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 articles 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 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.

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 [of 1913], 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

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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*.

mingling[5]). To answer this question Haas turns to study the dynamics of *intergovernmental* 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

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

[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.

integration had to follow economic and political integration, as money was seen as an 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

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[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

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[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

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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 Central 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. This is a situation different from that covered by Eggertsson and Le Borgne (IMF WP 03/144), who develop a theory describing when it is rational for an individual elected (and re-electable) politician to delegate tasks or not.
[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)

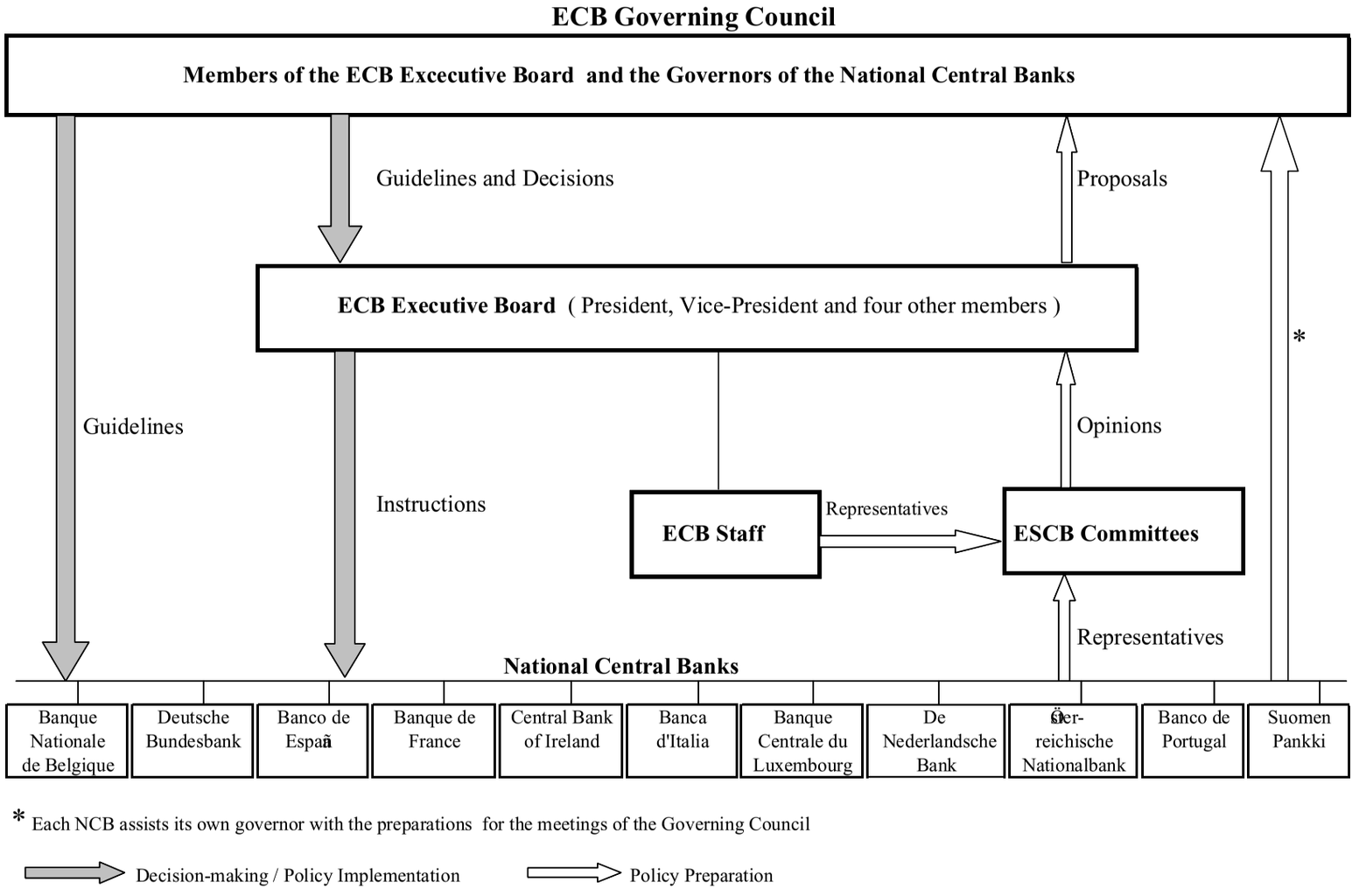
[2] See for instance the Memorandum of the German Minister of Finance Gerhard Stoltenberg ('The further development of monetary cooperation in Europe', dated March 15 1988), in which he reacts on earlier memoranda of Amato, Balladur and Genscher hinting at the possibility of Economic and Monetary Union. 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



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. 3.3-, 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

[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

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[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 not 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

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[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."

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[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)

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[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

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[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 Board member of the first hour and a prominent economist Adolph C. 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.182-192.)

[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 European 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.

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[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.

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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]

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[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; Kettl (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

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[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 <u>without</u> 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 <u>number</u> 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 <u>without</u> <u>any</u> 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. Welteke resigned and was succeeded by Axel Weter in April 2004.

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 Duisenberg 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) – see box 4 in chapter 8 (Banking Act of 1935). 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

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[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 [16]) above and Art. 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.

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[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

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[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]

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[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

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.

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importance of budgetary discipline with Delors. Then De Larosière had suggested that 'no-bail out' and 'no 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

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[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

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[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]

[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.'

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[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]

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[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.

./.

[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.

[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.

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[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.

[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

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[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 evidenced

[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.

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]

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[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

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[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]

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[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).

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[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.