MASTER THESIS

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„ The effectiveness of the monetary policy within the European Central Bank “

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List of abbreviations.

APP	Asset Purchase Programme
ECB	European Central Bank
ECJ	European Court of Justice
EDIS	European Deposit Insurance Scheme
EEC	European Economic Community
EMCF	European Monetary Cooperation Fund
EMI	European Monetary Institute
EMS	European Monetary System
EMU	Economic and Monetary Union
EPU	European Payments Union
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
EU	European Union
HICP	Harmonised Index of Consumers Prices
JST	Joint Supervisory Team
NCB	National Central Banks
OMT	Outright Monetary Transactions
SEA	Single European Act
SSM	Single Supervisory Mechanism
TEU	Treaty of European Union
TFEU	Treaty on the Functioning of European Union

Table of Contents.

1.Introduction

1.1The framework of master thesis.

On 1st June of 2018, the European Central Bank (ECB) celebrated its 20th anniversary. Over these decades, there were many monetary policy developments. The global economy has been hit by the most severe financial crisis, since the Great Depression in the 1930s. Politicians, economists and market participants have criticized the ECB over its monetary policy choices in Europe. Undoubtedly, some of this criticism comes from good and reasonable reasons.

After the hard time of crisis, the ECB's actions were on debate. Many claimed that ECB enabled the US born crisis to spread across Europe with a tremendous pace and resulted in remarkable consequences in the economy of the area. In December 2008, the executive board member of ECB, Lorenzo B. Smaghi stated that the situation in Europe was "very different" from the US. He continued by saying that even though the Fed has used all of its ammunitions regarding interest rate policy, the interest rates to households and companies in the US have remained as high as in Europe, despite the ECB's claimed lack of correct policy actions.

The motivation behind this study is to find out and if it is possible to evaluate the performance of the ECB, since the 1998 and more specifically, after the financial crisis, by focusing on the framework, which the ECB's policy is built on. How ECB responded to challenges posed by the European crises, using its toolbox? Does the monetary policy framework put an obstacle to ECB so as to act as fast as the other central banks? In such a case the ECB should not have received such hard criticism over its actions. On the contrary the criticism should be put on the whole functioning of the European System of Central Banks (ESCB).

1.2Objective and limitations.

The main objective of this paper is to evaluate whether the European Central Bank has been consistent and effective in its monetary policy approach, during the recent extraordinary financial conditions. Has the global economic distress changed the approach of monetary policy followed by ECB? This paper examines the effectiveness of the monetary policy of European Central Bank and evidence whether the widely criticized actions of the ECB, can result from the consistency of monetary policy actions and goals, rather than from dangerous economic conditions.

The time-frame limitation for this paper is such, that the evaluation will cover central banks' actions until early 2019. Any forecasting of future monetary policy decisions will be left outside the scope. Also, it will not be relevant to estimate the effectiveness of the most recent policy actions, since there exist gap periods before the benefits of the actions are visible in the economy.

1.3 Structure of the thesis.

The main objective of this thesis is to evaluate the consistency of the European Central Bank's monetary policy. The place to start in this discussion is to define precisely the Institution of European Central Bank. Firstly, it is necessary to provide a brief outline about the history of the development of Economic and Monetary Union and the establishment of European Monetary Institute. This part is provided in chapter 2, including an overview of reasons that led the Europe to create the European Central Bank. Also, this chapter describes the decision-making structure of the ECB.

The third chapter includes a description of the ECB's policy behavior, its strategy, the primary mandate and the two pillar approach of its policy **.**The non-standard monetary policies implemented by ECB, due to financial crisis, are also a part of this research, in order to have a wider picture of its functioning**.** The monetary policy itself is explained, while the there is a brief analysis about the functioning of ESCB. The price stability as the ECB's primary objective is defined and moreover its significance is explained. Price stability is the powerful tool for a central bank, so as to promote long term economic growth, high employment and financial stability.

In the fourth and last chapter of the main part, the study moves into the role of ECB as a supervisor. It contains a short testing about the transparency, credibility, accountability and communication policy of the ECB. After this analysis, the evaluation of the institution is taking place, drawing an overall picture of the ECB's role in recent times.Finally,a short discussion is made for the development of the strategic policy framework.

2.The establishment of European Central Bank.

2.1 Historical background.

2.1.1The Economic and Monetary Union.

The Economic and Monetary Union (EMU) represents a major step towards the European economic integration. According to Francis A. Mann, the purpose of States participating in monetary unions in the 19th century was “to unify their currency systems on a regional level in the sense not of merging independent systems into a single one, but of arranging them on a common basis.”[1] Monetary union as reflected in the Treaties, is a modern concept, differing from the classical one. However, the idea of monetary union is as old as the idea of European Integration.[2] Economic and Monetary Union (EMU) is a “core Europe” through which some EU Member States agreed to share a common single currency.[3]

Both the classical monetary unions and the modern ones **aim at creating a community of States, in order to constitute a single monetary territory**. In all modern monetary unions, there is the same currency issued by a central bank. **The Central bank is responsible for the common monetary policy.**

Americans and not Europeans were those that made the first serious political impetus to move on a European currency union. In the late 1940s, as the American government poured cash into Europe in an attempt to stipulate economic reconstruction, one of its principal concerns was cooperation among the Europeans, that would lead toward eventual political integration. The American-led European Cooperation Authority, which was responsible for the European Recovery program, had created a plan for the launch of monetary union by 1952.British government had disagreed with this plan, on the grounds that a development of a currency union was an infringement on Britain’s sovereignty. France also had a mixed reaction, due to some French policymakers that disliked the idea of yielding that much sovereign-

[1] Francis A. Mann, The Legal Aspect of Money (Oxford University Press 1992).

[2] David Howarth, “Policy-Making in the European Central Bank: The Masters of Europe's Money” by K. Kaltenthaler" (2009) Journal of Common Market Studies 47, no. 1, p.204-05.

[3] Cristina Pigui. "EMU – What Role for European Central Bank in the Asymmetric Shocks?" (2014) Journal of Law and Administrative Sciences, no. 2, p.32-39.

ty. The idea never really got off the ground and the economic circumstances did not seem to warrant such a move. From a European perspective, there was no compelling economic motivation to move to a currency union in the 1950s. In the 1950s, European economic integration was more concerned with trade, particularly trade in goods and not with monetary integration.[4] The Treaty of Rome (1957)[5]did not even mention the goal of monetary union. Some Europeans, such as the Vice President of European Commission, Robert Marjolin and Jean Monet began to push for the establishment of the monetary union, as a way of moving the Europe to political integration as well.[6]

The Article 2 of the Treaty of Rome (1957) had promulgated the "progressive approximation of the economic policies of member states."[7] Although there were no provisions for creating a regional currency bloc within the Treaty, a bloc was not seen as necessary, since the Bretton Woods system of 1945.The Bretton Woods system established fixed exchange rates using the U.S. dollar, as the undisputed global monetary standard.[8] This was the first example of a fully negotiated monetary order aimed to govern monetary relations among independent states. It was the result of the Bretton Woods Agreement of 1944.

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[4] Andreas Staab, "The European Union Explained: Institutions, Actors, Global Impact", (Indiana University Press 2008) p.114.

[5] The Treaty of Rome, originally (1957–93) Treaty Establishing the European Economic Community, succeeded by (1993–2009) Treaty Establishing the European Community and (2009) Treaty on the Functioning of the European Union. It was signed in Rome on March 25 1957, by Belgium, France, the Federal Republic of Germany (West Germany), Italy, Luxembourg, and the Netherlands. The Treaty of Rome established the European Economic Community (EEC), creating a common market and customs union among its members.
Official Website of Britannica < https://www.britannica.com/event/Treaty-of-Rome>accessed on 10 June 2019.

[6] David Howarth,"Policy-Making in the European Central Bank: The Masters of Europe's Money" By K. Kaltenthaler. (2009) Journal of Common Market Studies 47, no. 1, p.204-05.

[7]"The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it."

[8] It came to an end on 1970. The Bretton Woods Agreement also created two important institutions: the International Monetary Fund (IMF) and the World Bank Group, which were formally introduced in December 1945. The system of **Bretton Woods system** established the rules for commercial and financial relations among the United States, Canada, Western European countries, Australia and Japan.
Official Website of Britannica < https://www.britannica.com/event/Treaty-of-Rome>accessed on 10 June 2019.

The year 1969 proved a watershed moment in the history of the European project. During the Hague Summit, on 1 and 2 December 1969, the Heads of State of the six Member States **adopted the principle of a European economic and monetary union.** A study group headed by Pierre Werner, Luxembourg Prime Minister and Minister for Finance, was entrusted with the task to draw up more detailed proposals and establish a stage-by-stage procedure on the establishment of EMU. An interim version of the Werner Report, as it called, was presented to the Council of Ministers on 20 May 1970. **The Werner Plan was the earlier attempt for building an Economic Monetary Union.** It was consisted of three stages proposed the adoption of a single currency within a decade, **without recommending the establishment of a central bank.** [9]

A resolution was adopted by the council following the Werner report, on 22 March of 1971.[10] Unfortunately the plan failed due to generalized monetary instability dominated Europe and the world in the following years. Moreover, the fundamental divergence between the economists (led by the Germans) and the monetarists (led by the French) had as a result the failure of the Committee's proposals.[11]

The major institutional legacy of the EMU discussions was the creation of the European Monetary Cooperation Fund in 1973.It provided the central bank governors with their first collective task since the European Payments Union (EPU) of the late 1940s.The "Snake", established in April 1971,was about the management of a small percentage of European reserves pooled to help maintain stability in the first European monetary mechanism.These reserves were expanded with the creation of European Monetary System (EMS) in 1979.[12]The Snake-Fund legally based in Luxembourg and it was responsible for monitoring the Community's exchange rate system, even though only five of the nine EC member states, participated in it.[13]

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[9] Rene Smits, The European Central Bank, Institutional Aspects, (Kluwer Law International 1996) p.15.

[10] Rene Smits, The European Central Bank, Institutional Aspects, (Kluwer Law International 1996) p.15.

[11] David J. Howarth and Peter H. Loedel, The European Central Bank: The New European Leviathan? (Palgrave Macmillan 2003) p.29.

[12] Alex War Leigh, Understanding European Union Institutions (London Routledge 2002) p.87.

[13] David J. Howarth and Peter H. Loedel, The European Central Bank: The New European Leviathan? (Palgrave Macmillan 2003) p.30.

The process regained momentum in the 1980s. Many concrete developments were followed toward the realization of the EMU, from the end of the 1980s, against the backdrop of advance in economic integration.[14]The approval of Single European Act (SEA1986), eventually leaded to the completion of the single market and the elimination of capital controls. It was the first revision of the Basic treaties (Paris 1951 and Rome 1957).[15]

The SEA led to the insertion into the Treaty of Rome of a clause on EMU, which was more declaratory rather than prescriptive in character. The new provision had made clear that establishing EMU was not to be achieved through the adoption of secondary legislation.[16] Free movement of goods, services and capital in the continent, would eventually prove incompatible with stable exchange rates and autonomous national monetary policies, a point forcefully made by Padoa-Schioppa(1987).

It was Jacques Delors, the energetic Commission President behind the plan for the completion of the internal market. He pushed for the idea of materializing what, in the Single European Act, had only mentioned as an objective to be achieved. The Committee for the Study of Economic and Monetary Union, better known as **"Delor's Committee"** was tasked by the European Council, at the Hannover summit, in June 1988, with exploring ways of realizing a European Economic and Monetary Union (EMU). It was composed of Jacques Delors and all twelve central bank governors of the then-European Community, a Commissioner and three monetary experts.[17] The most important person on the Committee was the very respected president of Bundesbank Karl-Otto Pohl, that had tremendous credibility to bring to the deliberations. [18]

The Pohl proposal was about:

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[14] Shigeyuki Hamori and Naoko Hamori, "Introduction of the Euro and the Monetary Policy of the European Central Bank" (World Scientific 2009) p.12.

[15] Peter Fischer, Introduction to EU Law (University of Vienna 2018) p.36.

[16] Rene Smits, The European Central Bank, Institutional Aspects, (Kluwer Law International 1996) p.28.

[17] David Howarth, "Policy-Making in the European Central Bank: The Masters of Europe's Money,By K. Kaltenthaler." (2009) Journal of Common Market Studies 47, no. 1, p.204-05.

[18] Rene Smits, The European Central Bank, Institutional Aspects, (Kluwer Law International 1996) p.28.

- An independent central bank,
- modeled on the Bundesbank,
- with a strong price-stability mandate and
- expected to support the general economic policies of the European Union's member state's governments.

This proposal served as a basis for the work of Committee. The Committee also agreed that the path to monetary union should come in three stages:

Stage 1	The Liberalization of capital in the European Union.
Stage 2	The Establishment of a European System of Central Bank (ESCB) in order to supervise the progression toward full monetary union.
Stage 3	The introduction of a common currency. The start of monetary policy management by the proposed central bank.

The resulting "Delors Report" (officially, the "Report on Economic and Monetary Union in the European Community"),following the proposal, stated that the EMU was to be achieved in three successive stages:[19]

Stage 1	Began on 1 July 1990	The strengthening of fiscal and economic policy coordination among states and the participation of all currencies of the EC member states in the **European** Exchange Rate Mechanism would be realized. All the restrictions related to movement of capitals will be demolished.
Stage 2	Began on 1 January 1994	In this stage there was the establishment of the European System of Central Banks (ESCB). Also, there was the establishment of European Monetary Institute, on 1January 1994.The monetary policy would be at the jurisdiction of each state's central bank.

[19] Official Website of European Commission

<https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/economic-and-monetary-union/what-economic-and-monetary-union-emu_de,last> accessed on 10 June 2019.

Stage 3	Began on 1 January 1999	The ECB would implement integrated monetary policy, make decisions regarding intervention with a third country currency and centrally manage official reserves. Moreover, exchange rates would be permanently fixed, and a single currency would ultimately be introduced. Finally, EC common rules and procedures in the area of macroeconomic policy (e.g., fiscal policy) would be accorded binding force. [20]

The Delors' Committee proposal was adopted by the Treaty on European Union (Maastricht Treaty) in 1992, but still some important issues, concerned ESCB were left in ambiguity.[21] The Maastricht Treaty created a single European currency, the euro, whose stability was to be ensured by focusing on price stability ,the primary objective of ECB.

2.1.2 The European Monetary Institute.

The European Monetary Institute (EMI), began its operations at the start of the Second Stage of the EMU and it **was a crucial step towards the establishment of ECB**. The EMI was established in January 1994 and had its own legal personality[22].It replaced the Committee of the Governors.[23]It was directed and managed by the EMI council, consisting of a President, a Vice president and the Governors of the national central banks.[24] The EMI had two Presidents: first Alexandre Lamfalussy[25] from 1994 to 1997 and then Willem Frederik Duisenberg

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[20] Shigeyuki Hamori and Naoko Hamori, "Introduction of the Euro and the Monetary Policy of the European Central Bank" (World Scientific 2009) p.12.

[21]Shigeyuki Hamori and Naoko Hamori, "Introduction of the Euro and the Monetary Policy of the European Central Bank" (World Scientific 2009) p.13.

[22] Unlike the Committee of Governors before, the EMI got its own legal personality and quickly grew as an organization and in terms of staff numbers.

Official Website of European Central Bank.

<https://www.ecb.europa.eu/ecb/access_to_documents/archives/emi/html/index.en.html> accessed on 10 June 2019.

[23] Alex Warleigh, Understanding European Union Institutions (Routledge 2002) p.88.

[24] Ralph Mehnert-Meland, Central bank to the European Union (Kluwer Law International 1995) p.53.

[25] Belgian, who had been the president of the Bank of International Settlements. He was a popular and uncontroversial choice to lead the institute, as he was highly respected by his fellow central bankers. Found in: Shigeyuki Hamori and Naoko Hamori, "Introduction of the Euro and the Monetary Policy of the European Central Bank", (World Scientific 2009) p.28.

from July 1997. Frederik Duisenberg also became the first President of the ECB in 1998. The stipulations related to the EMI were set according to the Maastricht Treaty and the EMI Statute, that is, the protocol attached to that treaty.[26]

The EMI has the single general objective to contribute in achieving the necessary conditions for the transition in Stage 3 of the EMU.[27] The EMI records cover preparatory and operational activities between 1994 and 1998, such as meetings of working groups, administrative and organizational tasks and documents, on the key responsibilities relating to harmonizing payment systems, statistical methods, monetary policies, designing and issuing the euro banknote and other related issues.[28]

The EMI aimed to[29]:

- coordinate in a better way, the EU monetary policy,
- enforce financial stability,
- improve (cross-border) payment systems in the EU,
- develop a regulatory, organizational and logistical framework,
- develop a common monetary policy strategy for the euro,
- prepare a single money market.

The EMI was joined by the European Commission[30] and Eurostat in keeping watch over these practices and raising alarms, when they thought a country had gone too far. In the final phase of the EMU, the participating countries no longer have their own monetary sovereignty. Two countries, namely the United Kingdom and Denmark, have opted out of moving to Stage Three for the time being ("Member States with a special status").

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[26] Shigeyuki Hamori and Naoko Hamori, "Introduction of the Euro and the Monetary Policy of the European Central Bank", (World Scientific 2009) p.19.

[27] Ralph Mehnert-Meland, Central bank to the European Union (Kluwer Law International 1995) p.54.

[28] Official Website of European Central Bank

< https://www.ecb.europa.eu/ecb/access_to_documents/archives/emi/html/index.en.html> accessed on 10 June of 2019.

[29] Official Website of European Central Bank

< https://www.ecb.europa.eu/ecb/access_to_documents/archives/emi/html/index.en.html> accessed on 10 June of 2019.

[30] Shigeyuki Hamori and Naoko Hamori, Introduction of the Euro and the Monetary Policy of the European Central Bank (World Scientific 2009) p.29.

Monetary Policy in the euro area has been delegated to the European Central Bank. In order to prepare for the transition to stage three of the EMU, EMI made the necessary preparations related to the establishment of ESCB, comprising the ECB and the national central banks (NCBs) of all EU member states. The mission of the EMI was to complete these preparations by the end of 1996 and outline a regulatory, organizational, operational, and technical framework for the ESCB.[31] Furthermore, joining the EMU also required an independent central bank (Art. 130 TFEU)[32].

To conclude, there were **four factors** that played a role in getting the European Monetary process towards its realization:

⇒ The Widespread dissatisfaction with the dominance of the Bundesbank in European monetary affairs.

⇒ The activities of Jacques Delors and other Eurofederalists such as Scmidt and Giscard d'Estaing, who advocated deeper European Integration and the establishment of European Monetary Union.

⇒ The growth of intra union Trade and the necessity for deeper Economic Integration. The establishment of EMU had as a consequence the reduction of transaction cost.

⇒ The German Government perceived that it needed to anchor itself more deeply in the European Union and its Institutions, in order to assuage any fears that it was remerging as a threat to Europe.[33]

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[31] Shigeyuki Hamori and Naoko Hamori, Introduction of the Euro and the Monetary Policy of the European Central Bank (World Scientific 2009) p.21.

[32] Article 130:When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the ECB , nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies 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 European Central Bank or of the national central banks in the performance of their tasks.

[33] Shigeyuki Hamori and Naoko Hamori, Introduction of the Euro and the Monetary Policy of the European Central Bank (World Scientific 2009) p.21-22.

2.1.3 The establishment of European Central Bank.

The ECB is one of the seven institutions of the EU and the central bank for the entire Eurozone. **It was established, on 1 June of 1998, by Treaty of Maastricht,** following the Treaty of Amsterdam that amended the Treaty on the European Union.[34] The ECB was modeled on the attractive model of Deutsche Bundesbank, which had economic success both within Germany and in Western Europe. It was the central bank of Germany and the model that ECB followed, in terms of the bank's organization, its high level of independence from the government and its monetary policy tools. Bundesbank became the institutional and ideational model of ECB, because of its success in maintaining price stability and other positive economic outcomes in postwar Germany.

When the ECB's design became an issue for discussion between 1989 and 1991, Europe's internal bankers agreed that the Bundesbank's structure and principles were the best model for the future of ECB.[35]Why did the EU decide for the German model instead of the Anglo-French model? Basically, there were two reasons why the EU decided for the German model: (1) the monetarist counter-revolution and (2) the strategic position of Germany in the European monetary integration process. [36]

This institution is at the heart of the Euro system, tasked with administrating the monetary policy of the 19 EU member states taking part in the Eurozone. **The ECB is a supranational institution with legal personality.**

According to article 282 par.2 of the Treaty on the European Union (TEU)

"*The European Central Bank shall have legal personality. It alone may authorize the issue of the euro. It shall be independent in the exercise of its powers and in the management of its finances. Union in-*

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[34] Official Website of European Central Bank <https://www.ecb.europa.eu/ecb/orga/escb/html/index.en.html> accessed on 10 June 2019.

[35] Shigeyuki Hamori and Naoko Hamori, Introduction of the Euro and the Monetary Policy of the European Central Bank. (World Scientific 2009) p.53.

[36] Juergen Schroeder, "The European Central Bank and the International Role of the Euro" in Asian Economic Cooperation in The New Millennium (World Scientific Publishing Pte.2004) p. 57-70.

stitutions, bodies, offices and agencies and the governments of the Member States shall respect that independence".

According to Article 130 of the Treaty for the functioning of European Union and article 19 of **Single Supervisory Mechanism (SSM)**-Regulation, the ECB is an independent authority and shall enjoy privileges and immunities of the territories of the European Member States by performing its tasks.[37]

The Treaty of Amsterdam established the bank in 1998, and it is headquartered in Frankfurt, Germany. **The Maastricht Treaty[38] made the ECB politically independent.** The Maastricht Treaty made "price stability'' the ECB's primary objective but left it to the ECB to give precise meaning to the words. Until the Treaty of Lisbon the European Central Bank had always been treated in a different way from other EU institutions.

The European Central Bank is the **de facto successor of the EMI**. The EMI itself took over from the earlier European Monetary Co-operation Fund (EMCF).[39] The ECB formally replaced the EMI on 1 June 1998 by virtue of the Treaty on European Union (TEU, Treaty of Maastricht), however it did not exercise its full powers until the introduction of the euro on 1 January 1999, signaling the third stage of EMU. The bank was the final institution needed for EMU, as outlined by the EMU reports. During this time, the national central banks of the 11 EU member states transferred their monetary policy function to the ECB. Other states within the EU joined later on, with Greece, Slovenia, Cyprus, Malta, Slovakia, Estonia, Latvia and

[37] Stanyo Dinov, Central Banks as a Bank Supervisor. A comparison of the function of the Bank of England, the Federal Reserve and the European Central Bank (Tectum Wissenschaftsverlag 2017) p.67.

[38] The **Maastricht Treaty** or the "**Treaty on European Union"** was signed on 7 February 1992 by the members of the European Community in Maastricht, Netherlands. The treaty founded the European Union and established its pillar structure and expanded the competences of the EEC/EU. Moreover it led to the creation of the European single currency, the euro.
Official website of European Parliament <http://www.europarl.europa.eu/about-parliament/en/in-the-past/the-parliament-and-the-treaties/maastricht-treaty> accessed on 10 June 2019.

[39] The European Monetary Cooperation Fund ("EMCF", or "Fund"), was established in 1973 to increase cooperation between Member States working towards Economic and Monetary Union. It operated from Basel, with the Bank for International Settlements (BIS) providing the necessary administrative and technical support.
Official Website of European Central Bank
<https://www.ecb.europa.eu/ecb/access_to_documents/archives/emcf/html/index.en.html>accessed on 10 June2019.

Lithuania joining the EU between 2001 to 2015. The expansion enlarged the bank's scope, and it marked a milestone in the complex process of EU integration.[40]

The first President of the ECB, Win Duisenberg was also the former president of the EMI and Dutch Central Bank. His proponents saw him, as a guarantor of a strong Euro, and he had the support of German, Dutch and Belgian governments. The French government had opposed Duisenberg taking over the presidency of the ECB, instead opting to have a French citizen as the president. They resolved the disagreement through a gentleman's agreement, where Duisenberg agreed to step down prior the end of his term, for French Economist, Jean-Claude Trichet,[41] a French national, to take over. Trichet replaced Duisenberg as President in November 2003. On 1 November 2011, Mario Draghi replaced Jean-Claude Trichet as President of the ECB.

On 1 December 2009, the Treaty of Lisbon entered into force. According to Article 13 of the Treaty of European Union (TEU), the ECB gained official status of an EU institution. "***Each institution shall act within the limits of the powers conferred on it in the Treaties, and in conformity with the procedures, conditions and objectives set out in them*.**"

In article 13 of Treaty of European Union is stated that "The provisions relating to the European Central Bank… are set out in the Treaty on the Functioning of the European Union". The legal basis for the functioning of ECB includes:

- Articles 119-144, 219 and 282-284 of the Treaty on the Functioning of the European Union (TFEU).
- Protocol (No 4) to the Lisbon Treaty on the Statute of the European System of Central Banks (ESCB) and the European Central Bank (ECB).

The ESCB includes the ECB together with the national central banks (NCBs) of all the EU member states, including those that have not adopted Euro. The NCBs are legal entities formed under the European Law but the system itself does not have legal personality.[42]

[40]Official Website of Corporate Finance Institute. <https://corporatefinanceinstitute.com/resources/knowledge/economics/what-is-european-central-bank-ecb/ > accessed on 10 June 2019.

[41] Previous to his assumption of the presidency he served as Governor of the Bank of France from 1993 to 2003 under presidents François Mitterrand and Jacques Chirac.

[42] Rene Smits, The European Central Bank, Institutional Aspects (Kluwer Law International 1996) p.92.

The Euro system on the other hand, only comprises the ECB and the NCBs of the EU Member States that have adopted the euro as their currency (currently 19).

If all member states of the EU adopt the euro, the Euro system and ESCB will be synonymous. For as long as there are Member States that have not adopted the euro as their currency, the ESCB and the Euro system will continue to co-exist. **The ECB is the monetary authority for those Member States.** The ECB is responsible for the supervision of lending institutions in the Euro system and in participating non-euro-area member states.[43]

The Euro system is relatively decentralized: national central bankers have more sway collectively than, say, representatives from the American State Banks. European citizens are more likely to accept ECB monetary policy, if they know that they are represented, indirectly and unofficially, by NCB governors. Under these circumstances policy is designed in the fora of working groups, committees and the Governing Council, where NCB experts and officials predominate. Arguably, the decentralized nature of the euro system reflects the problematic legitimacy of EU in many member states.[44]

2.2 The decision making-structure in European Central Bank.

A well-designed decision-making mechanism is required for achieving the objectives of monetary policy. The structure of the ECB reflects the Bundesbank. Despite all the obvious institutional similarities between the two central banks, Bundesbank operated on quite different policy principles for much of the postwar period.[45]

There are **four decision-making bodies** of the ECB, responsible to undertake the objectives of the institution. These bodies include:

1. the Governing Council,
2. the Executive Board,
3. the General Council

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[43] Official Website of European Central Bank

<https://www.ecb.europa.eu/ecb/orga/escb/html/index.en.html> accessed on 10 June 2019.

[44] David J. Howarth and Peter H. Loedel, The European Central Bank: The New European Leviathan? (Palgrave Macmillan 2003) p.98.

[45] Shigeyuki Hamori and Naoko Hamori, Introduction of the Euro and the Monetary Policy of the European Central Bank (World Scientific 2009) p.35.

4. and the Supervisory Board.[46]

<u>The Governing Council:</u> is **the most important decision-making body of the ECB.** It consists of six executive board members, with one serving as the president, and the 19 governors of the national central banks of the euro-zone countries. The minimum term of office for national central bank governor is five years. Its responsibilities include:

- to adopt the guidelines and take the decisions for ensuring the performance of the tasks entrusted to the ECB and the Euro system,
- to formulate monetary policy for the euro area. This includes decisions relating to monetary objectives, key interest rates, the supply of reserves in the Euro- system, and the establishment of guidelines for the implementation of those decisions,
- banking supervision responsibilities that include decisions relating to the general framework, under which supervisory decisions are taken, and completing draft decisions proposed by the Supervisory Board, under the non-objection procedure. [47]

The meetings of the Governing Council are chaired by the president of the ECB or in case of unavailability, the vice president.[48]The Council decides, in principle, by simple majority. According to article 10 of the **Protocol on the statute of the European System of Central Banks and of the European Central:**

> "*In order for the Governing Council to vote, there shall be a quorum of two thirds of the members. If the quorum is not met, the President may convene an extraordinary meeting at which decisions may be taken without regard to the quorum*."

The setup of the ECB is therefore based on the principle of "one person, one vote." This way national central bankers are involved in monetary policy decisions. The Council members meet twice a month at the institution's offices in Germany. The proceedings of the

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[46] Official Website of European Central Bank <https://www.ecb.europa.eu/ecb/orga/decisions/govc/html/index.en.html >accessed on 10 June 2019.

[47] Official Website of European Central Bank <https://www.ecb.europa.eu/ecb/orga/decisions/govc/html/index.en.html >accessed on 10 June 2019.

[48] Karl. Kaltenthaler, Policymaking in the European Central Bank*:* The Masters of Europe's Money. (Rowman & Littlefield Publishers 2006) p.63.

meetings shall be confidential. The minutes of their meetings are required to be published prior the next meeting.[49]The Governing Council assesses economic and monetary developments and takes its monetary policy decisions every six weeks. At the other meetings, the Council focuses in discussing issues related to other tasks and responsibilities of the ECB and the Euro system. Separate meetings of the Governing Council are held in order to ensure the separation of the ECB’s monetary policy and other tasks from its supervisory responsibilities.

A press conference is held every six weeks, where the monetary policy decision is explained in detail. The President, assisted by the Vice-President, chairs the press conference. In addition, the ECB publishes regular accounts of the Governing Council’s monetary policy meetings before the date of the next one.[50]

The Executive Board: consists of the president, the vice president, and up to four other members appointed by the European Council, by qualified majority. Only nationals of Member States may be members of the Executive Board. If a member of the Executive Board no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct, the Court of Justice may, on application by the Governing Council or the Executive Board, compulsorily retire him.[51] The executive member’s term in office is an 8-year non-renewable.[52]

The article 11.2. of the Protocol on the Statute of the ESCB and of the ECB clearly states that:

> “In accordance with Article 112(2)(b) of this Treaty, the President, the Vice-President and the other members of the Executive Board shall be appointed from among persons of recognized standing and professional experience in monetary or banking matters by common

[49] Article 10.4. of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank.

[50] Official Website of the European Central Bank <https://www.ecb.europa.eu/ecb/orga/decisions/govc/html/index.en.html> accessed on 10 June 2019.

[51] Article 11.4. of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank.

[52] Official Website of the European Central Bank <https://www.ecb.europa.eu/ecb/orga/decisions/govc/html/index.en.html> accessed on 10 June of 2019.

accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the Council after it has consulted the European Parliament and the Governing Council." [53]

The responsibilities of executive board are the following:

- to prepare Governing Council meetings,
- to implement monetary policy for the euro area in accordance with the guidelines specified and decisions taken by the Governing Council. In so doing, it gives the necessary instructions to the euro area NCBs, [54]
- to manage the day-to-day business of the ECB with the support of the Chief Services Officer, Michael Diemer,
- to exercise certain powers delegated to it by the Governing Council. These are of a regulatory nature.

The General Council: consists of the president and vice president of the ECB and the governors of the national central banks of the 28 EU member states. Currently, only 19 out of the 28 EU member states have taken up the Euro as their single currency. As the central banks of the EU countries that have not (yet) adopted the euro continue to pursue national monetary policies, they will not participate in decisions related to the single monetary policy for the euro area. In the General Council they will, however, have the opportunity to discuss monetary policy issues and their exchange rate relations with the euro.[55]

The General Council is a transitional body that carries out responsibilities taken over from the European Monetary Institute (EMI). As a transitional body, the General Council is tasked with fixing the exchange rates of currencies for countries taking up the Euro. The council also contributes to the preparation of ECB annual report, setting conditions of employment of the European Central Bank members of staff and collection of data. It is responsible for support-

[53] Article 11.2. of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank.

[54] Rene Smits, The European Central Bank, Institutional Aspects (Kluwer Law International 1996) p.97.

[55] Official Website of the European Central Bank https://www.ecb.europa.eu/ecb/orga/decisions/genc/html/index.en.html accessed on 10 June 2019.

ing the ECB in consultation and coordination and assistance in the preparation of the Eurozone enlargement.[56]

<u>The Supervisory Board:</u> The Supervisory Board comprises the chair, vice-chair, four ECB representatives and representatives of national supervisors. The chair is appointed for a non-renewable term of five years, the vice chair is chosen from among the members of the ECB's Executive Board. If the national supervisory authority designated by a Member State is not an NCB, the representative of the competent authority can be accompanied by a representative from their NCB. In such cases, the representatives are together considered as one member for the purposes of the voting procedure.

The board plans and executes the supervisory function of the ECB. The Supervisory Board meets every three weeks to discuss, plan and carry out the ECB's supervisory tasks.[57]It also proposes draft decisions to the Governing Council through the non-objection procedure.

There is a Steering Committee that supports the board's activities, including organizing the board's meetings. The Steering Committee members comprise the Chair and Vice-Chair of the Supervisory Board, One ECB representative and five representatives of national supervisors. The five representatives of national supervisors are appointed by the Supervisory Board for one year based on a rotation system that ensures a fair representation of countries.[58]

2.3The European Central Bank's Capital.

The capital of the ECB comes from the NCBs of all EU Member States and amounts to €10,825,007,069.61.[59] The NCBs' shares in this capital are calculated using a capital key, which reflects the respective member's share in the total population and gross domestic prod-

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[56] Official Website of the European Central Bank <https://www.ecb.europa.eu/ecb/orga/decisions/genc/html/index.en.html >accessed on 10 June 2019.

[57] Official Website of the European Central Bank <https://www.ecb.europa.eu/ecb/orga/decisions/genc/html/index.en.html >accessed on 10 June 2019.

[58] Official Website of the European Central Bank <https://www.ecb.europa.eu/ecb/orga/decisions/genc/html/index.en.html >accessed on 10 June 2019.

[59]Official Website of European Central Bank <https://www.ecb.europa.eu/ecb/orga/capital/html/index.en.html> accessed on 10 of June 2019.

uct of the EU.[60] The ECB adjusts the shares every five years and whenever a new country joins the EU.

The adjustment is made on the basis of data provided by the European Commission. The article 28 par.3 of the Protocol on the Statute of the ESCB and of the ECB stipulate that the capital may be increased by a decision by the Governing Council acting by the **qualified majority.[61]** Also, according to paragraph.2 of the article 28 of the Protocol, the national central banks shall be the sole subscribers to and holders of the capital of the ECB.[62] The last decision of ECB for capital increase was on 13 December of 2010.

According to the article 1 of the ECB/2010/26 decision: "The ECB's capital shall be increased by EUR 5 000 million from EUR 5 760 652 402,58 to EUR 10 760 652 402,58."[63] The ECB's capital was increased to EUR 5 760 652 402,58 in accordance with Article 48.3 of the Protocol on the Statute of the Protocol of the European System of Central Banks and of the European Central Bank as a consequence of Member States acceding to the Union and their national central banks joining the European System of Central Banks.[64]

Finally, the Governing council has the exclusive jurisdiction, acting by the qualified majority provided in Article 10.3 of the Protocol on the Statute of ESCB and ECB,[65]to determine the extent and the form in which the capital shall be paid up. The fully paid-up subscriptions of

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[60] Official Website of European Central Bank
<https://www.ecb.europa.eu/ecb/orga/capital/html/index.en.html> accessed on 10 June 2019.

[61] 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."

[62] 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."

[63] Official Website of European Central Bank
https://www.ecb.europa.eu/ecb/legal/1001/1010/html/index.en.html accessed on 10 June 2019.

[64] ECB's Decision of 13.12.2010, ECB 2010/26.

[65] For any decisions to be taken under Articles 28, 29, 30, 32, 33 and 51, the votes in the Governing Council shall be weighted according to the national central banks' shares in the subscribed capital of the ECB. The weights of the votes of the members of the Executive Board shall be zero. A decision requiring a qualified majority shall be adopted if the votes cast in favor represent at least two thirds of the subscribed capital of the ECB and represent at least half of the shareholders. If a Governor is unable to be present, he may nominate an alternate to cast his weighted vote.

euro area NCBs to the capital of the ECB amount to a total of €7,536,110,121.69 and break down are described in the Annex 1.

3.Monetary Policy within ECB.

3.1 The strategy of ECB.

Strategy as a term refers to a detailed plan for achieving success in situations such as business, industry or war. It is a framework for setting the information for achieving a goal. Historically, there were three broad headings of functions that central banks have performed. The first one is the definition and implementation of monetary policy, the second is a contribution to the maintenance of financial stability, understood in a broad sense. The third is a contribution to the organization and the smooth functioning of the financial system, with a view to enhancing its effectiveness.[66]

There were two general models of monetary policy commonly used in the central banks in the Eurozone: One model, based on monetarist economic thinking, used by the Bundesbank and others, was to target growth of the money supply in order to preclude the growth of inflation. According to this model central bankers have to accomplish a money supply growth goal, so as to allow economic growth at a noninflationary pace. The central bank would then monitor the growth of the money supply during the year and adjust interest rates in order to keep the money supply growth rate, within the acceptable bounds established by the central bank. This strategy was introduced by the chief economist Helmut Schesinger in 1974, at the Bundesbank.[67]

The second model was to target inflation. It was used by the Finns and Spanish. This policy model called for an inflation target to be established each year and then monetary policy, would be created in order to keep inflation at or below the target. The advocates of this strategy considered it more efficacious than there were on the money supply.[68]

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[66]Fritz Breuss, "Challenges for Central Banks in an Enlarged EMU" (Springer 2005), European Community Studies Association of Austria (ECSA Austria), Publication Series 9.p.53.

[67]Karl. Kaltenthaler, Policymaking in the European Central Bank: The Masters of Europe's Money (Rowman & Littlefield Publishers 2006) p.55.

[68]Karl. Kaltenthaler, Policymaking in the European Central Bank: The Masters of Europe's Money (Rowman & Littlefield Publishers 2006) p.55.

It was the first chief economist, Otmar Issing, that was responsible for formulating the general monetary policy strategy of the central bank, setting the agenda at Central Bank Council meetings. He was chosen by the Eurozone heads of governments, because he would immediately lend the central bank credibility with financial markets. He was a well-known and respected central banker. Issing's views on monetary policy were not accepted by all of the other members of the Governing Council.[69]

In 1990, when EMU was designed, Folkerts-Landau and Garber published a paper under the title "The European Central Bank: A Bank or a Monetary Policy Rule?" In this paper, they introduce two concepts of Central Banking; the narrow and the wide one. The narrow concept only includes monetary stability while the broad includes both financial and monetary stability. The ECB's policy strategy is geared toward achieving the bank's primary objective of price stability. In fact, these concepts are two sides of the same coin. Failures or disruptions in the financial system have an impact in the real economy and likewise monetary imbalances may lead to financial instability.[70] **ECB follows the narrow concept and focused in monetary stability.**

The ECB carries out its tasks in accordance with the Treaty on the Functioning of European Union and the Protocol of the Statute of ESCB and ECB. The ECB is an exception of the standard model of Central Banks. Unlike the Federal Reserve or the Bank of England, **the ECB has only one primary objective: the price stability** regarding articles 127(1) and 282(2) TFEU.[71]

> "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 Union as laid down in Article 3 of the Treaty on European Union. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation*

[69] Karl. Kaltenthaler, Policymaking in the European Central Bank: The Masters of Europe's Money (Rowman & Littlefield Publishers 2006) p.56

[70] Jakob de Haan, Helge Berger, The European Central Bank at Ten (Springer 2010) p.172.

[71] Stanyo Dinov, Central Banks as a Bank Supervisor: A Comparison of the Function of the Bank of England, the Federal Reserve and the European Central Bank (Tectum Verlag 2017) p.66.

of resources, and in compliance with the principles set out in Article 119."
The Article 127 par.2 of the Treaty on the Functioning of the European Union provides the framework for the ECB's activities and lists the four basic tasks of the system: *"The basic tasks to be carried out through the ESCB shall be:* *- to define and implement the monetary policy of the Union;* *- to conduct foreign exchange operations consistent with the provisions of Article 219;* *- to hold and manage the official foreign reserves of the Member States;* *- to promote the smooth operation of payment systems."*

The ESCB's first basic task is the definition and implementation of monetary policy. What is monetary policy? There is no definition of what exactly constitutes monetary policy. This definition may be derived on the basis of the attributed competences.

The conduct of foreign exchange operations concerns the intervention in the foreign exchange markets and the other operations, which may be necessary for or conducive to the primary objective of price stability.[72]This second intent makes clear that the system is not only endowed with responsibilities for the internal monetary affairs of the Union, but it is also competent to act in the external sphere. This is consistent with the usual allotment of responsibilities to central banks, which perform foreign exchange operations on a day to day basis.[73]

The task to hold and manage the official foreign reserves of the member states has a close connection with the task of conducting foreign exchange operations. These reserves are entrusted to National Central Banks.[74]The official foreign reserves of Member States include all their holdings of gold, their foreign exchange reserves as well as the claims of International Institutions such as the IMF except for minor 'working balances' discussed below.[75]

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[72] René Smits, The European Central Bank: Institutional Aspects (International and Comparative Law Quarterly 45, 1996) p.197.

[73] Smits, René. "The European Central Bank: Institutional Aspects (International and Comparative Law Quarterly 45 1996) p.197.

[74] Article 30 of the Protocol on the Statute of the ESCB and ECB.

[75] René Smits, The European Central Bank: Institutional Aspects (International and Comparative Law Quarterly 45, 1996) p.198.

The fourth basic task, which is the promotion of smoothly operating systems has been worked out in article 22 of the Protocol on the statute of the ESCB and ECB: "*The ECB and national central banks may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries.*"

According to the fourth paragraph of the article 127 of the TFEU:

> 4."*The ECB shall be consulted:*
>
> *- on any proposed Union act in its fields of competence;*
>
> *- by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 129(4).*
>
> *The European Central Bank may submit opinions to the appropriate Union institutions, bodies, offices or agencies or to national authorities on matters in its fields of competenc*e."

With this paragraph the advisory functions of the ECB are laid down. The notion of act is a wide one and encompasses any measure, which purports to have legal effect. A distinction can be made between consultation on proposed Union acts and on proposed national legislative provisions. National authorities should consult the ECB. Also, regulations, directives, decisions would have to be submitted in draft form to the ECB, as well as International Agreements.[76]

It is interesting that even measures of non-binding character, such as recommendations and opinions, would also fall in this category. The absence of legal restraint does not completely rob such acts of their normative value, emanating as they do form Union Organs.[77]Resolutions of the Council that have a sui generis character, may also have to be submitted for advice and as a result, fall under the scope of the article. The ECB's involvement respects the institution-

[76] René Smits, The European Central Bank: Institutional Aspects. (International and Comparative Law Quarterly 45 1996) p.211.

[77] René Smits, The European Central Bank: Institutional Aspects. (International and Comparative Law Quarterly 45 1996) p.211.

al balance within the Union.[78]European Central Bank is not only obliged to give advice on draft legislation, but it is empowered to offer its advice to Union and national organs on its own initiative. The consultative capacity is limited to its fields of competence.

Article 127 par.5.of the TFEU "The ESCB shall contribute to the smooth conduct of policies pursued by the component authorities relating to the prudential supervision of credit institutions and the stability of the financial system."
Article 127 par.6.of the TFEU "The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings."

In paragraph 5, the ESCB and ECB that is a part of it, is entrusted with a contributory task in the area of prudential supervision and the stability of the financial system, which will be explained in the next part (3.5). Finally, the paragraph 6 of Article 127 of TFEU, contains an enabling clause under which ECB, may be given its own executive functions, in the area of prudential supervision of banks and other financial institutions.[79]These objectives that often are called secondary, include for example, balanced economic growth and a highly competitive social market economy, aiming at full employment and social progress.[80] [81]

In October of 1998, the Governing Council of the ECB announced the stability oriented monetary policy strategy of Euro system. This model was a mix of the Bundesbank model and perceived improvements based on Bundesbank experience and Eurozone realities.[82]The strategy consists of:

⇒ a quantitative definition of the primary objective of monetary policy and

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[78] Case C-70/88 European Parliament v. Council (1990) ECR 1990 I-02041.

[79] René Smits, The European Central Bank: Institutional Aspects (International and Comparative Law Quarterly 45, no. 2 (1996) p.179.

[80] Philip Hartmann, Frank Smets, Working Paper Series, "The first twenty years of European Central Bank: monetary policy." (European Central Bank, December 2018) p.5.

[81] Karl. Kaltenthaler, Policymaking in the European Central Bank: The Masters of Europe's Money (Rowman & Littlefield Publishers 2006) p.73.

[82] Karl. Kaltenthaler, Policymaking in the European Central Bank: The Masters of Europe's Money (Rowman & Littlefield Publishers 2006) p.57.

⇒ "two pillars" that are used to assess risks to future price stability. These pillars are a prominent role for money and a broadly-based assessment that encompasses a wide range of indicator variables.[83]

According to Centre for Economic Policy Research, the ECB strategy is unclear, due to the existence of two pillars. While there are important links between money growth and inflation in the medium and long run, in practice financial innovation makes these links unpredictable in the short run. Therefore, it is claimed that ECB will have to frequently ignore the signals coming from the first pillar, just like the Bundesbank has done in the past. It would be advisable, to simply disregard the first pillar and concentrate on the information from the second.[84]

Over the past three decades, there has been a growing belief that the goal of monetary policy ought to be to stabilize inflation. Monetary policy can have little positive long-run effect on the economy and using monetary policy for stabilization is difficult as there are long, variable and uncertain lags between the implementation of monetary policy and when its effects are realized. If the primary task of ECB is to achieve low and stable inflation, then making monetary policy is a job for technicians and not politicians.[85]

3.2 Price stability: the primary objective of ECB.

3.2.1 The definition of Price stability.

Price stability is a situation, where the prices of goods and services offered in a market, change very slowly and in some circumstances do not change at all. Inflation is sufficiently low and stable so as **not** to influence the economic decisions of households and firms. Employment and inflation[86] are two factors that affect this situation. This stability is the goal of

[83] Otmar Issing, The Monetary Policy of the European Central Bank: Strategy and Implementation, (CesiFo Forum 2000) p.4.

[84] Otmar Issing, Monetary Policy in the Euro Area: Strategy and Decision Making at the European Central Bank. (Cambridge University Press, 2001) p.108.

[85] Fritz Breuss, Challenges for Central Banks in an Enlarged EMU (European Community Studies Association of Austria, Publication Series, Springer, 2005) p.115.

[86] Inflation is a rise in the in the general price level of goods and services in an economy over a longer period of time resulting in a decline in the value of money and purchasing power. Deflation is a decrease in the general price level of goods and services over a longer period of time.

fiscal and monetary policy with the aim to support sustainable rates of economic activity. Policy is set in order to avoid **both persistent and high inflation or deflation.** The most important objective of overall economic policy is a stable economic growth that is sustainable over the long term.[87]

It seems surprising to find a discussion of price stability within the ECB strategy. The role of price stability is an overall objective of the European Union and the primary goal of European Central Bank. The ESCB is guided by this ultimate objective. **The objective of Euro system for maintaining price stability refers to the general level of prices in the economy.**

At a very early stage, the European Monetary Institute (henceforth, EMI) had mentioned that an operational, precise definition of price stability was essential for the future of ECB strategy. The definition of price stability is essential for the transparency of the central bank's objective. In December 1998, the ECB's Governing Council adopted a quantitative definition of price stability:

"**Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%.**"[88]

In defining price stability, the Governing Council encountered exactly this kind of problem. It was deemed particularly important to clarify that there is no mechanical rule according to which any possible price development outside the price stability range would automatically entail a given policy response.[89]

This definition used by European Central Bank was not without problems. Several people inside and outside of the ECB's Governing Council argued that the ECB should include in its thinking about price stability both the costs of inflation and the benefits of moderate positive inflation. In May 2003, the Governing Council announced that it had slightly changed its def-

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[87] Official Website of European Central Bank

< https://www.ecb.europa.eu/mopo/strategy/pricestab/html/index.en.html>accessed on 10 June 2019.

[88] Official Website of European Central Bank

< https://www.ecb.europa.eu/mopo/strategy/pricestab/html/index.en.html>accessed on 10 June 2019.

[89] Issing Otmar Issing "Monetary Policy in the Euro Area: Strategy and Decision-making at the European Central Bank." (ECB 2001) p.70-71.

inition of price stability. Now, the Governing Council would aim to “keep inflation rates below, but close to,2% over the medium term”.[90]

This definition allows a prompt *ex post* verification by an independent third party of whether current price developments are compatible with it.[91]The definition of price stability focused on consumer prices of the whole euro area and not only on a single EMU member state. **That focus reflects the fact that monetary policy within a monetary union, is not focused in country-specific inflation developments**. Therefore, price stability is assessed on the basis of price developments in the euro area economy. Secondly the definition refers to annual (year-on-year) price increases. The inflation measured in annual terms is prominent in the public debate, whereas the highly frequency price movements are not and, in any case, cannot be controlled by monetary policy.[92]

The definition of price stability given by the ECB was initially criticized for being ‘asymmetric’ owing to the lack of an explicit ‘floor’ for the range of rates of inflation compatible with price stability. After a careful reading of the ECB announcement, however, these criticisms appear to be misplaced. The definition refers to ‘price increases of less than 2 per cent’, and thus excludes the possibility of a fall in prices (that is, the possibility of deflation). Price stability in the euro area, therefore, excludes both inflation and deflation and is, in this sense, symmetric. [93]

The European Central Bank uses a measure of inflation known as the harmonized index of consumer prices (HICP), which ensures that the measure of inflation is essentially the same across all EMU member states. [94]As a result, ECB has a clear picture of price developments in the Eurozone.

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[90] Karl. Kaltenthaler, Policymaking in the European Central Bank: The Masters of Europe's Money (Rowman & Littlefield Publishers 2006) p.74.

[91] Issing Otmar Issing “Monetary Policy in the Euro Area: Strategy and Decision-making at the European Central Bank.” (ECB 2001) p.70-71.

[92] Issing Otmar Issing “Monetary Policy in the Euro Area : Strategy and Decision-making at the European Central Bank.”(ECB. 2001) p.70-71.

[93] Otmar Issing “Monetary Policy in the Euro Area:Strategy and Decision-making at the European Central Bank” (ECB 2001)p.75.

[94] Karl. Kaltenthaler, Policymaking in the European Central Bank: The Masters of Europe's Money(Rowman & Littlefield Publishers 2006) p.73.

The Governing Council had also clarified in 2003 that in the pursuit of price stability, it aims to maintain inflation rates below, but close to, 2% over the medium term. This definition has been maintained over the past two decades. The aim of Governing Council to keep euro area inflation below, but close to 2% over the medium term, signifies a commitment to avoiding both inflation, that is persistently too high and inflation that is persistently too low. Inflation rates of below, but close to, 2% are low enough for the economy to fully reap the benefits of price stability and in particular[95]:

- avoiding deflation risk. In a deflationary environment monetary policy may not be able to sufficiently stimulate aggregate demand by using its interest rate instrument. This makes it more difficult for monetary policy to fight deflation than to fight inflation,
- providing a sufficient margin to address the implications of inflation differentials in the euro area. As a result, individual countries in the euro area avoid living with too low inflation rates or even deflation.[96]

3.2.2 The importance of price stability.

Price stability is the most powerful tool for a central bank, so as to promote economic growth, high employment and financial stability. It is a fundamental aim of economic governance, because it brings **sustainable long-term growth.** No matter if having a single mandate like the European Central Bank or multiple ones like the United States Federal Reserve, price stability is more or less a constant among the objectives of the world's independent central banks. In ECB the primary goal of price stability implies that it should operate long term stability, rather than paying attention to short term factors.[97]

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[95] [95] Official Website of European Central Bank
https://www.ecb.europa.eu/explainers/tell-me-more/html/stableprices.en.html accessed on 10 June 2019.

[96] Official Website of European Central Bank
https://www.ecb.europa.eu/explainers/tell-me-more/html/stableprices.en.html accessed on 10 June 2019.

[97] Elizabeth Groch, "The Treaty of Lisbon and the European Central Bank" Master thesis (Diplomatic Academy of Vienna, 2008) p.6.

Fundamentally, price stability preserves the integrity and purchasing power of the nation's money.[98] Price stability implies avoiding both prolonged inflation and deflation. **Inflation** is a rise in the in the general price level of goods and services in an economy over a longer period of time. **Deflation** is a decrease in the general price level of goods and services over a longer period of time. **Too rapid inflation is negative for many reasons**: it complicates the economic decision-making process and slows economic growth. In addition, inflation diminishes the value of savings.[99]

Price stability enables monetary authorities to pursue secondary objectives. Such objectives include: the reduction of fluctuations in real economic activity and the management of financial and/or liquidity crises. These are referred as secondary goals, because a central bank is unlikely to succeed at limiting fluctuations in economic activity or containing financial crises**, unless the price level is stable**.[100]

If there is uncertainty about the price level, it will make it difficult for firms and households to determine whether changes in individual prices reflect fundamental shifts in supply and demand or merely changes in the overall rate of inflation. By eliminating this uncertainty, a monetary policy that maintains long-run price stability eliminates a potential drag on the efficient allocation of resources and, hence, on economic growth.[101]

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[98] Official Website of Federal Reserve.
<https://www.federalreserve.gov/newsevents/speech/bernanke20060224a.htm> accessed on 10 June 2019.

[99] Official Website of Eesti Bank.
<https://www.eestipank.ee/en/monetary-policy/importance-price-stability> accessed on 10 June 2019.

[100] Official Website of Federal Reserve Bank of St.Louis
<https://www.stlouisfed.org/publications/regional-economist/january-2008/stable-prices-stable-economy-keeping-inflation-in-check-must-be-no-1-goal-of-monetary-policymakers> accessed on 10 June 2019.

[101] ECB “Price stability: why is it important for you?” (April 2009, ECB) p.31-32.

Business decisions based on expectations of continuing inflation often turn out badly when inflation falls, resulting in higher default rates and business failures. Outright deflation is particularly notorious because a falling price level increases the real cost of servicing outstanding debt.

3.2.3 Benefits of price stability.

Price stability contributes to achieving high levels of economic activity and employment, in several ways. It serves to create economic and social security in the European environment. The benefits of achieving price stability are[102]:

- The monetary policy becomes more transparent. The price stability is a toll for the consumers in order to recognize changes in relative prices (i.e. prices between different goods). As a result, they make well informed consumption.
- There is a contribution to financial stability that leads to sustainability and long run growth.
- Encourages investments, while contributing to the development of credit markets.
- People concentrate on production and wealth protection is not a priority.
- Provides a clear and measurable yardstick against which the European citizens can hold the ECB accountable.
- Public is provided with guidance for forming expectations of future price developments.

[102] Official Website of European Central Bank <https://www.ecb.europa.eu/mopo/intro/benefits/html/index.en.html> accessed on 10 June 2019.

- Reducing inflation risk premia in interest rates (i.e. compensation creditors ask for the risks associated with holding nominal assets). This reduces real interest rates and increases incentives to invest.
- Avoiding unproductive activities to hedge against the negative impact of inflation or deflation.
- Reducing distortions of inflation or deflation, which can exacerbate the distortionary impact on economic behavior of tax and social security systems.[103]

These benefits are very important for ECB, whose working environment is not a single nation state. The ECB's policy stance of maintaining the euro area's price stability in medium- to longer- term perspectives is, therefore, to **support broader economic goals**. Whether price stability truly leads to a substantial contribution of achieving higher standards of living, high levels of economic activity and better employment perspectives, as listed by the ECB (ECB, 2004), continues to be a controversial topic.

Otmar Issing (2005) states that: *"We must be aware that price stability is not a sufficient condition for financial stability"*, and continues, *"Interestingly it has recently even been suggested that the conventional wisdom that price stability is good for financial stability has to be reversed"*.

[103] Official Website of European Central Bank <https://www.ecb.europa.eu/mopo/intro/benefits/html/index.en.html> accessed on 10 June 2019.

3.3. The two-pillar approach.

The European Central Bank’s policy framework is based on the two-pillar framework, or in other words, in two primary types of information. The ECB's approach to organizing, evaluating and cross-checking the information relevant for assessing the risks to price stability is based on two analytical perspectives, referred to as the "two pillars": economic analysis and monetary analysis.[104]The monetary analysis focuses on a longer-term horizon than the economic analysis. The separation between first and second pillar should therefore be seen mainly as an organizational framework to structure the available information, both internally and for the benefit of the public.[105]

3.3.1. Economic analysis.

The economic analysis assesses the short to medium-term determinants of price developments. It is a wide area of economic and financial data, which can indicate price developments in the future.[106]The focus is on real activity and financial conditions in the economy. The economic analysis takes account of the fact that price developments are influenced by the interplay of supply and demand in the goods, services and factor markets. The economic analysis also includes a thorough analysis of shocks hitting the euro area economy, their effects on cost and pricing behavior and the short to medium-term prospects for their propagation in the economy. Obviously, during the last several years, this analysis has played an increasingly important role in the decision-making process of the ECB.

The ECB regularly reviews, inter alia:[107]

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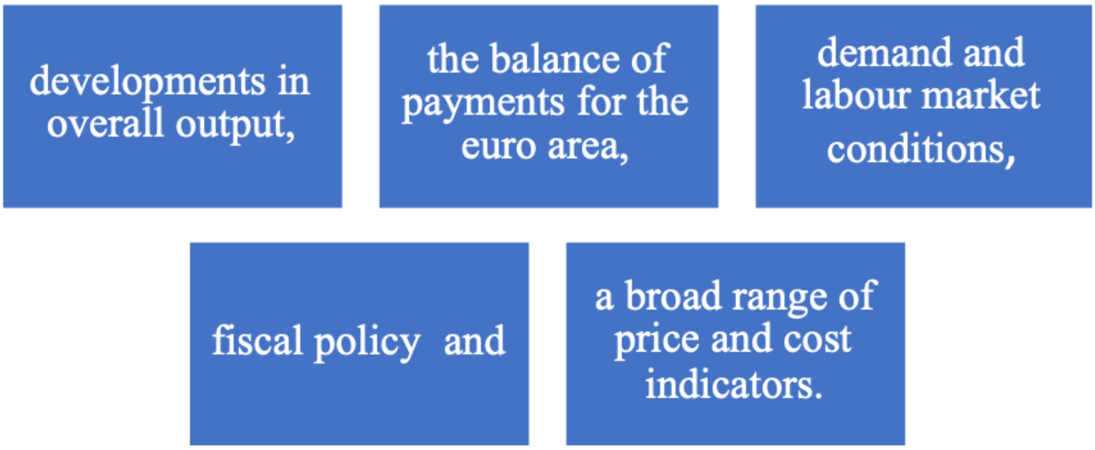
[104] Official Website of Central Bank.

<https://www.ecb.europa.eu/mopo/strategy/ecana/html/index.en.html> accessed on 10 June 2019.

[105] Otmar Issing, Monetary Policy in the Euro Area: Strategy and Decision Making at the European Central Bank (Cambridge University Press 2001) p.107

[106] Karl. Kaltenthaler, Policymaking in the European Central Bank: The Masters of Europe's Money (Rowman & Littlefield Publishers 2006) p.75.

[107] Official Website of European Central Bank, <https://www.ecb.europa.eu/mopo/strategy/ecana/html/index.en.html > accessed on 10 June 2019.



The ECB's economic analysis tries to take into account all the helping factors in assessing the dynamics of real activity and likely developments in prices. Asset prices and financial yields are also analyzed. Through them ECB is informed about the expectations of the financial markets, including expected future price developments. Regularly reviewed variables are those relating to developments in overall output, demand and labour market conditions, a broad range of price and cost indicators, fiscal policy, and the balance of payments for the euro area (ECB, 2004). [108]

For example, when buying and selling bonds, financial market participants implicitly reveal their expectations about future developments in real GDP growth and inflation. Using a variety of techniques, a central bank can analyze financial prices to extract the markets' implicit expectations about future developments.[109]

3.3.2 Monetary analysis.

Monetary analysis consists of a detailed analysis of monetary and credit developments, with a view to assessing their implications **for future inflation and economic growth**. In this type of analysis, which is conducted by ECB, there is a use of a wide set of tools and instruments. The econometric models of monetary and credit aggregates are developed by both academics and economists at public institutions.

[108] Official Website of European Central Bank, <https://www.ecb.europa.eu/mopo/strategy/ecana/html/index.en.html > accessed on 10 June 2019.

[109] Official Website of European Central Bank, <https://www.ecb.europa.eu/mopo/strategy/ecana/html/index.en.html> accessed on 10 June 2019.

Institutional and model-based analyses are important complementary blocks that enable the extraction of medium and long-term signals from the monetary data.[110]. In general, the appropriate definition of a monetary aggregate largely depends on the purpose for which the aggregate is intended. Given the fact that financial assets, transactions and means of payment are changing over time, it is not always clear how money should be defined, and which financial assets belong to which definition of money. For these reasons, central banks usually define and monitor several monetary aggregates.

The Euro system has defined three types of aggregates based on conceptual considerations and empirical studies, and in line with international practice: a narrow (M1), an “intermediate” (M2) and a broad monetary aggregate (M3). The degree of liquidity is the criterion of distinction between them (as assessed on the basis of the criteria of transferability, convertibility, price certainty and marketability) of the assets they include. M1 comprises currency, i.e. banknotes and coins, and overnight deposits. These deposits can immediately be converted into currency or used for cashless payments.M2 comprises M1 and, in addition, deposits with an agreed maturity of up to and including two years or redeemable, at a period of notice of up to and including three months.[111]

Broad aggregate (M3) includes currency, deposits with an agreed maturity of up to two years, deposits redeemable at notice of up to three months and repurchase agreements, money market fund shares/units and debt securities up to two years.[112]A high degree of liquidity and price certainty make these instruments close substitutes for deposits. As a result of their inclusion, broad money is less affected by substitution between various liquid asset categories and is more stable than narrower definitions of money.[113]

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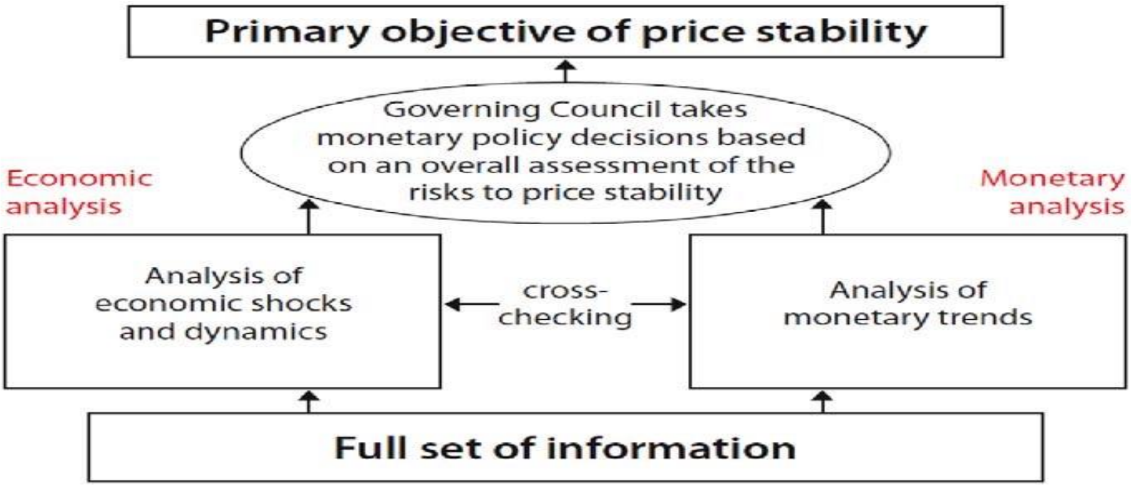
[110] Official Website of European Central Bank, https://www.ecb.europa.eu/mopo/strategy/monan/html/index.en.html accessed on 10 June 2019.

[111] Official Website of European Central Bank, https://www.ecb.europa.eu/mopo/strategy/monan/html/index.en.html accessed on 10 June 2019.

[112] Official Website of Organization for Economic Co-operation and Development. https://data.oecd.org/money/broad-money-m3.htm accessed on 10 June 2019.

[113] Official Website of European Central Bank, https://www.ecb.europa.eu/mopo/strategy/monan/html/index.en.html accessed on 10 June 2019.



[114]

3.4 The non-standard monetary policies implemented by ECB.

The financial crisis, which began in the U.S. in 2007 quickly spread to the rest of the world. Eventually, it had a major impact on the Member states of European Union (EU). The financial crisis brought to the fore the incomplete nature of European integration in economic and monetary affairs. [115]Banks play a predominant role in the euro area financial system, so it was particularly important to support banks' credit provision after the turbulence caused by the global financial crisis. Central banks started to implement non-standard monetary policy tools in order to help monetary policy transmission channels work effectively.[116]

Central banks cut interest rates aggressively and then, as policy rates approached zero, deployed a variety of untested and unconventional monetary policies [117]A non-standard monetary policy is a tool used by a central bank or other monetary authority that falls out of line

[114] Official Website of Generation Euro
<https://www.generationeuro.eu/files/Monetary-policy_ECB.pdf> accessed on 10 June 2019.

[115] Amy Verdun, "Political Leadership of the European Central Bank." (2017) Journal of European Integration 39, no. 2 p. 210.

[116] Remarks by Vitor Constancio, Vice President of the ECB at the ECB Workshop "Monetary Policy in Nom-standard times",11,12 September 2017, Franfurt am Main, Official Website of European Central Bank.

[117] Giovanni Dell' Ariccia, Pau Rabanal, Damiano Sandri, "Unconventional Monetary Policies in the Euro Area, Japan, and the United Kingdom" (October 2018) Hutchins Working papers.

with traditional measures. During these times, most standard or conventional methods become ineffective.

The ECB implemented non-standard monetary policies as in addition to the standard policy tools during this period. The non-standard monetary policies introduced by the ECB, were different from those implemented by other central banks (Fed, Bank of England) in terms of implementation and results. Firstly, the policies of the ECB were not specific to one single country. Secondly, the policies implemented were prepared by considering the factor that the banking system was the major source of financing in Europe.[118]

The ECB's response to the crisis and unconventional monetary policy implementation can be divided in three phases. First, between September 2008 and the end of 2009, the ECB focused on supporting the banking sector, using instruments which can be categorized as part of a central bank's function as "lender of last resort." Second, during the sovereign-debt crisis of several euro-area countries between early-2010 and late-2012, the European Central Bank purchased government bonds to restore market functioning and the transmission mechanism of monetary policy. Third, starting in mid-2013, the European Central Bank implemented a more aggressive combination of forward guidance, large-scale asset purchases, negative interest rates, and targeted credit supply policies. [119]

The non-standard monetary policy measures implemented by ECB are the following:

1.Outright Monetary Transactions(OMT) program.

In 2012, the global financial crisis had morphed into a sovereign debt crisis in the euro area. In stressed countries, interest rate spreads had grown excessively, and monetary conditions became tight despite the easy stance of monetary policy. **The problem was a liquidity crisis:** a general distrust among market participants about the future ability of distressed sovereigns to roll over their debt. The OMT programme was designed to diffuse such tensions. **This program offers conditional liquidity insurance.** In what way? By promising outright purchases of sovereign bonds with maturities up to 3 years, on the condition that the countries meet

[118] Meryem Filiz Baştürk. "Non-Standard Monetary Policies Implemented by The European Central Bank After The Financial Crisis." (Öneri 12, no. 48 2017) p.81.

[119] Giovanni Dell' Ariccia, Pau Rabanal, Damiano Sandri, "Unconventional Monetary Policies in the Euro Area, Japan, and the United Kingdom" Hutchins Working papers (October 2018) p.7.

domestic economic conditions. These conditions are laid out by an agreement with the European Stability Mechanism.

The credibility of the ECB has made the program successful. This program has contributed to the steep decline of sovereign spreads by as much as 2 percentage points. The evidence analyzed by ECB researchers in Altavilla, Giannone and Lenza (2016), concludes that this helped ensure a more uniform transmission of our exceptionally easy interest rate policy and led to substantial increases in credit growth, activity and prices in stressed countries, with some positive spill-overs to core countries. These events and the success of the different policy actions have drawn renewed attention to the relevance of macroeconomic frameworks that can help us understand situations with multiple equilibria and devise appropriate policy responses. [120]

2.Forward Guidance.

Forward guidance aims at providing information about its future monetary policy intentions, based on its assessment of the outlook for price stability.[121]It can come in two forms. In the first version, the central bank aims to clarify, how monetary policy will evolve in the future depending on its own expectations for economic activity or inflation. In the second more powerful form the central bank commits to keeping interest rates low, even if economic conditions improve in the future and warrant a monetary tightening.[122]

The ECB began using forward guidance in July 2013 when the ECB's Governing Council said that it expected interest rates to remain low for an extended period of time. Since then the formulation of the ECB's forward guidance has been adapted on a number of occasions, and it now clarifies the Governing Council's intentions not only with regard to the expected future path of the ECB's key interest rates, but also with regard to the horizon of its program. To remain credible, the content of the ECB's forward guidance on its policy intentions must al-

[120] Remarks by Vítor Constâncio, Vice-President of the ECB, at the ECB Workshop "Monetary Policy in Non-Standard Times" (11 and 12 September 2017) Frankfurt am Main, Official Website of European Central Bank.

[121] Official Website of European Central Bank

https://www.ecb.europa.eu/explainers/tell-me/html/what-is-forward_guidance.en.html accessed on 10 June 2019.

[122] Giovanni Dell'Ariccia, Pau Rabanal, Damiano Sandri, "Unconventional Monetary Policies in the Euro Area, Japan, and the United Kingdom" Hutchins Working papers (October 2018) p.4

ways be consistent with the Governing Council's assessment of the current economic situation and the outlook for the future, in particular for inflation.[123]

The effectiveness of forward guidance can be hindered by several factors. First, forward guidance may fail to alter expectations. Secondly, the way that the announcement of forward guidance is interpreted by markets, can lead to counterintuitive results. Alternatively, if market participants believe that forward guidance will be successful in increasing inflation and real GDP growth, long-term rates may increase rather than decrease—although optimism about the future may offset the increase in rates.[124]

3.Large scale Asset Purchases.

The **asset purchase programme (**APP) includes all purchase programs under which private sector securities and public sector securities are purchased, to address the risks of a prolonged period with low inflation over the medium term. The Euro system currently reinvests principal payments from maturing securities purchased under the **APP**. The period of APP net asset purchases ended in December 2018. [125]

With the lower bound for policy interest rates having been reached, quantitative measures changing the size or the composition of the balance sheet, remain the only effective tool to achieve further monetary policy accommodation.[126]This program was instrumental in eliminating deflation risks, contributes to the ongoing recovery and helps bring inflation closer towards to ECB's objective. The Euro system has already purchased more than 2 trillion euros of public and private assets. [127]

[123] Official Website of European Central Bank

< https://www.ecb.europa.eu/explainers/tell-me/html/what-is-forward_guidance.en.html>accessed on 10 June 2019.

[124] Giovanni Dell'Ariccia, Pau Rabanal, Damiano Sandri "Unconventional Monetary Policies in the Euro Area, Japan, and the United Kingdom" Hutchins Working papers (October 2018) p.4

[125] Official Website of European Central Bank

< https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html>accessed on 10 June 2019.

[126] Frank Moss, The ECB's non-standard monetary policy measures – domestic and global impact, Joint Vienna Institute Seminar, (ECB May 2015) p. 6.

[127] Remarks by Vítor Constâncio, Vice-President of the ECB, at the ECB Workshop "Monetary Policy in Non-Standard Times", 11 and 12 September 2017, Frankfurt am Main, European Central Bank Official Website.

The paper by De Graeve and his co-author (2016) confirms for the United States, that reducing the outstanding maturity of sovereign debt through asset purchases, does indeed reduce long-term interest rates. **This is consistent with recent euro area observations**.[128]

The APP is effective in the framework, because the central bank can temporarily improve the balance sheet constraints of financial intermediaries. As a result, an improved balance sheet leads to better credit conditions, improving the economic outlook and raising the inflation rate. On 13 December 2018, the Governing Council of the ECB decided to end the net purchases under the APP and announced that it "intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date, when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favorable liquidity conditions and an ample degree of monetary accommodation".[129]

4.Negative Interest Rates.

Negative policy rates, is an efficiency tool, introduced by European Central Bank, lowering not only short-term rates but also rates at longer maturities via expectations.[130]

The European Central Bank has implemented negative interest rates by charging, rather than paying, interest rates on the reserves that commercial banks hold at the central bank. The intention was that individual banks will reduce their excess reserves by increasing lending and purchasing other financial assets. In this way, the policy seeks to reduce lending rates, increase credit supply, and boost prices across financial markets.

Several concerns have been raised about negative rates. First, banks appear reluctant to pass negative interest rates on to retail depositors (although there is evidence of pass-through to corporate deposits).Even if, negative rates may harm bank profitability, banks seem to have

[128] Remarks by Vítor Constâncio, Vice-President of the ECB, at the ECB Workshop "Monetary Policy in Non-Standard Times", 11 and 12 September 2017, Frankfurt am Main, European Central Bank Official Website.

[129] Official Website of European Central Bank https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html accessed on 10 June 2019.

[130]Remarks by Vítor Constâncio, Vice-President of the ECB, at the ECB Workshop "Monetary Policy in Non-Standard Times", 11 and 12 September 2017, Frankfurt am Main, European Central Bank Official Website.

supported profitability by increasing noninterest income through charging other fees. The direct costs of negative reserves on bank reserves are also quantitatively small relative to banks' balance sheets.[131]

According to Vítor Constâncio, Vice-President of the ECB "negative rates are a tool that needs to be closely monitored. We are happy with the experience and we think the evidence accumulated so far points to the negative side effects being dominated by the positive aspects of the policy, which means that this is a new instrument in the central banks' toolkit to be used in exceptional circumstances".[132]

Overall, unconventional monetary policies had beneficial effects in preventing further financial distress. These measures were effective in restoring the functioning of financial markets and providing additional monetary accommodation by compressing long-term interest rates. Furthermore, these policies likely had beneficial effects on macroeconomic variables such as real GDP growth and price stability, although these are more difficult to model and measure.[133] It was accepted that ECB showed a flexibility in monetary solutions. This flexibility was a result of its independence and credibility.

3.5 European Central Bank as a supervisor.

Before 2014 the supervision of banks was quite decentralized. In November 2014, the ECB assumed substantial new powers and responsibilities as a bank supervisor for over 6,000 banks in the euro area. There were significant lapses in banking supervision by most EU member states prior to the crisis. The objectives of this supervisory role are focused in:

1.Financial Stability and Integration.

2. A Safe and sound banking system.

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[131] Giovanni Dell' Ariccia, Pau Rabanal, Damiano Sandri "Unconventional Monetary Policies in the Euro Area, Japan, and the United Kingdom," Hutchins Working papers (October 2018) p.5-6.

[132] Remarks by Vítor Constâncio, Vice-President of the ECB, at the ECB Workshop "Monetary Policy in Non-Standard Times", 11 and 12 September 2017, Frankfurt am Main, European Central Bank official website.

[133] Giovanni Dell'Ariccia, Pau Rabanal, Damiano Sandri "Unconventional Monetary Policies in the Euro Area, Japan, and the United Kingdom" Hutchins Working papers (October 2018) p.3.

3.Consistent supervision of banks.

The participating countries in this supervision framework are 19. The significant banks under ECB's supervision are 117 and under national supervision are 3.500 less significant banks . [134]A clear distinction is to be made between **prudential supervision** and **monetary control**. The former is concerned with the stability of financial institutions and geared towards the safety of deposits entrusted to the banks in their fiduciary capacity. Prudential supervision originated with the role of central banks in the area of payments, whether through the issue of bank notes for which they had been granted a monopoly, or through transfers of book money.[135]The European Central Bank was the most credible EU institution to be given the powers of prudential bank supervision because of[136]:

⇒ its relative success in maintaining price stability in the euro area,

⇒ its experience in guiding the euro area banks and sovereigns through the banking crises of 2007–09 and 2010–2012,

⇒ and its strong legal basis in the EU Treaties, which guarantee its independence from external political pressures.

Near its basic task to define and maintain the monetary policy regarding to Article 127. par.1 TFEU and Article 3 par.1of the Protocol on the Statute of ESCB and ECB, the ECB "shall contribute …to the prudential supervision of credit institutions and the stability of financial system". According to articles: 127 par.6 TFEU, 25 par.2 of Protocol on the Statute of ESCB and ECB and SSM-Regulation, **the ECB can be conferred "specific tasks" related to the prudential supervision of credit institutions and other financial institutions**. It seems that there is a

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[134]Official Website of European Central Bank

< https://www.bankingsupervision.europa.eu/about/ssmexplained/html/ssm.en.html>last accessed on 10 June of 2019.

[135] René Smits, The European Central Bank: Institutional Aspects (Kluwer Law International, Print. International Banking and Finance Law Ser. 5,1997) p.319.

[136] Alexander Kern, "The European Central Bank and Banking Supervision: The Regulatory Limits of the Single Supervisory Mechanism" (March 2016) European Company and Financial Law Review,p.467-469.

conflict, if these two policies are equal balanced, or the ECB specific supervisory tasks have to support the function of its primary monetary objective.[137]

Based on grammatical interpretation the provision of Article 127 par. 6 of TFEU, it should be considered as granting **limited competence** to the ECB with the right of veto in respect to bank supervision. It refers to “specific” and not to “all” supervisory functions. Thus article 127 par. 6 is not a sufficient basis for transferring all banking supervision to the ECB. However, according to teleological interpretation of Article 127 par. 6,it can be concluded that provision covers the entire transfer of banking supervision in the ECB. [138] There is no reason to fear that the ECB’s supervisory powers interfere with its monetary policy duties given the increasing link between financial stability and monetary policy.

Banking supervision in the euro area is conducted by the ECB and the national competent authorities (NCAs) of the participating countries, within the framework of the SSM. **The Single Supervisory Mechanism (SSM), the system of banking supervision in the euro area, became fully operational on November 4, 2014**.It is step towards a greater European Harmonization. It is a response towards the problems that’s financial crisis has caused. The SSM Regulation and the SSM Framework Regulation provide its legal basis. Together with the Single Resolution Mechanism (SRM) for banks and the European Deposit Insurance Scheme (EDIS), the SSM is one of the three pillars of the European banking union.[139]

SSM works in cooperation with the European Banking Authority (EBA), the European Parliament, the Eurogroup, the European Commission, and the European Systemic Risk Board (ESRB), within their respective mandates, and is mindful of cooperation with all stakeholders and other international bodies and standard-setters[140]. Under the SSM, the ECB is responsible for the supervision of banks in the euro area. Non-euro area EU countries may participate in the SSM **on a voluntary basis** through close cooperation between the competent supervisory authorities. No matter if some of the largest institutions are located in United Kingdom, its in-

[137] Stanyo Dinov, Central Banks as a Bank Supervisor: A Comparison of the Function of the Bank of England, the Federal Reserve and the European Central Bank (Marburg: Tectum Verlag, 2017),p.66-67.

[138] Stanyo Dinov, Central Banks as a Bank Supervisor: A Comparison of the Function of the Bank of England, the Federal Reserve and the European Central Bank (Marburg: Tectum Verlag, 2017),p. 78.

[139] ECB, Guide to the Banking Supervision (ECB 2014) p.4-6.

[140] ECB, Guide to the Banking Supervision (ECB 2014) p.4.

stitutions are not included to this supervisory list. Member States of the Eurozone can establish close cooperation between their supervisory authorities and the ECB under article 7 of SSM-Regulation.[141] Reflecting the decentralized organization of supervision under the SSM, the ECB and the national supervisory authorities have different tasks and responsibilities.[142]

The role of ECB is important at a macro and a micro lever in the new system of supervision. Regarding the macro level the ECB has to analyze the stability of the financial system and develop an early warning system for a potential risk. The ECB has to provide the European Systematic Risk Board (ESRB) with all necessary logistical support and to give evaluation and recommendations in respect of macro prudential supervision.

At the micro level the ECB assumes direct control over trans-border EU-credit institutions. In the event of a conflict between a Member State's supervisory authorities, the ECB plays the role of a binding mediator.[143]

Banking supervision at the ECB is organized into:

⇒ the Supervisory Board

⇒ and five business units, known as Directorates General, or DGs.

The Directorates General Micro-Prudential Supervision I and II:	are responsible for the direct day-to-day supervision of significant institutions.
The Directorate General Micro-Prudential Supervision III:	oversees the supervision of less significant institutions performed by NCAs.
The Directorate General Micro-Prudential Supervision IV:	performs horizontal and specialized tasks in respect of all credit institutions under the

141 Stanyo Dinov, Central Banks as a Bank Supervisor: A Comparison of the Function of the Bank of England, the Federal Reserve and the European Central Bank (Marburg: Tectum Verlag, 2017) p.84.

142 ECB, Guide to the Banking Supervision (ECB 2014) p.4.

143 Stanyo Dinov, Central Banks as a Bank Supervisor: A Comparison of the Function of the Bank of England, the Federal Reserve and the European Central Bank (Marburg: Tectum Verlag, 2017) p. 69.

	SSM's supervision and provides specialized expertise on specific aspects of supervision, for example internal models and on-site inspections.
Secreteriat to the Supervisory Board:	provides support for the work of the Supervisory Board, for example by assisting in meeting preparations and related legal issues.[144]

3.5.1 The supervised entities by ECB.

The ECB oversees all significant and less significant banks in the participating countries through direct and indirect supervision. The list of supervised entities is updated by the ECB of every month in the first week. The number of significant supervised entities is 117 and it includes:

- credit institutions established in participating Member States,
- financial holding companies established in participating Member States,
- mixed financial holding companies established in participating Member States,
- branches established in participating Member States by credit institutions established in non-participating Member States.[145]

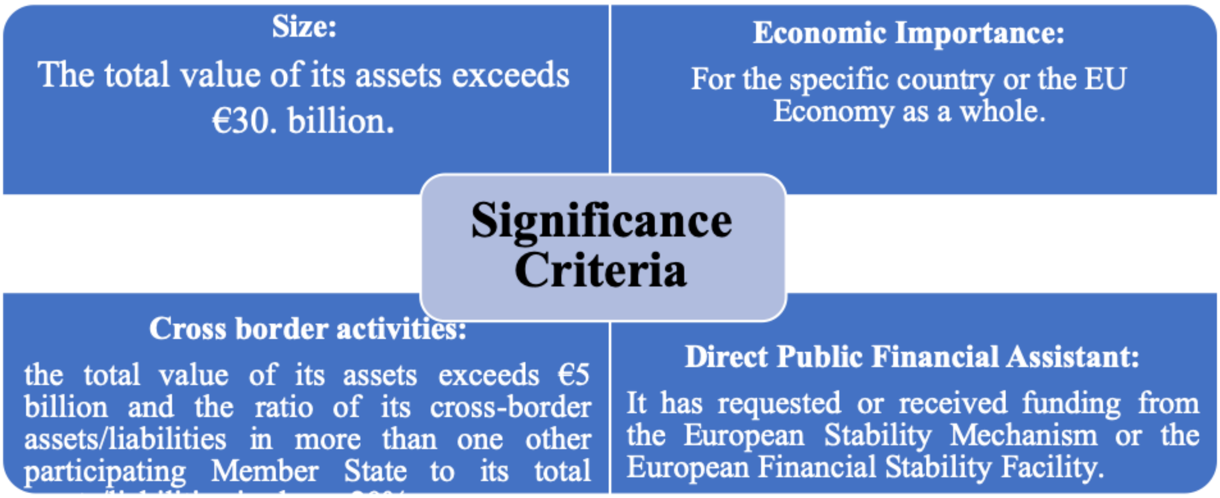
The list of significant supervised entities is published by the ECB, in accordance with article 49(1) of Regulation No.468/2014,[146] the so called SSM Framework Regulation. The ECB has also published the list of entities supervised by a national competent authority (NCA). This list gives the names of the supervised entities, in accordance with Article 49(2) of the

[144] Official Website of European Central Bank https://www.bankingsupervision.europa.eu/organisation/whoiswho/organigram/html/index.en.html accessed on 05 June 2019.

[145] Official Website of European Central Bank https://www.bankingsupervision.europa.eu/banking/list/who/html/index.en.html accessed on 10 June 2010.

[146] Regulation (EU) No 468/2014 of 16 April 2014 of the European Central Bank establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17).

SSM Framework Regulation and are referred to as “less significant institutions”[147]in accordance with Article 6(4) of the SSM Regulation, as well as the name of the relevant NCA. The SSM regulation and SSM Framework Regulation set out the criteria for determining whether banks are considered significant. If the banks are considered as significant, therefore there are under the ECB's direct supervision. To qualify as significant, it is essential for the banks to fulfil at least one of these criteria.[148]



In case that a significant bank fails to meet the criteria for three consecutive years, it can be reclassified as less significant. The responsibility of direct supervisory for it, will return to the relevant national authority. In case that a less, significant bank meets **any of the criteria** for the first time, it is reclassified as significant and ECB then takes over responsibility for direct supervision.[149]The national competent authorities that are in charge of banking supervision in participating countries, are called national supervisors. The list with the countries that participate as well as its authorities is given in Annex 2.

[147] Less significant supervised entity” means both (a) a less significant supervised entity in a euro area Member State and (b) a less significant supervised entity in a non-euro area Member State that is a participating Member State .

[148] Official Website of European Central Bank
https://www.bankingsupervision.europa.eu/banking/list/who/html/index.en.html accessed on 10 June 2010.

[149] Official Website of European Central Bank
https://www.bankingsupervision.europa.eu/banking/list/criteria/html/index.en.html accessed on 10 June 2010.

3.5.2 The ECB's supervisory powers.

The ECB is empowered to require significant credit institutions in participating Member States to take steps at an early stage to address problems. These problems may concern:

1.compliance with prudential requirements,

2.the soundness of management,

3. and sufficiency of the coverage of risks in order to ensure the viability of the credit institution.

In the first place, ECB may consider addressing the problems informally, before making use of its supervisory powers. Informal actions for example may include holding a meeting with the management of the credit institution or sending a letter of intervention.[150]The factors that determine the type of action taken are the seriousness of the deficiencies, the required time frame, the degree of awareness at the credit institution, the capability and reliability of corporate bodies, and the availability of human, technical and capital resources within the credit institution. If the action is based on the national law of a participating Member State, the respective NCA might be asked for support to ensure that all the legal prerequisites are covered. [151]

Supervisory powers consist of measures such as:

- ⇒ a listing of goals and the time frame for their supervised credit institution achievement.
- ⇒ the adoption of specific measures for prudential purposes (such as requiring the credit institution to take specific actions concerning regulatory matters: organisation of risk management and internal controls, capital adequacy, permissible holdings, limitation of risk, disclosure, or operational limits or prohibitions;
- ⇒ the use of other legal powers of intervention intended to correct or resolve irregularities, inaction or specific negligence;

[150] Official Website of Concilium.

<https://www.consilium.europa.eu/en/policies/banking-union/single-supervisory-mechanism/ > accessed on 10 June 2019.

[151] European Central Bank, Guide to banking Supervision (ECB November 2014) p.39.

⇒ the obligation for a credit institution to present a plan for restoring compliance with supervisory requirements.

The monitoring procedures ensure that the ECB adequately addresses any irregularities or insufficiencies detected in a credit institution in implementing the supervisory measures, thereby mitigating the risk of failure of the credit institution. [152]

3.5.3 The administrative penalties.

According to articles: 18 of the SSM Regulation and 132 of the SSM Framework Regulation, ECB can impose penalties within the remit of its supervisory tasks:[153]article 18, **administrative penalties:**

*"1. For the purpose of carrying out the tasks conferred on it by this Regulation… **the ECB may impose administrative pecuniary penalties of up to twice the amount of the profits gained or losses avoided because of the breach where those can be determined, or up to 10 % of the total annual turnover, as defined in relevant Union law**, of a legal person in the preceding business year or such other pecuniary penalties as may be provided for in relevant Union law.*
5.The ECB shall publish any penalty referred to paragraph 1, whether it has been appealed or not, in the cases and in accordance with the conditions set out in relevant Union law."[154]

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[152] European Central Bank, Guide to banking Supervision (ECB November 2014) p.39.

[153] Official Website of European Central Bank <https://www.bankingsupervision.europa.eu/banking/sanctions/html/index.en.html> accessed on 10 June 2019.

[154]For the publication of penalties **article 132 of** the SSM Framework states that:

"1. The ECB shall publish on its website without undue delay, and after the decision has been notified to the supervised entity concerned, any decision imposing an administrative penalty, as defined in Article 120, on a supervised entity in a participating Member State, including information on the type and nature of the breach and the identity of the supervised entity concerned, unless publication in this manner would either:

(a) jeopardize the stability of the financial markets or an on-going criminal investigation; or

(b) cause, insofar as it can be determined, disproportionate damage to the supervised entity concerned.

In these circumstances, decisions regarding administrative penalties shall be published on an anonymised basis. Alternatively, where such circumstances are likely to cease within a reasonable period of time, publication under this paragraph may be postponed for such period of time.

2. If an appeal to the Court of Justice in respect of a decision under paragraph 1 is pending, the ECB shall, without undue delay, also publish on its official website information on the status of the appeal in question and the outcome thereof.

3. The ECB shall ensure that information published under paragraphs 1 and 2 remains on its official website for at least five years."

In case of breaching regulatory requirements, the supervisor may impose sanctions on credit institutions and/or their management. The ECB may impose administrative pecuniary penalties on credit institutions of up to twice the amount of the profits gained or losses avoided because of the breach where those can be determined, or up to 10% of the total annual turnover in the preceding business year. In addition, in the case of a breach of a supervisory decision or regulation of the ECB, the ECB may impose a periodic penalty payment with a view to compelling the persons concerned to comply with the prior supervisory decision or regulation of the ECB.[155]

The penalties imposed by the ECB within the remit of its supervisory tasks are published below, according with the Official Website of European Central Bank are set out in Annex 3.

The ECB's Enforcement and Sanctions Division investigates – in the spirit of transparent investigation and decision-making – alleged breaches by credit institutions of directly applicable EU law, national law transposing EU directives or ECB regulations and decisions, observed by a JST[156] during the day-to-day supervision. In this case, the JST will establish the facts and refer the case to the Enforcement and Sanctions Division for follow-up. The Enforcement and Sanctions Division acts independently from the Supervisory Board to ensure the impartiality of the Supervisory Board members when they adopt a sanctioning decision.[157]

In accordance with Article 18(5) of the SSM Regulation and Article 134 of the SSM Framework Regulation, the ECB may ask the relevant national competent authorities to open proceedings with a view to imposing penalties if appropriate.[158]

[155] European Central Bank, Guide to Banking Supervision (ECB November 2014) p.38-39.

[156] Joint Supervisory Teams (JSTs) are one of the main forms of cooperation between the ECB and the national supervisors. They actively foster a common supervisory culture and promote consistent supervisory practices and approaches.

[157] European Central Bank, Guide to banking Supervision (ECB November 2014) p.38-39.

[158] Official Website of European Central Bank <https://www.bankingsupervision.europa.eu/banking/sanctions/html/index.en.html> accessed on 10 June 2019.

4.The Effectiveness of ECB's monetary policy.

4.1The independence of European Central Bank

4.1.1The legal base.

One fundamental aspect of the ECB is its policymaking independence from all political and societal authorities. The independence of ECB is conducive to maintain price stability.[159] **Independence is a prerequisite for the proper functioning of monetary policy in the European Union**. The bank must not seek influence, while EU institutions and national governments are bound by the treaties to respect the ECB's independence (political Independence). The ECB does not have to defend its actions to any EU or national body, although it does have to provide annual reports to the European Commission, European Parliament, Council of Ministers, and European Council[160](Art.15, Statute of the ESCB).[161]

Back to the negotiations leading to Maastricht, the degree of central bank independence from political influence was the key debate over its institutional structure and the policymaking powers. The most common question was, if the member states would have any authority and influence in the policy decisions of the future of ECB. The focus on central bank independence was strongly articulated by Germany and especially Bundesbank officials, given the fact that Germany has a strong tradition on non-inflationary monetary policy and independent central bank.[162]

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[159] Official Website of ECB

< https://www.ecb.europa.eu/ecb/orga/independence/html/index.en.html> accessed on 10 June 2019.

[160] Kelly H. Chang, Appointing Central Bankers: The Politics of Monetary Policy in the United States and the European Monetary Union (Cambridge UP 2003) p.99.

[161] Article 15: Reporting commitments

15.1. The ECB shall draw up and publish reports on the activities of the ESCB at least quarterly. 15.2. A consolidated financial statement of the ESCB shall be published each week. 15.3. In accordance with Article 284(3) of the Treaty on the Functioning of the European Union, the ECB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and the current year to the European Parliament, the Council and the Commission, and also to the European Council. 15.4. The reports and statements referred to in this Article shall be made available to interested parties free of charge.

[162] David J. Howarth and Peter H. Loedel, The European Central Bank: The New European Leviathan? (Palgrave Macmillan 2003) p.118.

Transparency and clear communication are a natural complement to strong independence, as it makes it easier to hold the central bank accountable, which in turn is a key element to maintain the political support for the high degree of independence.[163]Moreover, there is even empirical evidence that countries with more independent central banks perform better not only in terms of inflation, but also in terms of public finances as they have smaller and less variable fiscal deficits.[164]

There is a strong argument against central bank independence, based on democratic theory. According to this argument an independent central bank cannot be held democratically accountable for its politically sensitive actions. The delegation of power to note elected officials, can only be acceptable, if the bank is accountable in democratically elected institutions. President of ECB Duisenberg defined that the definition of price stability acts as a yardstick against and the public can hold the ECB accountable. Such a view introduces a dependency between accountability and independence.[165]

According to Article 130 TFEU:

> "*When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies 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 European Central Bank or of the national central banks in the performance of their tasks*". [166]

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[163] Philipp Hartmann, Frank Smets "The First Twenty Years of ECB" Working paper Series (December 2018) p.11.

[164] Rene Smits, The European Central Bank, Institutional Aspects (Kluwer Law International,1996)p.152.

[165] David J. Howarth and Peter H. Loedel. The European Central Bank:The New European Leviathan? (Palgrave Macmillan 2003) p.122.

[166] Also, it is mentioned in article 7 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank.

The independence of the bank comes from the legal framework governing it in the Treaty of Lisbon. L. B. Smaghi[167] asserts that “the legal provisions are necessary, but not sufficient to ensure central banks independence”.[168]Among Eurozone countries, national central banks either are open to political influence (Banque de France), either maintain a high level of independence (Deutsche Bundesbank).Across different constitutional traditions and governmental provisions,the specific institutional features of central bank independence vary. The independence of the ECB is very much related to improving price stability in the euro area. This independence is based on enough consensus of the common goals among the member states. This is the only way to attain sufficient commitment to these targets, in order for the ECB to act effectively.

The ECB **is often considered as the "most independent central bank in the world".**In general terms, this implies that the Euro system tasks and policies can be discussed, designed, decided and implemented in full autonomy, without pressure, or instructions from any external body. The Statute foresees long terms of office for the members of the Governing Council.[169]

In detail, the terms of office are the following:

- NCB governors have a minimum term of office of five years;
- members of the Executive Board of the ECB have a non-renewable term of office of eight years;
- both can be removed from office, only in the event of incapacity or serious misconduct;
- the Court of Justice of the European Union is competent to settle any disputes.[170]

[167] Lorenzo Bini Smaghi (born 29 November 1956 in Florence) is an Italian economist who is currently Chairman of Société Générale, a French multinational banking and financial services company.

[168] L. B. Smaghi speech about “Central Bank Independence from Theory to Practice” (Hungarian national assembly, April 2007) Official Website of European Central Bank.

https://www.ecb.europa.eu/press/key/date/2007/html/sp070419.en.html accessed on 10 June 2019.

[169] Official Website of European Central Bank,
https://www.ecb.europa.eu/ecb/orga/independence/html/index.en.html accessed on 10 June 2019.

[170] Official Website of European Central Bank,
https://www.ecb.europa.eu/ecb/orga/independence/html/index.en.html accessed on 10 June 2019.

4.1.2 The six pillars.

In practice, the ECB's independence has **six main pillars-elements**, which are reflected both in the Treaty on the Functioning of the EU and the Protocol on the Statute of the European System of Central Banks:

1. **Political independence:** Political independence refers not only to the lack of external pressure exercised on the monetary authority.[171] This type of independence includes a second dimension: the extent to which law can guarantee the independence from political interference of members of the central bank's council. It is reinforced by ECB's financial independence. Political independence refers to the formal legal competence of the ECB to choose a course of action without yielding to the overt or covert pressures of other political actors. The ECB's political independence is enshrined in the article 130 of the TFEU, as already mentioned.[172] ECB does not require external financing and symmetrically is prohibited from direct financing to public institutions and potential pressure from public authorities.

ECB has even greater level of independence than that of the Bundesbank,[173]at least as based on the statutes creating the ECB. **The statutes of ECB are part of the Treaty on European Union and will not be subject to revision**. The constitutional protection of ECB remains stronger than the Bundesbank's own constitutional protection.

2.Legal independence: The ECB enjoys its own legal personality (Art.9.par.1 Protocol on the Statute of ESCB and ECB).[174]The legal personality enables it to bring actions, before the Eu-

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171 Michael Senorer, Central Bank Independence and its Implications for the European Central Bank (University of Vienna 1996) p.54.

172 David J. Howarth and Peter H. Loedel, The European Central Bank: The New European Leviathan? (Palgrave Macmillan 2003) p.122.

173 David J. Howarth and Peter H. Loedel, The European Central Bank: The New European Leviathan? (Palgrave Macmillan, 2003) p.138.

174 Article 9: The European Central Bank

9.1. The ECB which, in accordance with Article 107(2) of this Treaty, shall have legal personality, shall enjoy in each of the Member States the most extensive legal capacity accorded to legal persons under its law; it may, in particular, acquire or dispose of movable and immovable property and may be a party to legal proceedings.

ropean Court of Justice to enforce its independence if necessary. Also, the ECB's own legal personality also allows the ECB to enter into international legal agreements independently from other EU institutions and be party of legal proceedings.[175]

3.Institutional independence: This concerns the legal autonomy of the monetary authority, being an institution separate from the other bodies of government.[176] The Treaty states that the ECB must not seek or take instruction from any institution, government or other body (Art. 130 TFEU). At the same time, Member State governments and other EU institutions are not allowed to influence the decision-making bodies of the ECB. The important point here, is not only the distance from day -to day- politics, but the management of money from the government.[177]

4.Functional independence: Functional independence has to do with the attribution of decision-making powers to the central bank or to the political authorities**.**[178]Through the Statute, the ECB is assigned all necessary competencies to achieve its primary objective of price stability. In addition, the ECB is prohibited from lending directly to the public sector. This shields it from pressure from public authorities. Decisions on interest rates and on transactions in the money and foreign exchange markets should be taken by the central bank without recourse to other bodies.[179]

This pillar of independence is affiliated with the pillar of political independence. In addition to monetary policy decisions, the ECB has the right to issue legally binding regulations, within its competence. If the conditions laid down in Union law are fulfilled, ECB can sanction non-compliant actors, if they violate legal requirements laid down in directly applicable Union regulations (Art.127 par.4 TFEU). Finally, the ECB can organize its internal structure as it sees fit.

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[175] Official Website of European Central Bank
https://www.ecb.europa.eu/explainers/tell-me-more/html/ecb_independent.en.html accessed on 10 June 2019.

[176] Rene Smits, The European Central Bank, Institutional Aspects (Kluwer Law International 1996) p.155.

[177] Official Website of European Central Bank
<https://www.ecb.europa.eu/explainers/tell-me-more/html/ecb_independent.en.html>accessed on 10 June 2019.

[178] Rene Smits, The European Central Bank, Institutional Aspects (Kluwer Law International 1996) p.167.

[179] Rene Smits, The European Central Bank, Institutional Aspects (Kluwer Law International 1996) p.157.

5.Financial and organizational independence: The financial independence is crucial for determining the level of central bank independence. It refers to the autonomy of central bank in terms of funding its activities. The ECB uses its own profits generated by its monetary policy operations and cannot be technically insolvent.[180]

Financial independence is defined either:

a.as internal-from the obligatory financing of governing debts or

b. as external-from the exchange rate arrangements or obligations such as those that existed under Bretton Woods and more recently within EMS.[181]

In case that governance can finance its expenditures directly or indirectly via central bank credits, then it can exercise influence over and limit the discretion of central bankers.

According to article 282 par.3 of TFEU ECB:

> "…*shall be independent in the exercise of its powers and in the management of its finances. Union institutions, bodies, offices and agencies and the governments of the Member States shall respect that independence. The ECB and the national central banks have their own financial resources and income*."

As a result, there is a limit in the external influence on the Euro system. The Statute allows the ECB to organize its internal structure. The ECB is the only body within the EU, whose statute guarantees budgetary independence through its own resources and income.

6.Personal independence: The decision makers of ECB will have to assume a transnational identity and act in the interests of Europe first instead of national interest. Institutionally and personally, the ECB is a hybrid of transnationalism and intergovernmentalism.[182] The personal aspect of independence relates to the safeguards in the procedures for appointment of persons to the central bank's decision making bodies, their security of tenure and the possibility

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[180] Official Website of European Central Bank.

https://www.ecb.europa.eu/explainers/tell-me-more/html/ecb_independent.en.html accessed on 10 June 2019.

[181] David J. Howarth and Peter H. Loedel, The European Central Bank: The New European Leviathan? (Palgrave Macmillan, 2003) p.133.

[182] David J. Howarth and Peter H. Loedel, The European Central Bank: The New European Leviathan? (Palgrave Macmillan, 2003, p.130

for the central bank to employ its own staff, separate from the civil service of Union and States.[183] Further elements of personal independence may concern the incompatibilities of central bank board tenure with other occupations and the salary of board members.[184]

The Statute protects the personal independence of the ECB's Executive Board members. Their eight-year term of work is long and non-renewable. The term of eight years seems long enough for the proper exercise of function by independent -minded professionals.[185]They can only be removed from office, in case of serious misconduct. Removals from office can only be decided by the European Court of Justice (ECJ), under the request of the ECB's Governing Council or the Executive Board (i.e. the ECB itself). In addition, ECB board members are vastly immune from judicial proceedings. National governors of the Euro system's national central banks can be dismissed, under national law (with possibility to appeal), in case they can no longer fulfil their functions or are guilty of serious misconduct.

The independence of European Central Bank as a principle concerns the National Banks of Members States that are a part of the ESCB. Their role in ECB deliberations is extremely important. The presidents of the National Central Banks should be appointed in accordance with the rulings of European Central Bank. "Each Member State shall ensure that its national legislation including the statutes of its national central bank is compatible with the Treaties and the Statute of the ESCB and of the ECB".[186]It is worth mentioning that the independence of European Central Bank does not exclude the democratic control.[187]

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183 Rene Smits, The European Central Bank, Institutional Aspects (Kluwer Law International1996) p.162.

184 Rene Smits, The European Central Bank, Institutional Aspects (Kluwer Law International 1996) p.162.

185 Rene Smits, The European Central Bank, Institutional Aspects (Kluwer Law International 1996) p.163

186 Article 131 of the Treaty of the Functioning of EU.

187 Asteris Pliakos, The law of European Union (Nomiki Vivliothiki 2018) p.283.

4.2 A route to Transparency followed by the European Central Bank.

4.2.1. Transparency in the ECB environment.

In economic terms, trust can be defined as “the belief or perception by one party (e.g., a principal) that the other party (e.g., an agent) will not cheat to a particular transaction”[188].In the case of a central bank and citizens, **trust stands for a belief that the central bank, as the agent in a principal–agent relationship, will deliver on its stated goals**. For the European Central Bank (ECB), price stability to its principal is the stated goal (i.e., citizens). [189]

Basically, two kind of definitions can be distinguished. Sometimes transparency refers to the activities of the central bank in providing information. In other cases, transparency relates to the public’s understanding of monetary policy. Winkler defines transparency as “*the degree of genuine understanding of the monetary policy process and policy decisions by the public*”.[190]

For a long time, the term secrecy was associated with Central Banks around the world. **During the last two decades transparency in monetary policy has increased dramatically**. Central banks have started publishing detailed information, about how they make monetary policy decisions.[191] According to the monetary policy transparency index provided by Dincer and Eichengreen (2014), **the ECB increased its transparency during the 2000s, and on a global level, it is one of the most highly transparent central banks,** but still below the central banks in the Czech Republic, Great Britain, Hungary, Israel, New Zealand, or Sweden. Greater transparency improves citizens’ trust, but only up to a certain point; too much transparency is not conducive to trust.

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[188] Stephen Knack “Trust, Associational Life and Economic Performance”(2001) Official Website of OECD <http://www.oecd.org/innovation/research/1825662.pdf >accessed on 10 June 2019.

[189] Michael Ehrmann, Michel Soudan and Livio Stracca. "Explaining European Union Citizens’ Trust in the European Central Bank in Normal and Crisis Times." (2013) Scandinavian Journal of Economics 115, no. 3.p.782.

[190] Jakob De Haan, Sylvester C. W. Eijffinger and Sandra Waller, The European Central Bank Credibility, Transparency, and Centralization (Cambridge 2005) p.83.

[191] Roman Horvath & Dominika Katuscakova "Transparency and Trust: The Case of the European Central Bank," Working Papers 352 (Institute for East and Southeast European Studies 2015).

After the financial crisis, the degree of trust in the ECB decreased markedly. Trust in the ECB has decreased from 50% to 60%, before the crisis, to less than 40% at the end of our sample period. Also, mistrust in the ECB increased during the crisis, and more respondents expressed an opinion about the ECB. Interestingly, trust in the ECB remained largely stable during the crisis in the non-euro area countries.

The level of trust exceeded 40% in most periods. The level of mistrust steadily increased nearly 40% during the crisis.[192] The highest level of trust was observed in the Netherlands, Finland, and Luxembourg, while a lower level of trust was noticed in France, Spain, Greece, and Cyprus. With regard to the non-euro area countries, citizens in Denmark and Sweden tend to trust the ECB the most, while citizens in the United Kingdom exhibit by far the least amount of trust. The level of distrust is also very high in Croatia, which is interesting given the high degree of euroization in this country. [193]

But why transparency is important? The transparency of ECB is in a strong connection with its economic performance and bring various benefits:

⇒ **Trust in public institutions creates a positive pay-off in terms of economic efficiency:** citizens have to spend less time protecting themselves from the possible poor functioning of institutions. As a result, they can devote more resources to productive activities.

⇒ Moreover, **a good example is set for public institutions with the leverage of the European central Bank,** as well as for the private sector. All in all, the more trust leads to the better functioning public institutions.[194]

[192]Roman Horvath & Dominika Katuscakova "Transparency and Trust: The Case of the European Central Bank," Working Papers 352 (Institute for East and Southeast European Studies 2016) p.4.

[193] Roman Horvath & Dominika Katuscakova "Transparency and Trust: The Case of the European Central Bank," Working Papers 352 (Institute for East and Southeast European Studies 2016) p.4.

[194] Michael Ehrmann, Michel Soudan, and Livio Stracca"Explaining European Union Citizens' Trust in the European Central Bank in Normal and Crisis Times." (*Scandinavian Journal of Economics* 115, no. 3, 2013) p.782.

4.2.2 Accountability and transparency of ECB.

It is common ground that independence goes hand in hand with accountability and transparency. Accountability is a requisite given by any central bank, which must comply with its statutory requirements.[195] The notion of accountable as defined in the Oxford English Dictionary is: "obliged to give a reckoning or explanation for someone's actions; **responsible**". **In Central Banking circumstances, accountability refers not only to the question whether a central bank has achieved its mandate, but also to what the central bank has done in attempting to achieve this mandate.**[196]

Accountability ensures that independence does not lead to arbitrariness and that the mandate is fulfilled. Independence and accountability are therefore two inseparable sides of the same coin and reinforce each other.[197]Monetary policy-makers should be made accountable to the government or to electorate, in order to prevent central banks from becoming too inflation averse. This point is explained by the fact that monetary policy has to take in account the will of general public.[198]Accountability is quite important for a central bank in order to avoid political pressures. Wim Duisenberg suggested that ECB would not conduct 'an extra tight monetary policy just to make the ECB more credible. Credibility must be earned. To do not gain in in one day'.[199]

The issue of how to achieve accountability arises only for independent bodies and as it was explained before, ECB is one of the most independent institutions in the world. It is an inherently ex post concept, as it has to do with explanation for, and responsibility over, observed acts and outcomes. The central bank should obviously be accountable for the achievement of

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195 Otmar Issing, Monetary Policy in the Euro Area: Strategy and Decision Making at the European Central Bank. (Cambridge 2001) p.131.

196 Jakob de Haan, Sylvester C. Eijffinge, Sandra Waller, Clemens Fuest, The European Central Bank: Credibility, Transparency, and Centralization (CESifo Book Series. 2005) p.108.

197 Otmar Issing, Monetary Policy in the Euro Area : Strategy and Decision Making at the European Central Bank (Cambridge 2001) p.139.

198 Michael Senorer, Central Bank Independence and its Implications for the European Central Bank (University of Vienna 1996) p.19

199 David J. Howarth and Peter H. Loedel, The European Central Bank:The New European Leviathan?(Palgrave Macmillan 2003)p.145.

its statutory objectives.[200] The key channels for accountability of the ECB are **the statutory reporting requirements to the European Parliament, such as the annual and quarterly reports.** The president of European Central Bank presents these reports to and discusses them in the relevant Committee of the European Parliament. European Parliament is the institution that directly derives its legitimacy from the citizens of the European Union.[201]

The basis for the ECB's accountability is provided by the mandate, in particular by the overriding 'primary objective to maintain price stability". A clear mandate contributed simultaneously to independence and accountability. If a mandate is defined clearly and narrowly it is to monitor the performance of the central bank and to justify the delegation of powers to a non-elected body. The society can then assess the performance of ECB in terms of this clearly specified measure, since an independent third party can check, at any moment in time, whether price developments are compatible with the published definition.[202]

According to Otmar Issing, democratic accountability of central banks requires disclosure. Second, transparency about the monetary policy making, may enhance the effectiveness and credibility of monetary policy, by providing the public with adequate information about its activities. [203]**As a result, the central bank can establish a mechanism for strengthening its credibility by matching its actions to its public statements.**[204]

Following Geraats (2000, 2002), there are five aspects of disclosure: political, economic, procedural, policy and operational disclosure. Each may give rise to different motives for disclosure:[205]

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[200] Otmar Issing, Monetary Policy in the Euro Area: Strategy and Decision-making at the European Central Bank (Cambridge 2001) p.131,

[201] Jakob de Haan, Sylvester C. Eijffinge, Sandra Waller, Clemens Fuest, The European Central Bank:Credibility, Transparency, and Centralization (CESifo Book Series. 2005) p.84

[202] Jakob de Haan, Sylvester C. Eijffinge, Sandra Waller, Clemens Fuest, The European Central Bank:Credibility, Transparency, and Centralization (CESifo Book Series. 2005) p.139.

[203] Chortareas et al.(2002) find for a sample of 87 countries that their index of disclosure that is based on central banks' published forecasts and ranges from zero to four ,is negatively related to average inflation.

[204] Jakob de Haan, Sylvester C. Eijffinge, Sandra Waller, Clemens Fuest, The European Central Bank:Credibility, Transparency, and Centralization (CESifo Book Series. 2005) p.84.

[205] Jakob de Haan, Sylvester C. Eijffinge, Sandra Waller, Clemens Fuest, The European Central Bank:Credibility, Transparency, and Centralization (CESifo Book Series. 2005) p.85.

1.Political Disclosure	refers to openness about policy objectives.	Political disclosure is enhanced by institutional arrangements, like central bank independence and Central Bank contracts, because they ensure that there is no undue influence or political pressure to deviate from stated objectives.
2.Economic Disclosure	focuses on the economic information that is used for monetary policy.	This includes: a. the economic data the central bank uses, the policy models it employs to construct economic forecasts or evaluate the impact of its decisions, and the internal forecasts the central bank relies on. The latter are particularly important since monetary policy actions are known to take effect only after substantial lags. So, the central bank's actions are likely to reflect anticipated developments.
3.Procedural disclosure	Refers to the way that monetary policy decisions are taken.	It involves an explicit monetary policy rule or strategy that describes the monetary policy framework, and an account of the actual policy deliberations and how the policy decision was reached, which may be achieved by, for instance, the release of minutes and voting records.
4.Policy dislosure	means a prompt announcement of policy decisions.	In addition, it includes an explanation of the decision and a policy inclination or indication of likely future policy actions.
5.Operational disclosure	concerns the implementation of the central bank's policy actions.	It involves a discussion of control errors in achieving the operating targets of monetary policy and (unanticipated).

Researchers have studied whether greater transparency improves the predictability of monetary policy for financial markets and whether transparency improves financial stability.[206] The

[206] see, for example, Gerlach-Kristen (2004), Crowe (2010), Ehrmann, Eijffinger, and Fratzscher (2012), and Horváth, Šmídková, and Zápal (2012), among many others.
Horvath, Roman and Dominika Katuscakova. "Transparency and Trust: The Case of the European Central Bank." (2016) Applied Economics 48, no. 57.

crucial question that has arisen and has a significance importance is, **how the public perceives the transparency of European Central Bank and moreover, how affects public's trust in European Central bank.** Public trust is a very important factor influencing the decisions of European Union member states, in order to join the euro area and transfer their monetary policy to the ECB.

The ECB legal framework clearly establishes confidentiality to be a premise of its decision-making process. Article 132 par.2 TFEU states that the European Central Bank may decide to publish its decisions, recommendations and opinions. Article 10.4 of the Protocol on the statute of ESCB and ECB confirms even more explicitly that the proceedings of the Governing Council meetings shall be confidential. The Governing Council may decide to make the outcome of its deliberation public. The legal framework in place does not contain criteria determining which documents and according to which criteria, will always be deemed confidential.[207]

Despite this confidentiality strategy, the ECB improved its transparency regarding the 'conventional' monetary policy. From 2015 ECB started publishing minutes from the Governing Council meetings. Even if, these minutes lack information about the voting procedure and voting records, ECB make a step further to the route of gaining more transparency, as it was one of the basis topics of criticism the last years. [208]

Transparency perceptions are a tool for the ECB to affect its credibility and credibility, **on its turn, influences inflation perceptions and inflation expectations,** which ultimately affect decisions with substantial future economic consequences, such as wage-setting, saving and borrowing.[209]

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[207] Pieter Van Cleynenbreugel, "Confidentiality behind Transparent Doors: The European Central Bank and the EU Law Principle of Openness." (2018) Maastricht Journal of European and Comparative Law 25, no.1, p.55.

[208] Roman Horvath and Dominika Katuscakova "Transparency and Trust: The Case of the European Central Bank." (2016) Applied Economics 48, no. 57 p.2.

[209], Van Der Cruijsen, and Eijffinger. "From Actual to Perceived Transparency: The Case of the European Central Bank." (2010) Journal of Economic Psychology 31, no. 3 p.390

4.2.3The ECB's credibility.

In monetary policy, the term credibility refers to the ability of a monetary authority to make the public believe that its policies are committed to a rule, such as maintain price stability. [210]Can the central bankers make credible commitments about their future conduct? The process of gaining credibility is long and convincing the public could take years. The creation of a stable environment will facilitate the establishment of credibility for the ECB. Monetary policy credibility must be measured over time and must be evaluated in terms of the monetary policies and behavior of the bank.[211]

The question here is if ECB's policies are credible. **In terms of fighting inflation, and keeping monetary growth under control, given the ECB's high level of independence, ECB's antiflation credentials are as strong as ever.** The power of the European Central Bank (ECB) is rooted in its independence established in the Maastricht Treaty of 1992. This power is reinforced though the bank's monetary policy credibility—achieved through meeting its price stability mandate, whilst resisting political pressures to manipulate monetary policy to other ends.[212]Yet, the ECB has achieved a credibility-enhancing transparency with the markets.

Despite widespread pessimism about the longevity of EMU and the rapid drop in the value of the euro during the first three years of EMU, **the ECB has had considerable success in achieving credibility thanks to its successful pursuit of its price stability mandate.** The ECB is frequently seen as the 'the most predictable central bank'—a virtuous reputation in central banking, where controlling expectations about future inflation is seen as crucial in increasing the effectiveness of monetary policy.[213]

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[210] Michael Senorer, "Central Bank Independence and its Implications for the European Central Bank" (University of Vienna 1996) p.56.

[211] David J. Howarth, and Peter H. Loedel, The European Central Bank: The New European Leviathan? (Palgrave Macmillan 2003)p.143

[212] David Howarth, The European Central Bank: The Bank that rules Europe? in Kenneth Dyson and Martin Marcussen, Central Banks in the Age of the Euro: Europeanization, Convergence, and Power (Oxford University Press, 2009) p 73-88.

[213] David Howarth, The European Central Bank: The Bank that rules Europe? in Kenneth Dyson and Martin Marcussen, Central Banks in the Age of the Euro: Europeanization, Convergence, and Power (Oxford University Press, 2009) p 73-88.

The more reliable and trustworthy a central bank is in maintaining price stability, the less incentive for different hedging strategies against inflation exists (Rudebusch, 2008a).

4.3 The Communication Policy Of ECB.

The European Central bank has regarded communication as an integral part of its monetary policy by communicating various issues to public. Communication is regarded as a key instrument for many Central Bankers as it may offer important benefits to central banks. The ECB's communication strategy is another of its aspects that is clearly inspired by the Bundesbank model.[214] The issues include its objective, its policy decisions and the economic outlook. Various communication channels were used, in order to inform the public in its decisions on a real time basis.[215] Since the start, the main communication vehicle has been the monetary policy press conferences held by the President and the Vice-President immediately after each monetary policy Governing Council. [216]

Two are the objectives of a Central bank's communication:
a. Contribution to accountability,
b. helping the central bank in managing expectations.[217]

The communication policy of European Central Bank has contributed to the effectiveness of its monetary policy. Clear communication helps anchoring inflation expectations, reducing policy induced uncertainty and making the transmission process of policy decisions more effective. [218]The expectations of private sector were affected and there has been a development in financial markets. In addition, communication has improved, what is called predictability of interest rate decisions.[219]

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[214] The form and style of the ECB's Montly Bulletin closely resembles the Bundesbank's Monthly Report. p.72 Karl. Kaltenthaler, Policymaking in the European Central Bank: The Masters of Europe's Money (2006) p.72

[215] Jakob de Haan, Helge Berger, The European Central Bank at Ten (Springer 2010) p.119.

[216] Philipp Hartmann, Frank Smets "The first twenty years of ECB: monetary policy." Working Paper Series, (ECB December 2018).

[217] Lorenzo Bini-Smaghi and Daniel Gros "Is the ECB sufficiently accountable and transparent? (Working paper no.7 September 2001,European Network of Economic policy research institute).

[218] Philipp. Hartmann and Frank Smets "The first twenty years of the European Central Banks: monetary policy" (Working Paper Series No 2219, December 2018) p.11.

[219] Jakob de Haan, Helge Berger, The European Central Bank at Ten (Springer 2010) p.138.

There are five strategies that consist the communication policy of ECB:

i. the issuance of a press release on monetary policy decisions immediately after each Governing Council meeting,

ii. the regular and frequent appearances of the President at the European Parliament,

iii. the ECB Monthly Bulletin,

iv. the numerous speeches and articles published by the members of the Governing Council,

v. more recently, audiovisual materials and broadcasts of press conferences have equally been added to the communications strategies envisaged in this regard.[220]

The first device, the press conference after policy meetings, is giving details about the motives behind a policy decision. The press conference includes a question-and-answer session, which is attended by key media representatives from across the euro area and beyond. In these conferences ECB provide details about the minutes of the meeting or the voting from 2015 and after. The press conference is effective in terms of presenting and explaining in a very timely manner the discussions in the Governing Council, and thus the monetary policy decision-making process. [221]The model of communication adopted by the ECB attempts to strike a reasonable balance between the objective of maximizing transparency and the special constraints deriving from the international character of the institution.[222]

Other important communication channel used by the ECB are the quarterly appearances of the ECB President before the European Parliament's Committee on Economic and Monetary Affairs and a large number of public speeches and interviews by members of the Executive Board. [223]

The third communication device for the ECB, its Monthly Bulletin is published one week after each monetary policy meeting. This Bulletin contains a summary of the Governing

[220] Pieter Van Cleynenbreugel, "Confidentiality behind Transparent Doors: The European Central Bank and the EU Law Principle of Openness." (2018) Maastricht Journal of European and Comparative Law 25, no. 1, p.60.

[221] Philipp. Hartmann and Frank Smets "The first twenty years of the European Central Banks: monetary policy" (Working Paper Series No 2219, December 2018) p.11.

[222] Issing, Otmar. Monetary Policy in the Euro Area: Strategy and Decision Making at the European Central Bank. (Cambridge 2001) p.142.

[223] Philipp. Hartmann and Frank Smets "The first twenty years of the European Central Banks: monetary policy" (Working Paper Series No 2219, December 2018) p.11.

Council view of economy and a short explanation regarding the previous interest rate decision.[224]

Despite the clarity surrounding of ECB monetary policy communications was the result of the combined reliance on five monetary policy communications strategies, this approach is not free from criticism. No matter if information is published in a timely manner, this communication policy is tested on the grounds of defining the actual policy inclinations underlying each decision. Apart from these general communications strategies that enable openness of ECB decision-making procedures, the ECB has opened up its policymaking discretion to the Council and the European Parliament.

An interinstitutional agreement[225] concluded between the ECB and the European Parliament as well as a Memorandum of Understanding concluded with the Council of European Union thus complementing the general openness framework. European Parliament and Council are able to have a closer look at the ECB decision- making processes. Both the interinstitutional agreement and the Memorandum of Understanding highlight that information can be transmitted to either institution in order for it to properly hold the ECB to account. More specifically, the ECB shall provide Parliament's competent committee with at least a comprehensive and record of the proceedings and the relevant decisions of the Supervisory Board in order to help the understanding of the discussions.

Memorandum of Council of European Union adopts the same approach for transmitting information with the only difference that exchanged information shall be confidential. This option is an opening of ECB's doors to democracy. Democracy is materialized by the representatives of the Member States and their voters, the European Union's people. The agreement and memorandum allow the Parliament and Council to look behind the closed-door operations of the ECB in prudential supervision.

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[224] Pieter Van Cleynenbreugel, "Confidentiality behind Transparent Doors: The European Central Bank and the EU Law Principle of Openness." (2018) Maastricht Journal of European and Comparative Law 25, no. 1, p.60.

[225] Interinstitutional Agreement between the European Parliament and the European Central Bank on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the Single Supervisory Mechanism(2013/694/EU).

In addition, Member States' parliaments are only given general reports in which no confidential information, will be made available to the extent that this can happen before the European Parliament or the Council. [226]

In addition, to its commitment to open communications, and in line with the long-standing individual fundamental right of access to documents, the ECB also adopted a complementary legal framework allowing individuals to request access to ECB documents, relating to both monetary policy and prudential supervision activities. Currently, ECB Decision 2004/258/EC, which replaced an earlier 1998 Decision, constitutes the starting point in this respect.[227]

According to that decision, any citizen of the Union, and any natural or legal person residing in or having its registered office in a Member State, has a right of access to ECB documents. The decision offers a procedure similar to the one in Regulation 1049/2001 enabling access to Commission, Council and European Parliament documents: first, an application can be lodged, following which a decision whether or not to grant access will be taken within 20 working days by the Director-General Secretariat of the ECB. In the event of a refusal, a confirmatory application can be made, also within 20 working days, to the Executive Board, asking for reconsideration.[228]

In accordance with the 2004 Decision, access can now be granted to any document with any medium content (written on paper or stored in electronic form or as a sound, visual or audio-visual recording) drawn up or held by the ECB and relating to its policies, activities or decisions. Also, access is granted to documents originating from the EMI and from the Committee of Governors of the central banks of the Member States of the European Economic Community (Committee of Governors). As a result, access rights are no longer limited to administrative documents, but also extend to monetary policy and prudential supervision documents.

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[226]Pieter Van Cleynenbreugel "Confidentiality behind Transparent Doors: The European Central Bank and the EU Law Principle of Openness." (2018) Maastricht Journal of European and Comparative Law 25, no.1, p. 60.

[227] Official Website of European Central Bank

https://www.ecb.europa.eu/ecb/legal/pdf/l_08020040318en00420044.pdf accessed on 10 June 2019.

[228] Pieter Van Cleynenbreugel "Confidentiality behind Transparent Doors: The European Central Bank and the EU Law Principle of Openness." (2018) Maastricht Journal of European and Comparative Law 25, no.1.

In the Dufour judgment,[229] the General Court confirmed that ECB databases are also to be considered as ‘documents’ falling within the ambit of the Public Access decision. According to the Court, ‘the entirety of the data contained in a database constitutes a document within the meaning of [Article 3(a) of Decision 2004/258]’; the specific organization, analysis and formatting of data in the context of a database does not take away the classification of those data – and of the database itself – as documents for the purpose of public access.

A set of exceptions is offered by the decision, that can be distinguished in per se exceptions, general exceptions and third-party exceptions. Those exceptions are related to documents undermining the public interest, the privacy and integrity of the personal data of individual in accordance with Union legislation.

4.4The Effectiveness of monetary policy within the ECB.

The power of the European Central Bank (ECB) is rooted in its independence that is reinforced though the bank’s monetary policy credibility. As it was analysed, credibility is achieved through meeting its price stability mandate. A growing volume of literature (e.g., Faust et al, 2001, Carstensen,2006,Arestis and Chortareas, 2006,Fendel and Frenkel, 2006, Sturm and Wollmershäuser, 2008) has attempted to evaluate the performance of the ECB in managing the aggregate economy of the euro area.[230]

During the periods of both crises, (financial crisis 2007-2008 and dept crisis of 2010-2012), EMU and its governing bodies were under test. In the first stage of financial crisis in Europe, in 2007, there was the problem of insufficient money to go around. ECB was the first central bank that took some measures, which facilitated banks to park their funds with the ECB. It was a bold and innovative step that few expected it was prepared to do.[231] These measures have stimulated the economy and rehabilitated the monetary transmission mechanism. This

[229] Julien Dufour v European Central Bank, T-443/09.

[230] Jim M. Lee, and Patrick M. Crowley. "An Evaluation of the ECB Policy Response to Changing Economic Conditions in Euro Area Member States." In Economic Performance (Nova Science Publishers 2012)p.79.

[231] Amy Verdun, "Political Leadership of the European Central Bank." (2017) Journal of European Integration 39, no. 2 p.209-210.

comprehensive block of measures has worked effectively through the financial system, leading to an improvement of financing conditions for consumers and firms. Together with improving financial and non-financial sector balance sheets, this has strengthened credit dynamics and supported domestic demand. It seems clear, however, that the ECB's evaluation of its monetary analysis is ongoing along a number of dimensions.[232]

Ten years after the start of the financial crisis, the question is whether the current monetary policy framework that the ECB has followed, remains appropriate. The most common argument about the ECB environment after 2018, is that it has become structurally more uncertain. Thus, it is important to find ways for monetary policy to manage uncertainty systematically.

The alteration of the ECB's definition of price stability might be a crucial part of providing such flexibility. Second, communication is a very important tool in any central bank's toolkit. In times of structural uncertainty however, communication becomes harder and possibly less effective.[233]

Another criticism came from Olli Rent, who mentioned on April 2019, that investors may be doubting the effectiveness of the European Central Bank's monetary policy measures in boosting inflation. Rehn, seen as a potential successor to ECB President Mario Draghi, emphasized the need for the ECB to continue providing stimulus to the economy and joined a growing number of policymakers in expressing skepticism about giving banks relief from a charge on their idle cash.[234]

The ECB is the most powerful supranational institution in the European Union. It has a great deal of autonomy, in order to make the kind of policies, which are right for the European Citizens. ECB's independence with all the six pillars is a major factor in International economic and monetary affairs and also a decisive factor for the European economic integration. It is the base of ECB's power that guarantees its credibility and transparency.

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[232] Jakob De Haan, and Helge Berger, The European Central Bank at Ten. (Springer Berlin Heidelberg 2010) p.39

[233] Gregory Claeys, Maria Demertzis, Jan Mazza "A monetary policy framework for the ECB to deal with uncertainty (European Parliament, November 2018) p.14

[234] Official Website of Reuters https://uk.reuters.com/article/uk-ecb-policy-finland/investors-may-be-doubting-effectiveness-of-ecb-policy-rehn-idUKKCN1S20VT accessed on 10 June 2019.

The ECB framework has proved flexible (even if it sometimes adjusted more slowly than in other jurisdictions during the crisis) and as discussed, its toolbox expanded greatly during the crisis.[235]The unconventional monetary policies had receiving effects in preventing European environment from a financial distress. These measures worked effectively regarding financial stability as well.

Bank lending rates for both euro area households and non-financial corporations have fallen by over 110 basis points since June 2014. Lending rates for small and medium-sized enterprises, which provide two-thirds of total private sector employment in the euro area, have declined by over 180 basis points. The sharp reduction in bank lending rates has been accompanied by easier access to funding, as recent ECB surveys on bank lending and access to finance have shown. But it is not just lending rates that are more favourable[236].

The difficulty that ECB is facing, is the lack of a single unified European financial system. Thus, it is essential to try to balance the needs of the national financial sectors to keep all these systems liquid and healthy. A popular classic quote on the need for price stability dates back to the seventeenth century:

If there is anything in the world which ought to be stable it is money, the measure of everything which enters the channels of trade. What confusion would there not be in a state where weights and measures are frequently changed? On what basis and with what assurance would one-person deal with another, and which nations would come to deal with people who lived in such disorder? (Le Blanc, 1690)

The extent of heterogeneity across national economies within the euro area, entails a challenge for delegating the responsibility of monetary policy to the ECB. Because economies of euro area member states have been quite unsynchronized, ECB policy actions, which might be adequate for the euro area as a whole, might have been too loose for such faster growing member states as Greece and Ireland but too tight for slower growing member states, such as

[235] Gregory Claeys, Maria Demertzis, J an Mazza “A monetary policy framework for the ECB to deal with uncertainty (European Parliament November 2018) p.14

[236] Victor Constancio “Effectiveness of Monetary Union on Capital markets” (Eurofi Conference, Malta 2017)

Official Website of European Central Bank

< https://www.ecb.europa.eu/press/key/date/2017/html/sp170404_2.en.html> accessed on 10 June 2019.

Italy.[237]

The euro crisis has brought a transformation, albeit not a radical one, in the functioning of the democratic control over the ECB. The Bank has become more responsive to parliamentary sensitivities, while retaining its status as an independent monetary and supervisory authority for the Eurozone. A persisting challenge for legislators will be to adjust their scrutiny to these different roles of the ECB and address the redistributive implications of a developing EMU. However, for this to be effective, the EU will need to devise further political ways to 'accommodate citizen concerns, while opening up decision-making processes to EU and national parliamentary representation'.[238]

4.5The evolution of ECB's monetary framework.

The monetary policy for ECB starts form its mandate, that is set out in the Treaty of Lisbon, without setting an explicit numerical target, time horizon or particular variable to target. The precise definition is defined by Governing Council and could be changed again by the ECB, if it is necessary. The answer to the criticism of ECB's uncertainty regarding its monetary policy, could be answered with an alteration of the definition of price stability.This alteration could be a step towards the evolution of the whole monetary framework.

Possible alterations to the definition could include: 1) the level of inflation targeted, 2) the choice of the particular price index to target, 3) the choice of the time horizon: medium-term versus over the cycle, for instance; and ultimately 5) the choice whether to target a growth rate or any other measure of prices as long as they are consistent with some form of price stability.[239]

Facing new challenges needs to increase flexibility of the framework. A recommendation for changing the definition of price stability could be the following: *"below but close to 2*

[237] Jim M. Lee, and Patrick M. Crowley. "An Evaluation of the ECB Policy Response to Changing Economic Conditions in Euro Area Member States." In Economic Performance (Nova Science Publishers 2012) p.106.

[238] Vivien A Schmidt, 'The Forgotten Problem of Democratic Legitimacy: "Governing by the Rules" and "Ruling by the Numbers"in Matthias Matthijs and Mark Blyth (eds), The Future of the Euro (Oxford University Press 2015) p.90, 112.

[239] Gregory Claeys, Maria Demertzis, J an Mazza "A monetary policy framework for the ECB to deal with uncertainty (European Parliament November 2018) p.17-20.

percent over the medium term" (generally defined as 18 months to 3 years) should become *"around 2 percent, on average, over the long run"* (i.e. a much longer time horizon than 18 months to 3 years). There would be a number of advantages of such a change compared to the current framework. [240]

The current definition of price stability, the term '*below but close*' suggests that the ECB targets implicitly a smaller number than 2 percent. Otmar Issing (2003) explained that inflation expectations should be between *"1.7 percent and 1.9 percent"*, an indication that the ECB was targeting roughly 1.8 percent. Given this lack of clarity, the word 'below' can be interpreted to mean that the ECB has a downward bias in its definition. Changing the definition to make it two-sided, around 2 percent, is a way of correcting for that without having to go very far from what is currently communicated.[241]

Firstly, it would also be important to define tolerance bands around the 2 percent target as a way of having a clear accountability framework. Tolerance bands should be numerically defined in order to know what inflation is acceptable or not. The tolerance bands need to be carefully chosen so that the target remains a good signal. Broad bands are easier to meet (but narrower bands are more precise.

Secondly, the period over which price stability is measured should be lengthened to increase flexibility. In practice, with this alteration, monetary policy will have long term expectations anchored at the inflation target.[242] It is important to highlight that this is a risky choice on the grounds of less controllability from instrument to target.

In addition, this suggestion that was presented, about the change to the definition of price stability, would be less radical than other proposals. It would be less complex and would thus avoid the risk of damaging the central bank's credibility. These monetary policy recommendations do not depart drastically from the current framework. There is no need for a radical change that might jeopardise the long-earned credibility of ECB.

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[240] Gregory Claeys, Maria Demertzis, J an Mazza "A monetary policy framework for the ECB to deal with uncertainty (European Parliament November 2018) p.17-20.

[241] Gregory Claeys, Maria Demertzis, J an Mazza "A monetary policy framework for the ECB to deal with uncertainty (European Parliament November 2018) p.17-20.

[242] Gregory Claeys, Maria Demertzis, J an Mazza "A monetary policy framework for the ECB to deal with uncertainty (European Parliament November 2018) p.17-20.

Concerning the improvement of communication strategy, it is important to inform the civil society, how ECB's actions prepare the economy better for the unknown. Communication, similarly, needs to inform why the policy choices made protect monetary policy objectives in a range of possible outcomes. [243]

[243] Gregory Claeys, Maria Demertzis, J an Mazza "A monetary policy framework for the ECB to deal with uncertainty (European Parliament November 2018) p.17-20.

5.Conclusion

European Economic and Monetary Union (EMU) is an unprecedented historical project, which resulted in the establishment of ECB. Eleven European Union (EU) countries introduced a common currency, with a single central bank, the European Central Bank (ECB)and a single monetary policy. Today nineteen quite diverse EU countries have joined the euro area and ECB runs the monetary policy for 340 million citizens.

The understanding of how an institution interacts, it is necessary in order to understand how any political or economic system works. The functioning and the effectiveness of ECB is a key variable for shaping the integration in Europe and reflects its problems, pressures and possibilities to reform. In this thesis, by exploring the degree of power and the nature of the tasks than ECB has, the picture of the integration process become clearer.

The ECB is the leading face of the Euro Area abroad and a new and important presence in several international economic fora. The ECB is effectively the ‘captain’ of the Euro system as well as of the wider European System of Central Banks (ESCB)—which includes all European Union (EU) National Central Banks. The ECB is responsible for coordinating the policy making of Euro system NCBs in a range of areas and NCB discussions on inflation forecasts.

The ECB acquired an important banking supervisory role since the November of 2014, which implied comprehensive microprudential and some limited macroprudential responsibilities. Following the outbreak of the financial crisis, this broadened monetary analysis was increasingly helpful in assessing fragilities in the banking sector. By assessing these fragilities, it was easier to define how they influence the monetary policy mechanism.

Overall, the main building blocks of the ECB’s monetary policy framework are its quantitative definition of price stability, the two pillars of economic and monetary analysis, the communication, transparency and accountability framework and the flexible operational framework have served the ECB well over the past twenty years. The monetary policy faces different challenges over its ability to control inflation and over the instruments that should be used and their effects on financial stability. As it was described over the units of this master thesis, it was important that ECB evolved in response to the challenges of the time.

The communication and accountability framework were adjusted, as the need for additional communication in a complex policy environment rose. The need for forward guidance became huge, as forward guidance is an essential tool for easing policy in a low interest rate context. The operational framework of ECB is well suited to provide ample liquidity to the ECB's counterparties. The well-designed operational structure of ECB helped addressing impairments in the early steps of the monetary mechanism. Undoubtedly this structure contributed to financial stability. Moreover, after the two crises, the zero-lower bound became a limit and the operational framework proved flexible enough, so as to allow the ECB to expand its tool set with other non-standard policy measures.

All in all, the ECB has adjusted its monetary policy to the changing and challenging circumstances over time. ECB's focused in achieving the primary objective of price stability as it is described in the Treaties, by an effective use of its strategy and framework. Broadening its tools over time paved the way for positive results. A percentage of incompleteness of EMU was addressed with a series of important reforms, followed the crises. In particular, these reforms included the establishment of the European Stability Mechanism, the implementation the Single Supervisory and Resolution Mechanisms, the signing of the Fiscal Compact and the introduction of a European Semester with a Macroeconomic Imbalance Procedure.

The complicated mission of maintaining price stability was successful. Looking forward, without prejudice to the objective of price stability, the ECB shall also support the general economic policies in the European Union, with a view to contributing to the achievement of the objectives of the EU such as a highly competitive social market economy, aiming at full employment and social progress. ECB's activities and new ideas should be under the umbrella of article 15 TFEU: "shall conduct their work as openly as possible", "in order to promote good governance and ensure the participation of civil society".

Annexes

Annex 1

The fully paid-up subscriptions of euro area NCBs to the capital of the ECB amount to a total of €7,536,110,121.69 and break down as follows[244]:

Euro area NCBs' contributions to the ECB's capital

National central bank	Capital key %	Paid-up capital (€)
1) Owing to rounding, the total may not correspond to the sum of all figures shown.		
Nationale Bank van België/Banque Nationale de Belgique (Belgium)	2.5280	273,656,178.72
Deutsche Bundesbank (Germany)	18.3670	1,988,229,048.48
Eesti Pank (Estonia)	0.1968	21,303,613.91
Central Bank of Ireland (Ireland)	1.1754	127,237,133.10
Bank of Greece (Greece)	1.7292	187,186,022.25
Banco de España (Spain)	8.3391	902,708,164.54
Banque de France (France)	14.2061	1,537,811,329.32
Banca d'Italia (Italy)	11.8023	1,277,599,809.38
Central Bank of Cyprus (Cyprus)	0.1503	16,269,985.63
Latvijas Banka (Latvia)	0.2731	29,563,094.31
Lietuvos bankas (Lithuania)	0.4059	43,938,703.70
Banque centrale du Luxembourg (Luxembourg)	0.2270	24,572,766.05
Central Bank of Malta (Malta)	0.0732	7,923,905.17
De Nederlandsche Bank (The Netherlands)	4.0677	440,328,812.57
Oesterreichische Nationalbank (Austria)	2.0325	220,018,268.69
Banco de Portugal (Portugal)	1.6367	177,172,890.71
Banka Slovenije (Slovenia)	0.3361	36,382,848.76
Národná banka Slovenska (Slovakia)	0.8004	86,643,356.59

[244] Official Website of European Central Bank https://www.ecb.europa.eu/ecb/orga/capital/html/index.de.html Accessed on 10 June 2019.

National central bank	Capital key %	Paid-up capital (€)
Suomen Pankki – Finlands Bank (Finland)	1.2708	137,564,189.84
Total[1]	**69.6176**	**7,536,110,121.69**

Annex 2

Austria	Finanzmarktaufsicht
Belgium	Nationale Bank van België/Banque Nationale de Belgique
Cyprus	Central Bank of Cyprus
Estonia	Finantsinspektsioon
Finland	Finanssivalvonta
France	Autorité de contrôle prudentiel et de résolution
Germany	Bundesanstalt für Finanzdienstleistungsaufsicht
Greece	Bank of Greece
Ireland	Central Bank of Ireland
Italy	Banca d'Italia
Latvia	Finanšu un kapitāla tirgus komisija
Lithuania	Lietuvos bankas
Luxembourg	Commission de Surveillance du Secteur Financier
Commission de Surveil-	Malta-Malta Financial Services Authority

lance du Secteur Financier	
Netherlands	De Nederlandsche Bank
Portugal	Banco de Portugal
Slovakia	Národná banka Slovenska
Slovenia	Banka Slovenije
Spain	Banco de España[245]

[245] Official Website of European Central Bank https://www.bankingsupervision.europa.eu/banking/list/who/html/index.en.html accessed on 10 June 2010.

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German Abstract

Am 1. Juli 2018 feierte die Europäische Zentralbank (EZB) ihr 20 jähriges Bestehen. Es waren zwei Jahrzehnte, die sich durch verschiedene finanzpolitische Entscheidungen auszeichneten. Die Weltwirtschaft sah sich mit der schwerwiegendsten Finanzkrise seit der Großen Depression der 1930er Jahre konfrontiert. Politiker, Wirtschaftswissenschaftler sowie am Marktgeschehen Beteiligte kritisierten die EZB aufgrund ihrer geldpolitischen Entscheidungen. Zweifellos gibt es für einige dieser Kritikpunkte gute und berechtigte Gründe.

Nach der harten Phase der Wirtschaftskrise stand die Handlungsweise der EZB zur Diskussion. Viele behaupteten, die EZB habe es der in den USA ausgebrochenen Krise ermöglicht, sich mit atemberaubender Geschwindigkeit in Europa auszubreiten, was zu außerordentlichen Konsequenzen im europäischen Wirtschaftsraum geführt habe. Im Dezember 2008 erklärte das Vorstandsmitglied der EZB Lorenzo B. Smaghi, dass sich die Situation in Europa sehr stark von der in den USA unterscheide. Trotz des Einsatzes aller verfügbaren Mittel der Zinspolitik durch die Fed seien die Zinssätze sowohl für Haushalte als auch für Unternehmen genauso hoch geblieben wie in Europa, obwohl es an entsprechenden Maßnahmen seitens der EZB gemangelt habe.

In dieser Studie geht es darum, die Arbeit der EZB ab 1998 und insbesondere nach Ausbruch der Finanzkrise zu untersuchen, und zwar unter besonderer Berücksichtigung des Rahmens, in dem sich die Geldpolitik der EZB bewegt. Wie hat die EZB auf die Herausforderungen, mit denen sie aufgrund der Krise konfrontiert war, reagiert und welche finanzpolitischen Instrumente hat sie eingesetzt? Stellten die währungspolitischen Rahmenbedingungen eventuell ein Hindernis dar, sodass die EZB nicht so schnell agieren konnte wie andere Zentralbanken? In diesem Fall hätte man sie nicht so scharf kritisieren dürfen. Vielmehr hätte die Kritik dann der Funktionsweise des Europäischen Systems der Zentralbanken (ESZB) in seiner Gesamtheit gelten müssen.

Das Ziel dieser Arbeit ist es, zu untersuchen, ob die Geldpolitik der EZB unter schwierigsten finanzpolitischen Bedingungen in ihrem Ansatz konsequent und effizient war. Dabei sind folgende Fragen zu beantworten: Hat die globale finanzielle Notlage zu einer Veränderung ihrer Politik geführt und sind die von vielen kritisierten Maßnahmen der EZB eher der Folgerichtigkeit finanzpolitischer Ziele und Aktivitäten geschuldet als den gefährli-

chen wirtschaftlichen Umständen?Die Untersuchung umfasst die Maßnahmen der EZB bis Anfang 2019. Prognosen über zukünftige geldpolitische Entscheidungen würden den Rahmen dieser Arbeit sprengen. Zudem wird auch die Wirksamkeit der jüngsten politischen Maßnahmen nicht eingeschätzt, da deren wirtschaftlicher Nutzen nicht unmittelbar sichtbar ist.

Schwerpunkt dieser Arbeit ist die Bewertung der Geldpolitik der EZB. Dabei geht es zuerst darum, die Institution der Europäischen Zentralbank genauer zu bestimmen. Im zweiten Kapitel folgt dann ein kurzer Überblick über die geschichtliche Entwicklung der Wirtschafts- und Währungsunion, über die Gründung des Europäischen Wirtschaftsinstituts sowie die Gründe, die zur Einrichtung der EZB geführt haben. In diesem Zusammenhang wird auch die Entscheidungsstruktur der EZB erläutert.

Gegenstand des dritten Kapitels sind die strategischen Entscheidungen der EZB im Rahmen ihrer Währungspolitik, die Hauptziele der EZB und ihre Zwei-Säulen-Strategie.Die unkonventionellen Maßnahmen, die aufgrund der Finanzkrise ergriffen wurden, sind ebenfalls Teil dieser Untersuchung, um auf diese Weise ein umfassenderes Bild der Funktionsweise der EZB zu erhalten. Es wird nicht nur die Geldpolitik selbst erklärt, sondern auch die Arbeit der EZB analysiert. Die Preisstabilität als Hauptziel der EZB wird definiert und in ihrer Bedeutung erklärt. Preisstabilität ist ein äußerst wichtiges Instrument, um langfristig wirtschaftliches Wachstum, eine hohe Beschäftigungsrate und finanzielle Stabilität zu erzielen.

Das vierte und letzte Kapitel beschäftigt sich mit der Aufsichtsfunktion der EZB. Untersucht werden die Transparenz, die Glaubwürdigkeit, die Rechenschaftspflicht und die Kommunikationspolitik der EZB. In der abschließenden Beurteilung wird ein Gesamtbild der Rolle der EZB in der jüngsten Vergangenheit gezeichnet und es werden Vorschläge für künftige Entwicklungen diskutiert.