB Council. In the period May – November 1990 the *Committee of Governors* detailed most of the provisions relating to the internal structure of the system. Most of the governors were rather inclined to minimize the role of the Board, because they liked to the Executive Board as an instrument of the Governing Council, a few NCBs, especially the Bundesbank, wanted an Executive Board endowed with sufficient powers of its own to protect the singleness of monetary policy – see especially Art. 10.2 below. On this very central issue of the relative role of the Executive Board the governors could not agree. In March 1991 the *deputies IGC* leaned towards the position of the Bundesbank, i.e. giving the Executive Board an independent responsibility and powers for ensuring that the Governing Council's monetary policy decisions are executed. On

[2] Stoltenberg memorandum of February 1988 and contribution by Pöhl in the Delors Report (1989).
[3] See Art. 1-ESCB, section II.2.

other issues the IGC did not change the balance as drafted by the Committee of Governors, implying the governors are the main designers of this part of the internal organization of the ECB.

Federal Reserve and other central banks and federal bodies
Like in clusters I and II we will in our analysis of the genesis of the articles refer to the Federal Reserve, as this will help us understand the different options available for federally organized central banking systems. The **Federal Reserve** has two decision-making bodies: the Board of Governors which takes all decisions except for the decisions on the open market operations, on which the second decision-making body, the Federal Open Market Committee, decides. The Board decides on regulatory, organizational, advisory and *some* monetary policy issues – the latter include reserve requirements and approval of discount rate adjustments by Federal Reserve Banks.[4] These Banks decided on their own discount rate, subject to approval by the Board of Governors (in practice the FRBs kept their rates closely together). However, the use of the discount window diminished strongly, already in the 1920's (its use actually being discouraged),[5] and thus the importance of the discount rate has declined to irrelevance. Instead open market operations became the most important channel for steering the liquidity of the banking system. Before 1935 FRBs coordinated their open market operations on a voluntary basis with the Board, since then these operations have been under complete control of the FOMC, consisting of the seven government appointed Board members and five out of the twelve FRB presidents (on the basis of a rotating scheme).[6] Though the Board has staff of its own, it has no monetary balance sheet. Board nor FOMC undertake operational activities, every action is conducted through (one of) the FRBs.
The structure of the only *federally organized* constituent central bank of the eurosystem, the **Bundesbank**, is different: the Landeszentralbanken are branches.[7] Nonetheless, the Bundesbank law awarded them specific operational tasks. However, all *policy* decisions were taken by the Zentralbankrat (ZBR). In this Rat the presidents of the eleven LZBs[8] and the members of the Direktorium (up to ten) each have one vote. The Direktorium prepared decision-making by the ZBR, made sure its decisions were executed, but also ran the Head Office of the Bundesbank, which was responsible for the open market operations with the federally important banks and for the foreign exchange management and operations.[9]

The *non-federally organized* constituent central banks of the eurosystem knew different governance structures, some of them working with a collegiate governance system, like the Dutch, Belgium, Danish, Irish and Portuguese central banks, and others characterized by a presidential-type of governance (France, Italy, Spain and the UK).[10] The Governing Council of the ECB is a collegiate-style body, which is understandable as a presidential-style body

[4] The Board of Governors does not have a direct mandate in the area of facilitating payments, the FRBs have. The Board exercises though general supervision over the FRBs, including whether they fulfil their tasks properly. Furthermore, the Board usually has the right to fix, for example, prices for FRB services and determine rules for activities like check clearing.
[5] See Art. 12.1c-ESCB, section I.2.
[6] See also appendix 1 at the end of cluster II.
[7] For a history, see appendix 3 at the end of this cluster.
[8] Initially ten, because West-Berlin received the status of Bundesland only later.
[9] See also chapter 8.2.4.
[10] Source: European Commission (1990a).

would not fit with the intended federal structure. Within collegiate bodies the position of the president may vary; for instance, he may or may not have the casting vote,[11] he may be appointed for a longer term than the other board members,[12] or with special approval of the federal president, giving him higher status and protection against dismissal,[13] he may have special powers in suspending decisions of other internal bodies.[14] When comparing these governing structures, one should also take into account that some central banks were more independent than others. As for the ECB, the members of the Board are relatively equal, they are appointed for the same term and according to the same procedure. On the other hand, the president has the casting vote in the event of a tie and he has a special position in the area of representation, externally (Art. 13.2-ESCB), especially vis-à-vis the European institutions (Art. 109b-EC) and legally (Art. 39-ESCB). Furthermore, he is not only chairman of the Executive Board, but also of the Governing Council and the General Council, making him more than *primus inter pares*.

The two main executive branches of the European Community (*Commission* and *Council of Ministers*) are also of a federal nature (all countries participating in them), however neither of them was applying the rule 'one country, one vote'. In the Commission large countries used to have a second Commissioner, each Commissioner having one vote, while in the Council of Ministers most decisions were (and are) taken by weighted votes.[15] The drafters of the ESCB Statute opted for the principle of 'one member, one vote'.[16] The ECB is also different in the sense that the Governing Council encompasses both regional members and Executive Board members, as if the members of a small-sized Commission were member of the Council of Ministers. There are no rules for the distribution of the nationality of Executive Board members. In view of the political appointment procedure,[17] the Board can however be expected to be dominated by national from large countries, but board members should - and can reasonably safely be - expected to act in complete independence, still upholding the principle of national equality. The larger economies of the countries receive a larger weight indirectly, because the ECB defines the euro area's inflation rate as the *weighted* average of the national harmonized consumer price indices.[18]

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[11] Central bank of Portugal; Bundesbank (casting vote in Direktorium).
[12] Central banks of Portugal and Ireland.
[13] Central banks of Denmark and Ireland.
[14] Central bank of Belgium.
[15] The Treaty of Nice (2000) determines that as of 2005 large countries lose their second Commissioner, in exchange for the rule that decisions by the Council of Ministers requiring a qualified majority need the support of Members States representing at least a certain minimum share of the population of the EU (double weighted voting). However, such decisions also require the support of at least half of the Member States (which protects the position of the smaller states). In the IGC of 2003 ideas were floated to reduce the number of votes for the Commissioners or, alternatively, to form a small cabinet of Commissioners with special responsibilities on behalf of the whole Commission.
[16] Weighted voting is restricted to cases of decisions affecting the relative financial positions of the ECB's shareholders (i.e. the NCBs).
[17] Art. 11.2-ESCB.
[18] The Treaty of Nice has opened the way for the political authorities to change the ECB's voting system (see Art. 10.2, section I.1), either based on a recommendation by the Governing Council or by the Commission. The Governing Council's recommendation to limit the number of votes for the governors as of a certain size of the Governing Council to fifteen was adopted by the political authorities in 2003. These votes will rotate over the governors within three different sized groups of NCBs, giving a preferential treatment to governors from larger countries. The alternative of equal rotation was not pursued, because it would probably have been blocked by the

In the next chapter we will describe the genesis of the relevant articles. This genesis will show us which considerations the drafters had in mind as to the division and sharing of power of the Executive Board and the Governing Council and their respective roles. In chapter 11 we will assess how stable the balance is, whether we see room for improvement, and we will mention a few recent developments. The articles we selected for this part relate to the composition of the Governing Council, the voting system and the respective decision-making powers of the Governing Council and the Executive Board.

larger Member States, in which case the Commission might have recommended reducing the number of votes for the governors to five. Rumour has it that this was (and still is) the preference of some parts of the Commission. The Executive Board would then outvote the governors, which, however, might make this board a likely target for political pressure. This might strengthen the Commission's position. A dominant Executive Board voting en bloc would lead to negative dynamics within the Governing Council, and it would allow the Executive Board to introduce changes leading to a centralization in the operational area and would put the continuity of the federal character at risk. Therefore, such a proposal would strike at the heart of the system.

CHAPTER 10: SELECTED ESCB ARTICLES (CLUSTER III)

Content

Selected articles: Article 10.1 and 10.2a (Composition Governing Council, voting in personal capacity), Article 10.2b-c ('One person, one vote'), Article 10.3 (Weighted voting), Art. 11.6 (Executive Board responsible for current business of the ECB), Article 12.1a-b (Delineation of responsibilities of Governing Council and Executive Board), Article 12.2 (Executive Board prepares Governing Council meetings), Article 12.3-5 (Some other Governing Council competences).

The genesis of Article 11.1 (Size and composition Executive Board) has been dealt with under Art. 11.2-ESCB, section II.2.

10.1 INTRODUCTION

We follow the structure we used before, that is for every article we will look for the main considerations which lay behind its formulation, starting with the relevant parts of the Delors Report, then analyzing the drafts of the Committee of Governors and the outcome of the IGC. This shows which relative powers of the Executive Board and of the governors the drafters had in mind. For each article the description of the genesis is preceded by a general introduction, placing the article in a wider context, and by a short description of the comparable features of the Federal Reserve System, where helpful for understanding the choices made in drafting the ESCB Statute.
The description in this chapter will be as factual as possible. In Chapter 11 we conclude how checks and balances were established and mention a few recent developments, i.e. relating to the voting regime of the Governing Council.

The Committee of Governors designed the draft Statute as a whole. The Commission's text for a draft Treaty mentioned, apart from the establishment of the 'Eurofed' (Commission wording for the ESCB), its tasks and relations with the political authorities, also that the Council of the Bank would be made up of the governors of the NCBs and six Executive Board members, and that voting would take place according to the rules laid down in the Statute. The French draft Treaty text stayed close to the Commission's text. The German draft repeated as little as possible the ESCB Statute, because the German government had decided to accept the draft ESCB Statute as the outcome of complex negotiations, which should be left as untouched as possible. In its view Treaty texts should not be used as an excuse to reopen the debate on the Statute. The Luxembourg non-paper of June 1991, following the example of the Commission, gave the composition of the Council a place in the Treaty. The Luxembourg

presidency added a paragraph describing the powers of the Council of the Bank and the Executive Board, and the compromise found for the use of NCBs in the execution of the tasks of the System ('to the extent deemed possible and appropriate'). The Dutch presidency, however, decided to duplicate as little as possible the text of the Statute in the Treaty; this implied that articles relating to the internal organization of the System were only mentioned in the Statute.

10.2 GENESIS OF SELECTED ARTICLES OF THE ESCB STATUTE (CLUSTER III)

Article 10.1 and 10.2, first paragraph

Article 10: The Governing Council

"10.1 In accordance with Article 109a(1) of this Treaty, the Governing Council shall comprise the members of the Executive Board of the ECB and the Governors of the national central banks.

10.2 (first par.) Subject to Article 10.3, only members of the Governing Council present in person shall have the right to vote. By way of derogation from this rule, the Rules of Procedure referred to in Article 12.3 may lay down that members of the Governing Council may cast their vote by means of teleconferencing. These rules shall also provide that a member of the Governing Council who is prevented from voting for a prolonged period may appoint an alternate as a member of the Governing Council."

(to be read in conjunction with Article 10.2-ESCB, second and third paragraph (Normal voting procedure); Article 10.3-ESCB (Weighted voting); Article 12.1-ESCB, first and second paragraph (Division of competences between Governing Council and Executive Board); Article 12.3-ESCB (Rules of procedure); Article 14.1-ESCB (NCBs))

I. Introduction

I.1 *General introduction*

The Governing Council is composed of the governors of the NCBs of the Member States without a derogation[1] and the members of the Executive Board. The Governing Council operates as the highest decision-making body of the eurosystem, which comprises the ECB and the NCBs of the Member States which have adopted the euro.

The composition of the Governing Council reflects the *federal* character of the ESCB. The federal character is further enhanced by the voting system, where each member of the Governing Council (each governor and each Board member) has one vote. Weighted voting is applied to a limited number of provisions relating to financial matters.

The first paragraph of Art. 10.2 emphasizes that only members of the Governing Council present in person are entitled to vote. Proxy voting is not allowed. This rule underlines that a governor does not 'represent' his NCB, he is member *ad personam*. To be more precise, the governors operate in three capacities related to System functions: as *ex-officio* members of the Governing Council the governors act in the interest of the euro area as a whole, when deciding on monetary policy and other System functions (*ad personam*); the governors act as representatives of their NCBs (i.e. as shareholders) when decisions are taken on patrimonial

[1] See Art. 43.4-ESCB.

issues;[2] and at their home NCB they are part of a directorate or board of directors, which is responsible for the implementation at NCB level of the decisions taken by the Governing Council.

The Statute does not provide for alternate members. Only when prevented from voting for a 'prolonged period' a governor may appoint an alternate (i.e. someone who carries his/her vote). An exception is made for decisions made on the basis of weighted voting (financial decisions), in which case a governor, when unable to be present, may always appoint a person who carries his vote for that particular issue. In the early days of the system the issue arose whether accompanying persons were at all allowed to attend Council meetings. It was argued that governors might feel inhibited in the presence of their deputies to speak out openly or change their minds during meetings. This argument did not prevail. It was considered that the governors need an accompanying person in case they have to leave the meetings for a short while, and for an efficient liaison with their own central bank. The accompanying persons attend the meetings, while sitting in a backbench close to their governor. The accompanying persons, like the governors, are not allowed to reveal confidential information to their organizations.

The meetings of the Governing Council can be attended by the president of the Council of Ministers and by a member of the European Commission. They do not have the right to vote.[3] Their presence forms part of the external checks and balances.

I.2 *Relevant features of the Federal Reserve*

The most important decision-making body on monetary policy in the US central banking system is the **Federal Open Market Committee (FOMC)**. It consists of both Board members and presidents of Federal Reserve Banks. The committee consists of the seven members of the Board of Governors and five of the twelve FRB presidents. The president of the FRB of New York is a permanent member; the other presidents serve one-year terms on a rotating basis.[4] All presidents participate in FOMC discussions, contributing to the Committee's assessment of the economy and of policy options, but of these twelve only the five presidents who are members of the Committee vote on policy decisions.
Officially, the representatives of the FRBs may also be first vice-president of a Reserve Bank: "[The FOMC shall consist of the members of the Board of Governors] and five representatives of the Federal Reserve Banks to be selected as hereinafter provided. Such representatives shall be presidents or first vice presidents of Federal reserve banks ...." [5] The Federal Reserve Act foresees also in the annual election of *alternate* members, normally the president of one of the other FRBs of the same group. In practice, however, the FRB representatives are FRB presidents. The only vice-president that sometimes cast his vote as a

[2] See Art. 10.3-ESCB.
[3] Art. 109b-EC.
[4] The rotation seats are filled from the four regional group of Banks, one Bank president from each group: Boston, Philadelphia, and Richmond; Cleveland and Chicago; Atlanta, St. Louis, and Dallas; and Minneapolis, Kansas City, and San Francisco.
[5] FRA (1988), section 12A(a).

member of the FOMC is the vice-president of the New York Fed in his capacity as alternate. The FRA does not contain provisions for appointing alternates for absent Board governors.

Every first meeting of the year the Committee elects the chairman and vice-chairman of the FOMC from among its membership, by tradition these are the chairman of the Board of Governors and the president of the New York Fed respectively. The FOMC decides by simple majority. The FOMC must meet 'at least four times a year'. In practice it meets every six weeks, but it can take decisions in-between meetings. The FOMC decides on open market operations. All other decisions relating to the FRS are taken by the Board of Governors. The FRA does not provide for weighted voting; this is understandable, as the FRBs are not shareholders of the Board of Governors; in fact, it is the other way around: the Board closely supervises the way the FRBs are managed[6] and the seigniorage after deducting costs and additions to general reserves flow to the Treasury.

II.1 HISTORY - DELORS COMMITTEE AND BEFORE

The idea of a European central bank had been mentioned in the Werner Report (1970). Already then the Federal Reserve System had been thought of as a possible example. The first person to rake up the idea of a European central bank in the '80s was the French minister of Finance Balladur. He had in mind a federal system, possibly mustered on the Bundesbank model. In his memorandum of 29 December 1987, which concentrated on ideas to improve the working of the EMS, he also envisaged the creation of a single currency area, 'in which one and the same currency would serve as a means of payment in all countries and in which a common central bank would exist as well as *"federal" banks* in every country.' The German minister of Foreign Affairs, Hans-Dietrich Genscher, took up the discussion on a European currency by issuing a personal memorandum in February 1988. In his memorandum Genscher referred to the establishment of a European central bank and the need for a statute, but he was not specific on the form. The German minister of Finance, Stoltenberg in a reaction labelled the establishment of an EMU an objective for the long-term. He also mentioned conditions for a possible future European central bank, among which the condition of a balanced relationship between central and federal elements in the decision-making ('ausgewogenes Verhältnis von Zentralen und föderativen Elementen bei der Willensbildung').[7] Therefore, at an early stage there was agreement among the main initiators that the system should be federal.

The Delors Committee took the federal concept as a starting point. In a draft paper, dated 2 December 1988, the first description of the institutional arrangements of the final stage of EMU read as follows: "The Council would be composed of the Board members as well as the Governors of the NCBs and act as policy-making authority." [8] At a meeting of the Delors Committee on 13 December 1988 Pöhl distributed a Bundesbank paper containing a possible

[6] See Art. 14.3-ESCB, section I.2.
[7] See Art. 1-ESCB, section I.1, footnote 2; Art. 7-ESCB, section II.1A; and chapter 8.1.
[8] CSEMU/5/88, 2 December 1988, p. 16. The same page mentioned that "the Board should have [three to ...] members and a Chairman."

outline for the committee's report. The paper included the main features of a European central bank:[9]
"- a federative structure of the central bank system, since this corresponds best to the political structure of the Community (e.g. a European Central Bank Council (ECBC) representing all the central banks in the union);
- a centralised body (Directorate) responsible for the implementation of ECBC decisions as far as they apply at Community level;"
It is unclear from this description whether the members of the Directorate (Board) were meant to be members of the Bank's Council, but later it was clarified that the ESCB Council would be composed of the Governors of the central banks and the members of the Board.
No mentioning was made of the size of the Board. As late as 7 April 1989 (with only one meeting of the Delors Committee to go) Danish governor Hoffmeyer expressed, in a telephone conversation with André Szász (vice-president of the Dutch central bank) his uneasiness about the Board, which 'undoubtedly' would come to consist of members from the larger countries on a permanent basis. For this reason Hoffmeyer preferred a Council consisting of only governors of all central banks. Szász reacted that, indeed, that issue had received little attention. However, he added that in his view creating a small Board would create flexibility in daily matters, while the appointment of the Board members by the European Council would add to the democratic legitimacy of the system. Dominance by the big countries could be prevented by deciding that the Council of the ECB, in which all NCBs were present, would determine the ESCB's general policy.

II.2 History: Committee of Governors and IGC

The first preliminary draft of the ESCB Statute[10] already contained the idea of a federal board: "[t]he Council shall comprise the Governors of the central banks of the Member States of the Community, the Director-General of the Luxembourg Monetary Institute and the members of the Board of Management." The formulation would change, but never the concept. The same draft also mentioned: "All members of the Council present in person shall take part in the voting and shall have, for that purpose, one vote (save as otherwise provided in the Statute)."

In a subsequent draft of 13 July 1990 the word 'All' had been put between square brackets. The brackets referred to two questions:
"- should all the members of the Executive Board have a vote or only the President of the System;
- should all governors have a vote or should there be a system of rotation along the lines of the Federal Reserve."
The Alternates, who had prepared the draft, had commented to the first indent that "the latter option [i.e. giving only the president the right to vote] was suggested by some Alternates but other Alternates were not inclined to give the President such standing." It was also suggested to write the details of a possible rotation scheme ('a constituency arrangement') in the Rules of Procedure.

[9] "Outline of a report to the European Council on Economic and Monetary Union (EMU)".
[10] "Legal foundations of the European System of Central Banks", 11 June 1990.

The governors agreed in their meeting of 11 September 1990 that all members of the Governing Council would vote. The square brackets around the word 'all' were deleted in Article 9.2 In the context of this Article, the Chairman [Pöhl] outlined briefly the contents of his statement made at the ECOFIN meeting in Rome on 8 September 1990 concerning voting procedures. Pöhl had stated that the Committee of Governors had fully recognized that in the final stage monetary policy constituted a collective undertaking. For that reason the Committee of Governors had advocated all NCB governors being *ex officio* members of the Council. Pöhl had told the Ecofin he rejected weighted voting, because especially in monetary policy decisions such a voting scheme would tend to give too much emphasis to regional considerations, while it should be oriented at the Community as a whole. Furthermore, given the important role that NCB governors were to play in their capacity as Council member, he had propagated that the Council of the System were to be consulted at the time of the appointment of an NCB governor.[11]
After discussing the possibility of introducing a procedure based on rotating voting, the general consensus reached by the Committee was that such technique would not be appropriate in the context of the System. It was agreed to establish a quorum of two-thirds of the members. Apparently governors had weighed the arguments for weighted and rotating votes, and had rejected them. They conceived of monetary policy as a *collective exercise* in which the Executive Board could join. At that stage the size of the Board was envisaged to be fixed at most six persons.[12] In other words, in their view Board members and NCB governors should act as a collegiate body.

The draft version of 19 October 1990 contained the following wording:

"10.1 The Council shall comprise the President, the Vice President, the other member of the Executive Board and the Governors of the national central banks. 10.2 Subject to Article 10.3, only members of the Council present in person shall have the right to vote. Each member has one vote. Save as otherwise provided for in the Statute, the Council shall act by a simple majority. In the event of a tie, the President shall have the casting vote. In order for the Council to vote, there shall be a quorum of two-thirds of the members." draft 19 October 1990

The Comments add:
"a) There was unanimous agreement to apply the principle of "one person, one vote" for all decisions, except those relating to capital assets and profits (see Article 10.3).
Moreover, it is understood that in the case of the absence of a Governor, the deputy may attend but would not be permitted to vote. The requirement of "present in person" could also mean a Teleconference. Procedures governing these issues should be addressed in the Rules of Procedure."

[11] See Art. 14.2, section II.1.
[12] See Art. 11.2, section II.2.

This final version of the draft Statute (27 November 1990) would read:

"10.1 The Council shall comprise the President, the Vice President, the other members of the Executive Board and the Governors of the national central banks.
10.2 Subject to Article 10.3, only members of the Council present in person shall have the right to vote. Each member shall have one vote. The Rules of Procedure referred to in Article 12.3 shall provide that a member of the Council who is prevented from voting for a prolonged period may appoint an alternate as a member of the Council."

draft 27 November 1990

The accompanying Commentary read:

" The composition and voting procedures of the Council laid down in the Article reflect the federative structure of the System: all national central bank Governors are ex-officio members of the Council which, in addition, will include the President, the Vice President and the other members of the Executive Board. [....]

Article 10.2 requires "presence in person" for voting: this would be met by a teleconference. A delegation of voting powers will only be possible if a member of the Council is prevented from voting for a prolonged period in which case he or she may appoint an alternative as a member of the Council. [13] *The emphasis on personal presence underlines that the responsibility for all policy-related decisions rests with the members of the Council."*

During the **IGC** this text was left basically unchanged, with only some reordening and the remark on teleconferencing being moved from the Commentary to the text of Statute itself.

[13] This sentence was added following comments by governor Duisenberg in the meeting of the Committee of Governors on 13 November 1990. This formulation resembles Article 6(3) of the Bundesbank law (Gesetz über die Deutsche Bundesbank): "[....] Die Satzung kann vorsehen, dass die Mitglieder des Zentralbankrats bei nachhaltiger Verhinderung vertreten werden." According to Art. 4.4 of the Rules of Procedure a prolonged period equals 'one month or more'.

Article 10.2, second and third paragraph:

Article 10-ESCB: The Governing Council

"10.2 (second and third par.) Subject to Articles 10.3 and 11.3, each member of the Governing Council shall have one vote. Save as otherwise provided for in this Statute, the Governing Council shall act by a simple majority. In the event of a tie, the President shall have the casting vote.

In order for the Governing Council to vote, there shall be a quorum of two-thirds of the members. If the quorum is not met, the President may convene an extraordinary meeting at which decisions may be taken without regard to the quorum."

(to be read in conjunction with Articles 10.1- and 10.2-ESCB, first paragraph (Composition Governing Council and voting ad personam); Article 10.3-ESCB (Weighted voting); Article 11.1-ESCB (Size Executive Board); Article 12.1a-ESCB (Responsibilities Governing Council and Executive Board); Article 12.2 (Executive Board prepares Governing Council))

I. INTRODUCTION

I.1 *General introduction*

This article determines largely how decision-making power is divided between the centre and the other elements of the system. The negotiations concentrated on three related questions: would the de facto monopoly of monetary decision-making by the Bundesbank be transferred to a new central, independent institution, or would it also be shared with the other NCBs and, if so, would it be shared equally among them. None of these questions were foregone conclusions, as indeed weighted voting was considered as one of the possible outcomes by participants in the negotiations. Related questions were whether to make a distinction between voting on policy-related issues and financial issues (touching upon the relative financial interests of the NCBs) and whether the size of the Executive Board should be large or small.
A final observation as to the role of voting is that until now (early 2004) the ECB has taken most of its decisions on the basis of consensus, only in exceptional circumstances ressorting to voting. In this sense the Governing Council has not only acted as a collegiate body, but also as a consensus body, which was considered a welcome and important development in the formative years of the ECB by its first president, Duisenberg. The ECB has been able to combine effective decision-making and effective monetary policy with a consensus culture. Consensus is not the same as unanimity, it refers to a willingness to accept a 'majority' view, in which arguments are weighed and not votes, or the number of votes.[1]

[1] To give an example: under a voting regime six votes in favour win from five votes against, while under the consensus approach it would matter how strong views are held. This could lead to a better outcome, depending on the quality of the chairman, a safeguard in that respect being that members could always request that a vote be taken (ECB Rules of Procedure, Art. 4.2). See also chapter 11.3.

Because the drafters of the ESCB Statute, having a federal system in mind, often made reference to the FOMC of the Federal Reserve System, we will pay some special attention to the origins of the voting procedure of the FOMC.

I.2 *Relevant features of the Federal Reserve System*

In 1913 US Congress designed a central banking system with centralized and decentralized elements. The system consisted of the Federal Reserve Board and twelve (local) Federal Reserve Banks. The Board was established as a central body of which the members were either appointed by the president (five of the seven members) or were officials of the Treasury (the Secretary of the Treasury and the Comptroller of the Currency). The FRB presidents were not represented at the Board. The Treasury officials were replaced by president-appointed members in 1935. The drafters of the FRA also paid attention to the checks and balances within the Board, which could have repercussions on the whole system. They made an effort that the Federal Reserve Board itself would not be dominated by only financial or East coast interests, though at the same time ensuring a minimum of professional expertise. The FRA of 1913 stipulated that the President, in selecting and appointing the Board members shall have "due regard to a fair representation of the different commercial, industrial and geographical divisions of the country. [....] Of the five members appointed by the President at least two shall be persons experienced in banking or finance." [2]

The FRA of 1913 mentioned that the Secretary of the Treasury, the Secretary of Agriculture and the Comptroller of the Currency (the "Organization Committee") should designate Federal Reserve cities and divide the US into corresponding districts. [3] The Senate had decided that the number of districts should be between eight (Republican preference) and twelve (preference of the Democrats[4]). The Organization Committee decided for twelve reserve cities. It is clear from these numbers ('at most twelve') that districts had to encompass more than one state (in 1913 the US consisted already of more than 45 states). In fact, in many cases the district lines do not even follow state border lines, but cut through them. Indeed, not only were small States not given their own reserve bank, neither was any State given its own

[2] Section 10, FRA (1913). In 1935 this was reformulated as: "due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country." (Section 10(1), FRA (1988).) The Federal Reserve Board was renamed into Board of Governors.

[3] The Organization Committee finished its job early 1914. (This explains why the names of the districts would only appear in the FRA at the occasion of the Bank Act of 1935, when the rotation system for the FOMC was established.) The Organization Committee based its decision on the outcome of a poll held among national banks and inter alia on the following basic criteria: the ability of member banks within a district to provide the necessary capital for their FRB (at least 4 mln dollar), the fair and equitable division of the available capital for the FRBs among the districts, geographic factors and the existing network of transportation (the famous 'one-night train ride': every bank should be within one-night train ride from a FRB or a branch), population and area). (C.H. Moore (1990), p.17.)

[4] However, not all Democrats shared this view. Warburg (Democrat and investment banker, originally from German Hamburg) considered twelve was too much: 'A large number of banks (....) would increase the danger that they would exhibit a purely local and parochial point of view and that, in consequence, so far from assisting the Board in formulating a national policy, the small banks would stress their local views, and, by doing so, confuse and resist the Board instead of aiding it.' (Warburg (1930), Volume I, p.426.) It is clear Warburg, a seasoned international banker, took a national (and not a regional) view of monetary policy.

reserve bank, which means that FRBs, unlike NCBs in the euro area, cannot be associated with a political constituency. They are more detached from regional politics.

Until 1935 the Board had only coordinating power in respect to open market operations, which had become the most important tool for managing the liquidity of the banking system. This changed with the Banking Act of 1935, which gave the Board of Governors a majority vote in the open market committee. The FOMC would henceforth consist of the (seven) members of the Board members and five representatives of the FRBs. Since 1942 the FRBs are divided over five groups: (1) New York, (2) Boston, Philadelphia, and Richmond, (3) Cleveland and Chicago, (4) Atlanta, Dallas, and St. Louis, and (5) Minneapolis, Kansas City, and San Francisco. In the years 1936 to 1942 New York had been part of a group too.[5] The non-voting presidents are also present and participate in the discussions of the FOMC. Each group elects each year from amidst itself the president which will be FOMC member for that year. The by-laws provide that members representing Banks do not serve as representatives of the particular Banks that elected them nor are they to be instructed by the boards of those Banks.[6] In practice, the FRBs rotate within their group on an equal basis. Looking at the composition of the groups it occurs that each group (both before and after 1942) exists of adjacent districts. This minimizes the risk that in one year for instance only Eastern states would have a vote. Also, chances of coalitions of economically similar districts seem remote with the present group composition, see table 10-1.[7]

History shows that the main aim of the present composition of the FOMC was to end the dominance of the New York Fed, which had risen to power because it harboured the largest financial markets and because before 1935 the Federal Reserve Board lacked power in the area of open market operations. While Board members became permanent member of the FOMC, membership of the FRB presidents is rotating and with it the right to vote. However, all FRB presidents participate in the discussion, creating a collegial atmosphere. Voting rights are unweighted. It should be noted though that the Board members do not vote as a block.[8] Dissenters come from both the FRBs and the Board itself. Since March 2002 the votes of the FOMC members are made public immediately after the FOMC meeting (for dissenters their proposal is shown as well). In practice, dissenting opinions are the exception.

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[5] The Annual Reports of the Board of Governors over 1937 and later show the following groups: (1) New York and Boston; (2) Philadelphia and Cleveland; (3) Richmond, Atlanta and Dallas; (4) Chicago and St. Louis; and (5) Minneapolis, Kansas City and San Francisco. In practice, each group used an equal rotation scheme, except the first group, because the president of New York was always elected, with the president of Boston always being elected alternate. This changed in 1942 when New York became a group on its own. We quote the Board's Annual Report of 1942 (p. 56): "By an Act of Congress, approved July 7, 1942, [….]. Under the law as amended one member of the Committee is elected annually by the [board of] directors of the Reserve Banks in each of the following groups: (1) New York, (2) Boston, Philadelphia, and Richmond, (3) Cleveland and Chicago, (4) Atlanta, Dallas, and St. Louis, and (5) Minneapolis, Kansas City, and San Francisco. This arrangement makes provision for continuous representation of the FRB of New York on the FOMC. This is for the reason that the New York Bank is in the principal capital market and acts as the agent for the FOMC in the operation of the System open-market account." We mention this to show that – unlike usually is assumed - the voting frequency is not directly determined by the economic size of the reserve bank district. E.g. see GAO (1996), table 4.3 for State population shares in 1910.

[6] Friedman and Schwartz (1963), p. 446n.

[7] See also Fase and Vanthoor (2000), p. 24.

[8] For more on the FOMC's decision-making process, see Art. 11.6 and 12.2, section I.2.

Table 10-1: Size and economic activities of the Federal Reserve districts [9]
(1999 GDP and population figures)

	percent of GDP	percent of population[10]	main economic activities
I	18	18	Agriculture, Light industry
II	19	18	Heavy industry, Financial markets
III	24	26.5	Cotton, Light industry, Oil, Natural gas, Commercial services
IV	28.5	29	Minerals, Heavy industry, Agriculture, Natural gas, Software
V	10.5	8.5	Financial markets, Commercial services
	100	100	100

I = Boston, Philadelphia, Richmond
II = Cleveland, Chicago
III = Atlanta, Dallas, St. Louis
IV = San Francisco, Kansas City, Minneapolis
V = New York

Comparing the Fed and the ESCB

In the US the FRBs were meant to allow for regional aspects in monetary policy (nowadays one could say: their presence in the FOMC adds relief to the overall federal picture). FRBs were also meant to prevent dominance by the centre – which becomes clearer if one considers the original design of the FRS, with the centre being more or less a regulatory agency with powers to control FRBs, e.g. with respect to the discount rate, but without powers to make policy itself. Both the Republicans and the Democrats were reluctant to create a strong centre, the former because they feared the centre could become dominated by the government, the latter because they feared the Board could collude with the powerful eastern district banks. Only as of 1935 did the Board receive voting power for setting monetary policy, namely when

[9] Olga Aarsman, 'The development of the FRS (1913-2000) and lessons for the ESCB', thesis Free University, Amsterdam, April/May 2001 (only available in Dutch).

[10] In 1999 the districts ranked as follows according to population shares: San Francisco (19.8%), Atlanta (13.2%), Chicago (11.1%), New York (8.7%), Richmond (9.3%), Dallas (8.2%), Cleveland (6.8%), Kansas City (5.7%), St. Louis (5.0%), Boston (5.0%), Philadelphia (3.5%), Minneapolis (3.5%). (These figures were probably more equal when the system was designed, e.g. in 1914 San Francisco served 6 per cent of the nation's population (M. Mayer (2001), p. 69). Differences under the Bundesbank regime (before the unification with East Germany) were in the same range, though somewhat larger: in 1991 Bayern represented 17.9 per cent of the nation's GDP and Bremen 1.2 per cent.

the Board members became member of the FOMC. However, voting does not take place along the lines 'Board versus regional banks'.[11]
In contrast, when the European central bank system was designed, attention in the Committe of Governors focussed on the question whether the NCBs of larger Member States should receive relatively more voting power, and focussed less on the power of the Executive Board vis-à-vis the governors. These issues are connected though, because in case of weighted votes the problem would arise how to weigh the votes of the Executive Board members (while also creating a situation in which they would start voting as a block). In fact, the issue never arose, as the governors opted for 'one person, one vote'. *Weighted voting was considered to introduce undesirable national elements, not befitting a collegiate body.* For financial issues an exception was made – see Art. 10.3-ESCB.

II.1 HISTORY: DELORS COMMITTEE

The Werner Report of 1970 mentioned the establishment of a 'Community system of central banks', but did not deal with the internal organization of such a system. In the proposals/memoranda of early 1988, which revived the discussion on EMU, voting rights were not yet an issue. Stoltenberg in his memorandum of 15 March 1988 for example merely noted that "The decision-making process must strike the proper balance between central and federative elements." [12] The Bundesbank, however, took a clear position at an early stage that all participating Member States should be represented in the decision-making, with the votes of the NCBs weighted to their economic position. [13]

The Delors Report consequently started with the assumption of weighted voting (though in the end the Report evaded the question, just mentioning that the modalities of voting procedures of the ESCB Council would have to be provided for in the Treaty). In a paper dated October 26 1988 Niels Thygesen, one of the expert members of the committee, however, advanced that "weighted voting as practised in purely intergovernmental cooperation" would be difficult to reconcile with the participation of European-nominated members of the Board along with the national central bank governors in one collegiate body.[14] Thygesen saw more merit in a rotation scheme as used in the FOMC, though also not without hesitations: "A literal translation of these provisions could imply, if all present EC-members were to participate, that the President of the Bundesbank had a permanent vote, the Governors of the four next largest central banks a vote every other year and the governors of the six smaller central banks a vote every third year. The procedure may appear undesirably discriminatory, even when it is recognized that all governors will be present at the meetings." However, we have seen in the

[11] During 2000 and most of 2001 the Board of Governors functioned with at least two vacancies, implying that during that period the Board members lost their 'majority'. (See J. Berry (2001), and Board of Governors Annual Report 2001, p. 335.) This did not stir large upheaval, underlining that the FOMC is not characterized by two permanent camps along these lines.
[12] HWWA (1993), p. 310-312.
[13] Contribution by Pöhl to the Delors Committee (section II.B(3)), as annexed to the Delors Report: "All member countries would need to be represented in the monetary policy *decision-making body*, with voting power being weighted in the light of the economic importance of the member countries."
[14] According to the paper of Thygesen Pöhl had in mind weighted voting according to the procedures followed in the Council of Ministers.

description of the procedures in the FRS that 'size' is not the relevant criterium for the rotation scheme in the FOMC,[15] but the special position of New York as the only financial market connected well enough to all parts of the country, i.e. de facto the only serious place for open market operations. It cannot be said that the rotation frequency for the other FRBs is a function of their relative economic size (see section I.1 above). Nonetheless, smaller countries were almost ready to accept such an outcome. For instance, internal documents of the Dutch central bank [16] showed a readiness to accept weighted voting, if that would be the price for a permanent presence in the ESCB Council.

In the Skeleton Report of 2 December 1988 a first attempt was made to draft a text on the internal organization of the ESCB:

> "- the system must reflect the federal structure of the Community. This implies an organization [perhaps analogous to the US Federal Reserve System] which, through appropriate representation [and weighted voting procedures] in governing bodies, ensures that the interests of all national central banks are adequately taken into account. [....] The Council would meet regularly [every two weeks] and .... its decisions would be made on the basis [of weighted voting reflecting the relative importance of national central banks?]"
>
> CSEMU/5/88, December 1988 [17]

This draft was discussed during the meeting of the Committee on 13 December 1988, on which occasion Pöhl distributed a Bundesbank note, called "Outline of a Report to the European Council on Economic and Monetary Union (EMU)". This document contained no direct reference to weighted or non-weighted voting. In the next draft of the Delors Report, that of 31 January 1989,[18] the reference to the voting procedures was deleted. This might just have been a consequence of copying parts of the text distributed by Pöhl into the draft Report.

The draft version of the Delors Report of 31 March 1989 again contained a reference to weighted voting:

> "**Structure and organization**
> - a federative structure, since this would correspond best to the political structure of the Community;
> - establishment of a ESCB Council (composed of the Governors of the central banks and the members of the Board), which would be responsible for the formulation of and decision on the thrust of monetary policy; decisions would be made by weighted majority vote".
>
> CSEMU/14/89, March 1989 [19]

[15] This is a mistake often made, not only by Thygesen, but e.g. also by Giscard/Schmidt in their 'Programma pour l'Action' (March 1988), prepared by the Comité pour l'Union Monétaire de l'Europe, which committee was chaired by them.

[16] An internal note, prepared for the board of directors of the Nederlandsche Bank (4 November 1988), said: "For us it is an essential interest that all governors participate in this body on a permanent basis, and not the smaller countries only on a rotating basis. A consequence of this would indeed be that weighting of votes will be necessary."

[17] CSEMU/5/88, par. II.4.

[18] CSEMU/10/89.

[19] CSEMU/14/89, par. 33.

During the last discussion in the Delors Committee on 11-12 April 1989, the word 'weighted' was first put between brackets and finally dropped and it was decided to add a sentence saying that the modalities of the voting procedures would have to be provided for in the Treaty. Apparently the members of the Delors group considered it wise to leave this highly sensitive and political issue for later negotiations. On the other hand, they may have doubted themselves whether weighted voting would add to strength of the System, because unweighted voting could be seen as conducive to establishing unity in monetary policy.

The final text as agreed at 12 April 1989 read:

"**Structure and organization**
- A federative structure, since this would correspond best to the political diversity of the Community;
- establishment of an ESCB Council (composed of the Governors of the central banks and the members of the Board, the latter to be appointed by the European Council), which would be responsible for the formulation of and decisions on the thrust of monetary policy; modalities of voting procedures would have to be provided for in the Treaty."

final Delors Report, par. 32

II.2 HISTORY: COMMITTEE OF GOVERNORS AND MONETARY COMMITTEE

There would be an intense debate on the issue both in the Committee of Governors and the Monetary Committee, which in view of the political sensitivities got involved as well. The discussion in the Committee of Governors was sometimes intense and difficult, especially on the part of the Germans, who started the discussion with the aim to achieve some sort of weighting. During the discussions they changed position several times. In the end the draft Statute would contain the principle of one man, one vote.

Monetary Committee discussion in 1990
It is interesting to see how country positions evolved in the Monetary Committee on the question of voting procedures. In January 1990 Pöhl had given an interview to the German magazine Die Zeit, in which he had expressed a preference for an unweighted 'one man, one vote' rule combined with a rotation scheme as used in the US Federal Open Market Committee. Pöhl might have considered this to be an indirect form of weighted voting, as for him the FOMC system probably stood for differentiated voting frequencies, allowing large NCBs to vote more often, but he had moved away from the preference of 'weighted votes'. In the meeting of the Monetary Committee on 6 February 1990 Tietmeyer (who had changed job from the Ministry of Finance to the Bundesbank) took the position that governors should not decide on the basis of weighted votes, because that would make them feel too much representatives of national interests. His view was shared among others by Crockett (Bank of England). At the end of this discussion chairman Sarcinelli concluded the Committee was inclined to favour a one man-one vote system, because weighted votes would lead to too much identification with national interests. An interim version of their report was discussed during the informal Ecofin meeting in Ashford on 31 March, 1990.[20] The report advocated that

[20] Monetary Committee, 'Report on EMU – beyond stage 1', printed in Agence Europe (1990), No. 1609, 3 April 1990, especially par. 30.

"within the ESCB Council, each member should have one vote and decisions should normally be taken by simple majority", thus also excluding (possibly differentiated) rotation.

An interesting meeting took place within the Coreper (the Committee of Permanent Representatives of the Council of Ministers in Brussels) on 23 May 1990. The Commission had presented a document ('Economic and Monetary Union: Institutional note') in which it had proposed that the votes of the governors should be equal to the votes used in the Council of Ministers, implying for example for each large country (Germany, France, UK and Italy) 10 votes, for Spain 8 votes, for the Netherlands 5 votes etcetera (74 votes in total). The Executive Board would receive 30 votes as a group. This approach was rejected, inter alia on the basis of a new argument relating to the System's desired independence. The Portuguese and Belgian delegations stated that weighted voting "was hard to reconcile with the independence of the central bank." This meant a link was made from weighted voting to national interests and the risk of national political pressure. Germany and Denmark also favoured one man, one vote. The Dutch ambassador, who apparently did not exclude the outcome could still tilt towards weighted voting, mentioned the possibility of looking at the weights used in the ecu basket. Internally the Netherlands had decided that any weighing of votes within the ESCB should be based not on political weights (related to population size), but on financial indicators. Nonetheless, the Commission tabled its document at the informal Ecofin meeting of 11 June 1990. However, Commission president Delors, also indicated that the principle of 'one man, one vote' would not be unacceptable to the Commission. The chairman of the Committee of Governors, Pöhl, cautiously stated that the issue was still under discussion among the governors. An important factor for the governors was to prevent that the distribution of votes would lead to 'regionalization', which would be inconsistent with the required independence of the eurosystem. Sarcinelli repeated that the members of the Monetary Committee supported the one man, one vote principle.

However, in the meeting of the Monetary Committee on 16 July 1990 Tietmeyer again moved away from the consensus in the committee on the one man-one vote principle. He said he wanted to keep open the option of weighted voting or rotating voting rights, to prevent a weak position of the Executive Board vis-à-vis the national governors. In this context Tietmeyer also put forward the possibility to give the Executive Board final responsibility for certain matters to be clearly defined. In other words, he viewed a strong Executive Board as an instrument which would create quickly a European set of mind in the governing body of the ESCB. The Bundesbank apparently had come to the conclusion that a strong centre was important to safeguard the position of the new central bank and to safeguard unity in monetary policy-making. Weighted/rotating voting became an instrument not only to defend 'national interests', but also to defend the interest of the centre!

In light of the German second thoughts the Monetary Committee could not reach agreement and left the decision to political authorities. The final version of the report of the Monetary Committee read, as regards the internal structure:

> *"[....] Within the ESCB Council, each member should have one vote and decisions should normally be taken by simple majority; some members felt that other possibilities may also have to be considered."*
>
> *Monetary Committee 19 July 1990* [21]

Committee of Alternates/Governors

Against the backdrop of the discussion in the Monetary Committee and partly parallel, the Alternates of the Governors discussed the issue of voting procedures on 28 May 1990. At that stage all Alternates (including Rieke of the Bundesbank) supported the notion of one man-one vote, although there was agreement that eventually the issue was a political one and should be reserved for the political authorities. The first rough draft of the draft ESCB Statute introduces the one man, one vote principle in the text as follows:

> *"8.1 All members of the Council [consisting of the governors and the board members] present in person shall take part in the voting and shall have, for that purpose, one vote (save as otherwise provided in the Statute)"*
>
> *draft 11 June 1990*

On 18 June 1990 this text was discussed by the Alternates for the first time. Lagayette of the Banque de France requested to leave open two options: one man-one vote (his personal preference) and weighting of votes based on the capital share of each respective national central bank. Rieke supported him, in a rare display of internal Bundesbank dissent, referring to the fact that, regrettably, Pöhl had reopened the discussion. Crockett saw this as a re-introduction of national interests in monetary policy-making, which he regretted as well. In his view the *common* objective of price stability is more important than national interests. Nonetheless, the text was amended to read as follows:

> *"9.2 All members of the Council present in person shall take part in the voting. Save as otherwise provided for in the Statutes, the Council shall act by simple majority, each member having [one vote]."*
>
> *draft 22 June 1990*

During the next Alternates meeting (29 June 1990) Dini of the Banca d'Italia suggested that on the part of the Executive Board only the president should be allowed to vote in the Governing Council, the other board members just being experts (like is the case in the Banca d'Italia). However, Szász (Dutch central bank), Crockett and Tietmeyer favoured the Executive Board to act as a collegiate body with the president being *primus inter pares*. Tietmeyer proposed a rotation system for the voting rights (like in the US) in order to give more leverage to the Executive Board. Szász however warned that the wish to leave open the option of weighted voting contradicted the character of an organization which was designed as a supranational and not as an intergovernmental organization.

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[21] Monetary Committee, 'Economic and Monetary Union beyond Stage 1 - Orientation for the preparation of the Intergovernmental Conference' of 19 July 1990. Published in HWWA (1993).

In a meeting of the Committee of Governors on 10 July 1990 the UK governor defended the one man, one vote-principle, his main argument being that a weighted vote would not be consistent with the spirit of co-operation. Central bank governors should not be delegates of their countries, but should take a corporate, objective view of Community monetary policy. The French governor observed that the acceptance of a 'one man, one vote' system was a major step. If the institution was not to be regarded as a representation of different intergovernmental alliances, it would indeed be more logical to have a vote system based on 'one man, one vote'. He said that in an organization such as the IMF, whose membership consisted of a large number a countries, a system of 'one man one vote' would have been totally impracticable. However, the situation with regard to the system was very different (fewer members and a common monetary objective). The governors of these two large countries supported the 'one man, one vote' system despite the fact that their voting power would be considerably less than under a weighted voting system. (One could speculate about their motives: they clearly argued in the interest of the system; but they might also have feared that weighted voting would, or could, lead to a situation of continued national political pressure. 'One man, one vote' would be the best guarantee for themselves being able to operate independently. The Bundesbank, coming from a tradition of much more independence, would have been less exposed to such a risk.) Pöhl nonetheless wanted to keep open the option of a voting system based on rotation. The governors agreed that the issue was politically very sensitive and could probably only be resolved in a political forum. The amended text read:

"8.2 [All] members of the Council present in person shall have the right to vote. Each member has one vote [a weighted vote]. Save as otherwise provided in the Statute, the Council shall act by a simple majority. In the event of a tie, the President shall have the casting vote."

draft 13 July 1990

The brackets around 'all' referred to the question: should all members of the Board have a vote (or only the President) and should all governors have a vote or should there be a rotating system along the lines of the Federal Reserve? The discussions came to a head at the meeting of the Alternates on 20 July, 1990. Tietmeyer explained he was thinking of a constituency system like in the IMF: the large countries would have a permanent seat, the smaller ones would form constituencies. This would reduce the number of voting governors and would strengthen the hand of the Executive Board. Borges (Portuguese central bank) stated that rejection of the one man, one vote principle could be a reason for a Member State not to sign the Treaty. Tietmeyer indicated that his ulterior motive was to create a strong Executive Board. He saw a link with Article 12.1a-ESCB, which dealt with the division of labour between the Executive Board and the Governing Council. Therefore, for the Bundesbank three conflicting factors played a role: first, they must have realized the increased risk of political interference in case of weighted (or non-equal) voting; second, they stood to lose relatively most in terms of influence when accepting the 'one man, one vote' principle; and third, they were concerned about the position of the Executive Board, which they feared could become too weak.

In the meantime the Commission had adapted to the generally held view. On 21 August 1990 it published a document,'[22] which described that the Eurofed would decide "by simple majority of its members' votes (one man, one vote)."
In the informal Ecofin meeting in Rome on 8 September 1990 Pöhl in his capacity of chairman reporting on the progress made by the Governors in drafting a Statute of the System, endorsed the principle of one man, one vote: "Except for very specific decisions, such as those relating to capital subscription and profit distribution, we have rejected the use of weighted voting; especially in monetary policy decisions such a voting scheme would tend to give too much emphasis to regional considerations and would thus weaken a decision-making process which must orient itself exclusively at the requirements for the Community as a whole." [23] At the same meeting Waigel took a similar line, warning that the ESCB "should not have a regional orientation". Pöhl had probably weighed the arguments mentioned above and had come out against weighted voting, but not yet against *rotating* votes. At the same time he had set his mind to creating a strong role of Executive Board, to which end he would submit a proposal to the Committee of Governors, containing a compromise proposal for Art. 12.1a-ESCB.

The minutes of the governors' meeting on 11 September 1990 show that 'after discussing the possibility of introducing a procedure based on rotating voting, the general consensus reached in the Committee was that such a technique would not be appropriate in the context of the System.' It was decided that all members of the Council of the System (i.e. including all members of the Executive Board) should have a vote.[24] Subsequently the committee discussed Pöhl's compromise proposal for Art. 12.1a. His proposal would be more or less endorsed by the governors - though afterwards the Bundesbank set out to strengthen the position of the Executive Board by proposing to endow the Executive Board with 'own', irrevocable (i.e. non-delegated) powers.[25]

In the end Article 10.2 of the draft of the ESCB Statute of 27 November 1990 would read:

" 10.2 Subject to Article 10.3, only members of the Council present in person shall have the right to vote. Each member shall have one vote. The Rules of Procedure referred to in Article 12.3 shall provide that a member of the Council who is prevented from voting for a prolonged period may appoint an alternate as a member of the Council.

Save as otherwise provided for in the Statute, the Council shall act by a simple majority. In the event of a tie, the President shall have the casting vote.

./.

[22] European Commission, 'Economic and Monetary Union' (Sec(90)1659 final), p. 14, published in HWWA (1993).
[23] Statement by President Pöhl on the Statute of the System at the Ecofin meeting on 7 July 1990 (distributed at the Ecofin meeting).
[24] It was also decided that decisions would normally require a quorum of two-thirds of the members. It was furthermore decided that weighted voting would be applied to financial matters – see Art. 10.3-ESCB. The weights would be based on the capital key, with the Board members having a 'zero weight'.
[25] See description of Art. 12.1a-ESCB below.

> In order for the Council to vote, there shall be a quorum of two-thirds of the members. If the quorum is not met, the President may convoke an extraordinary meeting at which decisions may be taken without regard to the quorum referred to above."
>
> draft 27 November 1990

The accompanying Commentary explains that *"each member of the Council has the right to vote. The principle of "one person, one vote" will apply to all decisions except those relating to capital, assets and profits (see Article 28). This principle strengthens the decision-making process which must be oriented exclusively towards the requirements for the Community as a whole. [….]"*

II.3. HISTORY: IGC

With regard to the voting system, the Commission's draft Treaty of 10 December 1990 contained the following text:

> "107.5 The Council of the Bank shall adopt its decisions by a majority vote of its members. The conditions governing the casting of the votes by the members of the Executive Board are laid down in the Statute of the Eurofed and the European Central Bank."
>
> Commission draft 10 December 1990

The Commission's accompanying commentary showed the Commission assumed a 'one man, one vote' system. According to the Commission "this rule reflects Eurofed's federal character while, at the same time, reinforcing the decision-making process and emphasizing that the members of the Council are responsible to the Community as a whole."
The French draft proposal of 25 January 1991 showed a striking resemblence with the Commission's draft, while the German draft Treaty of 26 February 1991 refrained as much as possible from mentioning details of the ESCB in the Treaty.
The Luxembourg presidency would follow the German approach in this respect and not mention the voting procedure in the Treaty. Under the Luxembourg presidency the ESCB Statute was discussed at two occasions, which led only to a few minor changes. The 'one man, one vote' principle was left untouched.
In the consolidated text of the Luxembourg presidency the article read:

> *" 10.2 Subject to Article 10.3, only members of the Council of the ECB present in person shall have the right to vote. The Rules of Procedure referred to in Article 12.3 shall provide that a member of the Council of the ECB who is prevented from voting for a prolonged period may appoint an alternate as a member of the Council of the ECB.*
>
> *Subject to Article 10.3 and 11.3 each member shall have one vote. Save as otherwise provided for in this Statute, the Council of the ECB shall act by a simple majority. In the event of a tie, the President shall have the casting vote.*
>
> *In order for the Council of the ECB to vote, there shall be a quorum of two-thirds of the members. If the quorum is not met, the President may convoke an extraordinary meeting at which decisions may be taken without regard to the quorum referred to above."*
>
> *Luxembourg presidency 6 June 1991*

There are two differences with the text of the governors. First, the sentence on the voting principle had been moved from the second to the first paragraph, while a cross-reference was inserted to Article 11.3, which specifies that the Executive Board members will not have a right to vote on matters relating to the terms and conditions of their employment. Second, the 'Council' is referred to as the 'Council of the ECB', to distinguish it from the Council of Ministers (in the Treaty the Council of Ministers is usually referred to as the Council).
During the Dutch presidency the name 'Council of the ECB' would be replaced by 'Governing Council' [26] and the possibility of holding a teleconference was integrated in the text of Article 10.2.

[26] The name 'Governing Council' first appeared in UEM/66/91 and UEM/67/91 of the Dutch presidency, dated 25 and 26 September 1991 respectively. Already in the deputies IGC meeting of 12 March 1991 different names had been discussed. At that occasion the name 'Governing Board' or 'Court', suggested by Wicks of the UK Treasury, had met some, though not general sympathy.

Article 10.3:

Article 10-ESCB (The Governing Council):

"10.3 For any decision to be taken under Articles 28, 29, 30, 32, 33 and 51, the votes in the Governing Council shall be weighted according to the national central banks' shares in the subscribed capital of the ECB. The weights of the votes of the members of the Executive Board shall be zero. A decision requiring a qualified majority shall be adopted if the votes cast in favour represent at least two-thirds of the subscribed capital of the ECB and represent at least half of the shareholders. If a Governor is unable to be present, he may nominate an alternate to cast his weighted vote."

(to be read in conjunction with Article 10.2-ESCB (Non-weighted voting); Articles 26-33-ESCB (Financial provisions); Article 48-ESCB (Subscribed capital for derogation NCBs); Article 51-ESCB (Smoothing of monetary income redistribution); for voting rules in the Executive Board, see Article 11.5-ESCB)

I. INTRODUCTION

I.1 *General introduction*

The NCBs are shareholders of the ECB. To an extent they are also stakeholders in each other, because they share their monetary income as calculated under Art. 32, defined as net income generated by assets held against their monetary liability base, basically banknotes.[1] Weighted voting is reserved for decisions of a 'patrimonial' nature. Decisions of the Governing Council which either involve the transfer of assets (capital or foreign reserves) to the ECB or affect the NCBs' relative financial positions are financial decisions of a patrimonial nature. These decisions are, for that reason, taken by weighted voting.[2] In these cases the governors act as shareholders with weights directly based on the shares of their NCBs in the ECB's capital. On patrimonial decisions the Executive Board members have zero weighted votes, as they are no shareholders. Most of the weighted decisions are taken by simple majority, some require a qualified weighted majority when related to decisions of an exceptional nature, like increasing the ECB's capital (Art. 28) or using an alternative method for calculating monetary income (Art. 32.3).[3] The governors do not use weighted voting when they decide on the budget of the

[1] See for a description De Nederlandsche Bank, Annual Report 2002, p. 170.

[2] The word 'patrimonial' appears in the Commentary to the draft ESCB Statute of 27 November 1990. It is not defined, other than by referring to the articles to which it applies. The above interpretation of 'patrimonial' (i.e. relating to their relative income positions or to the transfer of assets) is compatible with the list of articles enumerated in Art. 10.3, as some articles (Art. 28, 30 and 33) relate to the transfer of financial assets or the retention of profits (which could be seen as a capital transfer too), while the other articles (Art. 29, 32 and 51) relate to NCBs' relative positions, either through the determination of the capital key shares or the calculation and allocation of monetary income. (The word allocation is used, because it does not relate to the *distribution* of profits, but it is a (re)allocation of income.)

[3] If not specified to the contrary weighted voting is taken by simple majority. This follows from Art. 10.2, second paragraph: 'Save as otherwise provided for in this Statute, the Governing Council shall act by simple majority.'

ECB, as the expenses incurred by the ECB do not affect, other than marginally, their relative shares. Indeed, otherwise each decision e.g. to intervene or to develop physical operational infrastructures and even all policy decisions would then have to be subject to weighted voting, because all these decisions affect the profits of the ECB, and thus indirectly the profits of the NCBs. This explains why budgettary matters do not figure in the list of articles mentioned in Art. 10.3, which is a limitative list, implying the Executive Board members vote alongside the governors on matters relating to the ECB's budget.[4]
The Committee of Governors left a few important financial decisions to the political bodies, such as the size of the foreign reserve transfer, the size of the ECB's capital and the NCBs' shares in the capital, which would function inter alia as the key for weighted voting. The governors also saw a need for political approval for increasing the amount of transferred foreign reserves (Art. 30.4), because (in their words) 'such calls are indeterminate in size.[5] However, they did not apply this reasoning to Art. 28.1, which article allows to increase the ECB's capital. The governors described this right to increase the ECB's capital as 'an important element of financial autonomy.' [6] Apparently, they considered it of utmost importance that the ECB would not depend on the political authorities for decisions relating to the ECB's financial strength and solvency. The IGC though would embed this article in Art. 42 (complementary legislation), allowing the Council of Ministers to determine limits and conditions for such capital increases.[7] (In fact, this is an aspect of external checks and balances.)

Table 10-2: Assigned capital key shares in the ECB of EU central banks [8]

National central bank of:	%	% (normalized for euro area NCBs only)
Belgium	2.9	3.5
Germany	24.5	30.2
Greece	2.1	2.6
Spain	8.9	10.9
France	16.8	20.7
Ireland	0.8	0.9
Italy	14.9	18.4
Luxembourg	0.1	0.1

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[4] The Governing Council could delegate the budget to the Executive Board, but it has not done so - see Art. 12.3-ESCB and Art. 15 of the Rules of Procedure, which are adopted by the Governing Council.
[5] Commentary to the draft ESCB Statute of 27 November 1990.
[6] Commentary to Art. 29 of the draft ESCB Statute of 27 November 1990.
[7] The Ecofin Council has decided that the ECB is allowed to increase its capital with another euro 5 billion without further conditions – mentioned under Art. 33-ESCB in cluster II, which also mentions other ways in which ECB losses can be covered.
[8] Rounded figures (ECB Annual Report 2001, p. 193).

Netherlands	4.3	5.3
Austria	2.4	3.0
Portugal	1.9	2.3
Finland	1.4	1.7
Sub-total euro area NCBs	81.0	100
Non-euro area NCBs [9]	19.0	

I.2 *Relevant features of the Federal Reserve System*

In the FRS there are no comparable, patrimonial decisions, because unlike the euro area NCBs the Federal Reserve Banks are not shareholders of the central institution. In fact, the Board of Governors only generates costs, which are defrayed by assessments levied on the FRBs, according to their shares in the system's total capital stock. The member banks which hold their FRB's capital stock[10] receive an annual dividend of 6 per cent on the paid-in capital stock.[11] The surplus is used to increase the FRBs' general reserves (at most equal to its capital stock), while the remainder is paid to the Treasury (so-called: 'interest on Federal reserve notes' plus, in some years, statutory transfers). The annual amount paid to the Treasury has been erratic in the thirties and forties, but since 1948 the amount has always been positive and generally increasing.[12]

II.1 HISTORY : DELORS COMMITTEE AND COMMITTEE OF GOVERNORS

The *Delors Committee* did not pay attention to special voting procedures for financial issues, as it focussed entirely on the voting on monetary policy issues. However, already the first versions of the draft Statute of the *Committee of Governors* (dating from June 1990) mentioned the possibility of weighted voting, namely for 'to decisions concerning capital assets and profit'. At that stage they did not have a clear view of the financial provisions and financial structure of the system, but it was clear that national interests were at stake due to the distribution of NCB profits to their national Treasuries. According to the Committee of Governors weighted voting should be based on the key for capital shares. In these cases proxy voting was allowed for, because central banks should always be allowed to vote on decisions having direct financial implications.

[9] UK (14.7%), Sweden (2.7%), Denmark (1.7%). The out NCBs are assigned weights in the capital key, but they shall not pay up their capital, but for a small part as a way to contribute to the operational costs of the ECB (Art. 48-ESCB). After the accession of ten new Member States to the EU on 1 May 2004 the new non-euro NCBs hold 10,1% in the capital key.

[10] Each member bank has to subscribe six per cent of its paid-up capital stock and surplus (FRA(1988), Section 2.3).

[11] FRA (1988), Section 7.1.

[12] Board of Governors, Annual Report 2001, Statistical tables, table 6.

The draft Statute of 24 July 1990 read:

"9.3 Weighted voting shall apply to decisions pursuant to Article .... When weighted voting applies, the Governors' votes shall be based on the capital share of their respective national central bank. If a Governor is unable to be present, he may nominate an Alternate to cast his weighted vote.

draft 24 July 1990

At an early stage it was decided that the members of the Executive Board would not have a vote in the case of weighted voting, because weighted voting was reserved for financial decisions relating to capital assets and profit.

In July the financial provisions were discussed by the Alternates, of which Article 26 was devoted to voting on financial matters:

"Article 26 - Voting on financial matters
For the purpose of Articles 27 to 30 [capital, transfer of assets and liabilities to the Central Institution and allocation of income, losses and profits of the System], the votes in the Council shall be weighted according to the key attached to the Statute. A decision by qualified majority shall be deemed to be approved if it carries [..] votes on the total of [..]."

Alternates' chairman's note 29 August 1990

The accompanying comments read as follows:
'It is assumed that, after a period (length to be specified), the allocation of net profits of the System should be determined by the key attached to the Statute, which is also used for the provision of capital to the central institution and for the voting rights related to 'patrimonial decisions'. What this key should be deserves extensive discussion in view of its important (financial) implications.'

At their meeting of 11 September 1990, the Governors confirmed that weighted voting should apply only to financial matters and that votes should be weighted according to the key attached to the Statute. In the draft version of 14 September, Article 9.3 and 25 (formerly Art. 26) read as follows:

"9.3 Weighted voting shall apply in accordance with the provisions of Article 25. If a Governor is unable to be present, he may nominate an Alternate to cast his weighted vote."

"Article 25 - Voting on financial matters
25.1 For the purpose of Articles 26 to 29 {i.e. the other articles of the Chapter VI on Financial Provisions}, the votes in the Council shall be weighted according to the key attached to the Statute. A decision by qualified majority shall be deemed to be approved if it carries [..] votes on the total of [..].
25.2 The key referred to in Article 25.1 may be modified in accordance with Article ... of the Treaty, as amended by ....."

draft 14 September 1990

This developed further into the draft of 27 November 1990, which was transmitted to the IGC:

> "10.3 Weighted voting shall apply in accordance with the provisions of Article 28. If a Governor is unable to be present, he may nominate an Alternate to cast his weighted vote."
>
> "28.1 For any decisions to be taken under Article 29 to 32, the votes in the Council shall be weighted according to the key attached to the Statute. A decision by a qualified majority shall be deemed to be approved if it carries [..] votes out of a total of [..]."
>
> draft 27 November 1990

During the period until April 1991 the Committee of Governors continued its deliberations on some of the financial provisions (capital key, distribution of income). Article 28.1 was renumbered into 29a. In the draft version of 26 April 1991 (forwarded to the presidency of IGC) this article was combined with Article 10.3 which then read:

> "10.3 For any decisions to be taken under Article 28, 29, 30, 32 and 33, the votes in the Council of the ECB shall be weighted according to the national central banks' shares in the subscribed capital of the ECB. A decision by a qualified majority shall be approved if the votes cast in favour represent at least [..] % of the subscribed capital of the ECB. If a Governor is unable to be present, he may nominate an alternate to cast his weighted vote."
>
> draft 26 April 1991

The *Commentary* of the Committee of Governors which accompanied the draft read as follows:
'Weighted voting would apply to all decisions of a patrimonial nature which justify the derogation from the principle of "one person, one vote". The Executive Board members in the Council of the ECB will have no weighted votes and will therefore not take part in decisions made under Articles 28, 29, 30, 32 and 33.
In order to ensure an equitable system of balanced rights and obligations, the key for weighting votes will be the same as that for the subscription by national central banks to the capital of the ECB (Article 28) and of profits and losses of the ECB (Article 33), as well as the transfer of foreign reserve assets to the ECB (Article 30). In the case of weighted voting a Governor, who is unable to be present, may nominate an alternate to cast the vote.'

We conclude that the principle of weighted voting for patrimonial decisions was not contested. The difficulties that arose had nothing to do with the relations between the Executive Board (zero-weighted) and the governors, but with the relations among the NCBs, and then especially on the precise formula for the capital key.

II.3 HISTORY: IGC

The draft Treaty texts of the Commission and of France did not specify the voting arrangements of the ECB. Details were left to the Statute, the draft of which would be discussed during several meetings of the deputies IGC.

In the Luxembourg non-paper dated 6 June 1991, which summarized the findings of the first half year of the IGC, the changes in the draft Statute provided by the Committee of Governors

generally were limited. As regards Art. 10.3 the issue of the 'qualified majority', which had deliberately been left open by the governors, had been specified as 70% of the subscribed capital of the ECB, though the number was still between square brackets. In the second half of the IGC, the ESCB Statute was discussed mostly by the EMU Working Group, and not so much by the deputies or Ministers. In the Working Group the delegates of two countries (UK and Greece) had shown a strong preference for a qualified majority of two-thirds instead of 70 percent. They apparently feared that a higher threshold might risk handing to the German central bank *de facto* the right to veto qualified majority decisions, as their capital share could be close to 30%. The Dutch presidency adopted this in her consolidated text of 28 October,[13] initially using square brackets around [two-thirds].
During the meeting of the EMU Working Group on 27 November 1991 the delegates from small countries pointed to the fact that the central banks of the three or four largest countries would probably always represent more than two-thirds of the capital and proposed to combine the voting threshold with a critical mass of at least 7 central banks, in order to prevent strategic alliances. While this request was supported by the smaller countries, Germany and France favoured the original text. This issue was solved during the final ministerial IGC meeting of 30 November to 3 December 1991, at which it was agreed that a qualified majority in weighted voting should 'represent at least two-thirds of the subscribed capital of the ECB and represent at least half of the shareholders.' [14]

The chapter with Transitional Provisions in the ESCB Statute[15] would contain an article introducing the possibility to smooth possible abrupt changes in income allocation following the implementation of the Article 32 on the (re)allocation of monetary income.[16] During the legal nettoyage the phrase 'acting by a qualified majority' was deleted from this article after the UK delegation had suggested that 'Article 10.3 provides this procedural rule'. We have seen that this is not the right reading of Art. 10.3, which also allows for weighted voting by simple majority.

[13] UEM/90/91, dated 28 October 1991.
[14] Summary note of 6 December 1991 by the Secretariat of the Committee of Governors on the final meetings of the IGC held in Scheveningen and Brussels on 30 November to 3 December 1991, p.7.
[15] UEM/91/91.
[16] Article 45, later Article 51:

> "45.1 If, following the entry into Stage Three, the Council of the ECB, acting by qualified majority, decides that the application of Article 32 results in significant changes in NCBs' relative income positions, the amount of income to be allocated pursuant to Article 32 shall be reduced by a uniform percentage which shall not exceed [60] [30]% in the first financial year after the entry into Stage Three of EMU and which shall decrease by at least [12] [6] percentage points in each subsequent financial year."
>
> governors' draft 29 October 1991

Apparently it was considered desirable to put a heavy lock on this 'financial' door. The Commentary states that the ECB Council's room for manoeuvre would be limited in three respects. First, activation of Article 51 would be conditioned on the ECB Council's perception of significant effects on the relative income positions. Second, upper limits 'would ensure that only part of the monetary income would be exempted from the allocation scheme.' Third, the derogation would be temporary ('limited to a period of five years after the entry into Stage Three.') These five years would later be interpreted as five years as of the introduction of the euro, because that was the earliest moment of an income shock due to the allocation of monetary income (the seigniorage generated by national currency banknotes had been excluded from the definition of monetary income, as these national banknotes were legal tender only in their country of issue).

Article 12.1, first and second paragraph:

Article 12 (Responsibilities of the decision-making bodies – Governing Council and Executive Board):

"12.1 The Governing Council shall adopt the guidelines and make the decisions necessary to ensure the performance of the tasks entrusted to the ESCB under this Treaty and this Statute. The Governing Council shall formulate the monetary policy of the Community including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the ESCB, and shall establish the necessary guidelines for their implementation.

The Executive Board shall implement monetary policy in accordance with the guidelines and decisions laid down by the Governing Council. In doing so the Executive Board shall give the necessary instructions to national central banks. In addition the Executive Board may have certain powers delegated to it where the Governing Council so decides."

(to be read in conjunction with Article 3-ESCB (Tasks); Article 8-ESCB (ESCB governed by decision-making bodies of the ECB); Art. 9.3-ESCB (Decision-making bodies of the ECB are Governing Council and Executive Board); Article 11.6-ESCB (Executive Board responsible for current business ECB); Art. 12.1-ESCB, third paragraph (Decentralized implementation); Article 12.2-ESCB (Executive Board prepares Governing Council meetings))

I. INTRODUCTION

I.1 *General introduction*

The first paragraph of this article lays down the powers of the Governing Council, the second the powers of the Executive Board, while the third paragraph, which was dealt with in Cluster II, extends an obligation to the ECB to use as much as possible and appropriate the NCBs when implementing monetary policy. What makes this article interesting for our study is whether one decision-making body is dominating the other, or whether each body has independent powers (and not only delegated or derogatory ones), while at the same time needing the other. The discussion in the Committee of Governors on this issue was long and laborous and in the end the central bank governors decided to disagree - most of them preferring that the Executive Board should only have *delegated* powers, which the delegator, i.e. the Governing Council, could take back and redefine before giving back. Thus positioning the Executive Board as a secretariat with ad hoc executive tasks. The IGC was asked to take a final decision. It would opt for a – from our point of view - more balanced approach, which is in line with the principle of separation of powers, because it prevents the Governing Council, in which the NCB governors would dominate, from being able to assume all powers to the detriment of the centre. The Executive Board's own power lies in its duty to ensure that 'monetary policy' as formulated by the Governing Council is implemented (first sentence of

second paragraph of this article), though the Board has to operate always within the framework of the Governing Council's guidelines and decisions. One would assume that the Board's responsibility is not limited to monetary policy *in strictu sensu*, but that 'monetary policy' has been used in a generic sense (though probably not automatically and especially not formally encompassing all tasks entrusted to the ESCB, because in that case the wording of the first sentence of the first paragraph of Art. 12.1 should have been used). Any other interpretation would severely limit the meaning of these powers.
Outside this article there are only three other articles conferring specific tasks to the Executive Board: Art. 11.6 which specifies that 'the Executive Board shall be responsible for the current business of the ECB'; Article 12.2 which specifies that 'the Executive Board shall have responsibility for the preparation of meetings of the Governing Council'; and Art. 26 which specifies that the Executive Board shall draw up the annual accounts of the ECB and a consolidated balance sheet of the whole ESCB for analytical and operational purposes.[1] In contrast, the Governing Council is mentioned in 23 out of the 53 articles of the ESCB Statute.

The second paragraph (i.e. Art. 12.1b) stipulates that NCBs can be *instructed* by the Executive Board, to the extent necessary for implementing monetary policy. Such authority is necessary to assure the indivisibility of the monetary policy in the eurosystem. The same paragraph also contains a last sentence allowing the Governing Council to **delegate** 'certain powers' to the Executive Board. Until now the Executive Board has not been delegated with generic 'other' powers by the Governing Council, but only with smaller technical decisions[2]. There are limits to delegation. E.g. it is hard to imagine the Governing Council delegating strategic monetary powers, like interest rate decisions, to the Executive Board. Interest rate decisions are not just technical decisions, they require a fair amount of discretion and judgement, in the sense that they are not merely executive decisions. Though such delegation would neither resemble the delegation of discretionary powers to a third party (which is not allowed, cf *Meroni* v. *High Authority* case 1958) nor internal delegation (which within limits is allowed for practical reasons, cf *Commission* v. *BASF AG et al* case 1992)[3] , the delegation of a core function (in casu key interest rate decisions) to a sub-body (Executive Board) without clear practical reasons would seem problematic, because it would take away the federal character of the decision-making. Even when the governors might individually be less first-rank economists or be less informed than the Executive Board members together they provide for wider input and for better decisions whenever Executive Board members are not infallible. The foregoing is hypothetical, because there is no reason why the governors would delegate this power to the Executive Board. Moreover, such delegation would be reversible. A different situation would arise when the political authorities would take away the voting power from the governors (or reduce it substantially). This would affect the federal character and in the end also the central bank's independence, because a small decision-making body would be an easier target for political pressure than a large body.

[1] See also Art. 27, footnotes 10 and 29. Apart from this, the Executive Board is mentioned in Art. 9.3 (the Executive Board exists), in Art. 10.1 (its members are members of the Governing Council), in Art. 11 (composition, appointment, salary, voting procedure, replacement), Art. 39 (the president or two members of the Board could legally commit the ECB to third parties).
[2] See chapter 11.2.3.
[3] Kapteyn/Verloren van Themaat (1999) p. 244-247.

I.2 *Relevant features of the Federal Reserve*

Starting in 1913 the Federal Reserve Board was certainly not a dominant decision-making body. The Board had been set up as a regulatory agency, it approved discount rate changes, it supervised the FRBs, it supervised and regulated the issuing of notes and it could suspend reserve requirements. Changes in reserve requirements became a monetary policy tool in 1935, the power to change them was laid in the hands of the Federal Reserve Board of Governors. Before 1935 FRBs decided on open-market operations (OMOs) with the Board in a coordinating and regulatory role. In 1935 OMOs came under complete control of the FOMC. The FOMC is a separate entity, like the Board of Governors and the FRBs, but indeed one within the Board members constitute a majority. However, the FOMC meetings are not prepared by the Board. The FOMC has its own secretariat and preparatory staff, though most of them come from the Board of Governors.[4] It should be noted that the FOMC was not that powerful in the early years - before 1955 the FOMC met only four times per year and usually did little more than ratify decisions made earlier by a small working subcommittee led by the chairman, de facto transferring power to the centre. By the 1950s, the rapid development of air travel and the then-chairman Martin's consensus-building approach and his willingness to discuss led to the FOMC meeting every three weeks. [5]

It should also be noted that the FOMC (and not the Board) is in charge of the operations in the foreign exchange markets. (Foreign exchange interventions are decided upon by the Treasury, with the Fed usually participating in them). Like open market operations, foreign exchange interventions are conducted by the New York Fed, which is designated for this task by the FOMC.[6] Furthermore, the Board of Governors is often mentioned in other articles, especially articles relating to functions of the FRBs - the performance of many of these functions is subject to guidelines or approval by the Board of Governors, making the Board a powerful factor in almost every respect of the System. More in general, the Board acts as a supervisory board over the FRBs, with some far-reaching powers as regards the staff of the FRBs.[7]

The Board of Governors may delegate 'any of its functions, other than those relating to rulemaking or pertaining principally to monetary or credit policies, to [….] Federal reserve banks.' [8] The Board has delegated in this way certain supervisory and other functions.

Comparing the Fed and the ESCB

There are parallels and differences when comparing the decision-making bodies of the FRS with those of the ESCB. The Board of Governors would at first sight resemble the Executive Board (and the FOMC would come close to the Governing Council).

The FOMC and the Governing Council are both federally designed decision-making bodies with unweighted (non-political) voting regimes. A major difference between the FOMC and the Governing Council is that the FOMC only decides on open market operations and that

[4] See Art. 10.2-ESCB.

[5] Kettl (1986), p. 85.

[6] For an overview of the powers of the Board of Governors and the FOMC, see FRA, Sections 11 and 11A for the Board and Sections 12A and 14(b)(2) for the FOMC. See also Article 109-EC, section I.2 in cluster I.

[7] See Art. 27, section I.2 in cluster I.

[8] FRA (1988), Section 11(k).

within the FOMC the twelve FRB presidents only have five votes. This would imply the Governing Council is relatively more powerful within the ESCB than the FOMC is within the FRS.
As a corollary the Board of Governors has decision-making powers of its own which in the ESCB belong to the Governing Council. The Board of Governors determines some elements of the monetary policy framework (as regards non-open market policy) and it has the exclusive regulatory powers for non-monetary functions; [9] moreover, it dominates the monetary policy decision-making body (the FOMC). The Board of Governors is therefore relatively more 'powerful' than the Executive Board. On the other hand, the third sentence of Art. 12.1a implies the Executive Board orchestrates the implementation of the monetary policy guidelines and interest rate decisions of the Governing Council, implying the Executive Board is more involved in the implementation of open market operations than the Board of Governors. In general, in the eurosystem the regional elements dominate both in determining the general framework and in taking the interest rate decisions. We will see under Art. 11.6-ESCB that the Executive Board, as the body preparing the Governing Council meetings, is nonetheless very influential – the fact that they have a minority in the Governing Council understates their influence.

II.1 HISTORY: DELORS COMMITTEE

The division of labour between the Board and the wider composed Council of the ECB was debated by the Delors Committee, but not at great length. The first mentioning of organizational details appears in the so-called Skeleton Report of 2 December 1989. The following rather extensive quote shows that this report already contained many ideas which would later be included in the ESCB Statute.

"- the system must reflect the federal structure of the Community. This implies an organization [perhaps analogous to the Federal Reserve System] which, through appropriate representation [and weighted voting procedures] in governing bodies, ensures that the interests of all national central banks are adequately taken into account. To this end the organizational structure of the system could consist of a Board and a Council. The Board would have [three to ...] members and a Chairman, all of whom would be working full time for the FEMI[10] and not hold responsibilities in national institutions. The Board members would be appointed for a term of office of [eight years] [11] by the European Council. The Board would be responsible for the day-to-day management of the FEMI and be supported by its own staff. The Council would be composed of the Board members as well as the

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[9] E.g. the Board sets the supervisory framework, it approves the prices for financial services provided to banks by the FRBs (**MCA 1980**). As regards payment system, the FRBs decide on issues like the development of new products, which they co-ordinate among themselves through the Conference of FRB Presidents (a body without decision-making power). It would seem that the Board has a large degree of freedom in deciding how specific and detailed it will be in its regulations.
[10] Federal European Monetary Institution. Name for the ECB used only in this Skeleton Report.
[11] In an early paper, dated 26 October 1988 Niels Thygesen, one of the outside expert members of the Delors Committee had suggested a tenure of 8 years for the Executive Board members.

Governors of the national central banks and act as the policy-making authority. The Council would meet regularly [every two weeks] and be chaired by [the Chairman of the Board] and its decisions would be made on the basis [of weighted voting reflecting the relative importance of national central banks?]. The meetings of the Council could be attended by a member of the Commission [Council of Ministers?], who, however, would not have the right to vote;"

CSEMU/5/88, 2 December 1988

The frequency of the meetings of the Governing Council is relevant for the influence of the Council. A high frequency shifts power to the Council, because it allows for a hands-on approach; a low frequency would shift power away from the Council to the Board. Every two weeks would be a high frequency, for instance compared to the Federal Open Market Committee of the Federal Reserve, which meets only every six weeks (though it can take interest rate decisions in between by teleconference).
During the meeting of the Delors Committee on 13 December 1988 Pöhl distributed a memorandum[12] listing the features of a future monetary "Community decision-making body", among which:
"- a centralised body (Directorate) responsible for the implementation of ECBC decisions as far as they apply at Community level"

Pöhl's note was integrated into the next draft version of the report. Paragraph 18 of the Skeleton Report of 31 January 1989 contained the following formulation:

"The System (ESCB) could consist of a central institution, with its own balance sheet, and national central banks. At the final stage the ESCB - acting through its Council - would be responsible for formulating the thrust of monetary policy and managing the Community's exchange rate vis-à-vis third currencies. The day-to-day operations conducted at the Community level, possibly involving changes in interest rates and the use of other policy instruments, would be carried out under responsibility of the Board of the central institution, supported by its own staff. The national central banks would be entrusted with the implementation of policies at the regional level in accordance with guidelines established by the Council.
The European System of Central Banks, which would embody the Community's monetary order, should rest on the following basic principles: .

Structure and organization

- a federative structure, since this corresponds best to the political structure of the Community (e.g. a European Central Bank Council representing all the central banks in the union);
- a centralised body (Board with its supporting staff) responsible for the implementation of Council decisions as far as they apply at Community level;
- appointment of members of the Board for relatively long periods on an irrevocable basis;"

CSEMU/10/89, 31 January 1989

In a proposal dated 8 March 1989 [13] the Bundesbank proposed to add the underlined words

[12] See Art. 10.2, section II.1 above.
[13] Comments on CSEMU/12/89.

"At the final stage the ESCB - acting through its Council - would be responsible for formulating and implementing monetary policy as well as managing the Community's exchange rate policy vis-à-vis third currencies." This proposal was taken on board, thus bringing all monetary and operational decisions under the aegis of the ESCB's Council.

In a later version of 31 March 1989 some changes were made which reduced the role of the Board:

" [This new System] could consist of a central institution (with its own balance sheet) and the national central banks. At the final stage the ESCB - acting through its Council - would be responsible for formulating and implementing monetary policy as well as managing the Community's exchange rate policy *vis-à-vis* third currencies. The national central banks would be entrusted with the implementation of policies in conformity with guidelines established by the Council of the ESCB and in accordance with instructions from the central institution.
The European System of Central Banks should be based on the following principles:
[....]

Structure and organization
- a federative structure, since this would correspond best to the political structure of the Community;
- establishment of a ESCB Council (composed of the Governors of the central banks and the members of the Board, the latter to be appointed by the European Council), which would be responsible for the formulation of and decision on the thrust of monetary policy; decisions would be made by weighted majority vote;
- establishment of a Board (with supporting staff), which would monitor monetary developments and oversee the implementation of the common monetary policy;
- national central banks, which would execute operations in accordance with instructions given by the Board."

CSEMU/14/89, 31 March 1989

Compared to the draft of January the following sentence, which had added weight to the Board, had been deleted: "The day-to-day operations conducted at the Community level, possibly involving changes in interest rates and the use of other policy instruments, would be carried out under responsibility of the Board of the central institution, supported by its own staff." Instead the Board was 'to monitor monetary developments', 'oversee the implementation of monetary policy' and 'instruct' NCBs. On paper the role of the Board had diminished relative to that of the Council of the ESCB. It is not clear whether this was done at the request of one or more Committee members or whether this was just the result of new drafting by the rapporteurs.

The Board's role was further reduced in the final version of the Report, dated 12 April 1989, because under the heading 'Structure and organization', fourth indent, the words 'in accordance with instructions given by the Board' were replaced by 'in accordance with the **decisions taken by the ESCB Council.'** This was in line with an amendment under the second indent, where 'decision on the thrust of monetary policy' was replaced by '**decisions**

on the thrust of monetary policy', increasing the involvement of the Council of the ESCB in monetary policy decision-making. The reference to weighted voting was dropped and replaced by a sentence stating that the voting modalities would be provided for in the Treaty.
Under the heading **'Status'** the independence of the members of the central banks system was strengthened by including that also the **Governors** should have appropriate security of tenure, instead of merely stating that they should act independently of their government. The reference to the exact number of years for the tenure was dropped.

Therefore, in the final version the text under the heading 'Structure and organization' would read as follows:

" Structure and organization
- a federative structure, since this would correspond best to the political structure of the Community;
- establishment of an ESCB Council (composed of the Governors of the central banks and the members of the Board, the latter to be appointed by the European Council), which would be responsible for the formulation of and decisions on the thrust of monetary policy; modalities of voting procedures would have to be provided for in the Treaty;
- establishment of a Board (with supporting staff), which would monitor monetary developments and oversee the implementation of the common monetary policy;
- national central banks, which would execute operations in accordance with the decisions taken by the ESCB Council."

Delors Report April 1989, section 32

The precise division of tasks between the Council and the Board would be discussed in more detail by the Committee of Governors, when drafting the draft ESCB Statute.

II.2 HISTORY: COMMITTEE OF GOVERNORS

We must conclude that the role of the Board had not been filled in very clearly by the Delors Committee. The Delors Committee had not answered the question whether the Board should have autonomous executive tasks or whether these should be dependent on delegation by the Council. The discussion in the Committee of Governors on the important question for the checks and balances within the decision-making bodies of the system would not be conclusive either. Their final draft of the ESCB Statutes of 27 November 1990 would contain two alternative texts, on which the IGC was asked to take a decision.

Disagreement already showed during the first meeting of the Committee of Alternates on 18 June 1990, at which occasion they discussed a preliminary draft version of the ESCB Statute, prepared by the chairman of the Alternates, Jean-Jacques Rey, together with the staff of the secretariat of the Committee of Governors. That draft contained the following ideas:

"Article 7 - Responsibilities of the governing bodies
7.1 The Council shall adopt the monetary policy guidelines of the monetary union and fix the rates and terms for discounting, advances and loans. It may give the Board of

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Management and the NCBs the necessary instructions for implementing the monetary policy.

The Council shall adopt, in the context of the other tasks conferred upon the ESCB, the basic guidelines and general decisions required for the performance of its tasks.

It may delegate such powers as it may specify to the Board of Management.

7.2 The Board of Management shall be responsible for implementing guidelines laid down by the Council. It shall act in accordance with the Council's instructions.

The Board of Management shall be responsible for administering the ECB. It shall act on all matters not expressly reserved for the Council by the Statutes or the rules of procedure.

[....]"

draft 11 June 1990

The Alternates of the central banks of France and the UK (Lagayette and Crockett) concurred with the proposed strong decision-making role for the Council, with the Board members having executive powers only. However, the German and Dutch Alternates (Rieke and Szász) preferred a stronger Executive Board, with the Council only defining broad guidelines of monetary policy. Behind their preference lay the desire of creating a strong centre: a strong centre was considered necessary to ensure the system would operate without political interference, to attract qualified persons to serve on the board and to underline the unity and indivisibility of the system and its monetary policy.

Szász suggested the following text for the Executive Board capturing the German-Dutch position: 'The Executive Board shall be responsible for implementing the guidelines laid down by the Council. In doing so it shall fix the rates and terms for discounting, advances and loans. It shall act in accordance with the Council's instructions.'

It was clear that Szász was thus trying to increase the powers of the Executive Board, by allowing it to set interest rates, though within the context of the Council's instructions.

This resulted in two options for Article 8.2 in a subsequent draft version:

"Article 8 - Responsibilities of the governing bodies

8.2 The Executive Board shall be responsible for implementing the policy decisions laid down by the Council. [OPTION A: In doing so, it shall fix the rates and terms for discounting, advances and loans in accordance with the Council's instructions.] [OPTION B: It shall act in accordance with the Council's instructions.]

The Executive Board shall be responsible for the preparation of the meetings of the Council.

The Executive Board shall be responsible for administering the central body. It shall act on all matters not expressly reserved for the Council by the Statute or the Rules of Procedure."

draft 22 June 1990

The accompanying comments explain the differences:

'Option A confers upon the Executive Board greater responsibilities than Option B. The proponents of Option A consider this justified by the aim of:

- strengthening the centre of the ESCB;

- increasing the flexibility in the implementation of monetary policy within the ESCB;

The proponents of Option B consider that the Council should remain the supreme decision-making body with only day-to-day policy implementation being entrusted to the Executive Board. In their view, this approach would be more in line with the principles of federalism and democratic accountability.'

The difference between option A and B would widen, because as of early July the third sentence of OPTION B would read 'the *Council* shall act on all matters not expressly reserved to the Executive Board by the Statute or the Rules of Procedure', thus further increasing the power of the Council. Pöhl expressed the Bundesbank views also in public. In a speech held on 2 July 1990 he said 'it would [....] be wise to have a strong central element, call it a Directorate or otherwise, whose members would be an integral part of the Governing Board and would in nature of things give added force to the system's autonomy in the day-to-day of its task.' Therefore, we see Pöhl also established a link between a sufficiently strong (non-governors) centre and political independence. [14]
During the Alternates' meeting of 29 June 1990 it was decided that the Executive Board's responsibility for implementing monetary policy would include the right to give instructions to NCBs in order to be able to carry out the system's monetary policy.[15]

In the governors' meeting of 10 July 1990 most governors supported option B. They considered this option would best preserve the position of the Council, would provide for sufficient flexibility (through less or more delegation) and would be politically more realistic. The German and Dutch governors supported option A, though Pöhl wished to go even further. In his opinion option A would still leave the Executive Board powerless, while what the System needed was leadership: it needed a strong president and a strong Executive Board with sufficient weight in the voting procedure. Pöhl announced he would propose an alternative solution in due course. De Larosière favoured keeping the two alternative options and urged caution with regard to including a third proposal. It was also suggested to keep open the two alternative options and leave the final decision to the political level. According to one source present during this meeting Pöhl was concerned that the Council would become an indecisive body, 'as happened with the Council of the 'Buba', because of the presence of the presidents of Landeszentralbanken.'

During the governors' meeting on 11 September 1990 Pöhl distributed a compromise proposal according to which the Council would define the guidelines for monetary policy and would have to ('shall') delegate the necessary operational powers for implementing the monetary policy guidelines to the Executive Board; these powers could be revoked, but if so would have to be redefined and handed back to the Executive Board immediately.[16] When de Larosière

[14] Pöhl (1990b), 'Two monetary unions - the Bundesbank's view', lecture by Karl-Otto Pöhl at the Institute for Economic Affairs, London, 2 July 1990 – see Annex 3.
[15] Until then the right to instruct NCBs had been reserved for the Council - see Art. 7.1 of draft version of 11 June 1990. This right of instruction is therefore seen as part of the implementation, and not as a source of policy making.
[16] Pöhl's proposal read as follows:

"11.1 The Council shall take the decisions necessary for the performance of tasks entrusted to the System under the present Statute. The Council shall formulate the monetary policy of the Community and shall establish the necessary guidelines for its implementation.

suggested to insert in this proposal an explicit right for the Council to revoke these powers, Pöhl said this was unacceptable. However in the end, the governors were able to agree on an amended version of Pöhl's text, according to which the Council, apart from issuing guidelines for monetary policy, would also decide on 'basic interest rates' and the provision of liquidity:

"11.1 The Council shall take the decisions necessary for the performance of tasks entrusted to the System under the present Statute. The Council shall formulate the monetary policy of the Community including decisions on basic interest rates and overall liquidity supply in the System, and shall establish the necessary guidelines for its implementation.

The Council shall delegate to the Executive Board the necessary operational powers for implementing the monetary policy decisions and guidelines. The Council may delegate other powers as it may specify to the Executive Board.[17]

11.2 When implementing monetary policy in accordance with the decisions and guidelines established by the Council, the Executive Board shall give the necessary instructions to national central banks.

The Executive Board shall have responsibility for the preparation of the meetings of the Council."

draft 14 September 1990

However, disagreement re-emerged after advice was taken in from the legal departments of the central banks. The German legal expert proposed to show more clearly that the Executive Board should have 'eigene Kompetenzen' (own competences).[18] In his view the second part of Article 11.1 ('The Council shall delegate to the Executive Board ...)' should read: **'The Executive Board shall implement monetary policy in accordance with the decisions and guidelines laid down by the Council.'** [19] The result was that the second paragraph of Article 11.1 was put between square brackets.[20] (Article 11 would be renumbered into Article 12.) In the version of 19 October 1990 the words 'as appropriate' and 'intermediate monetary objectives' were inserted in Art. 12.1, second sentence relating to the powers of the Council, thus reading: 'The Council shall formulate the monetary policy of the Community, including, *as appropriate*, decisions relating to *intermediate monetary objectives*, key interest rates and

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The Council shall give to the Executive Board the necessary operational powers for implementing the monetary policy guidelines. The Council may delegate other powers as it may specify to the Executive Board and may, at its discretion, revoke such powers.

11.2 When implementing monetary policy in accordance with the guidelines established by the Council, the Executive Board shall give the necessary instructions to NCBs.

The Executive Board shall have responsibility for the preparation of the meetings of the Council. It shall be responsible for administering the central institution."

Pöhl's proposal early September 1990

[17] This was agreed on the understanding that: - powers delegated to the Executive Board for implementing monetary policy could be revoked by the Council, but the decisions and guidelines would have to be re-delegated, albeit on different terms; - the word 'delegate' did not mean a transfer of responsibilities and, therefore, the decision-making power would remain firmly in the hands of the Council. Minutes of the meeting of the Committee of Governors on 11 September 1990.

[18] Stellungname zum Draft Statute of the ESCB, Deutsche Bundesbank Hauptabteilung Recht - R 10, 19. September 1990.

[19] Draft ESCB Statute of 5 October 1990, *Comments* with Article.

[20] Draft ESCB Statute of 19 October 1990.

the supply of reserves in the System". The origins are not clear. The use of the words 'as appropriate' opened the possibility for the Council to delegate one or more of these functions to the Executive Board. At the same time the sentence serves to make clear that the power originates from the Governing Council.

"12.1 The Council shall take the decisions necessary to ensure the performance of tasks entrusted to the System under the present Statute. The Council shall formulate the monetary policy of the Community including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the System, and shall establish the necessary guidelines for their implementation.

[The Council shall delegate to the Executive Board the necessary operational powers for implementing the monetary policy decisions and guidelines. The Council may delegate other powers as it may specify to the Executive Board.]

12.2 When implementing monetary policy in accordance with the decisions and guidelines established by the Council, the Executive Board shall give the necessary instructions to national central banks.

The Executive Board shall have responsibility for the preparation of Council meetings."

draft 25 October 1990

When the governors discussed this matter in their meeting of 13 November 1990. Pöhl pleaded strongly for the wording of his legal expert. However, among others, the French and UK governors supported the existing wording, as they felt that the Council should always retain the right to withdraw the delegated powers of the Executive Board and to re-delegate them on different terms. They opposed that the members of the Executive Board would enjoy rights or functions independent of those of the Council. The German sentence was inserted as an alternative, and both alternatives were put between square brackets and were presented to the IGC in the final draft Statute:

"12.1 The Council shall take the decisions necessary to ensure the performance of tasks entrusted to the System under the present Statute. The Council shall formulate the monetary policy of the Community including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the System, and shall establish the necessary guidelines for their implementation.

[The Council shall delegate to the Executive Board such necessary operational powers as it thinks fit for implementing the monetary policy decisions and guidelines. The Council may delegate other powers as it may specify to the Executive Board.] [The Executive Board shall implement monetary policy in accordance with the decisions and guidelines laid down by the Council.]

12.2 When implementing monetary policy in accordance with the decisions and guidelines established by the Council, the Executive Board shall give the necessary instructions to national central banks.

The Executive Board shall have responsibility for the preparation of Council meetings."

draft 27 November 1990

The accompanying Commentary was quite clear on the arguments behind the two bracketed alternatives:
"Monetary policy is indivisible and the decision-making process needs to be centralised. The Council, pursuant to Article 12, will be the supreme decision-making body on all matters relating to the tasks of the System. Article 12.1 reserves to the Council in particular all strategic monetary policy decisions including those relating to intermediate monetary objectives, key interest rates and the supply of reserves in the System and the establishment of guidelines for their implementation. At the same time, as the daily execution of monetary policies takes place in response to market developments, there is a continuous need for operational decisions. The responsibility for such decision-making falls to the Executive Board.[21] However, views differ about the procedure for giving the necessary authority to the Executive Board. All but one of the Community central banks are of the opinion that the necessary operational powers for implementing the monetary policy decisions and guidelines should be delegated by the Council to the Executive Board. This legal construction would mean that the Council has the right to revoke such powers but would also be obliged to re-delegate them immediately on different terms. The Deutsche Bundesbank is of the view that the Executive Board should be given its own competences and that the Statute should clearly and irrevocably assign to the Executive Board the task of implementing monetary policy in accordance with the Council's decisions and guidelines."

The Dutch, who had shared the German views initially, had accepted the compromise of September 1990; Duisenberg had explicitly acknowledged and welcomed the compromise and the concessions made by those supporting a very centralized decision-making body with a strong Executive Board. In their eyes the Bundesbank had later broken away from an acceptable compromise and now was on its own. (In addition, already in July Belgian sources had felt hesitations in the Dutch camp to support Option A, because it risked separating the governors too much from the decision-making processes.)

We see great reluctance among most governors to hand over influence to a body of non-NCB governors. Only the president of the central bank of the most federally organized state in Europe, Germany, appreciated giving the centre some unequivocal and irreversible powers. His motives were at least to some extent, if not more, colored by personal experience, i.e. his personal frustration with the influence of the LZB presidents. Of course, this might have had a high personal content, as e.g. Duisenberg as first president of the ECB, though being a strong personality, was personally convinced of the importance of consensus as a value in itself for an organization bringing together so many different countries. Pöhl's wish for stronger centralization should also not be mistaken as a signal that the Bundesbank had not been effective, neither as an expression of a more general, deterministic trend of federally designed systems towards centralization. Indeed, the development of the Federal Reserve cannot be characterized as an evolution towards centralization. It is better to describe it as a correction to

[21] The Introductory Report which accompanied the draft Statute which was sent to the IGC used the same wording in describing the disagreement between the central banks. However, the Introductory Report is somewhat clearer on the daily responsibilities of the Executive Board (page 4): "There is full agreement that the daily management of monetary policy should be in the hands of the Executive Board, which would act in accordance with the decisions and guidelines established by the Council. However, views differ as to how the necessary authority should be conferred upon the Executive Board."

an earlier development in the opposite direction. The unforeseen emergence of open market operations as the most important monetary policy tool had left the Board of Governors, not having competences in this area, unintentionally powerless, while the FRBs did not manage their newly assumed responsibilities very well – see also appendix 1.

We will see that the Member States put up less of a fight on the powers of the centre, though one could have expected resistance from those Member States being concerned about a too independent ECB against a too powerful centre, unchecked by 'their' NCBs. On the other hand, even those Member States were inclined to see the system as a whole. The Netherlands and Germany would come out in favour of an Executive Board with meaningful monetary powers. As there were less sensitivities among the Member States on the precise power of NCBs, it was easier for them to agree on a compromise, especially after Trichet accepted a mixture of both options, which however took on board an essential element of the German position, i.e. making the Executive Board more than an administrator.

II.3 HISTORY: IGC

In the draft Treaty text submitted by the Commission to the IGC on 10 December 1990 the Commission had borrowed clearly from the draft Statute of the Committee of Governors when sketching the relative roles of the Council and the Executive Board of the ECB.

> "Article 107
>
> 4. The Council of the Bank shall take the decisions necessary to ensure performance of the tasks entrusted to Eurofed under this Treaty. It shall determine the Community's monetary policy and shall adopt the guidelines necessary for its implementation.
>
> 6. The Executive Board shall take the necessary administrative decisions in line with the guidelines and decisions adopted by the Council of the Bank. In addition, the Executive Board may, subject to the conditions set out in the Statute, be delegated certain powers by decision of the Council of the Bank.
>
> 8. The division of responsibilities between the Council of the Bank and the Executive Board is set out in the Statute."
>
> Commission's draft December 1990

At first glance, the Commission leaned towards the majority among the governors, because in its working document the Executive Board only received 'administrative' powers. On the other hand, their paragraph 8 referred the issue to the Statute. Apparently, the Commission felt this could be solved in the Statute. The French draft Treaty text copied the Commission text.[22] The German delegation (Köhler) had stated it would support the draft ESCB Statute as it stood. However, here he had to show a preference for the one or the other solution. In fact he did when the Dutch presented a text (their Article 107.4). According to their text the Council of the Bank would decide on intermediate objectives and the supply of reserves, but would not

[22] Projet de Traité sur l'Union Economique et Monétaire, article 2-5; dated 25 January 1991.

be the body responsible for setting the key interest rates. According to the Dutch delegation it was *'in confesso'* that it was up to the Executive Board to prepare and propose interest rate decisions.[23] Köhler agreed. However, Trichet (Trésor) defended the view that the Board should be an executive body with few discretionary powers. Nonetheless, after some discussion Trichet was willing to accept the second (German) version of the draft Statute of the governors ('The Executive Board shall implement monetary policy etc.'),[24] in combination with the last sentence of the first bracket (possible delegation of other powers). On the basis of this discussion the Luxembourg presidency concocted a new text (in which they also inserted the sentence relating to the ECB giving the necessary instructions to NCBs):

"Article 108 [25]
3. The Council of the Bank, acting by a majority of its members, shall adopt whatever guidelines and take whatever decisions are necessary for the ESCB to be able to carry out the tasks assigned to it.
4. The Executive Board shall implement monetary policy in accordance with the guidelines and decisions adopted by the Council of the ECB; this shall include giving the necessary instructions to the central banks of the Member States. In addition, the Executive Board may, under circumstances laid down in the Statutes, have certain powers delegated to it where the Council of the Bank so decides."

Luxembourg non-paper, 13 March 1991 [26]

However, during the deputies IGC of 10 May 1991 Dutch delegation leader Maas complained the chosen formulation endowed the Executive Board only with discretionary *implementation* powers. He preferred the formulation that the Council of the ECB should delegate the *necessary* powers to the Board, implying some interest rate decision power.[27] Köhler did not go along, because he still did not like the Executive Board being dependent on delegated powers. The text remained unchanged.

The Luxembourg presidency also presented an adapted version of Art. 12.1 of the draft Statute, taking the 'German' sentence and the second sentence of the first alternative:

"12.1 The Council of the ECB shall adopt the guidelines and take the decisions necessary to ensure the performance of tasks entrusted to the System under the Treaty and the present Statute. The Council of the ECB shall formulate the monetary policy of the Community including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the System, and shall establish the necessary guidelines for their implementation.

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[23] Deputies IGC of 12 March 1991.
[24] This formulation implies the Executive Board has competences of its own, i.e. non-delegated, though of course within the framework set by the Council of the ECB.
[25] The first two paragraphs of Art. 108 deal with the composition of the Council and the appointment procedures for the Executive Board members.
[26] Non-paper, UEM/34/91, March 13.
[27] Maas defended the position Dutch Minister of Finance (Wim Kok) had taken publicly.

> The Executive Board shall implement monetary policy in accordance with the guidelines and decisions laid down by the Council of the ECB including by giving the necessary instructions to national central banks. In addition the Executive Board may have certain powers delegated to it where the Council of the ECB so decides."
>
> Luxembourg non-paper, June 6 1991

The Dutch presidency preferred to mention ESCB-internal issues only in the Statute and therefore suppressed Art. 108.3 and 4 from the Treaty text. During their presidency the wording of Article 12.1 and 12.2 was changed on three editorial counts: first, the new name for the Council of the ECB, i.e. Governing Council, was introduced. Second, the word 'the' was inserted before 'tasks' in the first paragraph of Article 12.1. Third, the sentence relating to the 'instructions' was cut into two, the second part reading 'In doing so, the Executive Board shall give the necessary instructions to NCBs.'

In theory, the Governing Council could define broad guidelines and take relatively few decisions, leaving a lot to be decided by the Executive Board in the course of its ensuring that monetary policy is implemented. In practice, the Governing Council follows a relatively hands-on approach – we will come back to this in chapter 11.

Article 12.2 and 11.6:

Article 12 (Responsibilities of the decision-making bodies – Executive Board)
"12.2 The Executive Board shall have responsibility for the preparation of meetings of the Governing Council.

This article shall be dealt with together with Articles 11.6:

Article 11 (The Executive Board)
"11.6 The Executive Board shall be responsible for the current business of the ECB."

(to be read in conjunction with Art. 8 (ESCB is governed by the decision-making bodies of the ECB), Art. 9.3 (Decision-making bodies ECB are Governing Council and Executive Board), Art. 10.1-ESCB (Governing Council includes all Executive Board members), Art. 10.2 (Governing Council: one person, one vote), Art. 11.5 (Executive Board: one person, one vote), Art. 12.1, first and second paragraphs (Responsibilities Governing Council and Executive Board, possible delegation of powers to the Executive Board), Art. 12.3 (Governing Council adopts Rules of Procedure of the Governing Council and the Executive Board))

I. INTRODUCTION

I.1 *General introduction*

We treat Art. 11.6 and 12.2 together because both are relevant for determining the role of the Executive Board vis-à-vis the Governing Council. The articles gain in importance as Art. 12.1b does not clearly specify the executive role of the Executive Board. Art. 12.1b has given the Executive Board the unalienable right to implement the Governing Council's monetary policy guidelines and decisions. However, the degree of discretion for the Executive Board depends on how detailed or not these decisions and guidelines are, which is a sovereign decision of the Governing Council.

Art. 11.6 makes clear that, even while the Governing Council is one of the decision-making bodies of the ECB (Art. 9.3), the Governing Council should not run the ECB on a daily basis.[1] The managerial powers of the Executive Board are limited by two factors: first, the Governing Council determines the Rules of Procedures of the Executive Board (see Art. 12.3 below); second, the ECB's budget needs the approval of the Governing Council. Here we see a hybrid structure. We have seen when describing the genesis of Art. 1 that the Governing Council was attached to the ECB, because the NCBs' legal experts advised against attaching the Governing Council to the ESCB, because the ESCB would not receive legal personality. But in practice we see that the Governing Council has far-reaching powers as regards the functioning of the ECB: it approves the budget, it approves the annual accounts, it approves

[1] The Governing Council was made a decision-making body of the ECB, because it was considered desirable to attach the Governing Council to a body with legal personality, to avoid any resemblance with a regular Community institution – see Art. 1, section II.2 in cluster I above.

the Rules of Procedure, and in practice it endorses the appointments of the highest management positions in the ECB. This makes it the highest governing body, not only – as intended – of the ESCB, but also of the ECB. It is more than a supervisory board. A very specific feature is that the daily managing board (the Executive Board) is part of the highest governing body – this was intended and it is an expression of the federal character (as opposed to intergovernmental or centralized) of the System. As members of the Governing Council the Executive Board members vote à titre personnel. Collusion or voting as a block cannot be prohibited, but would generate negative dynamics within the Governing Council. The presence of the Board members in the Governing Council is meant to promote a system-wide focus and not to trigger antagonistic behaviour between the centre and the regional members.[2] The fact that the Executive Board does not determine its own budget sets a limit on how wide the Board can interpret its mandate of being responsible for the ECB's 'current business'. For instance, the Board cannot decide on its own to buy and install a dealing room. [3] Through its budgetary authority the Governing Council is also able to set a limit on the size of the ECB's staff. Staff size is not irrelevant, as may be inferred from a paper by Buchheim (1999) on the Bank deutscher Länder, the predecessor of the Bundesbank: 'The decentralized elements and the formal two-tier arrangement gradually faded away. In addition to the weight of its top managers, this trend was reinforced by the sheer weight of the apparatus of the Bank deutscher Länder and the associated information advantage of the Board of Managers, something a mere executive board would normally never have been able to develop.' [4]

The responsibility of the Executive Board for preparing the decisions of the Governing Council **(Art. 12.2)** also constitutes an important source of power for the Board. A similar experience is described by a member of the Board of Management of a former German Landeszentralbank: 'No less important is [....] the Directorate's responsibility for the implementation of the decisions taken by the Central Bank Council. By the inherent nature of the latter function, the Directorate is also largely responsible for the preparatory work leading up to these decisions. The fact that the Directorate can take the initiative in this way naturally means that it often has a decisive influence on the decision-making itself. Thus, the Directorate *de facto* assumes, by virtue of the intrinsic importance of its functions, a position of special prominence.' [5] The Executive Board prepares the decisions on both monetary and non-monetary issues. The Governing Council cannot by-pass the Executive Board; in fact the Executive Board should always have the opportunity to formulate a proposal, or at least its

[2] The Governing Council decides on the budget using the normal (i.e. unweighted) voting procedure. This means the Executive Board members vote along and the governors do not vote as shareholders. The precise budgetary procedures are laid down in the Rules of Procedure (see Art. 12.3 below). The Governing Council not only decides on the ECB's expenditures, it also influences the ECB's income. See the description of Art. 33 in cluster II, which shows that the Governing Council's decisions on the denomination and remuneration of intra-ESCB claims can have a substantial influence on the ECB's net income.

[3] A contentious issue is whether the ECB is fully entitled to hold and manage itself the pooled foreign reserves. We hold that, while policies on intervening are a responsibility of the Governing Council, the day-to-day management of these reserves within the overall guidelines of the Governing Council should be seen as part of the ECB's 'current business' in view of the wording and genesis of Art. 30.1-ESCB.

[4] In Deutsche Bundesbank (1999), p. 79. This does not mean that the Direktorium could not have wished a larger say still over policy-making.

[5] BIS (1963), p. 63 (in the chapter on the Deutsche Bundesbank, written by Schmidt, Manager, Landeszentralbank of Berlin).

opinion on the matter. In other words, the Governing Council cannot form its own secretariat and sideline the Executive Board. This position follows from the mere existence of and intention behind Art. 12.2. The intention being not so much to ensure that the Governing Council meetings are prepared, but to define the governing bodies' responsibilities and competences. It does not follow from the Rules of Procedure (1999), Article 5 of which provides for the possibility for each member of the Governing Council to remove from, but also to *add* items to the provisional agenda as drawn up by the Executive Board. If there is no urgent need to discuss a topic unprepared, such a procedure however could be viewed as an inroad to an important (and in fact one of the few hard) prerogatives of the Executive Board. The foregoing does not mean that each individual Executive Board member is bound by a proposal put by it on the agenda of the Governing Council, as they are, like the NCB governors, independent (ad personam) members of the Governing Council.

I.2 *Relevant features of the Federal Reserve*

In the case of the Fed we should distinguish between the preparation of the open market policy, which policy is decided upon by the FOMC and its own secretariat, and the preparation of the other System-related policies, which are prepared and decided upon by the Board of Governors. The Board of Governors does not act as a supervisory board of the FOMC, nor does the FOMC (which consists also of FRB presidents) act as a supervisory body over the Board of Governors. The budget of the Board of Governors is not subject to approval by another body. It is approved by the Board itself, and subject to ex post scrutiny by Congress, through the General Accounting Office.[6] We will deal with the monetary policy preparation more extensively below,[7] because it allows for an interesting comparison with the ESCB.

The relevant monetary (open market) decision-making body in the FRS is the FOMC, which comprises the seven members of the Board of Governors and, based on a rotation system, five of the twelve FRB presidents. The FOMC is obliged to meet in Washington D.C. and the Committee selects every year, from among the officers and employees of the Board and the FRBs, a secretary, a deputy secretary and a limited number of economists from the FRS, some of which might be designated as associate economists; these economists, in practice always staff of the Board,[8] have to 'prepare for the use of the Committee and present to it such information regarding business and credit conditions and domestic and international economic and financial developments as will assist the Committee in the determination of open market policies.' [9] To this end the economists prepare the so-called **Green Book**. They write this in an independent fashion. Members of the Board of Governors are not involved in preparing the economists' economic forecasts, sometimes much to the annoyance of the governors

[6] See sections I.2 of Art. 1, 7 and Art. 27-ESCB. For a discussion of the rules for approving the budgets of the FRBs, see Art. 14.3-ESCB, section I.2.

[7] Largely based on John Berry (1996b), 'The Barons and the Board', *Central Banking*, Vol. VII, nr. 2 (Autumn 1996), p. 35-43; and Bakker (1996).

[8] Some of the elected 'associate' economists might come from FRBs. The Board's Annual Report 2001, p. 307-308, shows four economists and eight associate economists, apart from the Secretary and General Counsel and their deputies and assistants.

[9] FOMC Rules of Procedure (1994), section 4(a) and (c).

themselves, though not of Greenspan, of whom it is said that he has never sought to participate in the staff meetings that eventually produce the Green Book forecast. Greenspan is always well informed and regularly disagrees with portions of the Green Book's outlook. Also at the table is an economists-prepared 'neutral' **Blue Book**, which presents the likely implications for the financial markets of three interest rate policy choices, raising or lowering rates or leaving them unchanged. Before each meeting of the FOMC a **Beige Book**, containing anecdotal information on business conditions in the Federal Reserve's twelve districts, is prepared, on a rotating basis by one of the FRBs, containing information on regional economic developments. (This book was an initiative by Burns, who did not like to listen to long exposés by the FRB presidents.) Nowadays FRB presidents spend three to five minutes describing the developments in their district as part of the general discussion. These three books appear before the FOMC meetings. Unlike the other 'books', the Beige book is released to the public (before the relevant FOMC meeting). A few days before the FOMC meets the members of the Board of Governors have the possibility to ask questions to the staff who prepared the FOMC. The chairman, vice-chairman and the president of the New York Fed discuss the most likely outcome of the meeting beforehand.
Traditionally the Manager of the SOMA first reports on the developments and transactions (conducted under the mandate of the Committee) in the foreign exchange and domestic financial markets, which transactions are then formally approved by the Committee. Subsequently the Committee turns to a discussion of the economic and financial outlook (including the presentation by the economists) and the implementation of monetary policy over the intermeeting period ahead. Thereafter the chairman presents a proposal (which he has not discussed with staff), on which in the end a vote is taken.[10]

Comparing the Fed and the ESCB
We note a few differences. In the eurosystem the interest rate decision is prepared under responsibility of the Executive Board member responsible for the Monetary Policy and Economic Developments Directorates, who presents the most important facts and gives his preference as to the interest rate decision to be taken. In the case of the FOMC, there is no proposal at the table at the start of the meeting and the meeting is prepared by an especially appointed group of staff, working independently for the Board of Governors. This difference would seem to suggest that the Executive Board has a potentially strong influence on the outcome of the decision, compared to the Board of Governors. Weighing against this, is the tradition that the Fed chairman plays a dominant role[11] and the fact that the Board of Governors has a majority in the FOMC.
Another difference is that the Executive Board's area of current business is smaller than that of the Board of Governors and that the Executive Board needs approval of the Governing Council for its annual budget. Indirectly, this also applies to the ECB's headcount; through

[10] Chairmen usually try to achieve consensus, but for instance Burns had a different style of leadership: "I vote *first*. I am willing to stick out my neck.' According to Kettl (1986, p. 120) Burns was ready to work at a far lower level of internal support than his predecessor Martin.
[11] Though Greenspan prefers to describe his role as merely running the meetings – see J. Berry (1996b), p. 37.

this channel the NCB governors (who have a majority within the Governing Council) exert influence over the resources available to the ECB.[12]

II.1 HISTORY: DELORS COMMITTEE AND COMMITTEE OF GOVERNORS

The *Delors Committee* envisaged the 'establishment of a Board (with supporting staff), which would monitor monetary developments and oversee the implementation of the common monetary policy'.[13] It did not specify the role of the Board vis-à-vis ESCB Council (which would be composed of the governors and the members of the Board), though it envisaged that the central institution would have its own balance sheet. A discussion on the role and/or prominence of the Board in the ESCB came only to the fore during the discussion in the *Committee of Governors* on the draft ESCB Statute.

In a first draft of the Statute, Art. 7 envisaged the following role for the Board of Management:

"7.2 The Board of Management shall be responsible for implementing the guidelines laid down by the Council. It shall act in accordance with the Council's instructions.

The Board of Management shall be responsible for administering the ECB. It shall act on all matters not expressly reserved for the Council by the Statutes or the rules of procedure.

[....]

7.3 The President shall be responsible for the day-to-day management of the ECB. He shall represent the ESCB externally."

draft 11 June 1990

During the meeting of the Alternates on 18 June 1990 Dutch Alternate Szász observed that a strong *Board* implied day-to-day management should rest with the collectivity of the Board and not only with its president.[14] Furthermore, a disagreement emerged regarding the role of the Executive Board in implementing monetary policy relative to that of the Council of the ECB. This resulted in a revised draft showing two options:

"Article 8 - Responsibilities of the governing bodies

8.2 The Executive Board shall be responsible for implementing the policy decisions laid down by the Council. [OPTION A: In doing so, it shall fix the rates and terms for discounting, advances and loans in accordance with the Council's instructions.] [OPTION B: It shall act in accordance with the Council's instructions.] [15]

./.

[12] The headcount increased from 740 at the start of the ECB in January 1999 to 1270 for 2003. All members of staff are selected and appointed by the Executive Board (RoP, Art. 20.1); the Governing Council sets a limit on the number of staff. The headcount of the Board of Governors is around 1700 (2000-figure).

[13] Delors Report, section 32.

[14] This was also based on Szász' own experience as member of the board of the Dutch central bank.

[15] For the arguments used in favour of option A and option B, see Art. 12.1a&b-ESCB, section II.2. Option A reflected the preference of the German and Dutch central bank for a strong board of directors and option B the French/British preference for a strong decision-making role for the Council. During the meeting of the Committee of Governors on 10 July 1990 the German central bank president opined that even option A was not adequate, because it left virtually no power to the Executive Board. He announced a third option.

The Executive Board shall be responsible for the preparation of the meetings of the Council.

The Executive Board shall be responsible for administering the central body. It shall act on all matters not expressly reserved for the Council by the Statute or the Rules of Procedure.

8.3 [16] The President of the ESCB, or in his absence, the Vice-President, shall:
- chair the meetings of the Council and the Board;
- represent the ESCB externally."

draft 22 June 1990

In July the contrast between options A and B would widen – see Art. 12.1a, section II.2 -, with the role of the Executive Board being further reduced in option A.

During their meeting on 11 September 1990 the governors agreed on a text, according to which the strategic monetary policy decisions were reserved to the Council. This reduced the role of the Executive Board as compared to option A. The next draft on the role of the Executive Board would read as follows:

"Art. 11 - Responsibilities of the governing bodies

11.2 [....]

The Council shall delegate to the Executive Board the necessary operational powers for implementing the monetary policy decisions and guidelines. The Council may delegate other powers as it may specify to the Executive Board.

The Executive Board shall have responsibility for the preparation of the meetings of the Council."

draft 14 September 1990

The sentence on the ECB being administered by the Executive Board was moved to Art. 12 on the European Central Bank:

"Article 12 - European Central Bank (ECB)

12.1 The ECB shall be administered by the Executive Board."

draft 14 September 1990

This was later moved again, but then to the article related to the Executive Board (previously Art. 10):

"11.8 The Executive Board shall administer the ECB."

draft 19 October 1990

The sentence relating to the Board's preparation of the meetings of the Council had become part of Art. 12.2 and read:

Article 12.2, second sentence

"The Executive Board shall have responsibility for the preparation of Council meetings".

draft October 1990

[16] Art. 8.4 in option B.

The sentences referring to the delegation of powers to the Executive Board are dealt with under Art. 12.1a above.
The sentences relating to the Board preparing the Council meeting and administering the ECB became part of the final draft ESCB Statute of 27 November 1990, in the wording used above. This draft was sent to the IGC.

II.2 HISTORY: IGC

During the IGC Art. 11.8 (later: Art. 11.6) would remain as it is in substance, but the Dutch presidency opted for wording already in use for the European Investment Bank:[17]

> "11.6 The Executive Board shall be responsible for the current business of the ECB."
> Dutch presidency 26 September 1991 [18]

The origin of this wording was pointed out during the EMU Working Group of 2 and 3 October 1991. The new wording was not discussed, and there are no indications a change in substance was intended or implied by this new wording.

[17] Art. 13.3 of the Statute of the EIB on the EIB's Management Committee.
[18] UEM/67/91.

Article 12.3-5:

Article 12 (Responsibilities of the decision-making bodies – Governing Council):

"12.3 The Governing Council shall adopt the Rules of Procedure which determine the internal organization of the ECB and its decision-making bodies.

12.4 The Governing Council shall exercise the advisory functions referred to in Article 4.

12.5 The Governing Council shall take the decisions referred to in Article 6."

(to be read in conjunction with Art. 4-ESCB (Advisory functions); Art. 6-ESCB (International cooperation); Art. 12.1-ESCB (Responsibilities Governing Council and Executive Board); 12.2-ESCB (Executive Board prepares Council meetings); and Art. 46.4 (General Council adopts its own Rules of Procedure))

I. INTRODUCTION

I.1 *General introduction*

We deal with these three articles together, because all three specify some responsibilities of the Governing Council.

Art. 12.3 (Rules of Procedure): As far as the external checks and balances are concerned, it is relevant to note that the Rules of Procedure do not need approval by the political authorities. Approval by the Council of Ministers would detract from the ECB's independence. The adoption procedure provided for in the Statute follows that of the **Commission**, which also adopts its own Rules of Procedure without any need for approval by the Council of Ministers.[1] Rules of Procedure of the **EIB** are also approved by its highest decision-making body, *in casu* the Board of Governors.[2] However, in this case this body consists of the ministers. This Board decides by majority, with the proviso that the majority should represent at least 45% of the subscribed capital.[3] However, in case of the ECB weighted voting is limited to patrimonial issues.[4]

There are also a number of interesting aspects relating to internal checks and balances. The Governing Council not only adopts its own procedures, but also those of the Executive Board. In theory the Governing Council could decide on very detailed rules for the Executive

[1] Art. 16-Merger Treaty. The Rules of Procedure of the **Court of Justice** are adopted by the Court, but need the unanimous approval of the Council of Ministers (Art. 188(3)-EEC). This is possibly related to the fact that these rules define inter alia the conditions under which witnesses may be heard (Art. 23 of Protocol on the Statute of the Court of Justice).
[2] Protocol on the Statute of the EIB, Art. 9(h).
[3] Protocol on the Statute of the EIB, Art. 4.1 and 10.
[4] See Art. 10.3-ESCB above.

Board's meetings and procedure. In practice, many of these issues are left to the Board – see the ECB's Rules of Procedure, which cover both the Governing Council, the Board and the organization of the ECB.[5] The Rules of Procedure stipulate that the Governing Council decides on the ECB's budget on a proposal of the Executive Board. Through the budget the Governing Council also sets a ceiling on the number of staff the ECB is allowed to hire.
Seen from the perspective of checks and balances it is interesting to note that Art. 9.3 of the Rules of Procedure of the ECB mentions the possibility for the Governing Council to establish committees, composed of representatives of the ECB and of the NCBs of each participating Member State.[6] They 'assist in the work of the ESCB'. In practice, they prepare studies for the Governing Council, allow for an exchange of views (and convergence of minds) and allow the Executive Board to prepare ready-made decision-making by the Governing Council. The Executive Board has proposed to replace the word 'representative' with 'expert', but a majority of NCBs have resisted this. The Executive Board hoped to prevent NCB representatives from defending 'national' positions; the NCBs feared this to be a way to allow the chairmen of committees (usually a ECB person) to reduce the size of, and participation in, the ESCB committees. NCBs preferred to postpone a discussion on this issue. [7]
The committees can only report to the Governing Council 'via the Executive Board', allowing the Board to write an accompanying (and possibly dissenting) note - in this way the Executive Board protects its important prerogative of preparing Governing Council meetings, which is in line with what we discussed under Art. 12.2 above.

Art. 12.4 and 12.5 (Advisory functions and external representation): It could be argued that Art. 12.4 and 12.5 are superfluous, as all responsibilities allocated which are to the ECB, but not to the Executive Board, should fall automatically to the highest-decision making body, the Governing Council, which could of course, if it so desires, delegate responsibilities, by simple majority, to the Executive Board. Apparently, the responsibility for external relations in the advisory field and the field of external representation was considered a sensitive area, which merited special mentioning as being in the hands of the Governing Council - making it very hard to delegate this to the Executive Board.[8]

I.2 *Relevant features of the Federal Reserve*

In case of the Federal Reserve, the Board of Governors and the FOMC, being a separate body, each adopt their own rules of procedure. The Federal Reserve's advisory functions are placed with the Board of Governors. The external representation is the exclusive competence of the Board of Governors. The FOMC decides on the location of open market operations (OMOs) and foreign exchange transactions. It has always selected New York. This has given New

[5] The Rules of Procedure are published in the Official Journal of the European Communities and are available on the ECB's website.
[6] There are 12 such committees (Annual Report ECB 2001, p. 181-182). The Governing Council lays down the mandates of the committees and appoints the chairpersons. The Budget Committee has a separate status, in that it reports directly to the Governing Council (Art. 15.2-RoP).
[7] See also our suggestions as to the future of the committees in chapter 8.3
[8] See Art. 12.1a-ESCB, section I.1.

York special expertise within the FRS as well as international visibility and exposure, on which the Board also relies.[9]

II.1 HISTORY: DELORS COMMITTEE, COMMITTEE OF GOVERNORS AND IGC

We have discussed the deliberations in the *Delors Committee* on the delineation of power between the centre and Council in section II.1 of Article 12.1a. We now turn immediately to the draft of the *Committee of Governors*.

The reference to Rules of Procedure already appeared in the first draft of 11 June 1990, which mentioned that the voting arrangements of the Executive Board (then called the Board of Management) would be specified in the rules of procedure. The version of 24 July would mention in the article on the Council of the ECB that '[t]he Council shall establish Rules of Procedure.' The legal experts, which studied the texts over the summer, advised to merge these texts to make clear there would be only one set of internal rules. The version of 8 October 1990 mentioned the Rules of Procedure only in the article 12, specifying that these rules would apply to the decision-making bodies and the ECB's internal organization.
The version of 19 October would show the following text:
"12.4 The Council shall adopt the Rules of Procedure which shall determine the internal organization of the ECB and its decision-making bodies."

draft 19 October 1990

This would also be the text of the final draft version of the Statute of 27 November 1990 presented to the IGC. In 1998 the Governing Council adopted the Rules of Procedure, based on draft proposals by the Executive Board.

The version of 19 October was the first draft in which the word System had been replaced in many instances by 'the ECB' or by 'the ECB and the NCBs'. In Art. 4 the advisory functions had until then been linked to the System (the System may be consulted; the System may give opinions). To preserve the idea that this function was linked to the System, and to prevent that NCBs would prepare their own advices, a new Art. 12.3 was added reading:
"12.3 The advisory functions referred to in Article 4 shall normally be exercised by the Council."

draft 19 October 1990

In the minutes of the meeting of the Committee of Governors of 13 November 1990 the word 'normally' was deleted. Apparently one did not want to create any ambiguity. The version of 27 November 1990 would read:
"12.3 The Council shall exercise the advisory functions referred to in Article 4."

draft 27 November 1990

During the same November meeting Article 6 was re-edited to read "... the ECB shall decide whether the System shall be represented by the ECB and/or the NCBs." It was decided at the

[9] See Art. 6-ESCB (in cluster II).

same time to add to Art. 12 a reference to the Council taking the decisions referred to in Article 6:[10]

"12.5 The Council shall take the decisions referred to in Article 6."

draft 27 November 1990

During the *IGC* only the word Council was replaced by Governing Council.

[10] This has been discussed under Art. 6 in cluster II.

CHAPTER 11: CONCLUSIONS TO CLUSTER III (ASSESSMENT)

11.1 INTRODUCTION

Whereas the previous cluster dealt with the division of operational power within the System, this cluster deals with the division of decision-making power. A system of central banks needs a central decision-making body. Initially the drafters of the Delors Report and of the ESCB Statute did not exclude that – with non-fully integrated financial markets – some local decisions might still be needed, e.g. as regards the timing of liquidity operations, but in the course of 1990 it became clear that the system could only be based on a structure in which there would be only one decision-making centre with overriding powers. It was acquis from the start that this central decision-making body should be composed of at least the NCB presidents and possibly the Executive Board members of the new central institution, the European Central Bank, though initially names circulated like 'agency, or 'board'. Board members were necessary to run the daily affairs of the new institution (whether large or small) and see to the execution of monetary policy. This issue of allocating decision-making power was not seen as a way to restore national decision-making power. It was accepted by all (also all governors) that monetary policy would be centralized and be made supranational – there would be no veto power. Once this had been agreed the drafters needed to decide on the composition of the highest decision-making body and the relative competences of this Council and the Executive Board.

The governors played an important role in devising the articles covering the internal checks and balances. We make four observations. **First**, the Delors Committee had not discussed the internal organization in detail, implying that the Committee of Governors could largely shape the internal organization itself. The Delors Report had nonetheless given two important guiding principles: the ESCB Council was to encompass the NCB governors and the Board members, and the decisions would emanate from the Council, while the Board was linked to ensuring the implementation. **Second,** the governors not only discussed the balance between the governors and the Executive Board, at the same time they had to decide on the relations between themselves, i.e. between the governors: would governors from big and small countries have the same weight? The governors opted to be equal, when not deciding on financial issues of a patrimonial nature. This can be seen as a major concession by the NCBs of the larger countries, though *two* factors weighed in heavily: the governors were afraid that differentation in voting rights on the basis of 'country size' would introduce regional elements distracting from the desired euro area focus and possibly even triggering political pressures, because each governor would be seen as representing his/her country; and, as importantly, their relationships were characterized by a high level of mutual trust, as they (and their predecessors) had met since 1964 on a monthly basis and as they had gone through a number of currency crises, during which they had learned to understand and trust each other, and as they had participated together in the Delors Committee. **Third**, the governors were not able to solve one crucial issue, that is the degree of discretionary powers to be given to the Executive Board. Only the president of the only federally organized central bank in Europe, the Bundesbank, advocated giving the centre some unequivocal and irreversible powers, the

others preferring or accepting a delegation model. Here the IGC would agree quite easily, by opting basically for the Bundesbank's formulation which gave the Executive Board some own (and not only delegated) powers, establishing the Executive Board as a decision-making body in its own right, though not in terms of policy-making, but implementing policy. **Fourth**, apart from the above the IGC made very little changes in the governors' draft of the articles covering the internal relations. Apparently, there was no political need to change the balance which the governors had reached as to the respective roles of the Executive Board and Governing Council.

In section 11.2 below we will summarize the articles of which we have presented the genesis in the previous chapter. In these summaries we will highlight the main concerns of the governors as regards the internal checks and balances, when they developed their ideas on the design of the new system. At the end of that section we will analyze the motives for continued involvement of the governors in the System's decision-making and the motives for an independent (i.e. not depending on delegation by the Governing Council) role for the Executive Board – thus covering the main factors determining the outcome in this respect. In sections 11.2.3 and 11.2.4 we will analyse the role of the Executive Board as it has evolved since 1999, while also discussing possible future developments. In section 11.3 we will present the checks and balances existing between the Governing Council (dominated by the governors) and the Executive Board in an overview table, using the categorization as developed in chapter 2 and applied in clusters I and II. Following this we will present possible improvements with respect to the checks and balances within the Governing Council.

11.2 CHECKS AND BALANCES BETWEEN THE EXECUTIVE BOARD AND THE GOVERNORS

Content

11.2.1 Short reviews (with emphasis on checks and balances)

Composition Governing Council (Article 10.1-10.2a-ESCB):

The German wish to create a system resembling the American or German federal system of central banks focussed the minds on a limited range of options. It was clear that there would be a central institution (though its powers were open for discussion) while the national central banks would continue to exist. The operational functions and own responsibilities of the Board would be hotly debated in the Committee of Governors – see Art. 12.1a-ESCB. Sharing decision-making power with the Board was not such a big issue, probably also because the Board was expected to be a small body. At least one small NCB was worried about the creation of a Board *ipso facto*, as in the opinion of that NCB the Board seats were more than likely to be filled by the larger Member States, giving them additional leverage within the Council. On the other hand, the existence of a board appointed at the European level was considered an asset because it would give the system accountability at the European level, which would make its independence more acceptable to the outside world. The genesis of the article does not show one had in mind to create a specific minimum size of the Executive Board vis-à-vis the governors. Article 50-ESCB mentions the possibility of a Board smaller than six members during the transitional period. This possibility was not introduced to secure a specific ratio between governors and Board members, but to reserve some seats for countries joining later, among others to make the specific possibility of starting EMU with a small group of countries politically more acceptable.

Voting system (Article 10.2b-ESCB):

The Delors Report had not been specific on the voting regime. However, it was clear from public pronouncements that the Bundesbank was attracted to the model of the FOMC of the Federal Reserve System. However, this model can be interpreted in two opposite ways: the FOMC stresses equality among the FRBs, with only one exception, i.e. New York,[1] or it can be interpreted as stressing the absence of equality. The Bundesbank was probably closer to

[1] The Federal Reserve Act, as amended in 1935, envisaged five seats for FRB presidents. To this end the twelve FRBS were divided over five groups, in casu two groups of three FRBs and three groups of two FRBs. Tradition has it that membership of the FOMC rotates on an equal basis within each group (the presidents being either member of the FOMC once every second year or once every third year, depending on their group). In 1942 New York became a group of its own, with permanent FOMC membership.

the second interpretation, as it showed a preference for some form of weighted or rotational voting, though its motive was to strengthen the relative position of the Executive Board. However, other governors, among them the governors of other large NCBs, stressed that weighted voting would introduce regionalization, and would detract from the collective enterprise. An important aspect of equal voting rights was that it would stimulate governors to think in euro area wide concepts and it would make interference or pressure by national authorities less likely. Moreover, a high degree of trust had built up among the governors which had been meeting in the Committee of Governors since 1964. Their thinking had converged (focus on price stability) and their European credentials had been established. This 'club-spirit' made the step towards equal voting rights less of a risk for Germany than would have been the case with a group of governors with unknown European credentials. Weighted voting for monetary decisions was rejected on the basis of the arguments mentioned above.[2] Or put differently, monetary policy was to be decided on the basis of facts, not nationality. This does not imply that the Governing Council should be replaced by a Monetary Policy Council, existing of a number of outside monetary experts. A role for the regional elements is a characteristic of all federal states and federations, as it prevents the dominance of a centre which at times might fall victim of promoting specific financial, political or geographical interests. Furthermore, national expertise and knowledge of local developments is relevant, because it can deepen the analysis and understanding of the facts on which monetary policy is based. This is especially the case as long as the fiscal regimes and structural policies continue to be decided along national lines. But it is even true for the US, because in the words of Greenspan the regional Fed presidents 'know what is happening in the various regions of the country well before the hard data are collected by national statistical agencies'.[3]

A complication of a system of weighted voting would have been the choice of the weights to be given to the Executive Board members, as they do not represent an economy, population or specific share in the capital key. Assigning the Board an aggregate weight, e.g. 30 per cent, would have forced the Board to vote as one block and would have introduced negative dynamics within the Governing Council (Board vis-à-vis the rest). The other possibility, rotational voting, was not discussed in depth. Using the FOMC model would have run into problems, as both Frankfurt and London could have claimed the role of New York, but this would have been unacceptable to Paris, while permanent votes for all large NCBs would have been unacceptable for small countries. [4]

At the beginning it had been doubted whether the Executive Board needed to have a vote, or perhaps only its president. This position was quickly discarded, as there was a commonly shared feeling that the system needed a clearly visible centre, possibly increasing the system's legitimacy, working as a binding factor and contributing to its independence.

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[2] Weighted voting is applied to patrimonial decisions (see Art. 10.3-ESCB).

[3] A. Greenspan (2000), Productivity and Efficiency in the Federal Reserve System, speech given at the dedication of the new Birmingham Branch Building of the Federal Reserve Bank of Atlanta.

[4] Rotation would come back as an option under the so-called enabling clause, not for principle reasons, but for practical reasons, as some quarters advanced the idea that the Governing Council threatened to become too large to function effectively after accession countries would have joined not only the European Union, but also the euro area – see section 11.2.4 below.

Weighted voting (Article 10.3-ESCB):

Weighted voting has been restricted to patrimonial decisions, i.e. decisions relating to capital and foreign reserve transfers from NCBs to the ECB and to decisions which directly affect the relative income positions of NCBs. The idea to apply weighted voting to these kind of decisions was not contentious. In some cases weighted voting is combined with qualified majority. Throughout the Statute we can distinguish six different voting procedures (unweighted and weighted), which are presented below:

Table 11-1: Voting arrangements in ESCB Statute

1. One person, one vote + simple majority :	main rule (e.g. monetary policy)
2. One person, one vote + no votes for Executive Board members:	Art. 11.3 (Board salaries)[5]
3. One person, one vote + majority of two thirds of the votes cast:	Art. 14.4 (non-System functions)[6] and Art. 20 (other instruments)[7]
4. Weighted voting + simple majority:	patrimonial decisions[8]
5. Weighted voting + majority of two-thirds of subscribed capital and at least half of shareholders:	Art. 28.1, 28.3 (capital increases), Art. 32.3 (alternative method for calculating monetary income).
6. Unanimity:	Art. 41.2 (simplified amendment procedure)[9]

The General Council is an advisory body and takes all its 'decisions' by unweighted, simple majority. Art. 46.4 of the Statute stipulates that the General Council determines its own Rules of Procedure; the Statute does not mention a specific voting rule for the General Council, though the 'one man, one vote' rule seems to be implicit, especially in Art. 45.2. The Executive Board always acts by simple majority (Art. 11.5). In the event of a tie the President has the casting vote (this applies both to the Executive Board and the Governing Council).

Responsibilities of the Governing Council and the Executive Board (Art. 12.1-ESCB, first and second paragraph):

This was the most contentious issue among the governors in this cluster. The Delors Committee had already envisaged that the Council of the ECB should be the supreme decision-making body. The Board members would be part of this Council, while the Board itself would basically be an administrative organ, monitoring monetary developments and overseeing the implementation of monetary policy. (At the same time would the central

[5] Determination of the salaries of the Executive Board members.
[6] Decision to forbid certain non-System function, when considered to interfere with the System.
[7] Introduction of other instruments of monetary control, imposing obligation on third parties.
[8] Art. 28.5, 29, 30, 32 and 33 ('technical' articles from Chapter VI on Financial Provisions) and Art. 51, which is part of Chapter IX on Transitional Provisions (though it rather belongs to Chapter VI - see Article 51).
[9] Unanimity is required for a recommendation to start this procedure; applicable to both monetary and financial (technical) articles.

institution have a balance sheet of its own,[10] though apparently under the aegis of the ECB's Council.) During the Committee of Governors discussions the Bundesbank would persistently try to strengthen the position of the Board. The Bundesbank insisted on a role of the Board going beyond executing tasks *delegated* by the Governing Council, as such an inferior position would unduly weaken the role of the Board. Germany wished a stronger role for the Board in order to maintain the unity within the federally designed central bank system and to give added force to the system's autonomy in its day-to-day execution of policy. The IGC would opt for a compromise going in the German direction after France accepted giving the Executive Board limited powers in its own right. The Governing Council remains clearly responsible for formulating monetary policy. This function cannot be delegated to the Executive Board, because it is a core function for which only the Governing Council can be held responsible and because delegation of this function to the six member Executive Board would de facto end the federal character of the System. What is possible is that the Governing Council decides only on the very broad lines of monetary policy, leaving many 'implementation decisions' (with a high policy content) to the Executive Board.

Other Executive Board tasks (Art. 11.6 and 12.2-ESCB):

The Executive Board is responsible for the ECB's current business of the ECB (Art. 11.6). This is an undefined concept – the border would seem to lie there where decisions can be seen as part of the System's monetary (or exchange rate) policy stance. The Executive Board also has the privilege and the right to prepare the meetings of the Governing Council (Art. 12.2). These prerogatives ensure the opinion of the Executive Board members outweighs their voting power. A large and highly qualified ECB staff could strengthen the Board's position. The Governing Council does control however the size of the staff through the budget approval procedure (see Art. 12.3).

Responsibilities of the Governing Council (Art. 12.3-5-ESCB):

When the Committee of Governors changed the words 'System' into 'ECB' in the drafts of Art. 4 (advisory functions of the ECB) and Art. 6 (external representation), they decided to explicitly state in Art. 12 that decisions in these fields pertained to the Council, and not the Executive Board. Art. 12.3 stipulates that the Governing Council also determines the Rules of Procedure for the Executive Board.[11]

11.2.2 Main motives of the governors with respect to the division of decision-making powers

We distinguish the following motives as to the division of responsibilities between the Governing Council and the Executive Board. For our purpose we equate a decision making

[10] Delors report, par. 32.
[11] The Rules of Procedure also provide for the establishment of ESCB committees. For their role see chapter 11.3 below.

role for the governors with a strong role for the Governing Council, in which the governors were expected to dominate (at least in terms of numbers).

Motives for continued participation and involvement of NCB governors:

- a Council without governors would come under more effective pressure from financial interest groups, European and national political authorities, because a Council without governors is small.
- as long as Executive Board members or governors are not infallible (i.e. the chance they take the 'right' decision is less than 1), increasing the Board size leads to better decisions. This is even true when the voting members have at their disposal exactly the same information. This issue here is about how 'good' they are in interpreting this information.[12] Increasing the size of the meetings entails higher costs (e.g. salaries), but the marginal cost of adding one extra member is in all likelihood small; the main 'balancing' factor seems to be the ability to conduct efficient meetings.[13]
- governors could enrich the discussions with relevant information attained through international or local contacts;
- NCB governors may also contribute through the research efforts of their staff; their staff would probably focus on different issues than are being researched by the ECB; research being done at NCBs has added value over that of research conducted at universities, because at NCBs the research is conducted by experts that are exposed to monetary policy, which allows them to combine this knowledge with a longer term research focus;[14]
- Governors are well positioned to translate the ECB's monetary policy into consequences for the national economic actors; especially in dire times public support could depend on having a national governor participating in the ECB's policy making;

Motives for a strong role of the Executive Board:

- A federal system requires a strong hand to achieve the required unity; a central bank not displaying a consistent view will have low standing in the markets, making it more difficult to influence expectations;
- a strong board reduces the possibilities for national political interference;[15]
- purely executive functions will not attract the required professional people;
- a strong European identity requires a strong board;
- a strong board is necessary to prevent that the Governing Council has to meet more than every two weeks.

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[12] See study by Berk and Bierut (2003), Committee Structure and its Implications for Monetary Policy Decision-Making, *De Nederlandsche Bank Meb Series* No. 2003-05. If there are no costs to adding an additional member, then the optimum size is unbounded. When marginal costs are introduced, the optimum size varies depending on the height of the marginal cost of adding one new member and with differences in the skill level q of the average committee member. Theoretically the size could vary from smaller than 13 to over 50.

[13] The efficiency factor would seem to be dominant over the cost factor, because over a certain size the exchange of views and information will become too time-consuming. From the study by Berk and Bierut follows that the optimum size of the committee is larger for cases where the members do not share all information. See also chapter 11.3 below.

[14] See Broaddus (1999) and Goodfriend (2000).

[15] A large Governing Council and a strong board can go together.

The position of the Bundesbank was especially influenced by the following experiences:

i. Pöhl was familiar with a system in which the centre had more than delegated functions;
ii. Pöhl had experienced that the state central bank presidents had thwarted him in taking certain interest rate decisions. To him the Zentralbankrat occasionally behaved as an indecisive body.[16]
iii. Pöhl also must have had in mind that the Bundesbank Law of 1957 had provided for a relatively large Direktorium of up to ten members against the same number of Landeszentralbankpresidenten.[17] In practice the Direktorium usually functioned with seven to eight members. In 1992 the number was formally reduced to up eight members, while the number of Landeszentralbanken was reduced to nine. Since then the Direktorium has functioned with seven and sometimes six appointees.

The considerations explain the Bundesbank's preference for a strong centre.

The preference for weighted or rotated votes with respect to monetary policy decisions was again mostly expressed by the Bundesbank. The arguments against weighted voting were however convincing, apparently also for the Bundesbank, which as one of the only central banks could have blocked an agreement, because of the importance of German participation. Weighted voting for monetary policy decisions would lead to an unwanted regional focus and would affect the independence of the NCB governors vis-à-vis their national authorities. A practical problem would also have been how to determine the votes for the Executive Board members. Rotating votes were usually mentioned in the same breath with weighted voting, but the issue was not studied in detail. Theoretically one can rotate on equal terms, but that possibility was never spelled out.

Overview of checks and balances between the decision-making bodies(listed per article)

We have noted before that, although the Statute is phrased in terms of the *Governing Council* and the *Executive Board*, the equilibrium we are studying is that between the governors and the Executive Board. The vehicle through which the governors express themselves is the Governing Council, within which they constitute a majority. This explains the method we use in the following overview, in which we interpret a strong position of the Governing Council as supportive of the relative position of the governors.

[16] This probably also explains why Pöhl liked to refer to the example of the FOMC, in which body the Board members have a majority.

[17] Bundesbank Law 1957, Art. 7(2) and 8(1). Berlin had a special status and would only late become the eleventh Land with its own LZB.

Below we list for each article treated in this cluster those elements which have a bearing on the relation between the Governing Council and the Executive Board. We show for each element whether it is supportive of the position of the Governing Council vis-à-vis the Executive Board or the other way around.

Table 11-2: Overview of checks and balances covering the relation between the Executive Board (EB) and the governors (listed per article)

	supportive of position of	
	EB	**Governors**
Art. 10.1:		
- Executive Board members part of Governing Council (GovC)	x	
- governors *de facto* in a majority position		x
Art. 10.2a:		
- voting in personal capacity	x [18]	
Art. 10.2b:		
- one man, one vote		(x) [19]
Art. 10.3:		
- weighted voting on patrimonial decisions	-	x [20]
Art. 11.6:		
- Executive Board responsible for current business	x	
Art. 12.1a		
first sentence:		
- GovC has general power and duty to ensure the performance of the tasks entrusted to the eurosystem		x
second sentence		
- power to formulate monetary policy, including the setting of key interest rates, rests with the GovC		x
Art. 12.1b		
first and second sentence:		
- implementation of monetary policy is an exclusive, original and irrevocable power of the EB, including the right to instruct NCBs for the purpose of the implementation of monetary policy [21]	x	
		./.

[18] This is seen as supportive for the Executive Board, as governors cannot say they are bound by the position of their own board, which would have given them a tool to block decisions in the Governing Council. (At the same time, this *ad personam* rule strengthens the independence of the governors vis-à-vis their governments.)

[19] This has to be seen in combination of Art. 10.1: if the Board would have constituted a majority, the one man-one vote principle would have strengthened their position.

[20] Relates only to issues affecting the relative income position of the NCBs, but concerns vital issues like the size of the ECB's capital.

[21] This power 'to instruct' cannot be delegated, also not to the Governing Council. Art. 12.1b, first and second sentence, refers, unlike the first sentence of Art. 12.1a, to implementation of *monetary* policy, and not to other policies, e.g. in the area of payment systems or financial stability. Therefore, the non-monetary powers, including those relating to their implementation, pertain only to the GovC. Handing over such powers to the Executive Board requires formally an explicit act of delegation by the Governing Council (ex Art. 12.1b, third sentence). Thus while it might be possible to give an extensive interpretation to the words 'implementation',

	supportive of position of **EB**	**Governors**
third sentence:		
- the GovC may delegate certain powers to the Executive Board [22]	(x)	
Art. 12.1c: [23]		
- operations decentralized to the extent deemed possible and appropriate	-	-
Art. 12.2:		
- Executive Board prepares the GovC meetings	x	
Art. 12.3:		
- GovC adopts the Rules of Procedure of both the Board and the GovC		x
Art. 12.4 and 12.5:		
- opinions by the ECB are delivered by the GovC as well as decisions relating to the external presentation of the ESCB		x

The most important articles are the ones that give the board or the council irrevocable powers. In our case these are Art. 12.1a, second sentence, which gives the Governing Council supreme power to define monetary policy, and Art. 12.1b, first and second sentence, which gives the Executive Board the sole right to execute the decisions and implement the guidelines adopted by the Governing Council. In this respect the Governing Council acts as the traditional 'legislator' and the Board as the 'executive branch'.

This comparison elicits the question whether the 'legislator' could not somehow seize the functions of the 'executive', in other words could the Governing Council turn into a 'Long Parliament'. In theory this could happen, namely when the Governing Council would start adopting very detailed guidelines, emptying the Board's executive competences, and very detailed Rules of Procedure. However, experience until now has shown that governors do not have a great desire to get involved in the daily practicalities of running monetary policy for the euro area. Furthermore, a practical difficulty would be that the governors would still depend on the Executive Board for designing such detailed guidelines (as it is the Board's staff who prepares the decisions) and the governors need to be almost unanimous, otherwise

'monetary policy' as used here cannot be interpreted in a generic sense, i.e. encompassing all central bank functions.

[22] We note that the GovC may not delegate discretionary policy powers to the Executive Board. This also applies to normative powers connected with issuing regulations, though in both cases some of the powers may be delegated to the Executive Board, when they of necessity follow from the Executive Board implementing guidelines or regulations decided upon by the GovC – see for instance Art. 17.3 of the Rules of Procedure: 'The Governing Council may delegate its normative powers to the Executive Board for the purpose of implementing its regulations and guidelines. The regulation or guideline concerned shall specify the issues to be implemented as well as the limits and scope of the delegated powers.' The formulation of Art. 17.3-RoP confirms that the Executive Board is not empowered to issue regulations, even though the implementation of a regulation itself may entail, of necessity, normative (judgemental) aspects.

[23] We mention Art. 12.1c, which was covered in cluster II, here in order to show that the right of the Executive Board to instruct NCBs does not include the right to **decide** on the degree of centralization of monetary policy operations. This is left to the 'ECB', in other words to the Governing Council, which sets the overall framework.

they do not have a majority in the Governing Council (in which the Board members have six votes). Therefore under normal circumstances, this is an unlikely development.

11.2.3 Actual situation

In practice, developments are rather pointing in the other direction, with the Executive Board becoming more dominant. To explain this we return to table 11-2 above. According to Art. 12.2 the Executive Board prepares the Governing Council meetings, which extends to monetary policy decision-making. We have seen that in practice one Board member, presumably in close consultation with at least the president of the ECB, both prepares and delivers the presentation and makes the interest rate proposal. Discussions on issues like the monetary strategy are presumably discussed in the full Executive Board, because the Board approves all ECB documents which are sent to the Governing Council. Therefore, we see a concentration of power in the area of policy-making which not necessarily follows from the Statute. Indeed, the second sentence in Art. 12.1a ('The Governing Council shall formulate the monetary policy of the Community ...') would allow for a more active input from the side of the governors, to which end they could request ESCB Committees to study a specific topic. This possibility is specifically allowed for by the Rules of Procedure, which however at the same time specify that the ESCB Committees shall report to the Governing Council via the Executive Board. Though the Executive Board is not able to stop a committee paper from reaching the Governing Council, it can always add a dissenting opinion. The fact that most committees are chaired by one of the ECB staff directors also strengthens the hand of the ECB.[24] As regards the important interest rate decisions, each Executive Board member determines its position independently. There are no signs of collusion between the members of the Board. However, the 'Board' has gained the lead, as the Board's member responsible for monetary policy preparation introduces the topic and formulates his preference. Thus the earlier conclusion is corroborated that the Executive Board has a strong policy-making influence, much stronger than would appear by just looking at their voting power. Their influence takes effect through their influencing decisions by the Governing Council, and not so much through independent decisions by themselves (i.e. by the Board). Neither does the General Documentation leave much room for the Board to choose instruments or procedures, except in emergency circumstances, though even then the Board has to operate within a Governing Council approved framework. Nonetheless, a number of smaller technical decisions is left to the Executive Board for practical reasons; e.g. relating to the allocation of liquidity to the banks under the ESCB's tender procedures. Delegation to the Executive Board in a formal sense is relatively rare, but has occurred in most non-monetary policy areas, like statistics, banknotes, accounting, payment systems and foreign reserve management. It would furthermore seem that the Executive Board has not yet attempted to define exhaustively the content of 'current business', which could lead – as we have earlier submitted[25] – to a larger role of the Board in the management of the ECB's foreign reserves.

[24] See Art. 9.2 and 9.3 of the Rules of Procedure of the ECB.
[25] Art. 30-ESCB.

11.2.4 Possible shifts in power

At first sight, likely developments seem to be limited to two cases: power shifting to the centre and/or to the larger NCBs. As regards the former, one should not mistakenly take full **centralization** as the logical end situation of any future development. There are many factors which support the logic of a decentralized system, including a federally structured decision-making body.[26] The Governing Council is such a body; see section 11.2.2 above for the arguments in favour of both a role for the governors and for involvement of the board members. The ratio between the number of the board members and the number of governors is only relevant when the board and the governors would act as two distinct groups – this has not been the case and this would detract from their *ad personam* membership. The above means that even with further political integration in Europe there is no need for a general movement towards increased centralization. Even in the United States, which is a political union, the central bank system benefits from its federal character. In chapter 8.2.4. we have seen that the inclusion of the members of the Board of Governors in the FOMC in 1935 is better described as a correction of an earlier unexpected development towards decentralization (that is, a loss of power of the centre) in the area of providing liquidity to the banking system. However, one cannot take from the above that there will never be proposals to reduce the role of the NCB presidents, as has happened in the US with respect to the membership of the FRB presidents of the FOMC.

As regards the second possibility (i.e. power shifting to the larger NCBs), a significant development has already taken place. We refer to the change in the **voting modalities** in the Governing Council. The potential number of governors and, therefore votes, had already increased to fifteen with the accession of Austria, Finland and Sweden to the EU in 1993 and increased further with the accession of ten new members of the EU as of 2004, which would eventually also adopt the euro. The Treaty of Nice of 2000 had introduced an article in the ESCB Statute (**Art. 10.6** – the so-called enabling clause) allowing the Heads of State to amend by unanimity Art. 10.2, either based on a recommendation of the ECB (Governing Council) or on a recommendation by the Commission,[27] 'in order to maintain the ECB's Governing Council's capacity for efficient and timely decision-making in an enlarged euro area.' [28] The Governing Council responded to this article and adopted a recommendation, which was subsequently adopted by the Heads of State on 21 March 2003. [29] The recommendation limited the number of votes for governors to fifteen, while also introducing a rotation scheme, using a three group model with a first group of the five largest countries (i.e. large in terms of a weighted indicator based on GDP and a financial criterion) sharing four

[26] We remind the reader that we have seen that also in the operational field more centralization does not necessarily imply more efficiency, because many tasks entail activities which could best be performed locally. That is not to say that each NCB (also the very small ones) should undertake all operations themselves. For instance, payment systems could probably be shared. (A decentralized system only works with a centralized decision-making body, though this body itself could be federally composed.)

[27] Art. 10.6-ESCB became known as the 'enabling clause', because it allows the protocol to be changed without a regular IGC procedure, though still requiring national ratification by all Member States. It allows for a change in the voting regime (not in the composition) of the Governing Council. Art. 10.6 was not triggered by a disfunctioning of the Governing Council at that moment (2000) or a lack of effectiveness, but was based on the idea that the Governing Council could not increase in size unlimitedly.

[28] Formulation used in provisional Conclusions of Council meeting on 21 March 2003.

[29] The decision has been ratified by each Member State (April 2004).

rotating votes, a second group consisting of half of all euro area NCB governors (again ranked according to size) who share eight votes and the remaining governors sharing three votes. Within these groups votes rotate on an equal basis. This system keeps alive the ***ad personam*** concept and the one person, one vote (i.e. equal weights for those who vote) system. The model allows all governors to speak, even when they do not have a vote.

An argument used by the proponents of Art. 10.6-ESCB had been that the ECB would lose credibility if very small states would in theory be able to tip the balance in any interest rate vote. (This would only be harmful, if the governors of these countries would not vote with the euro area interest in mind.) Also, there was some understanding for the fact that the governor of the Banque de France (large country (population of 60 million), large central bank staff) should have a higher voting frequency than the governor of the central bank of, say, Malta (400.000 people; small central bank staff). The economic reasoning seems to be that a governor of a large country is more likely to produce information which is relevant for the euro area as a whole than a small country – though of course this does not have to mean that this governor should have a vote (see also chapter 11.3 below).

The idea of an enabling clause had been tabled by the French government at a very late stage of the IGC leading to the Nice Treaty, and had been supported by Germany and Italy. The small countries had immediately feared this could lead to a relatively dominant position of the larger countries. The smaller countries operated along two lines: first, they ensured sufficiently strong safeguards in the procedure for activating the enabling clause, basically giving them a veto power. Second, during the negotiations within the Governing Council on the formulation of the recommendation under Art. 10.6, the NCBs of smaller countries firmly rejected proposals to reduce the number of votes for the governors to six. They feared that in such a constellation the largest countries would always manage to get their governors into the reduced Governing Council, while large countries would probably also be successful in filling a seat in the Executive Board. At the request of a few middle-sized NCBs the Governing Council first discussed equal rotation models with a large number of votes, with the rotation arranged in such a way that the governors with a vote would 'represent' countries covering at least 60% of the euro area's GDP. Discussion then moved to models with two or three groups of governors with a small number of votes, with each voting governor and each Board members having an equal vote; any form of weighted voting (or double weighted voting) was rejected, as weighted voting systems would invite political pressure on the governors representing a large weight – see Art. 10.2-ESCB. The Governing Council finally agreed on a three group model described above, which as a result also keeps the ratio Executive Board members – governors around the initial level. An important feature from the perspective of the smaller countries has been that the largest NCBs would not have a permanent vote, but would rotate as well. It was feared that NCBs with a permanent vote would, quite naturally, start consulting each other before each Governing Council meeting, thus possibly leading to precooked meetings and negative group dynamics. This aspect is also covered in the theoretical paper by Berk and Bierut.[30] When the Executive Board would not be unanimous, but would still decide to take a common position, the information of the Board minority is lost, and 'extra Board members need to be added to provide additional expertise necessary to correct for this loss.'

[30] Berk and Bierut (2003), p. 25.

The system, as proposed under Art. 10.6, could be described as containing three circles: the largest circle is the Governing Council, containing all voting and non-voting members; the next, smaller circle contains only those with a vote; and the innermost circle contains the executive board members, who are responsible for the day-to-day management of the System's monetary policy.[31] The rotation scheme will enter into force when the number of euro area countries exceeds fifteen[32]. It would seem a natural moment to consider changing from the present decision-making by consensus to decision-making by voting – some would even like to see this happen earlier. We will come back to this important issue in chapter 11.3.

[31] One could earmark the General Council as the fourth, most outer circle; however, the General Council only meets every quarter, does not take policy decisions and only comprises part of the Executive Board members (president and vice-president), though the other Board members are allowed to be present.

[32] There will be a transitional two-group rotation system as long as the number of governors is smaller than twenty-two.

11.3 Overview of Checks and Balances between Executive Board and NCB Governors, and Possible Improvements

11.3.1 Overview

We provide below an overview of the checks and balances, using the classification developed in chapter 2. (We follow the presentation used in chapters 5.4.1 and 8.3.1.) This will help us to form a judgement on the question whether the relation between the Executive Board members and the governors is balanced or, if not, a source of tension. There are at least fourteen articles or sub-articles containing checks and balances between Executive Board and governors, most of them concentrated in four articles (Art. 10-13). Some articles fall in more than one category.

Table 11-3: Overview check and balances Executive Board – NCB Governors

(a1) Checks and balances protecting the prerogatives of the Executive Board:
- Art. 10.1; 10.2b; 11.6; 12.1b; 12.2; 13 and 39 [1]

(a2) Checks and balances protecting the prerogatives of the governors:
- Art. 10.1; 10.2b; 10.3; 10.5; 12.1a; 12.4-5; 35.5 [2]

(b) Controlling (or blocking) mechanisms:
- Art. 10.2b; 11.3;[3] 12.1b; 12.2; 12.3 (RoP, budget)

(c) Consultation mechanisms:
- Art. 10.1; 10.2b; 12.2 and 12.3

(d) Accountability mechanisms:
- Art. 26.2 [4]

(e) Checks and balances allowing for intertemporal flexibility:
- Art. 10.6 (enabling clause); 12.1b, first sentence (implementation) and third sentence (delegation)

Explanation: Line (a1) contains the inalienable rights of the Board members: inter alia their membership of the GovC; the Board's right to run the ECB's current business and to prepare the GovC's meetings, their duty to get monetary policy implemented (to the extent deemed possible and appropriate through the NCBs, but else through the ECB itself). Line (a2) relates to the membership of the governors of the GovC, their control over certain financial, so-called patrimonial matters, and the GovC's role as the top decision-making body of the System (in which body the governors hold a majority and which has to meet at least ten times a year).[5] Category (b) contains both examples where the Board is in control of the GovC (e.g. by its right to set the GovC's agenda) and examples where the GovC sets the framework for the Executive Board (e.g. the framework for monetary policy implementation. The fact that both Board members and governors are voting members of the GovC is a controlling mechanism in

[1] Art. 13 and 39 vest the president of the Board with special representation power.
[2] Decisions to bring an action before the Court of Justice are the sole right of the Governing Council.
[3] Also mentioned in cluster I, as the Governing Council fixes the Board's salaries following a proposal by a partly external committee.
[4] The obligation to publish an Annual Report (Art. 109b) and its regulations and to notify decisions to those affected could be seen as a form of external openness showing how the respective decision-making bodies performed their tasks.
[5] A low frequency would mean power shifting to the Excecutive Board.

itself. Furthermore, the fact that they usually aim for consensus decisions creates an extra incentive to consult each other (category c). Category (d) contains an article relating to internal financial accountability of the Executive Board. Category (e) contains two articles, allowing for more or less discretionary power for the Executive Board and for a new voting rule for the Governing Council (at present one vote for each member).

The overview shows an evenly distributed presence of checks and balances, with the exception of category d (on which we will comment below) and at first sight category e – see also diagram 2 in chapter 12. When looking more in detail we observe the following. The position of both Board members and governors vis-à-vis each other is protected by their membership of the Governing Council (Art. 10.1), which is the supreme ruling body of the ESCB. The Executive Board members are in a minority. However, it can be noted that the governors are less likely to operate as an effective block, reducing the relevance of their majority. Their *ad personam* membership of the Governing Council (Art. 10.2a) implies the governors cannot play strategic games by invoking binding instructions or a limited mandate of their own boards. Two further articles contribute to an effective power base for the Executive Board: first, their right to implement the Governing Council's monetary policy (Art. 12.2) , and second their right to prepare and chair (through the president) the Council's meetings (Art. 13). The special position of the president adds more to the weight of the Board than that of the governors.
For our exercise we equated the relative power of the governors with that of the Governing Council, because most of the System's powers are vested in the Governing Council, and due to the 'one man, one vote' principle (Art. 10.2b) the governors constitute a majority,[6] allowing them where necessary to protect essential rights through the Governing Council. Furthermore, the governors will always remain in complete control of their financial interests through Art. 10.3 (weighted voting).
Blocking (category b) may occur, when the governors block a decision using their majority (though they seldomly operate as a block). On the other hand, the Executive Board's power to set the Governing Council's agenda is also a real power lever, as it is rare for the Governing Council to force a decision without preparation by the Board. Furthermore, the Governing Council 'controls' the Board indirectly through determining the ECB's and the ESCB's Rules of Procedure (RoP). One example is the fact that the ECB's budget needs to be approved by the full Council, a rule contained in the RoP. Another example is that through the RoP the Governing Council could give more prominence to the role of ESCB committees, though these committees cannot substitute for the Board's preparation. (All ESCB committees are supported by ECB staff and are in the present set-up, as a rule, chaired by a person from the ECB.)[7]

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[6] At present the ratio of votes between the Executive Board and the governors is 6:12 (6:15 when the UK, Denmark and Sweden would have joined the euro area); in the future after accession the ratio will be at most 6:15.

[7] On the surface the ESCB committees might look more useful for the NCBs than for the ECB, but they also increase the exchange of ideas within the System, and allow for smoother (non-monetary) decision-making in the Governing Council, provided the committee members act in a cooperative spirit. The committees are especially important, when the Governing Council decides by consensus (which is not the same as unanimity). But NCB representatives should not misuse this. For some ideas on improving the functioning of committees see chapter 8.3.

A number of the above mentioned factors also imply that governors and Board have to cooperate (category c). Decision-making by consensus, though not prescribed by the Statute, further strengthens this. Also, even when the Governing Council adopts the Council's and Board's Rules of Procedure, the Board writes the draft. (Art. 12.2 and 12.3). While the Board proposes the agenda for Governing Council meetings, the Council approves and Council members (governors) may add items.
Art. 26.2, contained in category (d), provides for accountability of the Executive Board vis-à-vis the Governors, because the Executive's Board's Annual account has to be approved by the GovC (in which the governors/shareholders hold a majority). In other areas there is no real hierarchy and no accountability mechanisms; governors and board members are already together when they take decisions.
Category (e) is at first sight weakly represented, containing only two articles. However, we will see that the two articles can potentially have a wide-ranging impact and could thus be seen as relatively powerful attributes of flexibility. Category (e) contains an article (Art. 12.1b) allowing the GovC to change the Executive Board's room for discretion by (i) making the guidelines for monetary policy implementation more (or less) detailed and/or by (ii) delegating some of its tasks to the Executive Board, though limits apply as to which tasks may be delegated (which limits are further explained in the footnote with Art. 12.1b in table 11-2). Remarkably, the Governing Council cannot delegate responsibility to NCBs, which within limits is the case in the FRS (see section I.2 of the genesis of Art. 12.1a above). Whereas in the United States new tasks can only be endowed to the Board of Governors (which subsequently may or may not be delegated by them), and not to the Federal Reserve System, in the case of the eurosystem new (European) tasks can only be endowed to the System as a whole, to which the decentralization principle would apply immediately.[8] However, endowing the System with a new task would require an amendment of the Treaty, in which case the amendment could of course specify that the new tasks are to be performed by the ECB itself, i.e. there is no general enabling clause.
Category e contains another article introducing flexibility over time, i.e. Art. 10.6. This article, which was introduced in 2000 by the Treaty of Nice, can be used to protect the role of the Executive Board by enabling the Council of Ministers in the composition of the Heads of State and Government to maximize the number of votes for the governors, which would rise when new EU Member States would qualify for the euro area. It should be added that this was not per se the aim of the Member States proposing this article at a late moment of the IGC negotiations leading up to Treaty of Nice. The proposal came from the larger Member States, which hoped that Art. 10.6 would lead to a system giving the NCBs of the larger Member States a larger weight than the NCBs of the smaller countries. We have seen that the outcome is beneficial to the Executive Board (though the Board might have wished a lower maximum for the governors' votes than the chosen fifteen). In contrast to the wishes of some of the larger Member States, the governors of the large NCBs will periodically lose their right to vote, though less often than the governors of smaller NCBs[9]. This outcome has preserved the

[8] An exception being specific tasks relating to prudential supervision as defined under Art. 25.2-ESCB.
[9] There are some similarities with the composition of the Commission as debated in the context of Europe's draft Constitution. The Commission, with each Commissioner having a specific portfolio, cannot grow one to one with the increasing number of EU Member States. The Commission proposed an equal rotation system, implying each Member State would periodically not have a national in the Commission. The larger Member States have suggested to divide the smaller number of Commission seats in important and less important ones, with a natural claim of the large countries on the important seats. This resembles the composition of the Executive Board of the

federal character of the System, or more precisely: it has helped prevent the introduction of intergovernmental processes in the governance of the ESCB, with those NCBs having permanent votes probably increasingly seeking to work together, creating a dichotomy within the System and making these NCBs a more attractive object for pressure from their national capitals.

11.3.2 Possible Improvements

1. We do not see an imminent need to improve the checks and balances between the centre and the regions as regards the decision-making process. As seen in diagram 2 in chapter 12, most categories of checks and balances are well represented. Category e, relating to flexibility over time, is small, but contains two articles which could lead to a substantial shift in relative power. Accountability mechanisms are also low in supply, but are less needed because governors and Executive Board members are together when they decide as Governing Council. One could say though that on paper the Executive Board lacks substantial original (non-delegated) powers. However, in practice the ECB has created for itself an influential role. This is due to its central role in the preparation of Governing Council meetings and probably also to its sizeable, highly-qualified staff which allows it to build-up, where necessary in a short time, knowledge and expertise in almost any area important to the System. If the Executive Board would also be allowed to take monetary decisions, power would one-sidedly accumulate in the Board. There would not seem to be any need to do so. The Governing Council is also not comparable to the German Zentralbankrat before EMU, where – as we have noted - the chairman of the Direktorium was sometimes annoyed by the provincial positions taken by the Landeszentralbankpresidenten. An important difference is that the NCB governors are internationally oriented and more involved in market operations than the Landeszentralbankpresidenten, which sets them less apart from the Executive Board members than the LZB-presidents from the Direktorium.
   We observed that the Executive Board is better positioned to use its staff effectively to influence the discussion in the Governing Council, because it prepares Governing Council meetings and most ESCB committees are chaired by ECB staff. This adds considerably to the influence of the Executive Board. This is not necessarily detrimental to the System, but it would if it would effectively shut out the views and insights of NCBs in the early stages of policy preparation. While respecting the Executive Board's role of preparing Governing Council meetings, the Governing Council could ask ECB staff to seek co-operation with NCB staff when preparing special topics. This could take several forms, like inviting NCB staff for secondments or through small-scale committees or liaison-officers.[10]
2. This would seem the right place to bring together the following issues touched upon before: the size of the Governing Council, the rotation scheme and the issue of voting versus consensus decision-making.[11]
   First we recall remarks we made earlier. It is sub-optimal when governors do not share

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ECB, where rumour has it that the large countries claim that four of the six seats have been reserved for the governors of the NCBs of the largest euro area countries – a claim not substantiated by others and not approved by national parliaments when ratifying the Treaty of Maastricht.

[10] See chapter 8.3.

[11] These issues were mentioned in chapter 11.2.2 and 11.2.4.

their information. A governor with relatively more information or more important information does not necessarily have better decisional skills, assuming he shares his information with others. When the Board votes as a block information is lost, leading to sub-optimal decisions. From this follows that there is no a priori reason to limit the size of the Governing Council, except for practical reasons. There is no a priori reason to differentiate between governors from large and small NCBs, as regards their voting frequency. On the other hand, the Governing Council also decides on many non-monetary issues, like the development of TARGET (the System's payment system) and banknote related issues, in which case the larger NCBs have more at stake. This might be an argument for a somewhat higher voting frequency for larger NCBs, though of course the interests of the larger NCBs do not necessarily coincide. We also mentioned the argument that in the context of the 2004 EU enlargement the new members were sometimes perceived as coming from a different stability culture, leading to the fear that they might change the way inflationary risks are evaluated. As most of the new member states are small or even very small, this translated into the idea that smaller countries should receive a lower voting frequency. We observed earlier that the introduction of the rotation scheme raised the issue whether voting should replace the present procedure of decision-making by consensus (not be confused with unanimity). The optimal rule is to weigh the votes according to the decisional skills of the members. Of course, in practice this is impossible. Another form of weighing is to take into account the conviction with which a certain position is held. Indeed, as in the case of interest rate decisions absolute certainty does not exist, some committee members will be strongly convinced of a certain position, while others may at the same time hold a different position, but with less conviction. Consensus decision-making allows the chairman to take this into account. The degree of conviction is an additional piece of information which is not used when a simple vote count is taken.[12] Taking this into account leads to a better decision. This requires special skills of the chairman. To prevent possible deadlock or undecisiveness[13] each Council member should have the right to ask for a vote (which is already the case under Art. 4.2 of the present Rules of Procedure). After the presentation by the ECB, the non-voting members could be asked to share their information with the meeting first (or possibly not all), and subsequently the voting governors and the Board members. Therefore, we conclude contrary to intuition that for this kind of single-issue decision-making the group does not need to be small (in fact to the contrary) and decision-making by consensus does not necessarily slow down the decision taking, while in fact allowing for better decisions. This, combined with the threat of pressure by their national political authourities once individual voting behavior is published or leaked, leads to the conclusion that voting is not necessary, not optimal and not in the interest of the independence of the System.

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[12] Other arguments against voting were mentioned in chapter 5.4 (under Practical improvements, proposal 5).

[13] There is no convincing theoretical or until now empirical proof that the Governing Council has been acting behind the curve due to procrastination in its decision-making process. See Blinder and Morgan (2000) and M. Artis (2002) respectively. In fact, Blinder and Morgan conduct two laboratory experiments, the outcome of which invalidates the commonly-believed hypothesis that groups make decisions more slowly than individuals do. Furthermore, they conclude that group decisions are on average superior to individual decisions. (In their experiment they conducted a statistical "urn problem" and a monetary policy experiment. In both cases decision-makers have to decide on the basis of subsequent drawings (information) whether the composition is deviating from a given previous composition.) Of course, issues like drafting communiqué's will take more time with larger groups, but this can be handled by setting time-constraints.

3. A related issue is whether to continue the practice that Governing Council meetings on monetary policy start with not only a presentation, but also an interest rate *proposal* by one of the Executive Board members. If this procedure allows others to side with this authorative interest rate proposal and thus to present only arguments in favour of this proposal, not all possible information becomes available, and the result may be suboptimally informed decision-making. Therefore, the presentation should not contain an interest rate proposal. Combining such a procedure with decision-making by consensus leads to the optimally informed decision-making process by the Governing Council. Such decision-making procedure is practical, the outcome would seem to be more open-ended (i.e. not predetermined) and in case of a close call which is not solved satisfactorily by the chairman anyone could ask for a vote. However, in the latter case it would seem really uncertain what is the right step and therefore the outcome of a vote is not necessarily a better one than the consensus proposal by the chairman. The described procedure is not only practical in case of voting where the chairman formulates a decision at the end of the discussion which he puts to a formal vote. It is also practical in case of consensus decision-making because in practice the monetary policy decision will be to change or maintain the interest rate. Governors and Board members could express their preferences after having listened to a staff presentation and to each other, after which the chairman weighs the convictions and formulates a decision, which can only be contested by asking for a vote. Changing the current rule of decision-making by consensus to voting would weaken the president's position; changing away from the practice that a Board member presents an interest rate proposal at the beginning of the monetary policy discussion would on the one hand eliminate the possibility for the president to influence the discussion by pre-arranging the interest proposal by his Board member (which is not necessarily present practice)[14], while on the other hand and to the extent such pre-arranging was not current practice, it would strengthen his position, while also allowing for a better discussion.

Priorities

Of the three mentioned possible improvements (i.e. making better use of committees, continuing the practice of consensus decision-making in an enlarged Governing Council, and abolishing the practice of starting the monetary meetings with an interest rate proposal) the third one lends itself for early implementation. The first one needs more preparation, while the second one probably needs to be decided before the new voting system is activated (which happens when the size of the Governing Council increases over twenty-seven members (Board members included)).

[14] In the early years of the ECB, its first president Wim Duisenberg put a large weight on achieving a European (i.e. not national or regional) view of the Governing Council when it was taking interest rate decisions. In case of important interest rate decisions he would contact members of the Governing Council beforehand – see interview with Duisenberg in the International Herald Tribune of 6-7 November 2004.

APPENDIX 3: Bank deutscher Länder (1948) [1]

The Bundesbank, though being an institution with a unitary structure (i.e. a Head Office with branches), borrowed many elements from its two-tier predecessor, the Bank deutscher Länder (BdL). The BdL itself was inspired strongly on the American Federal Reserve System. This is why we look into the creation of the BdL. We lean heavily on C. Buchheim (1999), 'The establishment of the Bank deutscher Länder and the West German Currency Reform', in: Deutsche Bundesbank (1999), *Fifty Years of the Deutsche Mark* (esp. p. 55-80). The Potsdam agreement proscribed a policy of decentralization for post-war Germany, also in economic life (though it was also stated that Germany should be treated as a single economic entity). The Americans were keen in breaking up the big banks and establishing a separate central bank and bank supervisor in each Land. The Americans established *Landeszentralbanken* (Land Central Banks (LCBs)) in their zone in 1946, followed in 1947 by the French in their zone, while the British relied on the remnants of the Reichsbank unitary structure with branches. The LCBs in the American zone clearly resembled the American FRBs. At the same time a Bank Council was established, which issued quasi-binding recommendations on monetary policy. (In the French zone a similar Coordinating Committee was set up, its decisions however were binding.) Not only the two-level structure resembled the Federal Reserve, also a number of more specific features. The capital stock of the LCBs was linked to the total size of deposits held by banks in that Land. The capital stock was to be subscribed by local credit institutions, but was initially subscribed by the Länder – and this was not changed, until 1957 when the LCBs became part of the Bundesbank (see below). The LCBs functioned as state bank for the individual Länder. The LCBs were given instruments, most of which had already been available to the Reichsbank. One innovation was a minimum reserve policy based on the American model. The governing bodies of the LCBs were an Executive Board, which included the President or General Manager and his alternate, and a Supervisory Board. Each Supervisory Board was charged with deciding the level of minimum reserves to be held with the LCBs by the commercial banks as a proportion of their customers' deposits, as well as the level of interest rates applied by the central bank to its operations. The President of the Executive Board and his alternate were nominated by the Land Prime Minister (the shareholder) and could be recalled any time for substantial reasons. The Prime Minister also nominated the chairman of the Supervisory Board. The *ex officio* deputy chairman was the President of the LCB. Further members included the head of the banking supervisory authority and representatives from agriculture, industry, and employees, to be nominated by the finance minister. There was no mention in the laws of direct, binding instructions from the government.

Rather quickly it became clear the zones needed to coordinate. In 1947 the three western zones opened an interzonal clearing system. In 1948 the British also established LCBs, while the Americans accepted the central board to be placed above the LCBs would have more than just a weak coordinating function, as the Americans had wanted. This institution, the **Bank deutscher Länder**, was also necessary to implement the still needed currency reform. Unlike the LCBs the BdL was allowed to issue new currency (the LCBs had only been allowed to reissue curency).[2] Furthermore, the BdL set monetary policy, it was authorized to engage in

[1] See also chapter 9.

[2] On 21 June 1948 the Deutsche Mark replaced the Reichsmark as the currency unit in the western occupied zones of Germany.

foreign transactions and to act as federal fiscal agent. It was prohibited from dealings with credit institutions, which was reserved for the LCBs. Concurrently an Allied Banking Commission was constituted. One of its duties was to supervise the BdL and its monetary policy. The BdL's capital was held by the State central banks according to their total deposits. The BdL comprised a Board of Directors (Zentralbankrat (ZBR)) and a Board of Managers (Direktorium). The Board of Managers had the task of executing the policies and decisions of the ZBR. The ZBR which consisted of a chairman, the presidents of the LCBs and the president of the Board of Managers was the policy board of the Bank. The ZBR elected its own chairman for a renewable term of three years. During his term of office the chairman was excluded from being board member of any LCB.[3] There was no channel for pressure from the German government authorities to put pressure on the management of the BdL. 'The independence of the BdL from any political authorities whatsoever (apart from the Allied Banking Commission) was firmly anchored in the law.' [4] Article I.3 of the law establishing the BdL read: '[e]xcept as otherwise provided herein or by law, the Bank shall not be subject to the instructions of any political body or public non-judicial agency.' [5]

In 1951 the Allied High Commission offered to dispense with the powers of the Allied Bank Commission if these could be governed elsewhere by federal law. The Ministry of Finance then drafted a bill in which the words 'Allied Bank Commission' were replaced by 'Federal Government'. This met with strenuous protests from the bank and the general public.
Subsequently the following text was adopted and designed to remain in force until the Bundesbank Act envisaged in the Basic Law (Constitution) had been passed: 'In the performance of its duties the BdL is obliged to observe ('zu beachten') and to support the general economic policy of the Federal Government.' (Therefore, this is the origin of a similar provision in section 12 of the Bundesbank Act of 1957, which would find its way to Art. 2 of the ESCB Statute.)
When the Bundesbank was established the German central bank system took its own identity. The Federal government preferred a one-tier system and the Länder the existing two-tier system. A compromise was found by retaining the LCBs as the main administrations of the Bundesbank in the Länder, though they lost their legal personality.[6] The LCB presidents however retained their vote in the (enlarged) central decision-making body, the Zentralbankrat.[7] On the independence views also diverged, with Adenauer being critical of the central bank's past independent behaviour and Ludwig Erhard defending it.[8] The independence from instructions was regulated in section 12: 'The Deutsche Bundesbank shall be obliged insofar as is consistent with its functions, to support the general economic policy of the Federal Government. *In the exercise of the powers conferred on it under this Law it shall not be subject to instructions from the Federal Government.*' In section 13 a provision was added according to which the Ministers of Finance and Economic Affairs were allowed

[3] Amtenbrink (1999), p. 86-87.
[4] Buchheim (1999) in Deutsche Bundesbank (1999), *Fifty Years of the Deutsche Mark*, p. 76-77.
[5] Amtenbrink (1999), p. 87-88.
[6] See also footnote [9] in chapter 6.
[7] Amtenbrink (1999), p. 90.
[8] Buchheim (1999) in Deutsche Bundesbank (1999), p. 114. See also chapter 6 above and Loedel (1999), p.46.

to participate in the meetings of the Bundesbank's Zentralbankrat, without a right to vote, but with the right to suspend for two weeks to taking of a decision.[9]

[9] See also Konrad von Bonin (1979), *Zentralbanken zwischen funktioneller Unabhängigkeit und Politischer Autonomie*, p. 79-82. Like Buchheim (1999), in Deutsche Bundesbank (1999), *Fifty Years of the Deutsche Mark*, p. 67 and 73, also von Bonin (p. 81) explicitly states that the American concepts for a post-war German central bank system were heavily inspired by the situation in the US itself.

CHAPTER 12: CONCLUSIONS

In the previous chapters we have studied the genesis of the articles of the Statute of the European System of Central Banks (ESCB),[1] which allowed us to come to a clear understanding of their meaning *both from an economic and a text-interpretative perspective*. This covers most of the pages of this study, and should be of interest to practitioners and academics. At the same time we have tried to make a map of the checks and balances present in the Statute. Checks and balances would seem indispensable for an institution like the ESCB, which is designed as a federal central bank system with a centre and regional banks, neither of which was supposed to be dominant, though at the same time monetary policy has to be one and indivisible. The ESCB's external relations are also characterized by checks and balances; for example while the ESCB is independent, its Board members are appointed by he political authorities. In fact, right from the beginning the designers of the Statute (basically the governors) took great care to introduce adequate checks and balances, in order to make the ESCB's independence politically acceptable. On the basis of the description of the genesis of the articles of the Statute, we conclude that the Statute has a good measure of checks and balances. These checks and balances fall into different categories. We distinguished five categories, which followed from reviewing the concept of and the literature on federalism. The checks and balances concept is a new method of describing the ESCB Statute and the relevant Treaty articles on Monetary Union. It allows us also to discover possible weak spots in the design and from this we can derive suggestions for features to be improved.

As an intermediate step we reverted to the literature on economic integration, in a search for criteria for optimal forms of international organizations, allowing us to assess the design of the ESCB. In fact, most studies on international organizations are limited to providing a factual description, and do not provide a framework or criteria for the optimal design of international organizations. A distinction made by the neo-functionalist theory of economic integration is that between purely intergovernmental organizations and supranational organizations. The first category is of a purely voluntary nature and consists basically of its members, a place to meet and a secretariat.[2] The basic thesis of the neo-functionalists is that cooperation in one functional area will spill over in other areas, thus cascading into deeper integration. This process will only flourish though, when there is a supranational body with some own (though possibly reversible) powers and preferably a mandate for furthering integration in general. The neo-functionalist theory could explain the first decennia of post-war European integration (starting from the Schuman plan), but not the subsequent standstill from the mid-seventies until the mid-eighties – for which reason this particular theory lost much of its glamour. Other integration theories however also failed to describe (and predict) the uneven process of European integration. The pure intergovernmentalists for instance cannot explain the surrender of sovereignty. However, it would seem that even when progress

[1] Officially called the Statute of the European System of Central Banks and of the European Central Bank. The study is based on material covering the period of the Delors Committee until 1992 (the signing of the Treaty of Maastricht). In 2000 it was decided to add an Article 10.6 to the Statute (Treaty of Nice). This article has been added to Annex 4 containing the ESCB Statute. Our study also shows the genesis of the Treaty articles relating to Monetary Union. Since Maastricht most Treaty articles have been renumbered. This is shown for the relevant articles in Annex 5.

[2] In the typical intergovernmental structure all entities keep their veto power on important decisions.

takes places, possibly at uneven steps and maybe strongly dependent on persons (Adenauer, Kohl, Mitterrand) and events (unification), no such progress can be permanent without embedding it in institutions with a formal mission with an expansive element.

Economic integration theories did not provide a framework for the optimal design of supranational institutions. Therefore, we turned to the literature on **federalism**, looking for concepts allowing us to assess the design of the ESCB. Indeed, monetary integration in Europe has taken a federal form – federal as opposed to unitary and also as opposed to hierarchical.[3] We find that an important element of federalism is power *sharing* and not just separation of powers. The American political system is usually taken as the prototype of a system of checks and balances, with a distinction made between executive, legislative and judicial powers. At the same time though there are many interlinkages, for instance the president appoints members of the Supreme Court, but needs the approval of the Senate; the president has full executive powers, but for his budgetary appropriations he needs Congressional approval (see chapter 2 for more examples). A main fear of the drafters of the American Constitution was that the branches would develop their own powers, indirectly encroaching on the domains of the others; one example being the absolute monarchs in Europe, but also the British Long Parliament, largely overlapping with the Cromwell period, which assumed executive and judicial (prosecuting and sentencing) powers. These principles of balancing powers are also visible in the design of the **Federal Reserve**, where public interest (with rampant anti-financial sector feelings) had to be balanced with private sector interests (banking sector), both sides fearing dominance by the other. This fear pervades the set-up of the system (Federal Reserve Banks and a Board) and the internal distribution of powers.

To be workable federalism needs **checks and balances** between the entities involved to prevent deadlock, but also to prevent dominance of one entity over the other(s). More specifically, we would expect to find a clear description of each entity's own powers combined with checks and balances that keep the power of the other entity (entities) in check, that oblige them to consult each other, that require openness towards the other entities and, in cases of checks and balances vis-à-vis the political authorities, the people. To these traditional ingredients of checks and balances we added the important requirement of *flexibility over time*. This flexibility will serve the longevity of the system, because it allows for different degrees of power concentration, which could serve possible changing circumstances. Any system of checks and balances could be characterized by the elements (sub-categories) contained in the above definition. We would expect all five categories to be present for *any system* to be stable over the long-run.

The ESCB has been designed as a federal structure, consisting of the NCBs and a new centre. This was already proposed by the Werner Report and was repeated in the first proposals by Balladur and subsequently formulated as a condition by Stoltenberg, together with the requirement of independence. The centre was conceived by the Delors Committee and the Committee of Governors to be more than just a secretariat or a regulatory agency, at least potentially. We are interested in the question whether the designers of the ESCB used checks and balances as defined above. The absence of checks and balances would not bode well for

[3] See our definition of federalism in chapter 2.

the effectiveness of the system. As federalism and checks and balances relate to the relations between specific entities, we distinguish three groups of relations, each representing a non-hierarchical federal structure between entities operating at the same level: **first**, due to the required independence of the ESCB, its non-hierarchical relation with the other relevant Community institutions (the 'political authorities') had to be defined. This area is usually studied in terms of (too much) independence versus (too little) accountability. Instead we show that the Statute contains a number of features which increase both the System's accountability and its independence, taking away the idea that institutional (political) independence and accountability are enemies.[4] The **second** area covers the tasks of and the relations between the ECB and the NCBs. In theory the ECB and NCBs could be given own (exclusive) responsibilities, alternatively they could operate alongside each other. The **third** area is that of the relations within the Governing Council, i.e. between the Executive Board and the governors. The Executive Board has been given votes and some powers of its own.

Most articles clearly fall into one of the above mentioned areas (i.e. the System's external relations, its operational aspects or its decision-making design), which allows us to study them systematically from the perspective of checks and balances.

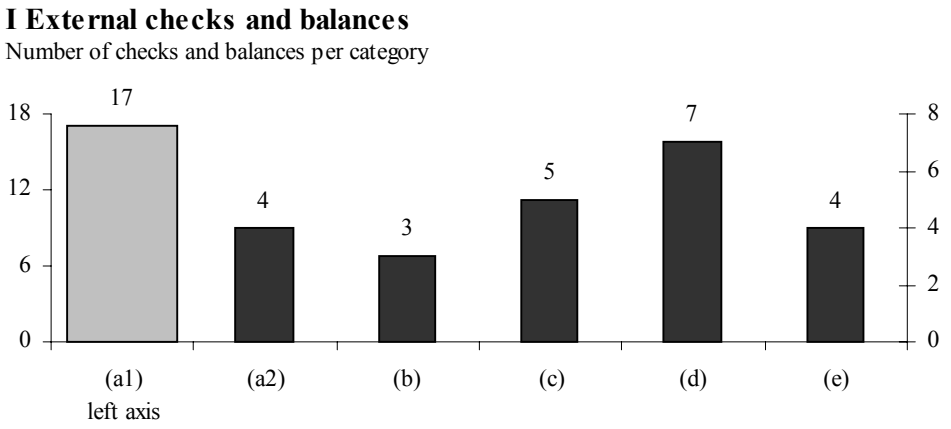
The definition and categorization of checks and balances, developed in chapter 2, has been helpful in gaining insight in the way powers are defined, protected and controlled. In particular the *overviews* presented at the end of each cluster have been helpful. In **diagram 2** , shown at the next page, we capture a rough image of the way the checks and balances are divided over the five categories ((a) to (e)).

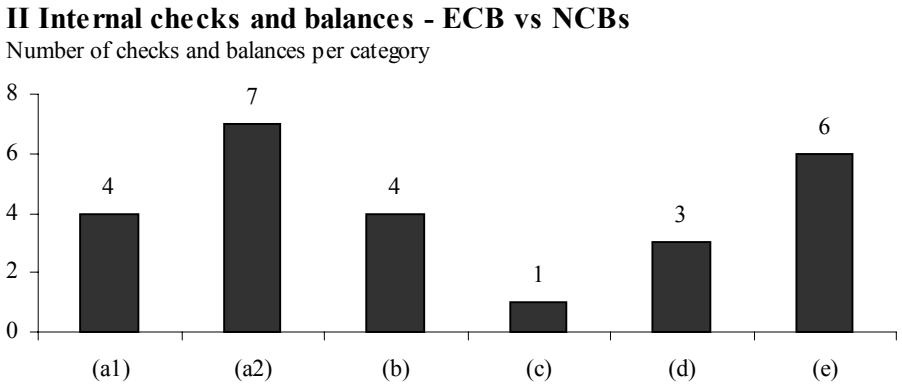
If we were to present our most important conclusions and recommendations in a short way, we would present them as follows:

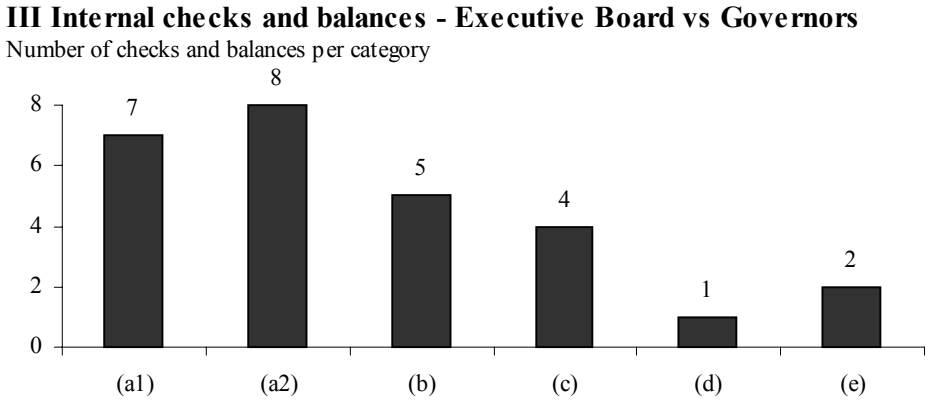
1. The genesis shows that checks and balances played an important role in the discussions on the draft Statute, an aspect neglected until now in legal, economic and political studies on the ECB and on Monetary Union, which usually have focussed on one or at most a few aspects of the Statute and the related articles of the Treaty. In fact, the Statute contains many checks and balances, with mostly clearly defined responsibilities and many checks on each other's powers, also vis-à-vis the external authorities.
2. The central bank governors themselves played an important role in the genesis of these articles, because they were aware of the need for checks and balances. Indeed, a number of them had gone through the experience of attaining independence for their central banks in a national context and they knew therefore by experience which were the most important conditions for attaining political support for a (de facto or formally) independent central bank. This influence already showed in their contributions to the Delors Report, which report in many respects precedes and preludes the content of the ESCB Statute.

[4] See chapter 5.2.2.

DIAGRAM 2: Categorization of checks and balances of clusters I, II and III







(Legenda: see next page)

Legenda:
I (a1) Checks and balances protecting the prerogatives of the ESCB
(a2) Checks and balances protecting the prerogatives of the other EC institutions
(b) Controlling (or blocking) mechanisms
(c) Consultation mechanisms
(d) Accountability mechanisms
(e) Checks and balances allowing for intertemporal flexibility.

II (a1) Checks and balances protecting the prerogatives of the ECB
(a2) Checks and balances protecting the prerogatives of the NCBs
(b), (c), (d), (e) - see above.

III (a1) Checks and balances protecting the prerogatives of the Executive Board
(a2) Checks and balances protecting the prerogatives of the Governors
(b), (c), (d), (e) - see above.

See also chapter 2 (p. 18-21), and chapters 5.4.1, 8.3.1 and 11.3.1. We added for each category the number of articles containing checks and balances as presented in tables 5.3, 8.3 and 11.3, even though not all checks and balance-items are as important. Nonetheless, and at first sight, part I tentatively shows that none of the categories looks to be underrepresented, while category (a1) seems to be overrepresented. In part II the emphasis lies on flexibility. In part III most categories are well represented; category e is small, but in fact contains two articles with potentially far-reaching impact, while there is less need for specific articles under d.

(end of diagram 2)
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3. From chapters 5, 8 and 11 it follows that in all three clusters the checks and balances have been designed in relatively balanced and complete way with all sub-categories of checks and balances represented.
   3.1. The least balanced cluster is **cluster II** with a strong presence of category e (intertemporal flexibility). More specifically, the division of responsibilities is too open-ended, even though the decentralization principle might be seen as protecting an operational role of NCBs. However, this is not an inalienable right, but based on the application (and interpretation) of a decentralization principle and therefore in the end not guaranteed. We propose that the Statute should have provided that standing facilities are by definition offered by NCBs, while the management of the System's pooled foreign reserves should be completely centralized at the ECB. (We submit that the latter point was foreseen by the drafters anyhow.) At present, the ECB acts more as a US-style regulatory agency. This issue might become especially relevant when new (sometimes small) countries join the euro area, which could lead to a rearrangement of operational procedures, possibly triggering centralization or specialization. We nontheless concluded that the present reliance on decentralized implementation of monetary policy is effective in practice and allows more

commercial banks to contact their central bank directly, with whom they hold minimum reserves anyhow and in some cases are their supervisors allowing for synergy, than in a more centralized system with a limited number of primary dealers (see chapter 8.2.4). We also make the point that the decentralized set-up of the system, which is an important characteristic of its federal character, strengthens the independence of the system. We also noted from the overview presented in chapter 8.3.1 that the NCBs' financial position is much better protected than that of the ECB, while the NCBs also have a strong financial leverage over the ECB's expenditures, through the budget approval procedure. This makes their position relatively more powerful than that of the Federal Reserve Banks in the United States or the Landeszentralbanken in the pre-EMU Bundesbank system. This is related to the fact that the NCBs are the ECB's (only) shareholders, whereas the FRBs' capital is owned by their member banks and the Landeszentralbanken are branches of the Bundesbank. We also noted that the Federal Reserve System is not an example of a centralized system, but – as regards the open market operations – as an example of specialization with a large role for the New York Fed. We also noted that it is not correct to describe the history of the Fed as one of increasing centralization, but as one of increased decentralization at the early years (though unplanned), followed by a strong correction.

3.2. **Cluster I** shows all categories well represented. This might surprise, as the ESCB has been accused of being too independent and too little accountable. This easily creates the impression that these concepts are negatively correlated. However, we make the case that independence and accountability may in fact strengthen each other.[5] We conclude that the ECB is not only more independent, but also more accountable than the Bundesbank. (In passing we note differences with the Fed, one of which is that the requirements in the area of transparency leave a lot to leeway to the Fed, while another difference is that there are no government officials present at FOMC meetings.) We recommend that appointments of Executive Board members are formally subject to the consent of the European Parliament. This both increases the accountability aspect (because of the involvement of a directly elected body) and the ECB's independence (as it makes the politically motivated appointments less likely). We see further room for improvement in the area of communication. We recommend less frequent communication, but at the same time more detailed information, better showing the arguments pro and con used in making interest rate decisions. We draw the line however at publishing the voting record, because of the traditional argument that this could lead to national pressure on NCB governors and because we support the idea that the Governing Council has a collegiate responsibility (versus the more Anglosaxon concept of individual accountability).

3.3. In fact this is in line with our recommendation under **cluster III**, where we advised to continue the present practice of consensus voting on monetary policy, because in case of a close call it allows the chairman to weigh the arguments, which possibility is absent in case of straight voting.[6] The possibility to request for a vote should nonetheless be maintained as a safeguard – see chapter 11.3. The ECB is sometimes

[5] The best example being the ESCB's limited mandate – see also chapter 5.2.2.

[6] Another argument against voting is the risk of leakage, and national pressure on the national central bank presidents. Therefore, voting on interest rate, should be the exception.

criticized in the financial press for being too slow in taking interest rate decisions. However, we have shown that theoretically larger groups do no digest information more slowly than smaller ones, neither do recent studies indicate the ECB being behind the curve (see chapter 11.3.2, and also chapter 11.2.2). More in general, we see few imbalances in the relation between the Board and the governors, even though on paper the powers of the Board are limited. In practice though, the Board's position is more influential than its share in the votes of the Governing Council would suggest. First, governors, though they constitute a majority, seldom operate as block (neither has the Board, at least not in case of interest rate decisions). Second, the Board has a powerful position because of its responsibility for preparing the Governing Council meetings. Third, the ECB is chairing most of the ESCB committees. Fourth, the Board is relatively well endowed with staff, which has a size comparable to that of the Board of Governors of the Federal Reserve. Fifth, a Board member takes the lead in the monetary policy discussions by presenting an interest rate proposal at the beginning of the interest rate discussions in the Governing Council – though we recommend ending this practice, see also chapter 11.3.

4. The *role of committees* deserves special attention, as this topic has been mentioned in both cluster II and III. In both clusters we recommended a stronger role for ESCB committees, not so much larger committees, but a role more conducive to generating new ideas and creating an atmosphere of cooperation and trust. In fact, the ECB should see it as her responsibility to manage the intra-System relations, for which a special functionary could be appointed, falling under one of the Executive Board members.
5. A final observation relates to the *external representation* of the ESCB. We have seen that in the Federal Reserve System the external relations were completely centralized after a period in which New York had dominated the System's international relations. A main difference with the Federal Reserve is that the NCBs of the ESCB, unlike the FRBs of the Fed, have remaining non-System responsibilities, which in many cases bring along external contacts (e.g. in the area of supervision, but also IMF-related matters, payment systems oversight, research and statistics). In fact, this outward orientation of many NCBs strengthens the level of knowledge, indirectly also in monetary affairs. This improves the contribution they can make to the monetary policy discussions, making for better decisions.
6. In our description of checks and balances we stressed the importance of sufficient features of flexibility. Flexibility absorbs pressures which might otherwise lead to a break-up of the system. An example from cluster I is the possibility for political authorities to appoint, once the term of a current member has ended, a new member of the Governing Council (Board or NCB governor), and possibly one who is more of their political thinking. We have seen that cluster II provides a large degree of flexibility with regard to the division of labour, while cluster III contains Art. 10.6 which has been used to limit the share of votes for the governors, while Art. 12.1b allows for delegation of powers of the Governing Council to the Executive Board.

The overall outcome is a relatively balanced system as seen from the perspective of checks and balances, which bodes well for the System's longevity. There is room for improvement. The direction in which these should go is given by our analysis of checks and balances, though the direction could also entail 'more of category x' instead of 'less of category y'. Indeed, though the ESCB has a comparatively high independence, we reject for reasons

indicated the idea that the political authorities should decide the quantification of the ESCB's price stability objective (see chapter 5.4.2 and the last part (p. 31) of chapter 3). Likewise, we reject the introduction of an override mechanism (see chapter 5.4.1). The existence of so many checks and balances should not surprise us, as this concept was very much in the back of the minds of the governors when they discussed the design of EMU and the ESCB Statute. The importance of their role has until now been underestimated, as most studies look upon EMU as being the result of negotiations between France and Germany, with France aiming for monetary integration and Germany insisting on a German-styled design of the new central bank. However, the governors did more than copy the Bundesbank. They improved on it (improving on its accountability, but also on its independence)[7] and they formulated views on the economic side of EMU. On this last issue they were to be less successful, as we will see below. First we pay some more attention to the role of the governors.

Role of the central bank governors

The Committee of Governors not only played a very important role in the drafting of the Statute, the governors were also involved in the earlier production of the Delors Report. Large parts of the Delors Report, which was written by two rapporteurs guided by chairman and Commission president Delors, were influenced by text proposals tabled by the Bundesbank. When two years later the Committee of Governors started to draft the articles for an ESCB Statute, not surprisingly many of its ideas coincided with those expressed in the Delors Report. The Delors Report had been agreed upon unanimously by all its members[8] and had been welcomed by the Heads of State as 'a' basis for the preparation of a possible EMU. Even the economic part of the Delors Report, which lay outside the mandate of the Committee of Governors, can be found back in the Treaty of Maastricht, though not necessarily in a satisfactory way – we will come back to this later.

We also conclude that among the governors a major role was played by the German and French central banks, while at least the Dutch central bank also played an important role. The Dutch central bank aimed at preventing isolation of the Bundesbank. It played an important role in steering the Delors Committee towards a clearly formulated (single) objective for monetary policy, and it had (together with the German central bank) a keen sense for issues like political accountability. This last point can be explained by the fact that they – more than the other central banks – were experienced in the accountability demands which are placed on an independent central bank. The French central bank had accepted at an early stage (see section IIA of Art. 7) the independence of the ESCB as a *sine qua non* for the success of the whole enterprise. The other central bank governors shared this view – including the governor of the Bank of England, although he could not commit himself to the ultimate objective of establishing EMU, because his authorities objected to the creation of a federal central bank.[9]

During the IGC no government had tried to limit the independence of the ESCB. As regards the internal design of the System, the most important objective of the Bundesbank was a guarantee that monetary policy in the single currency area would be one and indivisible (requiring in their view a strong presence of the central body in an otherwise federally

[7] Improved transparency, larger role parliament, sharper objective, Treaty-based statute. See examples mentioned in chapter 5.3 after tables 5-1 and 5-2 in cluster I.

[8] Much to the dismay of Mrs Thatcher, the UK prime minister. Later the UK Treasury would present alternative options for monetary integration, based on the idea of competing (and parallel) currencies.

[9] In the final stage of the IGC the UK would negotiate an opt-out clause for itself.

organized system). For the Banque de France the most important principle was that of subsidiarity (read: decentralization) and for the Bank of England transparency and cost-effectiveness. Most smaller countries leaned towards the French view – explicitly described by the Spanish delegate in the IGC as the need to involve all NCBs in the execution of the ESCB's policies.
The leading role played by the Bundesbank can be explained by three factors: first, it was the only central bank that was perceived to be able to block agreement at home, when the outcome would not be satisfactory for itself. This strong domestic position was based on its high degree of political independence and the strong support it enjoyed among the public as successful stability anchor for Germany. Second, its internationally recognized success also introduced the possibility to 'borrow' its credibility by borrowing its characteristics for the new central bank system, especially relating to its independence. Third, conceptually the Bundesbank model lent itself very well as an example for a federally designed European central bank system, because – despite its unitary structure[10] – it was very much a federally designed central bank system itself vested in a federally structured country. This is especially made clear by looking at the origins of the Bundesbank, described in appendix 3 at the end of chapter 11. This made the Bundesbank model a natural compass for the design of the ESCB, more by logic than by force. Therefore, the fact that the ESCB Statute resembles the Bundesbank law more than it resembles the statute of any other EC central bank statute of those days, should not be misread as simply a victory for the German participants. The Bundesbank-model itself was based indirectly on the design of the American Federal Reserve System, both as regards its internal structure and as regards its position as a relatively independent actor alongside other governmental branches,[11] though for historical reasons the Bundesbank was endowed with relatively more independence. For this reason we have added to the genesis of each article a paragraph describing similar articles in the Federal Reserve Act.

Because the governors were able to rely on a natural and credible model and because they paid explicitly and consciously attention to the accountability aspect, they were able to present the IGC a model which was very balanced. Their draft allowed for both a high degree of independence and a high degree of accountability – in fact we conclude that both the ESCB's independence and accountability are stronger than that of the Bundesbank[12] - and it reconciled a high degree of federalism with effective decision-making and operational flexibility, while in addition the IGC ensured a sufficient check on its operational efficiency. As regards transparency, it was not an important issue these days, but according to the then prevailing standards the System allowed for a transparent way of making and communicating policy.
This is not to say that the design could not be improved – we have mentioned examples in the concluding chapters of each of the three clusters, a part of which we repeated above. As an essential feature however stands out the large number of checks and balances incorporated in the Statute. These checks and balances are not so much necessary to bridge opposing views, i.e. they do not constitute compromises, but they allow each party to play its role in the most effective way, promoting co-operation and not deadlock.

[10] The Landeszentralbanken are branches of the Bundesbank.
[11] See appendix 3 on the Bank deutscher Laender, the predecessor of the Bundesbank, at the end of cluster III.
[12] See chapter 5, section 5.2.2 and 5.3.

The fact that the governors were able to play an important role in shaping EMU is in our view due to two factors: first, Delors knew EMU would not have a chance when the Bundesbank would express its opposition;[13] second, the governors, or at least part of them, had an astute feeling for the political acceptability of their ideas on the independence of the ESCB. Though they might resemble an epistemic community, i.e. a network of likeminded experts, [14] it is stretching the argument a bit to contend that the governors were called in by national executives for being such an epistemic community which could achieve international policy coordination, because instead the purpose was rather to bind in the Bundesbank and also because the Committee of Governors was not invited, but volunteered itself to draft an ESCB Statute.[15] This likemindedness was confined to a shared desire for independence, while for some – at least initially – the external component of EMU (breaking the dominance of the dollar and of the Bundesbank) was as important as price stability. This explains the initial emphasis by the French and Italian central bank on establishing a European Reserve Fund in stage two of EMU and on the possibility of a parallel currency.[16]

The system of checks and balances present in the ESCB Statute also complies with the basic norms to which in our view any system of checks and balances should comply. We refer to the eight basic norms mentioned in chapter 2. Indeed, the powers of the ESCB are narrowly circumscribed; it is accountable to the 'democratic complex' through various mechanisms (among which appointment procedures, reporting requirements towards the European Parliament and the executive branch); infringement on rights of others is very limited, because the system and its operating procedures are almost completely market-based;[17] the separation of powers doctrine holds; it has so far proven to be effective; its efficiency though is not clearly proven, though (1) well-informed governors (i.e. informed also by their own staff) make for better decisions, and (2) a small monetary policy decision-making body does not necessarily take better decisions. (In short, the federal structure has advantages from an economic and political point of view, but also brings along costs, mostly borne by the regional NCBs; some of these costs may be self-evident and worthwhile, like local research, collection of local monetary statistics and locally available money market standing facilities[18], other costs may not be as easily defendable. Finally, the rule of law applies (as the ESCB falls within the jurisdiction of the Court of Justice) and the system is democratically, because Treaty-, based.

The 'E' of EMU[19]

We noted earlier that the effectiveness of the system is not completely ensured, because there are external risk factors. Even at the time of the Delors Report the governors were aware of

[13] See chapter 1 under 'Description of the main documents, committees and historical setting', and section II.1A of Art. 7 in cluster I.

[14] See Amy Verdun (1999), p. 311-312, who refers to other arguments used to explain the important role of the governors, one reason being 'the structural changes in the nature and structure of capitalism', which refers to the increased openness of the economies and the increased importance attached to price stability and another reason being the high level of trust among the central bankers – a point also made by us earlier.

[15] See chapter 1.

[16] See also D. Cameron (1995), p. 48.

[17] Exceptions only exist in non-exclusive System functions, like banknote production.

[18] See also Appendix 2 (cluster II)

[19] See chapter 2 in the paragraph on 'checks and balances', Art. 21-ESCB, section II.3 (cluster I), chapter 5.1 and 5.2.1 (under Article 109C).

these risks. Large parts of the meetings of the Delors Committee were devoted to describing the conditions for economic policy that need to be fulfilled in order to have successful monetary integration. The Delors Report made clear that binding fiscal rules would be indispensable (see Delors Report, par. 25, 30 and 33).[20]

We could say that the introduction of national budgetary rules was felt to be a quid pro quo for the surrender of monetary sovereignty. This demand was understandable in view of the very high fiscal deficits then prevailing in some EC countries. Debts were very high too, and due to short maturities debt servicing costs were affected rapidly by changes in interest rates.[21] Budgetary rules were new to most EC countries, only Germany knew the so-called golden financing rule – which allows borrowing only for investment purposes (this rule existed at federal level (Art. 115 Basic Law (version 1969), with a conjunctural escape clause) and at the regional level (Delors Report, p. 104)). Therefore, the recent failure of some Member States to live up to the Treaty provisions regarding the limitation of the deficit (and of the Ecofin to enforce it) is a breach of the checks and balances underlying EMU, and in fact a breach of the conditions of the stability-oriented countries for surrendering their monetary sovereignty.

This breach brings to the fore that the 'excessive deficit procedure' (EDP) - laid down in Art. 104C-EC and clarified in the Stability and Growth Pact – contains a fundamental flaw. The flaw is that in the EDP Ecofin is both legislator, executive and judge.[22] This is in flagrant contradiction to the doctrine of separation of powers; any regime based on such a construction is bound to derail. In the United States discretionary powers are sometimes given to an independent governmental agency or regulatory commission, consisting of non-reappointable board members. This could be copied here, with such a body working on the basis of an authoritative interpretation of the EDP, e.g. taking over from the Ecofin the power to decide on the existence of an excessive deficit and on the imposition of sanctions, based on evidence by the Commission and possibly the Ecofin.[23] (It would seem that at present the Commission cannot fulfil such a function, as in the end the Commission is not only a technocratic, but also a political body, also because it handles so many other politically sensitive dossiers at the

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[20] Par. 25: "…. an appropriate balance between the economic and monetary components would have to be ensured for the union to be viable." Par. 30: "binding rules are required that would: firstly, impose effective upper limits on budgetary deficits of individual member countries of the Community, although in setting these limits the situation of each member country might have to be taken into consideration; secondly, exclude access to [monetary financing]."

[21] Expansionary deficits could not only feed into debt dynamics and possible pressure on the central bank to lower interest rate costs, but such behaviour would also become more likely as the elimination of the national currency took away the exchange rate as disciplining factor – in other words EMU would increase the possibilities for beggar-thy-neighbour policies, in which a country with an expansionary deficit would reap most of the benefits, while the costs, e.g. in terms of higher long-term interest rates, would be shared out over the other EMU members.

[22] The Court of Justice is explicitly sidelined for a large part of the EDP, see Art. 104C(10), though it remains possible to bring the Council of Ministers or the Commission to the Court for reason of 'failure to act' (Art. 175-EC, (Art.232 according to new numbering)), but not Member States for infringement of the rules. The Ecofin, if unanimous, may change the protocol on the Excessive Deficit Procedure containing the specification of the reference value for the fiscal deficit (i.e. 3% of gdp) and may specify (and therefore respecify) the implementation provisions of the EDP, following a proposal from the Commission and after consulting the European Parliament and the ECB; see Art. 104C(14).

[23] One could also imagine this body being responsible vis-à-vis the European Parliament for taking or not taking action.

same time.)[24] In any case, one should extend a formal role to the European Parliament extending beyond consultation, in all cases where the Ecofin wants to amend the interpretation of the fiscal rules contained in the Treaty (or when it wants to amend the Pact). This would end the Ecofin being the only legislator in its own case. Such a solution would achieve a better balance between the Economic and the Monetary part of EMU.
Apart from the procedures one could also consider to improve the rule itself. More emphasis on structural deficits (i.e. corrected for the position in the business cycle) is imagineable, but these lend themselves less well for triggering sanctions, as the exact level of the structural deficit can only be determined with a considerable lag. One could however put more emphasis on monitoring the structural deficit over the whole business cycle, because the seed for excessive deficits is usually sown in the period of economic upswings.[25] In this respect one could give a strong role to the new autonomous body just referred to. However, because doing away with annual targets increases the risk of misjudgements, one should only apply such a rule to countries with a low debt ratio. As long as the debt to GDP ratio is at low levels, one could even consider allowing countries to opt for certain alternative rules, like a balanced current budget over the cycle, which allows borrowing for certain well-defined investment expenditures. But in all cases an independent body remains indispensable to take impartial decisions, including on sanctions. Finally, it is to be expected that tax reductions in a situation where a country is running a deficit close to the three percent of GDP ceiling will become increasingly less effective as an electoral tool to stimulate growth, as in those circumstances consumers will increasingly be aware of the need for the country to raise taxes (or to reduce expenditures) in order to respect the Treaty.[26]

Checks and balances and the draft Constitution
The study of the genesis of the articles of the ESCB Statute fills a blank in the sense that the Treaty of Maastricht does not contain an Explanatory Memorandum – in fact Treaties never do. The closest one can get to such a Memorandum is the Commentary of the Committee of Governors accompanying their draft ESCB Statute of 27 November 1990. Our study allows for a better understanding of the articles, the reasons for their inclusion in the Statute and for their precise formulation. Many articles can only be fully understood when seen in relation to other articles – the cross-references at the beginning of each article show the most important links.
The ESCB came into existence in June 1998. In 2003 a Convention was convened to look inter alia into a simplification and reorganisation of the EU Treaty structure, which would affect the parts agreed in Maastricht as well. The discussions in the Convention resulted in a draft Constitutional Treaty, which was taken up in the subsequent IGC of 2004. The text of the protocol containing the Statute of the ESCB and of the ECB has remained relatively

[24] One could counter that such an independent body would lack authority, whereas the Commission might develop towards a directly elected body or its president might be elected directed, in which case the Commission president would politically come at par with the Heads of State. This would increase his weight and independence. However, this requires a much broader movement towards more supranationalism and less intergovernmentalism.
[25] See also M. Buti, S. Eijffinger and D. Franco (2003), 'Revisiting the Stability and Growth Pact: grand design or internal adjustment', *European Economy, Economic Papers*, No. 180, January 2003. When the structural deficit is under control and at a right level, automatic stabilizers can be allowed to work, i.e. the deficit may breath along with the business cycle and there is no need for pro-cyclical fiscal measures.
[26] The so-called Ricardian equivalence, implying that if the government dissaves more, the public will save more and vice versa.

unchanged; whereas the Convention had focussed on the Treaty text, the presidency of the IGC only once tried to amend the text of the Statute (see chapter 5.3, p. 249), and the ESCB focussed its comments on the texts produced by the Convention, while also suggesting some technical amendments and requesting for the introduction of the term 'Eurosystem' in the Statute (which was granted). The suggestion of the Convention to introduce a first shortened part of the Treaty with the basic (basic in the sense of 'constitutional') articles was adopted by the IGC. The Constitutional Treaty has been signed by the Heads of State and Government on 29 October 2004. It still has to be ratified by all member states. It is therefore referred to as the draft Constitutional Treaty.

A substantial part of Part III of the draft Constitutional Treaty (i.e. Title III containing all articles relating to the Union's Internal Policies and Action, among which the chapters on the Internal Market and Economic and Monetary Policy) can be slightly more easily amended than the other parts of the Treaty, *viz* by unanimity of all Member States including national ratification, but without the need to convene a full-scale IGC first.[27]

Taking a step back we first present which elements relating to the ESCB should in our view have been mentioned upfront in Part I of the Constitution for reasons of visibility and legal protection, because the articles relating to the ESCB and EMU are either mentioned in Part I or Title III of Part III of the Treaty:

- the establishment of the ECB and of the ESCB, consisting of the ECB and the NCBs, to indicate that the monetary competence of the Community (or the Union) has been endowed to the Union itself and not to the executive or legislative branch of the Union
- the ESCB's independence and its (limited) price stability mandate; a broader mandate (e.g. aiming for exchange rate stability or employment objectives) would make the ESCB's independence less acceptable to the political authorities and will reduce its ability to pre-commit to low inflation (see p. 255 in chapter 5.4 for a full list of arguments); the System's secondary objective could be mentioned too
- the concept of stable prices, being a social good and being in the interest of the weaker in society, should also be mentioned among the Union's general objectives
- the ESCB's federal structure not only hinges on the operational role of the NCBs, but also on the membership of the NCB governors of the Governing Council; it would seem important to define in Part I the composition of all institutions mentioned in Part I of the Constitution. The federal decision-making structure of the ESCB also strengthens the system's independent status, reducing the risk it becomes seen and treated as a mere governmental agency.

In addition, one should not lose sight of the fact that monetary policy has been surrendered to supranational level within the context of EMU, i.e. under the proviso of simultaneous economic union. Therefore, the existence of fiscal rules should have Constitutional status (i.e. Part I) as well, the precise form could be spelt out in Part III of the Constitution relating more in detail to the Union's policies.

The draft Constitutional Treaty, which has been approved by the Heads of State or Government in June 2004 and signed on 29 October 2004, can be commented upon in the light of the above. We establish that some very important elements have become part of Part I of the Constitutional Treaty, while others have not, and that in our area in no way improvements have been made.

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[27] Compare Art. IV-443 and IV-445 of the draft Treaty establishing a Constitution for Europe.

The points that have been taken up in Part I are the establishment of the ECB and of the ESCB (defined as encompassing the ECB and the NCBs) with price stability as its primary objective; stable prices are mentioned as one of the (many) objectives of the Union; and the ECB is independent.

A number of important points though are missing. To begin with the last issue mentioned in the one before last paragraph, i.e. EMU, it occurs that the concept of Economic and Monetary Union, which was still mentioned as one of the Community's objectives in Art. 2-EC [28] has altogether disappeared from Part I of the new Treaty text. A logical place to mention EMU would have been Art. I-3 of the new Treaty on the Union's objectives, following the example of Art. 2-EC. This would have safeguarded the idea that Monetary Union does not stand on its own and requires the partly surrender of economic power, which idea has now been disregarded. The only place where 'economic and monetary union' appears is in Articles III-194 and 196 of Title III of Part III, which Title falls under a different (lighter) amendment procedure. Furthermore, we note that the text of the draft Constitutional Treaty puts the ECB and the ESCB in the category Union's Institutions, because they are mentioned under Title IV of Part I ("The Union's Institutions and Bodies"),[29] while they fall outside the institutional framework of the European Union, because the ECB and the ESCB are mentioned in chapter 2 of Title IV of Part I *after* chapter 1 (titled "The institutional framework"). This contradicts a recent Judgment by the Court of Justice in a case involving the specific competences of OLAF (Office européen de lutte antifraude), the Community's anti fraud bureau, with respect to the ECB, in which the Court of Justice puts the ESCB 'squarely within the Community framework'. [30] This issue can be solved by naming Title IV 'The Union's Institutional Framework' and chapter 1 'The Union's Institutions', while keeping the ESCB and the Court of Auditors in chapter 2 covering 'The other Union Institutions and Bodies'. We also note that the composition of the Governing Council is missing in Part I, whereas the compositions of other institutions (the Council of Ministers, the Commission, the Court of Justice and even the Court of Auditors) are mentioned in Part I.

We also observed that the Convention and the IGC did not provide improvements in the checks and balances in the monetary area – in fact they only took some steps backward. The role of the ESCB is a difficult one in this respect, as it is hesitant to produce suggestions for improvement, for fear of opening a Pandora's box. Nonetheless, a well-prepared report pointing to (the need for) improvements might be useful input for any future IGC. This would prevent the ECB from having to operate from the defensive only.[31]

More in general, we learn from the above, in particular from the ease with which changes in the monetary part of the Treaty can be realized, that a central bank is only as independent as its environments accepts, and that the importance of legal independence is easily overstated

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[28] "The Community shall have as its task, by establishing a common market and an economic and monetary union …, ... a harmonious and balanced development of economic activities, sustainable and non-inflationary growth, …" (Art. 2-EC).

[29] Listing the ESCB (or the ECB) as Community (or a Union's) institutions could constitute a route for the legislative branch to force rules on the ESCB which could be detrimental to its independence (think of an obligation to publish voting, but also rules governing the languages).

[30] C-11/00, Commission v European Central Bank, paragraph 92. See also Elderson and Weenink (2003), 'The European Central Bank redefined? A landmark judgement of the European Court of Justice', *Euredia* 2003/2

[31] The ECB does not have the right to propose amendments to the Statute other than technical ones covered by Art. 41-ESCB.

(because amendments are possible, especially when part of larger package deals).[32] At the same time, changes should remain possible, otherwise the system might risk breaking. To paraphrase a Dutch saying: What bends, does not break. However, changes should be costly in political terms, otherwise the Treaty or Statute does not provide stability.

In sum, we conclude the ESCB Statute is full of checks and balances, as defined in chapter 2. We distinguished three areas of checks and balances: checks and balances vis-à-vis the outside (political) world, intra-System checks and balances (i.e. between the ECB and NCBs) and checks and balances within the Governing Council (i.e. between the Executive Board and the NCB governors). We developed a definition and categorization of checks and balances, which allows us to study in a systematical way federal structures, characterized by non-hierarchical relations between entities sharing power. The definition and categorization led us to find a number of instances where the checks and balances could be improved.

Finally, we think that the concept of checks and balances, which formed the looking glass through which we looked at the design of the European System of Central Banks, is better approached by Churchill's words of 1946, when he said "The structure of the United States of Europe, if well and truly built, will be such as to make the material strength of a single state less important. Small nations will count as much as larger ones and gain their honour by their contribution to the common cause" [33] than by Thucydides' words of around 400 BC when he wrote "Our Constitution ….. is called a democracy, because power is in the hands not of a minority but of the greatest number." (Thucydides II: 37, cited in the Preamble of the draft Treaty establishing a Constitution for Europe by the European Convention (July 2003).)

[32] See also Issing in De Haan ed. (2000), p. 154-5. In this respect we can point to calls by the Italian prime minister Berlusconi and French president Chirac to broaden the mandate of the ECB to include the promotion of economic growth (Handelsblatt, July 15, 2004), to the aborted efforts by the Italian presidency of the IGC to introduce a simplified amendment procedure for a few core articles of the Statute, and to the way the enabling clause relating to Art. 10.2-ESCB was tabled at a very late moment of the 2000-IGC (see p. 465-7 in chapter 11.2.4)

[33] Winston Churchill, speech Zürich, Switzerland, 19 September 1946.

ANNEX 1: SELECTION OF ARTICLES *(AND DIVISION OVER CLUSTER I, II AND III)*

Article	Cluster (I, II or III) [1]	Selected for further analysis [2]
1 Constitution	I	x
2 Objectives	I	x
3.1-2 Basic tasks	I	x
3.3 Prudential supervision and financial stability	II	x
4 Advisory tasks	I	- (dealt with under Art. 109c(2)-EC)
5 Statistical task	II	x
6 External representation	II	x
7 Independence	I	x
8 ESCB governed by ECB's decision-making bodies	I	- (dealt with under Art. 1)
9.1 and 9.3 ECB	I	- (dealt with under Art. 1)
9.2 ECB	II	- (dealt with under Art. 12.1c)
10.1 GovC	III	x
10.2-3 and 10.5 GovC voting	III	x
10.4 Minutes	I	x
11.1 Composition Exec. Board	III	- (dealt with under Art. 11.2)
11.2 and 11.7 Personal and financial independence Board	I	x
11.3-5 Exec. Board	I	- [3]
11.6 Board's current business	III	x
12.1(a+b) Own powers GovC and Exec. Board	III	x
12.1c Decentralized execution	II	x
12.2 Board prepares GovC	III	x
12.3-5 GovC other responsibilities	III	x
13.1 President chairs	III	-
13.2 President represents	III	-

[1] Cluster I (relations with other public institutions); cluster II (ECB vis-à-vis NCBs); cluster III (roles Executive Board and NCB governors). Some articles are relevant for more than one cluster. E.g. the articles determining the voting procedures (Art. 10.2) and the composition of the Governing Council (Art. 10.1) are relevant for the relation between the governors and the Executive Board, but also for the independence of the System (as a large body is less easily put under effective political pressure than a small board), and for the way Art. 12.1c-ESCB, containing the principle of decentralization, is applied. Art. 15 is relevant for the System's external accountability, but at the same time this responsibility falls mostly onto the president of the ECB and the Executive Board.

[2] Articles not selected are of a technical nature or otherwise less important for the focus of this study, i.e. the study into the checks and balances. It should be noted that Articles 43-53 of Chapter IX of the Statute ('Transitional and other provisions for the ESCB') are not dealt with here. They relate mostly to derogation countries, which subject is outside the focus of this study. However, an exception is made for Article 50 (Initial appointment of the members of the Executive Board) and for Article 51 (Derogation from Article 32), because these articles shed light on Articles 11 and 32 respectively.

[3] Articles 11.3, 11.4 and 11.5 are touched upon chapter 5.2.2, chapter 4 (Art. 7, section I.1) and chapter 11.2.1 (Art. 10.3) respectively.

Article	Cluster I, II or III	Selected for further treatment
NCB statutes and independence governors	I	x
14.3 NCBs integral part ESCB	II	x
14.4 Non-System functions NCBs	II	x
15 Financial reporting	I	- (dealt with under Art. 109b-EC)
16 Banknotes	II	x
17-20 and 22-24 (Monetary functions and operations)[4]	II	x
21 Operations with public entities	I	x
25 Prudential supervision	II	x (dealt with under Art. 3.3)
26 Financial accounts	II	-
27 Auditing	I	x
28 ECB capital and shareholders	I	x
29 Capital key	II	x
30-31 ECB and NCB reserves	II	x
32-33 and 51 Financial provisions	II	x
34-38 General provisions	I	-
39-40 General provisions	III	-
41 Simplified amendment procedure	I	x
42 Complementary legislation	I	- (dealt with under Art. 41)
50 Initial appointment Board	I	- (dealt with under Art. 11.2)
51 (see above 32-33)		
43-49, 52-53 Transitional provisions (not dealt with)		

Many of these articles have also been incorporated in the Treaty. Such duplication was accepted because the ESCB Statutes should remain self-contained and self-reading. Three important articles, which are mentioned only in the main text of the EC Treaty (and not in the ESCB Statute), are also analysed in the context of the first cluster, i.e. Article 109, paragraphs 1 and 2 (Exchange rate policy), Article 109b (Interinstitutional dialogue) and Art. 109C(2) (Economic and Financial Committee).

Whenever there is a relationship between an article and other articles of the ESCB Statute, these articles are listed at the beginning of the treatment of the genesis of such article, which constitutes a useful overall cross-reference. At the end of the book there is a separate index for each article mentioned in this study, whether ESCB or EC Treaty article.

[4] Articles 17-20 and 23 empower the ESCB to use its money market and financial market instruments at its own discretion (that is without approval by the Council of Ministers). Therefore, they constitute the backbone for the 'functional independence' of the System. However, relations with the markets and financial institutions are dealt with under the second cluster, because these articles relate strongly to the relative competences of the ECB and the NCBs.

ANNEX 2: GENERAL OVERVIEW OF SOURCES RELEVANT FOR THE GENESIS OF THE ARTICLES

The sources used for this study can be divided over three periods: the period of the Delors Committee, the drafting of the ESCB Statute and the IGC.

Delors Committee period

The main document is the Delors Report, including a collection of papers submitted to the Committee, partly at the initiative of the members of the committee, partly at the request of the chairman (annexed to the Report). Also important are the draft versions of the Delors Report (made available for research purposes due to the courtesy of dr Szász). In addition, internal reports[1] have shed light on the discussions in the Committee. The Delors Committee met eight times [2] and produced 5 (sometimes only partial) draft versions of its report. Other important documents are: the Genscher memorandum, the Stoltenberg memorandum, the press conference of the Bundesbankpresident on May 1988, the conclusions of the European Council summits of June 1988 and June and December 1989. These documents have been published either in HWWA (1993)[3] or in the Presseauszüge of the Bundesbank.
Other reference documents are: the Werner Report and a number of autobiographies Lawson (1992), Thatcher (1993), Kohl (1996) and the voluminous study by Dyson and Featherstone (1999).

Period of drafting the ESCB Statute

The Committee of Governors met four times at the level of governors [4] and more than ten times on the level of the Alternates[5] and they discussed numerous internal draft versions of the ESCB Statute. The basic document is the draft Statute of 27 November 1990 (published in HWWA (1993)), which was sent to the IGC. The draft contained a limited number of bracketed elements, indicating where the governors had not been able to agree among themselves. On 26 April 1991 a new version was sent to the IGC, now including the chapter on financial provisions (chapter VI), a chapter on general provisions (chapter VII) and proposals for a simplified amendment procedure and complementary Community legislation (chapter VIII) (CONF-EMU 1613/91, 29 April 1991). On 28 October a draft version of chapter IX (Transitional Provisions)[6] was transmitted to the IGC, together with a draft version

[1] There are no official minutes of the meetings of the Delors Committee. The internal reports are based on debriefings to staff.
[2] On 13 September, 10 October, 8 November, 13 December 1988 and on 10 January, 14 February, 14 March and 11 and 12 April 1989.
[3] HWWA (1993) stands for a study by Krägenau and Wetter, who brought together a large volume of documents relating to European monetary integration, which was published in 1993 by the **HWWA**-Institut für Wirtschaftsforschung – Hamburg.
[4] On 10 July, 11 September, 13 November 1990 and 9 April 1991. In the second half of 1991 the governors met to discuss the draft EMI Statute and the chapter on transitional provisions.
[5] Alternates: 29 May, 18 June, 29 June, 9 July, 20 July, 3 September, 9 September, 15-16 October 1990 and 10 February, 10 March and 7 April 1991. Apart from this, several specialized committees or ad hoc working groups met over the period summer 1990 - spring 1991 to discuss legal, monetary and supervisory aspects. (Not mentioned are the meetings of the Alternates spent on drafting the EMI Statute and the chapter on transitional provisions, which took place in the second half of 1991.)
[6] Later renamed into 'Transitional and other provisions'.

of the EMI Statute. All draft versions of the draft ESCB Statute are available through the courtesy of dr Szász. There are no official records of the meetings of the Alternates. The author based himself on internal reports by the participants of the Nederlandsche Bank. The discussion among the governors has been recorded in minutes. Many of the arguments used in the discussions between the central bankers were also reflected in official speeches, a number of which are published at the end of this book (speeches by Bundesbankpresident Pöhl and the French governor de Larosière) – see Annex 3.

Period of IGC

The IGC met 14 times at the ministerial level[7], 23 times at the deputies level [8]and 6 times at the level of the EMU Working Group[9]. This Working Group, chaired by Dutch civil servant Bernard ter Haar, redrafted the Treaty texts on the basis of the outcome of the discussions at the Deputies level and sometimes solved problems for them. The author attended most of the IGC meetings at the Deputies level, chaired by Yves Mersch and Cees Maas in the first and second half of 1991 respectively, and most meetings of the EMU working group. There were also six informal Ecofin meetings (joint meetings of ministers of finance and governors).[10] The delegations and presidency of the IGC produced 120 UEM-documents over the course of one year. All these documents were numbered, with numbers starting with UEM/../year, for instance UEM/34/91. Many of these documents were made public by Agence Europe.[11]
Important IGC documents are: the draft Treaty text of the Commission, France and Germany (published in HWWA (1993)[12]. Other important conference documents are the Luxembourg presidency's non-paper of 10 May and its reference document of 18 June (CONF-UP-UEM 2008/91) and the Dutch presidency's draft Treaty text (UEM/82/91) of 28 October (all printed in HWWA (1993). The Dutch presidency presented new consolidated versions on 22 November (UEM/112/91), on 28 November (UEM/118/91) and 5 December (CONF-UEM 1620/91). The draft Treaty version of 5 December is available in the Metten-archives.[13] Many other conference documents have been published by Agence Europe. There are no official minutes of IGC meetings. Most of the drafting took place at the level of the deputies (or the EMU working group). The exchange of views between the delegations was witnessed by the author as a member of the Dutch delegation and made it possible to understand the evolution of the wording of the draft articles.

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[7] Ministers: 15 December 1990 and 28 January, 25 February, 18 March, 8 April, 10 June, 9 September, 7 October, 11-12 November, 20-21 November, 25 November, 1 December, 2-3 December 1991, 9 December 1991.

[8] Deputies: 15 January, 29 January, 19 February, 26 February, 12 March, 19 March, 2 April, 9 April, 23 April, 10 May, 21 May, 4 June, 2 July, 9 July, 3 September, 10 September, 1 October, 8 October, 22 October, 5 November, 13 November, 26 November, 30 November 1991.

[9] Working Group: 17 October, 30-31 October, 6 November, 14 November, 18-21 November, 26-28 November 1991.

[10] 20 May 1989 (s'Agaro), 9 September 1989 (Antibes), 31 March 1990 (Ashford Castle), 8 September 1990 (Rome), 11 May 1991 (Luxembourg), 20-21 September 1991 (Apeldoorn).

[11] International treaties are prepared in a peculiar way. There are no parliamentary discussions, there are no official records, there is no official Commentary. However, during the IGC the French press agency (Europe) published many interim conference documents.

[12] Most documents in HWWA (1993) are published in German translation.

[13] These archives are available for research purposes through the Institute of Social Sciences and History in Amsterdam. The archives contain documentation used by Alman Metten (the Member of the European Parliament) and Bart van Riel (assistant to the Dutch socialist party members of the European Parliament) in writing 'The Choices of Maastricht' (Van Riel and Metten, 2000), only available in Dutch.

Other useful documents of the same period:
Commission documents: 'Economic and Monetary Union', 21 August 1990 (published in HWWA (1993)); 'Central bank legislation in 16 countries', Commission document II/77/90, January 1990, circulated to the Monetary Committee (available in the Metten-archives), circulated to the Monetary Committee as II/77/90-EN.
Monetary Committee document: 'Economic and Monetary Union beyond Stage 1: Orientations for the Preparation of the Intergovernmental Conference' (version of 26 March 1990, published by Europe (Europe Documents, no. 1609, 3 April 1990) and final version of 23 July 1990 published in HWWA (1993).
Germany: Stellungnahme der Deutschen Bundesbank zur Errichtung einer Wirtschafts- und Währungsunion in Europa, 19 September 1990 (published in HWWA (1993)).

All these documents and the records of the meetings have been studied to trace the genesis of those articles considered most important for the constitution of the ESCB.

ANNEX 3: EXCERPTS FROM SPEECHES BY PÖHL AND DE LAROSIÈRE IN THE PERIOD 1988-1991

Excerpts from speeches by Pöhl and De Larosière from the period 1988-1991 relating to the future ESCB (Source: Deutsche Bundesbank, Auszüge aus Presseartikeln)

Pöhl

1. Excerpt from 'Die Zukunft der Deutschen Mark in der europäischen Währungsintegration', Vortrag von Bundesbankpräsident Karl Otto Pöhl auf der Jahrestagung des Vereins für Socialpolitik am 7. Oktober 1988 in Freiburg i. Br.[1]

Die radikalste, aber auch 'sauberste' Lösung für das Problem einer Vergemeinschaftung der Geldpolitik in einer Währungsunion wäre die Schaffung eines europäischen Notenbanksystems, etwa analog zum Federal Reserve System der USA.

Ein europäisches Notenbanksystem müßte unmißverständlich auf das Ziel verpflichtet werden, für Preisstabilität zu sorgen.

Die Aufgabe, für Preisstabilität zu sorgen, wird zumindest erleichtert, wenn nicht überhaupt erst ermöglicht, wenn ein europäisches Notenbanksystem ausreichend unabhängig in seiner Willensbildung und in seiner Entscheidungsfindung ist; unabhängig nicht nur von nationalen Regierungen, sondern auch von den Einrichtungen der Europäischen Gemeinschaft, also von der Kommission und vom Ministerrat.

Stabilisierung der Wechselkurse kann und darf deshalb nicht das primäre Ziel der Geldpolitik sein. Sie kann mit ihrer eigentlichen Aufgabe allzuleicht in Konflikt geraten. Das heißt aber nicht, daß es keinen Spielraum für währungspolitische Kooperation mit Ländern außerhalb der Gemeinschaft gibt, die auch Interventionen an den Devisenmärkten beinhalten kann. Eine europäische Notenbank, die dafür verantwortlich wäre, müßte deshalb zumindest einen Teil der jetzt noch nationalen Währungsreserven definitiv erwerben und verwalten.

Realistischerweise muß man wohl davon ausgehen, daß Regierungen und Parlamente in Europa in absehbarer Zeit nicht bereit sind, ihre geldpolitische Souveränität auf eine supranationale Institution wie eine europäische Notenbank zu übertragen. Bezeichnenderweise kommt das Wort europäische Zentralbank und europäische Währung in dem Kommuniqué von Hannover auch gar nicht mehr vor.

[1] Bundesbank, Presseauszüge, Nr. 75, 13 October 1988.

2. Excerpt from: 'Anforderungen an eine europäische Wirtschafts- und Währungsunion'[2]

Ein europäisches Notenbanksystem lässt sich wohl nur dezentralisiert, föderalistisch organisieren, also nach dem Subsidiaritätsprinzip, wonach nur dass zentralisiert wird, was unbedingt nötig ist, und soviel wie möglich an nationalen Kompetenzen erhalten bleibt. Eine europäische Notenbank sollte also mehr dem Bundesbank-System oder dem Federal-Reserve-System in den USA ähneln als dem zentralisierten Aufbau der Notenbanken in den meisten europäischen Ländern.

3. Excerpt from: 'Grundzüge einer europäischen Geldordnung'. Rede von Karl Otto Pöhl, Präsident der Deutschen Bundesbank, bei einer Vortragsveranstaltung von 'Le Monde' am 16. Januar 1990 in Paris[3]

Wie läßt sich diese Grundbedingung einer Währungsunion sicherstellen, wenn die Zuständigkeit für die Geldpolitik von nationalen Institutionen auf eine Gemeinschaftseinrichtung übertragen wird? Die historische Erfahrung zeigt, daß dies am besten von einem System zu erwarten ist, das von politischen Weisungen unabhängig ist. Dies gilt für die EG in noch höherem Maße als für Nationalstaaten, weil in einer Konföderation wie der EG immer die Tendenz besteht, sich an Durchschnitten und Kompromissen zu orientieren, was aber der schlechteste Kompaß für die Geldpolitik ist. Nur eine unabhängige Institution ist auch in der Lage, den in der Praxis immer wiederkehrenden Wünschen der Politik zu widerstehen, der Geldpolitik Ziele vorzugeben, die mit dem Stabilitätsziel häufig unvereinbar sind, etwa die Stabilisierung von Wechselkursen oder Förderung von Wachstum und Beschäftigung oder Ausgleich regionales Ungleichgewichte.

Mit dem Beschluß, Ende des Jahres bereits mit Vertragsverhandlungen über ein Europäisches Notenbanksystem zu beginnen, haben die Regierungen sich dazu verpflichtet, Farbe zu bekennen, ob sie tatsächlich bereit sind, die Entscheidung über die Geldpolitik in Zukunft einer unabhängigen Gemeinschaftsinstitution übertragen zu wollen. Ich hätte es für besser gehalten, zunächst einige Jahre Erfahrungen mit der 'Ersten Stufe' einer Wirtschafts- und Währungsunion zu sammeln und erst einmal das zu verwirklichen, was bereits beschlossen worden ist, insbesondere den Binnenmarkt, die Liberalisierung des Kapitalverkehrs, die Steuerharmonisierung etc., bevor man weiterreichende institutionelle Schritte ins Auge faßt. Aber ich respektiere selbstverständlich die Entscheidung der Staats- und Regierungschefs und verstehe auch die dahinter stehende politische Motivation.

Das System wäre ausreichend demokratisch legitimiert, wenn es durch einen Vertrag zwischen demokratischen Regierungen zustande käme, der durch demokratisch gewählte Parlamente ratifiziert und mit einem klar definierten Mandat versehen würde. Darüber hinaus könnten die Direktoriumsmitglieder durch den ECOFIN-rat, die Ratsmitglieder durch die

[2] Aussenwirtschaft (The Swiss Review of International Economic Relations), 43. Jahrgang (1988), Heft IV, 455-459.
[3] Bundesbank, Presseauszüge, Nr. 4, 16 January 1990.

nationalen Regierungen bestellt werden. Die Rechnungsführung (nicht die Geld- und Währungspolitik!) könnte durch einen neutralen Rechnungshof geprüft werden.

Sehr viel schwieriger als die Frage der "demokratischen Kontrolle" ist die Frage zu beantworten, welche Funktionen den nationalen Notenbanken verbleiben. Auch hier sollte der Grundsatz der Subsidiarität gelten, d.h. nur die Aufgaben sollten auf die Gemeinschaftsinstanz übertragen werden, die auf nationaler Ebene nicht befriedigend erfüllt werden können, soweit hierdurch nicht die Erfordernisse einer einheitlichen Geldpolitik "aus einem Guß" tangiert werden. Dies sind in erster Linie alle Entscheidungen über Zinsen, Liquidität und Geldmenge, d.h. die Geldpolitik im eigentlichen Sinne. Das muß notwendigerweise auch Entscheidungen über Kauf und Verkauf von Drittwährungen (vor allem Dollars) umfassen, weil davon direkt Wirkungen auf Liquidität und Geldmenge ausgehen. Damit verbunden ist das schwierige Problem der Übertragung von Devisenreserven auf Gemeinschaftseinrichtungen und die Entscheidung darüber, wem die Erlöse daraus zufließen sollen. Trotz dieser weitreichenden Befugnisse könnte das EZBS mit einem vergleichsweise kleinen Stab auskommen, etwa analog zum Board of Governors des Federal Reserve Systems, denn exekutive Funktionen könnten weitgehend auf die eingespielten Apparate der nationalen Notenbanken übertragen werden, die dann im Gemeinschaftsauftrag handeln würden. Abwicklung des Zahlungsverkehrs, Offenmarktgeschäfte mit Banken, Auftragsgeschäfte für staatliche Institutionen u.a. könnten durchaus – im Rahmen der Richtlinien und Weisungen des EZBS – von nationalen Notenbanken ausgeführt werden. Darüber hinaus sollte meines Erachtens den nationalen Notenbanken die Zuständigkeit für die Banken- und Börsenaufsicht übertragen werden, soweit das wie z.B. in der Bundesrepublik noch nicht der Fall ist. Die nationalen Notenbanken würden also eine ähnliche Rolle spielen wie die Federal Reserve Banks in den USA oder die Landeszentralbanken im System der Bundesrepublik. Die Kompetenz für eine eigenständige Geldpolitik müßten sie (und/oder die Finanzminister!) jedoch zwangsläufig abgeben. Insbesondere für die Bundesrepublik hätte dies weitreichende Folgen. Der Zentralbankrat, heute das oberste geldpolitische Entscheidungsgremium, würde seine wichtigste Funktion verlieren, eine Konsequenz, die vielleicht noch nicht jedem Befürworter eines EZBS in der Bundesrepublik klar geworden ist.

Auch eine starke und unabhängige Notenbank kann ihre Aufgaben nur erfüllen, wenn ihre Politik nicht durch die Fiskalpolitik konterkariert wird. Deshalb muß vertraglich festgelegt werden, daß der effektive Einsatz der Notenbankinstrumente nicht durch Art und Umfang staatlicher Mittelaufnahmen in unerwünschter Weise behindert oder beeinflußt werden darf.

Ein ausreichendes Maß an Selbstdisziplin auf allen staatlichen Ebenen könnte die Notwendigkeit bindender Regeln für die Finanzpolitik auf ein Mindestmaß reduzieren oder sie sogar überflüssig machen. Solche bindenden Regeln, mit Obergrenzen für die Haushaltsdefizite einzelner Mitgliedsländer, hatte bekanntlich der Delors-Bericht für erforderlich gehalten, auch um 'einen kohärenten Mix aus Finanz- und Geldpolitik' in der Gemeinschaft zu gewährleisten. Wo solche Bedingungen ansetzen sollen, wie sie zu bemessen wären, wie sie durchgesetzt werden könnten, darüber bestehen bis jetzt noch keine sehr klaren Vorstellungen.

4. Excerpts from: 'Two monetary unions – the Bundesbank's view'. Lecture by Karl Otto Pöhl, President of the Deutsche Bundesbank, at the Institute for Economic Affairs, London, July 2, 1990[4]

Monetary policy cannot be subdivided; it has to be of one piece.

The notion of a European Central Bank determining the broad guidelines for monetary policy in the Community, and national central banks implementing them with a large degree of freedom in accordance with the special circumstances of their national economies and the needs of their financial markets, would in my view be unacceptable as a basis to build on.
Even though, for well-understood reasons, the ECBS would in all likelihood have a federal structure, with one central bank per member, the central element would have to be strong enough to assure policy consistency and operational efficiency. A strong central element would also underpin the independence of the system from Community and Government interference. As members of the Governing Board of an ECBS, the national central bank governors will be expected to act without any national mandate, responsible only to the objectives laid down in the ECBS Statute and to its rules-book. It would nevertheless be wise to have a strong central element, call it a Directorate or otherwise, whose members would be an integral part of the Governing Board and would in the nature of things give added force to the system's autonomy in the day-to-day of its task.
The framework of the ECBS as outlined in more detail in my Paris lecture[5] and the distribution of tasks does not rule out the possibility that certain responsibilities that are not central to the pursuit of a consistent monetary policy could be left in the hands of national central banks acting as the operational arm of the system. The settlement of payments, open market operations with the banks, business on behalf of government institutions and the like could well be taken care of by the national central banks – acting in accordance with the guidelines and instructions of the ECBS. In addition, the national central banks should, in my opinion, be made responsible for bank and stock exchange supervision where this is not already the case, as, for example, in the Federal Republic of Germany. This means that the national central banks would play a role similar to that of the Federal Reserve Banks in the United States or the Land Central Banks in the Federal Republic of Germany.

I believe a high degree of autonomy bestowed upon an ECBS in its sphere of competence should not be equated with lack of accountability. If there is agreement that inflation is democracy's enemy No. 1, success in ensuring price stability should be taken as adequate testimony to the central bank's accountability.
I believe that the future ECBS should also be responsible for the management of the foreign currency reserves and for intervention in the exchange markets, subject to any agreements that may be concluded at government or Community level involving the exchange rate regime. The ECBS would, of course, have an important role in any such agreement for the simple reason that commitments in the area of exchange rates and intervention have direct implications for monetary policy. It is important that operations in foreign exchange markets should not undermine the central objective of price stability.

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[4] Bundesbank, Presseauszüge, Nr. 54, 27 July 1990.
[5] "Basic Features of a European Monetary Order", Paris, January 16, 1990.

De Larosière

5. Excerpt from: 'National Monetary Policy and the Construction of European Monetary Union'. Rede von Jacques de Larosière, Gouverneur der Banque de France auf dem Zweiten Internationalen Frankfurter Bankenabend, Frankfurt, 8. November 1989[6]

While monetary union is not an absolutely indispensable condition for the working of the single market, it is nevertheless its logical extension.

[…] the use of a common currency would reduce transaction costs, fostering intra-European exchanges; beyond the frontiers of the Community, it would provide Europe with a monetary identity commensurate with its commercial power and allow it to play a more active role in the international monetary system.

[…] nor should we lose the benefits of what has been achieved so far in terms of progress towards non-inflationary convergence by a certain number of States. We need to build on this achievement and start to put in place an institutional framework leading to a European System of Central Banks. The latter will have in charge the shaping of a common monetary policy, the introduction of an intra-European fixed parity system and, in due time, the issue of a common currency. Needless to say, any such construction would be meaningless unless directed towards monetary stability, which is the pre-condition of all enduring growth, and unless it is based on sound, credible institutions enjoying adequate autonomy vis-à-vis national governments and Community institutions. The Delors Committee Report, unanimously adopted by the Governors of the Central Banks, is especially clear on these different issues.
Economic and monetary union implies not only a common monetary policy; it also requires the support of compatible and consistent economic policies, notably in the fiscal sphere and with regard to changes in economic structures.

6. Excerpts from: 'European Economic and Monetary Union: what is at stake, and the main points at issue between its member countries'. Speech by Mr. Jacques de Larosière, Governor of the Banque de France, to the Siparex Club, Lyon, February 26, 1990[7]

I would add that the speed of monetary decisionmaking required by the markets would scarcely be compatible with the workings of an intergovernmental institution whose members would be bound by possibly divergent national instructions. Running a monetary policy on the scale of the European union presupposes that the competent institution has decisionmaking powers and hence autonomous managing organs.

Rather than speak in terms of 'abandoning' sovereignty, perhaps we ought to think in terms of sharing sovereignty inside a balanced institution in which everyone can have his say. Hence the advantage of broad geographical participation by all the member countries of the EEC in

[6] Bundesbank, Presseauszüge, Nr. 89, 10 November 1989.
[7] Bundesbank, Presseauszüge, Nr. 23, 19 March 1990.

the construction envisaged. One of the points needing to be spelled out in this respect concerns the way in which the future institution will report to the political organs of the Community. This is what the English-speaking world calls 'accountability'. This is an essential notion. The terms on which the leaders of the European Central Bank System are appointed, and how they report on their work will be key elements in the answer. Beyond these legal aspects, however, institutional relations will also depend on how the Council of Ministers and the European executive successfully reinforce their own decisionmaking powers with regard to the framing of economic policy on a European scale, since any monetary policy needs to be part of a broader macroeconomic framework.

Obviously, countries' fiscal policies, particularly those of the major Community members, can have a substantial macroeconomic impact on their partners. Indeed, a series of fiscal slippages would make it very difficult, and ultimately impossible, to achieve the goal of stability. ..... a surge in public expenditure in one member country (which nowadays often goes hand in hand with an external deficit) will no longer push the balance of payments into deficit or weaken its exchange rate relative to its partners (in the present state of affairs this represents a serious warning signal). Consequently, the task of correcting fiscal imbalances will fall essentially on the attitude of the capital markets toward this or that public-sector signature. It is to be feared that any such corrective intervention will take time, less because of the market's myopia than because operators may have their own interpretation of what would happen if a member state of the Economic and Monetary Union became overindebted.

So one can see why the authors of the Delors Committee report envisaged more direct, more binding formulas in order to limit the possible drawbacks of fiscal deficits. Hence the idea of placing a ceiling on Member States' public-sector deficits, under certain conditions. This is a politically sensitive point and will be the subject of discussion. The proposal assumes a collective definition of what represents a tolerable fiscal deficit, i.e. in fact a case-by-case analysis of the medium-term viability of a deficit and public-sector debt.

Two notions strike me as worth underlining in this respects:

- the principle of 'subsidiarity' which is posited as one of the bases of the Delors Committee Report, is a key element in the discussion. New powers given the European institutions should be strictly confirmed to what cannot be done by national bodies;
- from this point of view, the existence of a European framework for achieving macroeconomic coherence in fiscal matters does not appear to be incompatible with the existence of autonomous national fiscal policies, and hence with national policies regarding broad priorities. What is at issue is not national choices, but the compatibility of the financial consequences of all these choices with the pursuit of the Union's 'collectively agreed' objective of monetary stability.

..... great hopes ride on the success of Economic and Monetary Union. The hope for a strong Europe (it has the largest share of world trade), for faster economic growth, for a stable, powerful financial centre capable of decisively influencing the workings and evolution of the International Monetary System.

7. Excerpts from: 'Union Monétaire Européenne'. Intervention de M. de Larosière, Gouverneur de la Banque de France, devant l'Association Europe et Entreprises, 20 september 1990[8]

Les Gouverneurs de la C.E.E. s'emploient dès maintenant à donner un contenu au statut du futur "système Européen de Banques Centrales". Si tous les points concernant l'organisation et le fonctionnement du futur système ne sont pas encore réglés en détail, un accord se dessine déjà pour une structure de type fédéral, regroupant les actuelles banques centrales nationales autour d'une institution centrale qui devra disposer du pouvoir essentiel de formulation et de décision en matière de politique monétaire.
Cette organisation à deux niveaux permettra une répartition des tâches entre institutions nouvelles et anciennes tenant compte du principe de subsidiarité, principe posé par le rapport Delors comme un des éléments essentiels de la construction européenne en cours. Ce principe signifie que les pouvoirs nouveaux donnés aux institutions centrales doivent être strictement limités à ceux qui ne peuvent être assurés par les instances nationales dans des conditions satisfaisantes pour l'ensemble.

8. Excerpt from: 'Stabilität ist der Schlüssel zum Erfolg in Europa'. Von Jacques de Larosière, Gouverneur der Banque de France, Die Welt, Bonn, vom 2. November 1990[9]

Die Präsidenten der Zentralbanken der EWG sind dabei, letzte Hand an die Abfassung der Satzung des künftigen 'Europäischen Zentralbanksystems' zu legen. In diesem System sollen im Rahmen einer föderalen Struktur die gegenwärtigen nationalen Zentralbanken um eine zentrale Institution gruppiert werden, die auf dem Gebiet der Währungspolitik ungeteilt über die wesentliche Formulierungs- und Entscheidungsbefugnis verfügt.

9. Excerpts from: 'Die Europäische Währungsunion'. Vortrag von Jacques de Larosière, Gouverneur der Bank von Frankreich, vor dem Finanzausschuß des Deutschen Bundestages, Bonn, vom 18. September 1991[10]

Der Entwurf des Statuts des Europäischen Zentralbanksystems und der Europäischen Zentralbank, der Ende November vom Ausschuß der Notenbankgouverneure den Finanzministern der Gemeinschaft zugeleitet wurde, sieht eine föderative Struktur vor, bei der die derzeitigen nationalen Zentralbanken in einer zentralen Institution zusammengeschlossen sind, die über die erforderliche Unabhängigkeit und die wesentliche Formulierungs- und Entscheidungsbefugnis auf dem Gebiet der Geldpolitik verfügen muß. Die Unteilbarkeit der Geldpolitik ist in diesem Statutenentwurf klar und deutlich festgeschrieben.
Um ein demokratisches Funktionieren der Institutionen zu gewährleisten, wird es notwendig sein, die Art und Weise festzulegen, in der die künftige Institution den politischen Instanzen der Gemeinschaft gegenüber rechenschaftspflichtig ist, das, was die Angelsachsen

[8] Bundesbank, Presseauszüge, Nr. 74, 26 September 1990.
[9] Bundesbank, Presseauszüge, Nr. 85, 2 November 1990.
[10] Bundesbank, Presseauszüge, Nr. 69, 19 September 1991.

'accountability' nennen. Es handelt sich hier um einen wesentlichen Begriff, den die EG-Notenbankgouverneure bei ihrem Entwurf des Statuts des künftigen Europäischen Zentralbanksystems nicht aus den Augen verloren haben.
Dieser zweistufige Aufbau ermöglicht eine Aufteilung der Aufgaben zwischen den neuen und den alten Institutionen auf der Grundlage des Subsidiaritätsprinzips, das im Delors-Bericht eines der wesentlichen Elemente des im Gang befindlichen europäischen Aufbauwerks darstellt. Dieses Prinzip bedeutet, daß die den zentralen Institutionen zugewiesenen neuen Kompetenzen streng auf die Aufgaben beschränkt sein müssen, die von den nationalen Instanzen nicht unter für das Ganze befriedigenden Bedingungen wahrgenommen werden können.

ANNEX 4: PROTOCOL ON THE STATUTE OF THE EUROPEAN SYSTEM OF CENTRAL BANKS AND OF THE EUROPEAN CENTRAL BANK*

THE HIGH CONTRACTING PARTIES,

DESIRING to lay down the Statute of the European System of Central Banks and of the European Central Bank provided for in Article 4a [8] of the Treaty establishing the European Community,

HAVE AGREED upon the following provisions, which shall be annexed to the Treaty establishing the European Community.

CHAPTER I

CONSTITUTION OF THE ESCB

Article 1

The European System of Central Banks

1.1. The European System of Central Banks (ESCB) and the European Central Bank (ECB) shall be established in accordance with Article 4a [8] of this Treaty; they shall perform their tasks and carry on their activities in accordance with the provisions of this Treaty and of this Statute.

1.2. In accordance with Article 106(1) [107(1)] of this Treaty, the ESCB shall be composed of the ECB and of the central banks of the Member States ('national central banks'). The Institut monétaire luxembourgeois will be the central bank of Luxembourg.

* Protocol annexed to the Treaty establishing the European Community.
See also OJ C 191, 29.7.1992, p. 78. Article numbers referring to the EC Treaty are followed by square-bracketed new numbering as introduced by Treaty of Amsterdam (1997).

CHAPTER II

OBJECTIVES AND TASKS OF THE ESCB

Article 2

Objectives

In accordance with Article 105(1) of this Treaty, the primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 of this Treaty. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a [4] of this Treaty.

Article 3

Tasks

3.1. In accordance with Article 105(2) of this Treaty, the basic tasks to be carried out through the ESCB shall be:

— to define and implement the monetary policy of the Community;

— to conduct foreign-exchange operations consistent with the provisions of Article 109 [111] of this Treaty;

— to hold and manage the official foreign reserves of the Member States;

— to promote the smooth operation of payment systems.

3.2. In accordance with Article 105(3) of this Treaty, the third indent of Article 3.1 shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances.

3.3. In accordance with Article 105(5) of this Treaty, the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.

Article 4

Advisory functions

In accordance with Article 105(4) of this Treaty:

(a) the ECB shall be consulted:

— on any proposed Community act in its fields of competence;

— by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out buy the Council in accordance with the procedure laid down in Article 42;

(b) the ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence.

Article 5

Collection of statistical information

5.1. In order to undertake the tasks of the ESCB, the ECB, assisted by the national central banks, shall collect the necessary statistical information either from the competent national authorities or directly from economic agents. For these purposes it shall cooperate with the Community institutions or bodies and with the competent authorities of the Member States or third countries and with international organizations.

5.2. The national central banks shall carry out, to the extent possible, the tasks described in Article 5.1.

5.3. The ECB shall contribute to the harmonization, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its fields of competence.

5.4. The Council, in accordance with the procedure laid down in Article 42, shall define the natural and legal persons subject to reporting requirements, the confidentiality regime and the appropriate provisions for enforcement.

Article 6

International cooperation

6.1. In the field of international cooperation involving the tasks entrusted to the ESCB, the ECB shall decide how the ESCB shall be represented.

6.2. The ECB and, subject to its approval, the national central banks may participate in international monetary institutions.

6.3. Articles 6.1 and 6.2 shall be without prejudice to Article 109(4) [111(4)] of this Treaty.

CHAPTER III

ORGANIZATION OF THE ESCB

Article 7

Independence

In accordance with Article 107 [108] of this Treaty, when exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and this Statute, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.

Article 8

General principle

The ESCB shall be governed by the decision-making bodies of the ECB.

Article 9

The European Central Bank

9.1. The ECB which, in accordance with Article 106(2) [107(2)] of this Treaty, shall have legal personality, shall enjoy in each of the Member States the most extensive legal capacity accorded to legal persons under its law; it may, in particular, acquire or dispose of movable and immovable property and may be a party to legal proceedings.

9.2. The ECB shall ensure that the tasks conferred upon the ESCB under Article 105(2), (3) and (5) of this Treaty are implemented either by its own activities pursuant to this Statute or through the national central banks pursuant to Articles 12.1 and 14.

9.3. In accordance with Article 106(3) [107(3)] of this Treaty, the decision making bodies of the ECB shall be the Governing Council and the Executive Board.

Article 10

The Governing Council

10.1. In accordance with Article 109a(1) [112(1)] of this Treaty, the Governing Council shall comprise the members of the Executive Board of the ECB and the governors of the national central banks.

10.2. Subject to Article 10.3, only members of the Governing Council present in person shall have the right to vote. By way of derogation from this rule, the Rules of Procedure referred to in Article 12.3 may lay down that members of the Governing Council may cast their vote by means of teleconferencing. These rules shall also provide that a member of the Governing Council who is prevented from voting for a prolonged period may appoint an alternate as a member of the Governing Council.

Subject to Articles 10.3 and 11.3, each member of the Governing Council shall have one vote. Save as otherwise provided for in this Statute, the Governing Council shall act by a simple majority. In the event of a tie, the President shall have the casting vote.

In order for the Governing Council to vote, there shall be a quorum of two thirds of the members. If the quorum is not met, the President may convene an extraordinary meeting at which decisions may be taken without regard to the quorum.

10.3. For any decisions to be taken under Articles 28, 29, 30, 32, 33 and 51, the votes in the Governing Council shall be weighted according to the national central banks' shares in the subscribed capital of the ECB. The weights of the votes of the members of the Executive Board shall be zero. A decision requiring a qualified majority shall be adopted if the votes cast in favour represent at least two thirds of the subscribed capital of the ECB and represent at least half of the shareholders. If a Governor is unable to be present, he may nominate an alternate to cast his weighted vote.

10.4. The proceedings of the meetings shall be confidential. The Governing Council may decide to make the outcome of its deliberations public.

10.5. The Governing Council shall meet at least 10 times a year.

10.6.† Article 10.2 may be amended by the Council of Ministers meeting in the composition of the Heads of State or Government, acting unanimously either on a recommendation from the ECB and after consulting the European Parliament and the Commission, or on a recommendation from the Commission and after consulting the European Parliament and the ECB. The Council shall recommend such amendments to the Member States for adoption. These amendments shall enter into force after having been ratified by all the Member States in accordance with their respective constitutional requirements.

A recommendation made by the ECB under this paragraph shall require a decision by the Governing Council acting unanimously.

Article 11

The Executive Board

11.1. In accordance with Article 109a(2)(a) [112(2)(a)] of this Treaty, the Executive Board shall comprise the President, the Vice-President and four other members.
The members shall perform their duties on a full-time basis. No member shall engage in any occupation, whether gainful or not, unless exemption is exceptionally granted by the Governing Council.

11.2. In accordance with Article 109a(2)(b) [112(2)(b)] of this Treaty, the President, the Vice-President and the other members of the Executive Board shall be appointed from among persons of recognized standing and professional experience in monetary or banking matters by common accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the Council after it has consulted the European Parliament and the Governing Council.
Their term of office shall be eight years and shall not be renewable.

Only nationals of Member States may be members of the Executive Board.

11.3. The terms and conditions of employment of the members of the Executive Board, in particular their salaries, pensions and other social security benefits shall be the subject of contracts with the ECB and shall be fixed by the Governing Council on a proposal from a Committee comprising three members appointed by the Governing Council and three members appointed by the Council. The members of the Executive Board shall not have the right to vote on matters referred to in this paragraph.

† Enabling clause as added by the 2000 Treaty of Nice (entered into force 2003).

11.4. If a member of the Executive Board no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct, the Court of Justice may, on application by the Governing Council or the Executive Board, compulsorily retire him.

11.5. Each member of the Executive Board present in person shall have the right to vote and shall have, for that purpose, one vote. Save as otherwise provided, the Executive Board shall act by a simple majority of the votes cast. In the event of a tie, the President shall have the casting vote. The voting arrangements shall be specified in the Rules of Procedure referred to in Article 12.3.

11.6. The Executive Board shall be responsible for the current business of the ECB.

11.7. Any vacancy on the Executive Board shall be filled by the appointment of a new member in accordance with Article 11.2.

Article 12

Responsibilities of the decision-making bodies

12.1. The Governing Council shall adopt the guidelines and take the decisions necessary to ensure the performance of the tasks entrusted to the ESCB under this Treaty and this Statute. The Governing Council shall formulate the monetary policy of the Community including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the ESCB, and shall establish the necessary guidelines for their implementation.

The Executive Board shall implement monetary policy in accordance with the guidelines and decisions laid down by the Governing Council. In doing so the Executive Board shall give the necessary instructions to national central banks. In addition the Executive Board may have certain powers delegated to it where the Governing Council so decides.

To the extent deemed possible and appropriate and without prejudice to the provisions of this Article, the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB.

12.2. The Executive Board shall have responsibility for the preparation of meetings of the Governing Council.

12.3. The Governing Council shall adopt Rules of Procedure which determine the internal organization of the ECB and its decision-making bodies.

12.4. The Governing Council shall exercise the advisory functions referred to in Article 4.

12.5. The Governing Council shall take the decisions referred to in Article 6.

Article 13

The President

13.1. The President or, in his absence, the Vice-President shall chair the Governing Council and the Executive Board of the ECB.

13.2. Without prejudice to Article 39, the President or his nominee shall represent the ECB externally.

Article 14

National central banks

14.1. In accordance with Article 108 [109] of this Treaty, each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation, including the statutes of its national central bank, is compatible with this Treaty and this Statute.

14.2. The statutes of the national central banks shall, in particular, provide that the term of office of a Governor of a national central bank shall be no less than five years.

A Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct. A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Governing Council on grounds of infringement of this Treaty or of any rule of law relating to its application. Such proceedings shall be instituted within two months of the publication of the decision or of its notification to the plaintiff or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.

14.3. The national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB. The Governing Council shall take the necessary steps to ensure compliance with the guidelines and instructions of the ECB, and shall require that any necessary information be given to it.

14.4. National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB.

Article 15

Reporting commitments

15.1. The ECB shall draw up and publish reports on the activities of the ESCB at least quarterly.

15.2. A consolidated financial statement of the ESCB shall be published each week.

15.3. In accordance with Article 109b(3) [113(3)] of this Treaty, the ECB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and the current year to the European Parliament, the Council and the Commission, and also to the European Council.

15.4. The reports and statements referred to in this Article shall be made available to interested parties free of charge.

Article 16

Banknotes

In accordance with Article 105a(1) [106(1)] of this Treaty, the Governing Council shall have the exclusive right to authorize the issue of banknotes within the Community. The ECB and the national central banks may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community.

The ECB shall respect as far as possible existing practices regarding the issue and design of banknotes.

CHAPTER IV

MONETARY FUNCTIONS AND OPERATIONS OF THE ESCB

Article 17

Accounts with the ECB and the national central banks

In order to conduct their operations, the ECB and the national central banks may open accounts for credit institutions, public entities and other market participants and accept assets, including book entry securities, as collateral.

Article 18

Open market and credit operations

18.1. In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may:

— operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in Community or in non-Community currencies, as well as precious metals;
— conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral.

18.2. The ECB shall establish general principles for open market and credit operations carried out by itself or the national central banks, including for the announcement of conditions under which they stand ready to enter into such transactions.

Article 19

Minimum reserves

19.1. Subject to Article 2, the ECB may require credit institutions established in Member States to hold minimum reserve on accounts with the ECB and national central banks in pursuance of monetary policy objectives. Regulations concerning the calculation and determination of the required minimum reserves may be established by the Governing Council. In cases of non-compliance the ECB shall be entitled to levy penalty interest and to impose other sanctions with comparable effect.

19.2. For the application of this Article, the Council shall, in accordance with the procedure laid down in Article 42, define the basis for minimum reserves and the maximum permissible ratios between those reserves and their basis, as well as the appropriate sanctions in cases of non-compliance.

Article 20

Other instruments of monetary control

The Governing Council may, by a majority of two thirds of the votes cast, decide upon the use of such other operational methods of monetary control as it sees fit, respecting Article 2.

The Council shall, in accordance with the procedure laid down in Article 42, define the scope of such methods if they impose obligations on third parties.

Article 21

Operations with public entities

21.1. In accordance with Article 104 [101] of this Treaty, overdrafts or any other type of credit facility with the ECB or with the national central banks in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments.

21.2. The ECB and national central banks may act as fiscal agents for the entities referred to in Article 21.1.

21.3. The provisions of this Article shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the ECB as private credit institutions.

Article 22

Clearing and payment systems

The ECB and national central banks may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries.

Article 23

External operations

The ECB and national central banks may:

— establish relations with central banks and financial institutions in other countries and, where appropriate, with international organizations;

— acquire and sell spot and forward all types of foreign exchange assets and precious metals; the term 'foreign exchange asset' shall include securities and all other assets in the currency of any country or units of account and in whatever form held;

— hold and manage the assets referred to in this Article;

— conduct all types of banking transactions in relations with third countries and international organizations, including borrowing and lending operations.

Article 24

Other operations

In addition to operations arising from their tasks, the ECB and national central banks may enter into operations for their administrative purposes or for their staff.

CHAPTER V

PRUDENTIAL SUPERVISION

Article 25

Prudential supervision

25.1. The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system.

25.2. In accordance with any decision of the Council under Article 105(6) of this Treaty, the ECB may perform specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

CHAPTER VI

FINANCIAL PROVISIONS OF THE ESCB

Article 26

Financial accounts

26.1. The financial year of the ECB and national central banks shall begin on the first day of January and end on the last day of December.

26.2. The annual accounts of the ECB shall be drawn up by the Executive Board, in accordance with the principles established by the Governing Council. The accounts shall be approved by the Governing Council and shall thereafter be published.

26.3. For analytical and operational purposes, the Executive Board shall draw up a consolidated balance sheet of the ESCB, comprising those assets and liabilities of the national central banks that fall within the ESCB.

26.4. For the application of this Article, the Governing Council shall establish the necessary rules for standardizing the accounting and reporting of operations undertaken by the national central banks.

Article 27

Auditing

27.1. The accounts of the ECB and national central banks shall be audited by independent external auditors recommended by the Governing Council and approved by the Council. The auditors shall have full power to examine all books and accounts of the ECB and national central banks and obtain full information about their transactions.

27.2. The provisions of Article 188c [248] of this Treaty shall only apply to an examination of the operational efficiency of the management of the ECB.

Article 28

Capital of the ECB

28.1. The capital of the ECB, which shall become operational upon its establishment, shall be ECU 5 000 million. The capital may be increased by such amounts as may be decided by the Governing Council acting by the qualified majority provided for in Article 10.3, within the limits and under the conditions set by the Council under the procedure laid down in Article 42.

28.2. The national central banks shall be the sole subscribers to and holders of the capital of the ECB. The subscription of capital shall be according to the key established in accordance with Article 29.

28.3. The Governing Council, acting by the qualified majority provided for in Article 10.3, shall determine the extent to which and the form in which the capital shall be paid up.

28.4. Subject to Article 28.5, the shares of the national central banks in the subscribed capital of the ECB may not be transferred, pledged or attached.

28.5. If the key referred to in Article 29 is adjusted, the national central banks shall transfer among themselves capital shares to the extent necessary to ensure that the distribution of capital shares corresponds to the adjusted key. The Governing Council shall determine the terms and conditions of such transfers.

Article 29

Key for capital subscription

29.1. When in accordance with the procedure referred to in Article 109l(1) [123(1)] of this Treaty the ESCB and the ECB have been established, the key for subscription of the ECB's capital shall be established. Each national central bank shall be assigned a weighting in this key which shall be equal to the sum of:

— 50% of the share of its respective Member State in the population of the Community in the penultimate year preceding the establishment of the ESCB;

— 50% of the share of its respective Member State in the gross domestic product at market prices of the Community as recorded in the last five years preceding the penultimate year before the establishment of the ESCB.

The percentages shall be rounded up to the nearest multiple of 0.05 percentage points.

29.2. The statistical data to be used for the application of this Article shall be provided by the Commission in accordance with the rules adopted by the Council under the procedure provided for in Article 42.

29.3. The weightings assigned to the national central banks shall be adjusted every five years after the establishment of the ESCB by analogy with the provisions laid down in Article 29.1. The adjusted key shall apply with effect from the first day of the following year.

29.4. The Governing Council shall take all other measures necessary for the application of this Article.

Article 30

Transfer of foreign reserve assets to the ECB

30.1. Without prejudice to Article 28, the ECB shall be provided by the national central banks with foreign reserve assets, other than Member States' currencies, ECUs, IMF reserve positions and SDRs, up to an amount equivalent to ECU 50 000 million. The Governing Council shall decide upon the proportion to be called up by the ECB following its establishment and the amounts called up at later dates. The ECB shall have the full right to hold and manage the foreign reserves that are transferred to it and to use them for the purposes set out in this Statute.

30.2. The contributions of each national central bank shall be fixed in proportion to its share in the subscribed capital of the ECB.

30.3. Each national central bank shall be credited by the ECB with a claim equivalent to its contribution. The Governing Council shall determine the denomination and remuneration of such claims.

30.4. Further calls of foreign reserve assets beyond the limit set in Article 30.1 may be effected by the ECB, in accordance with Article 30.2, within the limits and under the conditions set by the Council in accordance with the procedure laid down in Article 42.

30.5. The ECB may hold and manage IMF reserve positions and SDRs and provide for the pooling of such assets.

30.6. The Governing Council shall take all other measures necessary for the application of this Article.

Article 31

Foreign reserve assets held by national central banks

31.1. The national central banks shall be allowed to perform transactions in fulfilment of their obligations towards international organizations in accordance with Article 23.

31.2. All other operations in foreign reserve assets remaining with the national central banks after the transfers referred to in Article 30, and Members States' transactions with their foreign exchange working balances shall, above a certain limit to be established within the framework of Article 31.3, be subject to approval by the ECB in order to ensure consistency with the exchange rate and monetary policies of the Community.
31.3. The Governing Council shall issue guidelines with a view to facilitating such operations.

Article 32

Allocation of monetary income of national central banks

32.1. The income accruing to the national central banks in the performance of the ESCB's monetary policy function (hereinafter referred to as 'monetary income') shall be allocated at the end of each financial year in accordance with the provisions of this Article.

32.2. Subject to Article 32.3, the amount of each national central bank's monetary income shall be equal to its annual income derived from its assets held against notes in circulation and deposit liabilities to credit institutions. These assets shall be earmarked by national central banks in accordance with guidelines to be established by the Governing Council.

32.3. If, after the start of the third stage, the balance sheet structures of the national central banks do not, in the judgment of the Governing Council, permit the application of Article 32.2, the Governing Council, acting by a qualified majority, may decide that, by way of

derogation from Article 32.2, monetary income shall be measured according to an alternative method for a period of not more than five years.
32.4. The amount of each national central bank's monetary income shall be reduced by an amount equivalent to any interest paid by that central bank on its deposit liabilities to credit institutions in accordance with Article 19.

The Governing Council may decide that national central banks shall be indemnified against costs incurred in connection with the issue of banknotes or in exceptional circumstances for specific losses arising from monetary policy operations undertaken for the ESCB. Indemnification shall be in a form deemed appropriate in the judgment of the Governing Council; these amounts may be offset against the national central banks' monetary income.

32.5. The sum of the national central banks' monetary income shall be allocated to the national central banks in proportion to their paid up shares in the capital of the ECB, subject to any decision taken by the Governing Council pursuant to Article 33.2.

32.6. The clearing and settlement of the balances arising from the allocation of monetary income shall be carried out by the ECB in accordance with guidelines established by the Governing Council.

32.7. The Governing Council shall take all other measures necessary for the application of this Article.

Article 33

Allocation of net profits and losses of the ECB

33.1. The net profit of the ECB shall be transferred in the following order:

(a) an amount to be determined by the Governing Council, which may not exceed 20% of the net profit, shall be transferred to the general reserve fund subject to a limit equal to 100% of the capital;

(b) the remaining net profit shall be distributed to the shareholders of the ECB in proportion to their paid-up shares.

33.2. In the event of a loss incurred by the ECB, the shortfall may be offset against the general reserve fund of the ECB and, if necessary, following a decision by the Governing Council, against the monetary income of the relevant financial year in proportion and up to the amounts allocated to the national central banks in accordance with Article 32.5.

CHAPTER VII

GENERAL PROVISIONS

Article 34

Legal acts

34.1. In accordance with Article 110 of this Treaty, the ECB shall:

— make regulations to the extent necessary to implement the tasks defined in Article 3.1, first indent, Articles 19.1, 22 or 25.2 and in cases which shall be laid down in the acts of the Council referred to in Article 42;

— take decisions necessary for carrying out the tasks entrusted to the ESCB under this Treaty and this Statute;

— make recommendations and deliver opinions.

34.2. A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States.

Recommendations and opinions shall have no binding force.
A decision shall be binding in its entirety upon those to whom it is addressed.

Articles 190 to 192 [253, 254 and 256] of this Treaty shall apply to regulations and decisions adopted by the ECB.

The ECB may decide to publish its decisions, recommendations and opinions.

34.3. Within the limits and under the conditions adopted by the Council under the procedure laid down in Article 42, the ECB shall be entitled to impose fines or periodic penalty payments on undertakings for failure to comply with obligations under its regulations and decisions.

Article 35

Judicial control and related matters

35.1. The acts or omissions of the ECB shall be open to review or interpretation by the Court of Justice in the cases and under the conditions laid down in this Treaty. The ECB may institute proceedings in the cases and under the conditions laid down in this Treaty.

35.2. Disputes between the ECB, on the one hand, and its creditors, debtors or any other person, on the other, shall be decided by the competent national courts, save where jurisdiction has been conferred upon the Court of Justice.

35.3. The ECB shall be subject to the liability regime provided for in Article 215 [288] of this Treaty. The national central banks shall be liable according to their respective national laws.

35.4. The Court of Justice shall have jurisdiction to give judgment pursuant to any arbitration clause contained in a contract concluded by or on behalf of the ECB, whether that contract be governed by public or private law.

35.5. A decision of the ECB to bring an action before the Court of Justice shall be taken by the Governing Council.

35.6. The Court of Justice shall have jurisdiction in disputes concerning the fulfilment by a national central bank of obligations under this Statute. If the ECB considers that a national central bank has failed to fulfil an obligation under this Statute, it shall deliver a reasoned opinion on the matter after giving the national central bank concerned the opportunity to submit its observations. If the national central bank concerned does not comply with the opinion within the period laid down by the ECB, the latter may bring the matter before the Court of Justice.

Article 36

Staff

36.1. The Governing Council, on a proposal from the Executive Board, shall lay down the conditions of employment of the staff of the ECB.

36.2. The Court of Justice shall have jurisdiction in any dispute between the ECB and its servants within the limits and under the conditions laid down in the conditions of employment.

Article 37

Seat

Before the end of 1992, the decision as to where the seat of the ECB will be established shall be taken by common accord of the governments of the Member States at the level of Heads of State or Government.

Article 38

Professional secrecy

38.1. Members of the governing bodies and the staff of the ECB and the national central banks shall be required, even after their duties have ceased, not to disclose information of the kind covered by the obligation of professional secrecy.
38.2. Persons having access to data covered by Community legislation imposing an obligation of secrecy shall be subject to such legislation.

Article 39

Signatories

The ECB shall be legally committed to third parties by the President or by two members of the Executive Board or by the signatures of two members of the staff of the ECB who have been duly authorized by the President to sign on behalf of the ECB.

Article 40 *

Privileges and immunities

The ECB shall enjoy in the territories of the Member States such privileges and immunities as are necessary for the performance of its tasks, under the conditions laid down in the Protocol on the privileges and immunities of the European Communities.

CHAPTER VIII

AMENDMENT OF THE STATUTE AND COMPLEMENTARY LEGISLATION

Article 41

Simplified amendment procedure

41.1. In accordance with Article 107(5) of this Treaty, Articles 5.1, 5.2, 5.3, 17, 18, 19.1, 22, 23, 24, 26, 32.2, 32.3, 32.4, 32.6, 33.1(a) and 36 of this Statute may be amended by the Council, acting either by a qualified majority on a recommendation from the ECB and after consulting the Commission, or unanimously on a proposal from the Commission and after consulting the ECB. In either case the assent of the European Parliament shall be required.

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* As amended by Article 6, point III(4) of the Treaty of Amsterdam.

41.2. A recommendation made by the ECB under this Article shall require a unanimous decision by the Governing Council.

Article 42

Complementary legislation

In accordance with Article 106(6) [107(6)] of this Treaty, immediately after the decision on the date for the beginning of the third stage, the Council, acting by a qualified majority either on a proposal from the Commission and after consulting the European Parliament and the ECB or on a recommendation from the ECB and after consulting the European Parliament and the Commission, shall adopt the provisions referred to in Articles 4, 5.4, 19.2, 20, 28.1, 29.2, 30.4 and 34.3 of this Statute.

CHAPTER IX

TRANSITIONAL AND OTHER PROVISIONS FOR THE ESCB

Article 43

General provisions

43.1. A derogation as referred to in Article 109k(1) [122(1)] of this Treaty shall entail that the following Articles of this Statute shall not confer any rights or impose any obligations on the Member State concerned: 3, 6, 9.2, 12.1, 14.3, 16, 18, 19, 20, 22, 23, 26.2, 27, 30, 31, 32, 33, 34, 50 and 52.

43.2. The central banks of Member States with a derogation as specified in Article 122(1) of this Treaty shall retain their powers in the field of monetary policy according to national law.

43.3. In accordance with Article 122(4) of this Treaty, 'Member States' shall be read as 'Member States without a derogation' in the following Articles of this Statute: 3, 11.2, 19, 34.2 and 50.

43.4. 'National central banks' shall be read as 'central banks of Member States without a derogation' in the following Articles of this Statute: 9.2, 10.1, 10.3, 12.1, 16, 17, 18, 22, 23, 27, 30, 31, 32, 33.2 and 52.

43.5. 'Shareholders' shall be read as 'central banks of Member States without a derogation' in Articles 10.3 and 33.1.

43.6. 'Subscribed capital of the ECB' shall be read as 'capital of the ECB subscribed by the central banks of Member States without a derogation' in Articles 10.3 and 30.2.

Article 44

Transitional tasks of the ECB

The ECB shall take over those tasks of the EMI which, because of the derogations of one or more Member States, still have to be performed in the third stage.

The ECB shall give advice in the preparations for the abrogation of the derogations specified in Article 109k [122] of this Treaty.

Article 45

The General Council of the ECB

45.1. Without prejudice to Article 106(3) [107(3)] of this Treaty, the General Council shall be constituted as a third decision-making body of the ECB.

45.2. The General Council shall comprise the President and Vice-President of the ECB and the Governors of the national central banks. The other members of the Executive Board may participate, without having the right to vote, in meetings of the General Council.

45.3. The responsibilities of the General Council are listed in full in Article 47 of this Statute.

Article 46

Rules of Procedure of the General Council

46.1. The President or, in his absence, the Vice-President of the ECB shall chair the General Council of the ECB.

46.2. The President of the Council and a Member of the Commission may participate, without having the right to vote, in meetings of the General Council.

46.3. The President shall prepare the meetings of the General Council.

46.4. By way of derogation from Article 12.3, the General Council shall adopt its Rules of Procedure.

46.5. The Secretariat of the General Council shall be provided by the ECB.

Article 47

Responsibilities of the General Council

47.1. The General Council shall:

— perform the tasks referred to in Article 44;

— contribute to the advisory functions referred to in Articles 4 and 25.1.

47.2. The General Council shall contribute to:

— the collection of statistical information as referred to in Article 5;

— the reporting activities of the ECB as referred to in Article 15;

— the establishment of the necessary rules for the application of Article 26 as referred to in Article 26.4;

— the taking of all other measures necessary for the application of Article 29 as referred to in Article 29.4;

— the laying down of the conditions of employment of the staff of the ECB as referred to in Article 36.

47.3. The General Council shall contribute to the necessary preparations for irrevocably fixing the exchange rates of the currencies of Member States with a derogation against the currencies, or the single currency, of the Member States without a derogation, as referred to in Article 109l(5) [123(5)] of this Treaty.

47.4. The General Council shall be informed by the President of the ECB of decisions of the Governing Council.

Article 48

Transitional provisions for the capital of the ECB

In accordance with Article 29.1 each national central bank shall be assigned a weighting in the key for subscription of the ECB's capital. By way of derogation from Article 28.3, central banks of Member States with a derogation shall not pay up their subscribed capital unless the General Council, acting by a majority representing at least two thirds of the subscribed capital of the ECB and at least half of the shareholders, decides that a minimal percentage has to be paid up as a contribution to the operational costs of the ECB.

Article 49

Deferred payment of capital, reserves and provisions of the ECB

49.1. The central bank of a Member State whose derogation has been abrogated shall pay up its subscribed share of the capital of the ECB to the same extent as the central banks of other Member States without a derogation, and shall transfer to the ECB foreign reserve assets in accordance with Article 30.1. The sum to be transferred shall be determined by multiplying the ECU value at current exchange rates of the foreign reserve assets which have already been transferred to the ECB in accordance with Article 30.1, by the ratio between the number of shares subscribed by the national central bank concerned and the number of shares already paid up by the other national central banks.

49.2. In addition to the payment to be made in accordance with Article 49.1, the central bank concerned shall contribute to the reserves of the ECB, to those provisions equivalent to reserves, and to the amount still to be appropriated to the reserves and provisions corresponding to the balance of the profit and loss account as at 31 December of the year prior to the abrogation of the derogation. The sum to be contributed shall be determined by multiplying the amount of the reserves, as defined above and as stated in the approved balance sheet of the ECB, by the ratio between the number of shares subscribed by the central bank concerned and the number of shares already paid up by the other central banks.

Article 50

Initial appointment of the members of the Executive Board

When the Executive Board of the ECB is being established, the President, the Vice-President and the other members of the Executive Board shall be appointed by common accord of the governments of the Member States at the level of Heads of State or Government, on a recommendation from the Council and after consulting the European Parliament and the Council of the EMI. The President of the Executive Board shall be appointed for eight years. By way of derogation from Article 11.2, the Vice-President shall be appointed for four years and the other members of the Executive Board for terms of office of between five and eight years. No term of office shall be renewable. The number of members of the Executive Board may be smaller than provided for in Article 11.1, but in no circumstance shall it be less than four.

Article 51

Derogation from Article 32

51.1. If, after the start of the third stage, the Governing Council decides that the application of Article 32 results in significant changes in national central banks' relative income positions, the amount of income to be allocated pursuant to Article 32 shall be reduced by a uniform percentage which shall not exceed 60% in the first financial year after the start of the third

stage and which shall decrease by at least 12 percentage points in each subsequent financial year.

51.2. Article 51.1 shall be applicable for not more than five financial years after the start of the third stage.

Article 52

Exchange of banknotes in Community currencies

Following the irrevocable fixing of exchange rates, the Governing Council shall take the necessary measures to ensure that banknotes denominated in currencies with irrevocably fixed exchange rates are exchanged by the national central banks at their respective par values.

Article 53

Applicability of the transitional provisions

If and as long as there are Member States with a derogation Articles 43 to 48 shall be applicable.

PROVISIONS AMENDING THE TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY WITH A VIEW TO ESTABLISHING THE EUROPEAN COMMUNITY (TREATY OF MAASTRICHT) ‡

PART ONE "PRINCIPLES"

Article 2

The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing the common policies or activities referred to in Articles 3 and 3a, to promote throughout the Community a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and social protection, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.

Article 3

1. For the purposes set out in Article 2, the activities of the Member States and the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein, the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.

2. Concurrently with the foregoing, and as provided in this Treaty and in accordance with the timetable and the procedures set out therein, these activities shall include the irrevocable fixing of exchange rates leading to the introduction of a single currency, the ECU, and the definition and conduct of a single monetary policy and exchange rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition.

3. These activities of the Member States and the Community shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments.

Article 4

1. The tasks entrusted to the Community shall be carried out by the following institutions:
a EUROPEAN PARLIAMENT,

‡ Art G (TEU). See Annex 5 for renumbering under Treaty of Amsterdam (1997).

a COUNCIL,
a COMMISSION,
a COURT OF JUSTICE,
a COURT OF AUDITORS.
Each institution shall act within the limits of the powers conferred upon it by this Treaty.

2. The Council and the Commission shall be assisted by an Economic and Social Committee and a Committee of the Regions acting in an advisory capacity.

Article 4a

A European System of Central Banks (hereinafter referred to as 'ESCB') and a European Central Bank (hereinafter referred to as 'ECB') shall be established in accordance with the procedures laid down in this Treaty; they shall act within the limits of the powers conferred upon them by this Treaty and by the Statute of the ESCB and of the ECB (hereinafter referred to as 'Statute of the ESCB') annexed thereto.

Article 4b

A European Investment Bank is hereby established, which shall act within the limits of the powers conferred upon it by this Treaty and the Statute annexed thereto.

PART THREE "COMMUNITY POLICIES"

TITLE VI "ECONOMIC AND MONETARY POLICY"

CHAPTER 1: ECONOMIC POLICY

Article 104

1. Overdraft facilities or any other type of credit facility with the ECB or with the central banks of the Member States (hereinafter referred to as national central banks') in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments.

2. Paragraph 1 shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the ECB as private credit institutions.

Article 104a

1. Any measure, not based on prudential considerations, establishing privileged access by Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States to financial institutions, shall be prohibited.

2. The Council, acting in accordance with the procedure referred to in Article 189c, shall, before 1 January 1994, specify definitions for the application of the prohibition referred to in paragraph 1.

Article 104b

1. The Community shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.

2. If necessary, the Council, acting in accordance with the procedure referred to in Article 189c, may specify definitions for the application of the prohibition referred to in Article 104 and in this Article.

Article 104c

1. Member States shall avoid excessive government deficits.
2. The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline on the basis of the following two criteria:
whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value, unless:
either the ratio has declined substantially and continuously and reached a level that comes close to the reference value;
or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;

whether the ratio of government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.
The reference values are specified in the Protocol on the excessive deficit procedure annexed to this Treaty.
3. If a Member State does not fulfil the requirements under one or both of these criteria, the Commission shall prepare a report. The report of the Commission shall also take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium term economic and budgetary position of the Member State.
The Commission may also prepare a report if, notwithstanding the fulfilment of the requirements under the criteria, it is of the opinion that there is a risk of an excessive deficit in a Member State.
4. The Committee provided for in Article 109c shall formulate an opinion on the report of the Commission.
5. If the Commission considers that an excessive deficit in a Member State exists or may occur, the Commission shall address an opinion to the Council.
6. The Council shall, acting by a qualified majority on a recommendation from the Commission, and having considered any observations which the Member State concerned may wish to make, decide after an overall assessment whether an excessive deficit exists.
7. Where the existence of an excessive deficit is decided according to paragraph 6, the Council shall make recommendations to the Member State concerned with a view to bringing that situation to an end within a given period. Subject to the provisions of paragraph 8, these recommendations shall not be made public.
8. Where it establishes that there has been no effective action in response to its recommendations within the period laid down, the Council may make its recommendations public.
9. If a Member State persists in failing to put into practice the recommendations of the Council, the Council may decide to give notice to the Member State to take, within a specified time limit, measures for the deficit reduction which is judged necessary by the Council in order to remedy the situation.
In such a case, the Council may request the Member State concerned to submit reports in accordance with a specific timetable in order to examine the adjustment efforts of that Member State.
10. The rights to bring actions provided for in Articles 169 and 170 may not be exercised within the framework of paragraphs 1 to 9 of this Article.
11. As long as a Member State fails to comply with a decision taken in accordance with paragraph 9, the Council may decide to apply or, as the case may be, intensify one or more of the following measures:
to require the Member State concerned to publish additional information, to be specified by the Council, before issuing bonds and securities;
to invite the European Investment Bank to reconsider its lending policy towards the Member State concerned;
to require the Member State concerned to make a non interest bearing deposit of an appropriate size with the Community until the excessive deficit has, in the view of the Council, been corrected; to impose fines of an appropriate size.

The President of the Council shall inform the European Parliament of the decisions taken.
12. The Council shall abrogate some or all of its decisions referred to in paragraphs 6 to 9 and 11 to the extent that the excessive deficit in the Member State concerned has, in the view of the Council, been corrected. If the Council has previously made public recommendations, it shall, as soon as the decision under paragraph 8 has been abrogated, make a public statement that an excessive deficit in the Member State concerned no longer exists.
13. When taking the decisions referred to in paragraphs 7 to 9, 11 and 12, the Council shall act on a recommendation from the Commission by a majority of two thirds of the votes of its members weighted in accordance with Article 148(2), excluding the votes of the representative of the Member State concerned.
14. Further provisions relating to the implementation of the procedure described in this Article are set out in the Protocol on the excessive deficit procedure annexed to this Treaty.
The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the ECB, adopt the appropriate provisions which shall then replace the said Protocol.
Subject to the other provisions of this paragraph, the Council shall, before 1 January 1994, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, lay down detailed rules and definitions for the application of the provisions of the said Protocol.

CHAPTER 2: MONETARY POLICY

Article 105

1. The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 3a.
2. The basic tasks to be carried out through the ESCB shall be:
to define and implement the monetary policy of the Community;
to conduct foreign exchange operations consistent with the provisions of Article 109;
to hold and manage the official foreign reserves of the Member States;
to promote the smooth operation of payment systems.
3. The third indent of paragraph 2 shall be without prejudice to the holding and management by the governments of Member States of foreign exchange working balances.
4. The ECB shall be consulted:
on any proposed Community act in its fields of competence;
by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 106(6).
The ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence.

5. The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.
6. The Council may, acting unanimously on a proposal from the Commission and after consulting the ECB and after receiving the assent of the European Parliament, confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

Article 106

1. The ESCB shall be composed of the ECB and of the national central banks.
2. The ECB shall have legal personality.
3. The ESCB shall be governed by the decision making bodies of the ECB which shall be the Governing Council and the Executive Board.
4. The Statute of the ESCB is laid down in a Protocol annexed to this Treaty.
5. Articles 5.1, 5.2, 5.3, 17, 18, 19.1, 22, 23, 24, 26, 32.2, 32.3, 32.4, 32.6, 33.1(a) and 36 of the Statute of the ESCB may be amended by the Council, acting either by a qualified majority on a recommendation from the ECB and after consulting the Commission or unanimously on a proposal from the Commission and after consulting the ECB. In either case, the assent of the European Parliament shall be required.
6. The Council, acting by a qualified majority either on a proposal from the Commission and after consulting the European Parliament and the ECB or on a recommendation from the ECB and after consulting the European Parliament and the Commission, shall adopt the provisions referred to in Articles 4, 5.4, 19.2, 20, 28.1, 29.2, 30.4 and 34.3 of the Statute of the ESCB.

Article 107

When exercising the powers and carrying out the tasks and duties conferred upon them by this Treaty and the Statute of the ESCB, neither the ECB, nor a national central bank, nor any member of their decision making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body. The Community institutions and bodies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision making bodies of the ECB or of the national central banks in the performance of their tasks.

Article 108

Each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation including the statutes of its national central bank is compatible with this Treaty and the Statute of the ESCB.

Article 108a

1. In order to carry out the tasks entrusted to the ESCB, the ECB shall, in accordance with the provisions of this Treaty and under the conditions laid down in the Statute of the ESCB:
make regulations to the extent necessary to implement the tasks defined in Article 3.1, first indent, Articles 19.1, 22 and 25.2 of the Statute of the ESCB and in cases which shall be laid down in the acts of the Council referred to in Article 106(6);
take decisions necessary for carrying out the tasks entrusted to the ESCB under this Treaty and the Statute of the ESCB;
make recommendations and deliver opinions.
2. A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States. Recommendations and opinions shall have no binding force.
A decision shall be binding in its entirety upon those to whom it is addressed. Articles 190 to 192 shall apply to regulations and decisions adopted by the ECB. The ECB may decide to publish its decisions, recommendations and opinions. 3. Within the limits and under the conditions adopted by the Council under the procedure laid down in Article 106(6), the ECB shall be entitled to impose fines or periodic penalty payments on undertakings for failure to comply with obligations under its regulations and decisions.

Article 109

1. By way of derogation from Article 228, the Council may, acting unanimously on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach a consensus consistent with the objective of price stability, after consulting the European Parliament, in accordance with the procedure in paragraph 3 for determining the arrangements, conclude formal agreements on an exchange rate system for the ECU in relation to non Community currencies. The Council may, acting by a qualified majority on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach a consensus consistent with the objective of price stability, adopt, adjust or abandon the central rates of the ECU within the exchange rate system. The President of the Council shall inform the European Parliament of the adoption, adjustment or abandonment of the ECU central rates.
2. In the absence of an exchange rate system in relation to one or more non Community currencies as referred to in paragraph 1, the Council, acting by a qualified majority either on a recommendation from the Commission and after consulting the ECB or on a recommendation from the ECB, may formulate general orientations for exchange rate policy in relation to these currencies. These general orientations shall be without prejudice to the primary objective of the ESCB to maintain price stability.
3. By way of derogation from Article 228, where agreements concerning monetary or foreign exchange regime matters need to be negotiated by the Community with one or more States or international organizations, the Council, acting by a qualified majority on a recommendation from the Commission and after consulting the ECB, shall decide the arrangements for the negotiation and for the conclusion of such agreements. These arrangements shall ensure that the Community expresses a single position. The Commission shall be fully associated with the negotiations.

Agreements concluded in accordance with this paragraph shall be binding on the institutions of the Community, on the ECB and on Member States.
4. Subject to paragraph 1, the Council shall, on a proposal from the Commission and after consulting the ECB, acting by a qualified majority decide on the position of the Community at international level as regards issues of particular relevance to economic and monetary union and, acting unanimously, decide its representation in compliance with the allocation of powers laid down in Articles 103 and 105.
5. Without prejudice to Community competence and Community agreements as regards economic and monetary union, Member States may negotiate in international bodies and conclude international agreements.

CHAPTER 3: INSTITUTIONAL PROVISIONS

Article 109a

The Governing Council of the ECB shall comprise the members of the Executive Board of the ECB and the Governors of the national central banks.

2. a. The Executive Board shall comprise the President, the Vice President and four other members.

b. The President, the Vice President and the other members of the Executive Board shall be appointed from among persons of recognized standing and professional experience in monetary or banking matters by common accord of the governments of the Member States at the level of Heads of State or Government, on a recommendation from the Council, after it has consulted the European Parliament and the Governing Council of the ECB. Their term of office shall be eight years and shall not be renewable. Only nationals of Member States may be members of the Executive Board.

Article 109b

1. The President of the Council and a member of the Commission may participate, without having the right to vote, in meetings of the Governing Council of the ECB.
The President of the Council may submit a motion for deliberation to the Governing Council of the ECB.
2. The President of the ECB shall be invited to participate in Council meetings when the Council is discussing matters relating to the objectives and tasks of the ESCB.
3. The ECB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and current year to the European Parliament, the Council and the Commission, and also to the European Council. The President of the ECB shall present this report to the Council and to the European Parliament, which may hold a general debate on that basis.

The President of the ECB and the other members of the Executive Board may, at the request of the European Parliament or on their own initiative, be heard by the competent committees of the European Parliament.

Article 109c

1. In order to promote coordination of the policies of Member States to the full extent needed for the functioning of the internal market, a Monetary Committee with advisory status is hereby set up.
It shall have the following tasks:
to keep under review the monetary and financial situation of the Member States and of the Community and the general payments system of the Member States and to report regularly thereon to the Council and to the Commission;
to deliver opinions at the request of the Council or of the Commission, or on its own initiative for submission to those institutions;
without prejudice to Article 151, to contribute to the preparation of the work of the Council referred to in Articles 73f, 73g, 103(2), (3), (4) and (5), 103a, 104a, 104b, 104c, 109e(2), 109f(6), 109h, 109i, 109j(2) and 109k(1);
to examine, at least once a year, the situation regarding the movement of capital and the freedom of payments, as they result from the application of this Treaty and of measures adopted by the Council; the examination shall cover all measures relating to capital movements and payments; the Committee shall report to the Commission and to the Council on the outcome of this examination.
The Member States and the Commission shall each appoint two members of the Monetary Committee.
2. At the start of the third stage, an Economic and Financial Committee shall be set up. The Monetary Committee provided for in paragraph 1 shall be dissolved.
The Economic and Financial Committee shall have the following tasks:
to deliver opinions at the request of the Council or of the Commission, or on its own initiative for submission to those institutions;
to keep under review the economic and financial situation of the Member States and of the Community and to report regularly thereon to the Council and to the Commission, in particular on financial relations with third countries and international institutions;
without prejudice to Article 151, to contribute to the preparation of the work of the Council referred to in Articles 73f, 73g, 103(2), (3), (4) and (5), 103a, 104a, 104b, 104c, 105(6), 105a(2), 106(5) and (6), 109, 109h, 109i(2) and (3), 109k(2), 109l(4) and (5), and to carry out other advisory and preparatory tasks assigned to it by the Council;
to examine, at least once a year, the situation regarding the movement of capital and the freedom of payments, as they result from the application of this Treaty and of measures adopted by the Council; the examination shall cover all measures relating to capital movements and payments; the Committee shall report to the Commission and to the Council on the outcome of this examination.
The Member States, the Commission and the ECB shall each appoint no more than two members of the Committee.
3. The Council shall, acting by a qualified majority on a proposal from the Commission and after consulting the ECB and the Committee referred to in this Article, lay down detailed

provisions concerning the composition of the Economic and Financial Committee. The President of the Council shall inform the European Parliament of such a decision.
4. In addition to the tasks set out in paragraph 2, if and as long as there are Member States with a derogation as referred to in Articles 109k and 109l, the Committee shall keep under review the monetary and financial situation and the general payments system of those Member States and report regularly thereon to the Council and to the Commission.

Article 109d

For matters within the scope of Articles 103(4), 104c with the exception of paragraph 14, 109, 109j, 109k and 109l(4) and (5), the Council or a Member State may request the Commission to make a recommendation or a proposal, as appropriate. The Commission shall examine this request and submit its conclusions to the Council without delay.

CHAPTER 4: TRANSITIONAL PROVISIONS

Article 109g

The currency composition of the ECU basket shall not be changed.
From the start of the third stage, the value of the ECU shall be irrevocably fixed in accordance with Article 109l(4).

Article 109l

1. Immediately after the decision on the date for the beginning of the third stage has been taken in accordance with Article 109j(3), or, as the case may be, immediately after 1 July 1998:
the Council shall adopt the provisions referred to in Article 106(6);
the governments of the Member States without a derogation shall appoint, in accordance with the procedure set out in Article 50 of the Statute of the ESCB, the President, the Vice President and the other members of the Executive Board of the ECB. If there are Member States with a derogation, the number of members of the Executive Board may be smaller than provided for in Article 11.1 of the Statute of the ESCB, but in no circumstances shall it be less than four.
As soon as the Executive Board is appointed, the ESCB and the ECB shall be established and shall prepare for their full operation as described in this Treaty and the Statute of the ESCB. The full exercise of their powers shall start from the first day of the third stage.
2. As soon as the ECB is established, it shall, if necessary, take over tasks of the EMI. The EMI shall go into liquidation upon the establishment of the ECB; the modalities of liquidation are laid down in the Statute of the EMI.
3. If and as long as there are Member States with a derogation, and without prejudice to Article 106(3) of this Treaty, the General Council of the ECB referred to in Article 45 of the Statute of the ESCB shall be constituted as a third decision making body of the ECB.

4. At the starting date of the third stage, the Council shall, acting with the unanimity of the Member States without a derogation, on a proposal from the Commission and after consulting the ECB, adopt the conversion rates at which their currencies shall be irrevocably fixed and at which irrevocably fixed rate the ECU shall be substituted for these currencies, and the ECU will become a currency in its own right. This measure shall by itself not modify the external value of the ECU. The Council shall, acting according to the same procedure, also take the other measures necessary for the rapid introduction of the ECU as the single currency of those Member States.
5. If it is decided, according to the procedure set out in Article 109k(2), to abrogate a derogation, the Council shall, acting with the unanimity of the Member States without a derogation and the Member State concerned, on a proposal from the Commission and after consulting the ECB, adopt the rate at which the ECU shall be substituted for the currency of the Member State concerned, and take the other measures necessary for the introduction of the ECU as the single currency in the Member State concerned.

Article 109m

1. Until the beginning of the third stage, each Member State shall treat its exchange rate policy as a matter of common interest. In so doing, Member States shall take account of the experience acquired in cooperation within the framework of the European Monetary System (EMS) and in developing the ECU, and shall respect existing powers in this field.

From the beginning of the third stage and for as long as a Member State has a derogation, paragraph 1 shall apply by analogy to the exchange rate policy of that Member State.

OTHER RELEVANT TREATY ARTICLES

Article 173

The Court of Justice shall review the legality of acts adopted jointly by the European Parliament and the Council, of acts of the Council, of the Commission and of the ECB, other than recommendations and opinions, and of acts of the European Parliament intended to produce legal effects vis-à-vis third parties.

It shall for this purpose have jurisdiction in actions brought by a Member State, the Council or the Commission on grounds of lack of competence, infringement of an essential procedural requirement, infringement of this Treaty or of any rule of law relating to its application, or misuse of powers.

The Court shall have jurisdiction under the same conditions in actions brought by the European Parliament and by the ECB for the purpose of protecting their prerogatives.

Any natural or legal person may, under the same conditions, institute proceedings against a decision addressed to that person or against a decision which, although in the form of a regulation or a decision addressed to another person, is of direct and individual concern to the former.

The proceedings provided for in this Article shall be instituted within two months of the publication of the measure, or of its notification to the plaintiff, or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.

Article 174

If the action is well founded, the Court of Justice shall declare the act concerned to be void.

In the case of a regulation, however, the Court of Justice shall, if it considers this necessary, state which of the effects of the regulation which it has declared void shall be considered as definitive.

Article 175

Should the European Parliament, the Council or the Commission, in infringement of the Treaty, fail to act, the Member States and the other institutions of the Community may bring an action before the Court of Justice to have the infringement established.

The action shall be admissible only if the institution concerned has first been called upon to act. If, within two months of being so called upon, this institution concerned has not defined its position, the action may be brought within a further period of two months.

Any natural or legal person may, under the conditions laid down in the preceding paragraphs, complain to the Court of Justice that an institution of the Community has failed to address to that person any act other than a recommendation or an opinion.

The Court of Justice shall have jurisdiction, under the same conditions, in actions or proceedings brought by the ECB in the areas falling within the latter's field of competence and in actions or proceedings brought against the latter.

Article 176

The institution or institutions whose act has been declared void or whose failure to act has been declared contrary to this Treaty shall be required to take the necessary measures to comply with the judgment of the Court of Justice.

This obligation shall not affect any obligation which may result from the application of the second paragraph of Article 215.

This Article shall also apply to the ECB.

Article 177

The Court of Justice shall have jurisdiction to give preliminary rulings concerning:

the interpretation of this Treaty;

the validity and interpretation of acts of the institutions of the Community and of the ECB;

Article 180

The Court of Justice shall, within the limits hereinafter laid down, have jurisdiction in disputes concerning:

the fulfilment by Member States of obligations under the Statute of the European Investment Bank. In this connection, the Board of Directors of the Bank shall enjoy the powers conferred upon the Commission by Article 169;

measures adopted by the Board of Governors of the European Investment Bank. In this connection, any Member State, the Commission or the Board of Directors of the Bank may institute proceedings under the conditions laid down in Article 173;

measures adopted by the Board of Directors of the European Investment Bank. Proceedings against such measures may be instituted only by Member States or by the Commission, under the conditions laid down in Article 173, and solely on the grounds of non-compliance with the procedure provided for in Article 21(2), (5), (6) and (7) of the Statute of the Bank;

the fulfilment by national central banks of obligations under this Treaty and the Statute of the ESCB. In this connection the powers of the Council of the ECB in respect of national central banks shall be the same as those conferred upon the Commission in respect of Member States by Article 169. If the Court of Justice finds that a national central bank has failed to fulfil an obligation under this Treaty, that bank shall be required to take the necessary measures to comply with the judgment of the Court of Justice.

Article 190

Regulations, directives and decisions adopted jointly by the European Parliament and the Council, and such acts adopted by the Council or the Commission, shall state the reasons on which they are based and shall refer to any proposals or opinions which were required to be obtained pursuant to this Treaty.

Protocol (No 7)
amending the Protocol on the privileges and immunities of the European Communities
THE HIGH CONTRACTING PARTIES,
CONSIDERING that, in accordance with Article 40 of the Statute of the Euro pean System of Central Banks and of the European Central Bank and Article 21 of the Statute of the European Monetary Institute, the European Central Bank and the European Monetary Institute shall enjoy in the territories of the Member States such privileges and immunities as are necessary for the performance of their tasks,
HAVE AGREED upon the following provisions, which shall be annexed to the Treaty establishing the European Community.
Sole Article
The Protocol on the privileges and immunities of the European Communities, annexed to the Treaty establishing a Single Council and a Single Commission of the European Communities, shall be supplemented by the following provisions:
'Article 23
This Protocol shall also apply to the European Central Bank, to the members of its organs and to its staff, without prejudice to the provisions of the Protocol on the Statute of the European System of Central Banks and the European Central Bank.
The European Central Bank shall, in addition, be exempt from any form of taxation or imposition of a like nature on the occasion of any increase in its capital and from the various formalities which may be connected therewith in the State where the bank has its seat. The activities of the Bank and of its organs carried on in accordance with the Statute of the European System of Central Banks and of the European Central Bank shall not be subject to any turnover tax.
The above provisions shall also apply to the European Monetary Institute. Its dissolution or liquidation shall not give rise to any imposition.'

Protocol (No 10)
on the transition to the third stage of economic and monetary union
THE HIGH CONTRACTING PARTIES
Declare the irreversible character of the Community's movement to the third stage of economic and monetary union by signing the new Treaty provisions on economic and monetary union.
Therefore all Member States shall, whether they fulfil the necessary conditions for the adoption of a single currency or not, respect the will for the Community to enter swiftly into the third stage, and therefore no Member State shall prevent the entering into the third stage.
If by the end of 1997 the date of the beginning of the third stage has not been set, the Member States concerned, the Community institutions and other bodies involved shall expedite all preparatory work during 1998, in order to enable the Community to enter the third stage irrevocably on 1 January 1999 and to enable the ECB and the ESCB to start their full functioning from this date.
This Protocol shall be annexed to the Treaty establishing the European Community.

ANNEX 5: TABLES OF EQUIVALENCES REFERRED TO IN ARTICLE 12 OF THE TREATY OF AMSTERDAM[1]

A.TREATY ON EUROPEAN UNION	
Previous numbering **Title VII**	**New numbering** **Title VIII**
Article N	Article 48

B.TREATY ESTABLISHING THE EUROPEAN COMMUNITY	
Previous numbering **Part one**	**New numbering** **Part one**
Article 1 Article 2 Article 3 Article 3a Article 3b Article 3c Article 4 Article 4a Article 4b	Article 1 Article 2 Article 3 Article 4 Article 5 Article 6 Article 7 Article 8 Article 9
Part three **Title VI**	**Part three** **Title VII**
Chapter 1	**Chapter 1**
Article 102a Article 103 Article 103a Article 104 Article 104a Article 104b Article 104c	Article 98 Article 99 Article 100 Article 101 Article 102 Article 103 Article 104

[1] OJ C 340, 10.11.1997, pp. 85-91.

B.TREATY ESTABLISHING THE EUROPEAN COMMUNITY	
Previous numbering **Part three** **Title VI**	**New numbering** **Part three** **Title VI**
Chapter 2	**Chapter 2**
Article 105 Article 105a Article 106 Article 107 Article 108 Article 108a Article 109	Article 105 Article 106 Article 107 Article 108 Article 109 Article 110 Article 111
Chapter 3	**Chapter 3**
Article 109a Article 109b Article 109c Article 109d	Article 112 Article 113 Article 114 Article 115
Chapter 4	**Chapter 4**
Article 109e Article 109f Article 109g Article 109h Article 109i Article 109j Article 109k Article 109l Article 109m	Article 116 Article 117 Article 118 Article 119 Article 120 Article 121 Article 122 Article 123 Article 124
Part five **Title 1**	**Part five** **Title 1**
Chapter 1	**Chapter 1**
Article 138 Article 148(2) Article 151 Article 152 Article 155 Article 158(1) Article 164 Article 167 Article 168a	Article 190 Article 205(2) Article 207 Article 208 Article 211 Article 214(1) Article 220 Article 223 Article 225

Previous numbering **Part five** **Title I**	**New numbering** **Part five** **Title I**
Chapter 1	**Chapter 1**
Article 173-177 Article 180 Article 188a Article 188b Article 188c	Article 231-234 Article 237 Article 246 Article 247 Article 248
B.TREATY ESTABLISHING THE EUROPEAN COMMUNITY	
Chapter 2	**Chapter 2**
Article 189 Article 189a Article 189b Article 189c Article 190 Article 191 Article 191a (*) Article 192	Article 249 Article 250 Article 251 Article 252 Article 253 Article 254 Article 255 Article 256
Chapter 3	**Chapter 3**
Article 193 Article 194 Article 195 Article 196 Article 197 Article 198	Article 257 Article 258 Article 259 Article 260 Article 261 Article 262
Part six	**Part six**
Article 210	Article 281
Article 215	Article 288
Article 228 Article 228a	Article 300 Article 301

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LIST WITH ABBREVIATIONS

BCE	Banque Centrale Europeénne
BdF	Banque de France
BdI	Banca d'Italia
BdL	Bank deutscher Laender
BIS	Bank for International Settlements
BoE	Bank of England
BSSC	Banking Supervisory Sub-Committee of the Committee of Governors
CdG	Comité des Gouverneurs (Committee of Governors of the central banks of the EC Member States)
CoJ	Court of Justice
Coreper	Committee of Permanent Representatives (Ambassadors of EU Member States at the EU in Bruxelles)
DNB	De Nederlandsche Bank
EC	European Communities
ECA	European Court of Auditors
ECB	European Central Bank
Ecofin	Council of Ministers consisting of finance ministers
ECSC	European Coal and Steel Community
Ecu	European Currency Unit/écu
EEC	European Economic Community
EFC	Economic and Financial Committee
EIB	European Investment Bank
EMCF	European Monetary Cooperation Fund
EMI	European Monetary Institute
EMS	European Monetary System
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism of the EMS
ELA	Emergency Liquidity Assistance
EP	European Parliament
ESF	Exchange Stabilization Fund (US)
ESCB	European System of Central Banks
EU	European Union
Euraton	European Atomic Energy Community
Fed	Federal Reserve
FOMC	Federal Open Market Committee
FRA	Federal Reserve Act
FRB	Federal Reserve Bank
FRS	Federal Reserve System
GAO	General Accounting Office (established by US Congress)
GD	General Documentation on ESCB monetary policy instruments and procedures
GovC	Governing Council of the E(S)CB
HICP	Harmonized Index of Consumer Prices
HWWA	HWWA-Institut fuer Wirtschaftsforschung – Hamburg
IGC	Intergovernmental Conference

ILO	International Labour Organization
IMF	International Monetary Fund
LCB	Land Central Bank
LZB	Landeszentralbank
MCA	Depository Institutions Deregulation and Monetary Control Act (1980)
NCB	National Central Bank
NBB	National Bank of Belgium
OCC	Office of the Controller of the Currency of the Department of the Treasury (US)
OMOs	Open Market Operations
RoP	Rules of Procedure
RTGS	Real-Time Gross Settlement (system)
SEA	Single European Act (1985)
SEBC	Système Européen de Banques Centrales
SOMA	System Open Market Account
TARGET	Trans-european Automated Real-time Gross settlement Express Transfer system
TEU	Treaty on European Union
ZBO	Zelfstandig Bestuursorgaan
ZBR	Zentralbankrat