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Frankfurt’s double standard: the politics of the European Central Bank during the Eurozone crisis

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Abstract In this article, I examine the bias in favour of financial markets displayed by the European Central Bank (ECB) during the Eurozone crisis. Having analysed the roots of the ECB’s bias, I explore the discrepancy between the conditionality of ECB financial support that is directed towards states and that which is directed towards markets. On the one hand, the ECB has exerted strong coercive and cognitive pressures to reform Eurozone economic governance in a market-friendly way. On the other hand, it has employed monetary measures to save large Eurozone banks from a complete meltdown without controlling how these banks use their provided liquidities. I conclude by stressing the democratic problems engendered by the ECB’s bias.

Introduction

Because central banks play an interface role between financial markets and democratic states, they are crucial regulatory authorities that are located at the heart of capitalist systems. Throughout history, the autonomy of central banks relative to the authority of markets and states has fluctuated according to the dominant economic paradigms (Singleton 2010; Knafo 2013). Following the diffusion of neo-classical ideas and the coercive pressure of international organizations in the 1980s, the central bank independence (CBI) template1 became the organizational norm for central banking in advanced industrial economies. The European Central Bank (ECB) is one of the best examples of this phenomenon (McNamara 2002).

With the advent of the CBI template, most of the monetary policy literature and political debates focused on how to ensure the independence of central banks vis-à-vis governments (Alesina and Summers 1993). Conversely, concerns about the other main dimension of CBI (vis-à-vis financial markets) were put on the back burner. For example, the main point of contention between European states during the creation of the ECB was about the appropriate degree of its isolation from political pressures (Dyson and Featherstone 1999; Howarth and Loedel 2005, chapter 5).

From this perspective, the 2007 financial crisis was a game-changer, as it renewed public attention and academic debates on the financial dimension of

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1 The CBI template prescribes that the objectives of central banks should be limited to price stability. To achieve this goal, central banks should be protected from political interference. According to the New Classical Economics literature, without such protections, central banks would not be credible in the eyes of market operators in their commitment to maintaining price stability (Kydland and Prescott 1977; Rogoff, 1985).
CBI. Scholars have identified three causal explanations for the influence of commercial banks over central banks. First, like any other regulatory agency, central banks are prone to ex ante and ex post regulatory capture\(^2\) by financial institutions (Adolph 2013; Kwak 2013). Second, as central bankers rely on the cooperation of financial operators to have an indirect impact on the economy through the channels of transmission of monetary policy, the financial sector exercises an infrastructural power over central banks (Braun 2018; Gabor and Ban 2016). Third, the sheer size and interconnectedness of financial institutions give them structural power over central banks because the economic and social costs linked to the collapse of too-big-to-fail banks invite preferential treatment from the monetary authority (Dyson 2009; Blyth 2013, chapter 3). In addition to these causal explanations, descriptive analyses of the financial dimension of CBI are emerging in the literature. For example, the Federal Reserve has been criticized on the grounds that it ‘constantly favors banks and investment firms’ (Jacobs and Kings 2016, 3). Such a study has not yet been conducted in the case of the ECB.

How does this power of finance over the ECB translate into its policies and politics? This article argues that, since the crisis, there has been an asymmetry in the conditionality attached to the ECB’s monetary instruments: central bankers ask for very strict conditions when they intervene to stabilize Eurozone states while they are much more lenient when they provide liquidity to Eurozone banks. In fact, ECB politics and policies have been characterized by a strong bias towards the protection of private financial interests, and this bias has become exacerbated because the ECB has managed to extend its power and influence since the beginning of the crisis.

The argument for focusing on the ECB’s conditionality goes as follows. In order to avoid a collapse of the financial system, the ECB and other central banks heavily use their balance-sheets (instead of concentrating solely on the setting of interest rates) to provide long-terms loans to the banks with relaxed collateral conditions and purchase financial assets on secondary markets (Borio 2011; Goodhart 2011; Ertürk 2014). Since banks’ and states’ balance sheets are deeply interlinked, one could argue, alongside central bankers themselves, that these unconventional policy measures benefit society as a whole. Yet, central banks’ interventions as lender of last resort have always come at the price of conditionality in order to avoid moral hazard.\(^3\) Since the ECB is not supposed to fuel moral hazard by providing financial help to failed states, or to failed banks, an analysis of the ECB’s conditionality helps to define the scope of its political choices, which extends beyond economic and legal constraints.\(^4\)

\(^2\) Ex ant capture relates to career socialization concerns: when central bankers have formerly worked within the financial industry, it is more likely that the banking sector will have influenced their economic beliefs. Ex post capture refers to the hiring of central bankers by the financial industry. In this case, central bankers have an incentive to send favorable signals to their future employers in the financial sector.

\(^3\) Moral hazard occurs when financial players take excessive risks because of the knowledge that they will be bailed out by an LoLR in crisis times.

\(^4\) While economic and legal factors constrain ECB policies, the latter still has room for manoeuvre. For example, in its ‘Gauweiler ruling’ on the OMT programme (see section two), the Court of Justice of the European Union (CJEU) granted broad discretion to the ECB in the definition of its monetary policy and conditionality (Hinarejos 2015). While they are not the focus of this article, the interactions between the CJEU and the ECB offer vibrant future research perspectives.
This analysis of the bias displayed by the ECB stands in strong contrast with the (implicit rather than explicit) positive evolution of the role played by central bankers during the crisis in most of the literature (Salines et al 2012; Torres 2013; Henning 2016; Genovese et al 2016; Verdun 2017). Rather, this study of the ECB double standard aligns with the critical political economy literature that analyses financial constraints on democratic systems (Crouch 2004; Hay 2007; Streeck and Schäfer 2013). In particular, following Streeck and Schäfer’s framework, this article highlights the crucial role played by central bankers in the promotion of the interests of the ‘market’ constituency, at the expense of the ‘people’ constituency.

From a methodological point of view, this article relies on primary and secondary sources, including semi-structured interviews with high-level policymakers who are involved daily in the Eurozone crisis resolution process. Since the Eurozone crisis resolution process is heavily shaped by intergovernmental dynamics (Bickerton et al 2015), and central bankers are very reluctant to disclose information, I gained information about perceptions of the ECB and empirical data about the crisis resolution process from member states’ representatives. I did this by interviewing, in November 2010, members of the preparatory committee of intergovernmental meetings in the Economic and Financial Committee (EFC), which is the hearth of Eurozone economic governance (Grosche and Puetter 2008). These interviews focus on the policy solutions and temporary arrangements chosen during the first phases of the Eurozone crisis (January–November 2010). According to the ‘path-dependency’ concept lying at the heart of the historical institutionalist approach, these first phases were crucial, since they narrowed down the range of policy options and institutions available to policymakers in the subsequent phases of the crisis (Verdun 2015).

This article unfolds as follows. The aim of the first section is to demonstrate the ECB’s long-standing bias towards the protection of financial interests. Before the crisis, the impact of the ECB’s bias was limited because it could not exert much influence over either the member states’ economies or the regulation and supervision of financial systems. The next section explains why the crisis was a game-changer with the presentation of the two channels of influence that permitted the ECB to extend its power within the Eurozone and use the crisis as a window of opportunity to pursue its reform agenda beyond the realm of monetary policy. The last two sections show how the ECB’s bias became exacerbated during the crisis by analysing the conditionality of the ECB’s financial support with respect to states and financial markets.

The two faces of the ECB independence

Bundesbank policies and the CBI template heavily influenced the creation of the ECB (Dyson and Featherstone 1999). As a result, the ECB is tasked with an overarching objective of price stability, and it is considered to be the most independent central bank for three main reasons. First, Eurozone governmental

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5 These authors claim that the ECB’s leadership helped to foster EU integration and tame market and social pressures. An important exception is the growing stream of critical research on the ECB’s democratic accountability (Högenauer and Howarth 2016; Peroni 2017).
and legislative authorities are fragmented because of divergent policy interests, economic ideas and institutional structures and, therefore, lack policy leadership and oversight power in relation to the ECB (Jabko 2009). Moreover, as there is no legal basis for the monetary dialogue that takes place between the ECB and the European Parliament (EP), the latter lacks effective tools to control the activities of the former (Collignon and Diessner 2016). Second, ECB decision-making procedures are more opaque than in other currency areas, since the individual composition of the votes taking place at the Governing Council is kept secret. This lack of transparency gives leverage to the ECB to the extent that governments cannot hold individual central bankers accountable for their decisions. This discrepancy of power is greater than in the cases of the Federal Reserve system (Fed) and the Bank of England (BoE) (Goodhart and Meade 2004). Third, the ECB is better able to resist governmental pressures than the Fed and the BoE, since a change in its treaty-based statute would require the highly unlikely unanimous approval of the 28 European Union (EU) member states. While the ECB’s level of independence from elected officials has been thoroughly scrutinized in the literature, the other face of its independence, namely its independence from financial interests, has been overlooked. This article examines the two faces of the ECB’s independence in order to show the roots of its market-friendly policy preferences.

The ECB as a promoter of market-friendly reforms

How do governments gain from delegating their monetary policies to independent agencies? What are the political effects of this kind of delegation? CBI is strategically motivated in the sense that, like certain other forms of statecraft, it allows governments officials to tie their hands in a way that is perceived as being politically advantageous (Crouch 2004). Indeed, it allows governments to deny responsibility for the socio-economic changes associated with the goal of low inflation (such as market-friendly labour market reforms or budgetary controls) while reaping the economic benefits from the increased confidence of financial markets (such as lower sovereign interest rates). For example, French and Italian policymakers perceived the creation of the euro as a window of opportunity to reform their economies without taking any political responsibility for the negative consequences of their reforms (Dyson and Featherstone 1999). These strategic and ideational factors have been strong enough to ensure that Eurozone governments have not seriously attempted to alter the ECB’s monetary policy since its creation (Howarth 2004).

Second, the ECB has been promoting market-friendly economic reforms within the Eurozone since its creation in 1999. Although their competencies are officially limited to monetary policy, central bankers have vested interests in extending their influence beyond their official responsibilities in order to protect their level of independence (Forder 2002). This is partly a result of ideational factors: a weakening of the neo-classical consensus would impair the ideational roots of the ECB’s independence. Moreover, the ECB’s legitimacy is output oriented and is assessed solely according to its success in achieving price stability (Scharpf 1997). Consequently, ECB representatives try to prevent the implementation of any non-monetary policies that might spur inflation. For example, the ECB called every month for the swift implementation of so-called structural reforms (aiming at
labour market flexibilization) and budgetary ‘sustainability’ measures, despite lacking the means to effectively influence governmental policies prior to the crisis (Fontan 2013). In this sense, the ECB is a political player that attempts to isolate economic policies (and thus issues of distribution) from electoral outcomes, arguably for the benefit of the most well-off.

So far, I have shown that the CBI template has not confined the ECB’s interests to the monetary realm. On the contrary, although they were unable to do so before the Eurozone crisis, European central bankers have promoted the isolation of Eurozone economic governance from electoral pressures. This permanent pressure on non-monetary policies is even more striking when compared with the weak ECB interest in financial regulation.

The ECB’s benign neglect towards problematic finance

Since the mid-1990s, financial institutions have increased in size, complexity and instability. This process of financialization has diminished the central banks’ regulatory capacities and their control over liquidity circulation. It has been driven by regulatory and political choices in which central banks have been active players rather than powerless spectators (Engelen et al. 2011). While the Fed, with its policy of ‘benign neglect’, has often been singled out as a symbol of complacency towards the interests of financial markets, the ECB has been spared such criticism in Eurozone policy circles (see section two). This is surprising, because, as the following two arguments will indicate, the policy preferences of the ECB towards financialization were not different from those of the Fed prior to the crisis (Dietsch et al. 2018, chapter 3).

First, the ECB has been one of the promoters of the ‘regulatory liberalism’ paradigm in the EU (on this paradigm, see Mügge 2011). Indeed, even though it did not have any kind of formal financial supervision competency before 2010, the ECB is part of the ‘Basel Committee’ forums and it delivers many legal opinions on supervisory issues. For example, Jean-Claude Trichet\(^6\) promoted the self-regulation of markets as the best regulatory option until at least October 2007.\(^7\)

Second, the ECB has been one of the main players that, in the name of EU economic integration, has actively promoted EU financial integration and participated in the build-up of financial imbalances in the Eurozone. In particular, the financial incentives that encouraged risky, large-scale lending to the Eurozone periphery countries were very similar to those which led to the American subprime mortgage crisis, with the key difference that they involved public debt rather than private debt. The ECB created a basket of government securities in which the debt of any Eurozone country (Greece or Germany for example) has the same value when used as collateral in ECB refinancing operations (Gabor and Ban 2016).\(^8\) By doing so, it encouraged financial operators to

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\(^7\) Speech of Jean-Claude Trichet, 3 November 2007. All the speeches are available on the ECB website: http://www.ecb.europa.eu
\(^8\) More precisely, a report from a high-level expert group created by the Commission first pointed out the problems raised by the lack of integration of Eurozone repo markets (Giovannini 1999). Then, through its collateralized operations, the ECB encouraged private actors to create ‘baskets’ of Eurozone sovereign bonds (ECB 2002, 66) and in the end threw its weight behind the European Commission’s Financial Collateral directive.
use government debts as collateral for Eurozone’s repo market in an undifferen-
tiated way. This policy revived the Eurozone repo market: its size tripled between 2001 and 2008, mostly because 75 per cent of the repo transactions used government debt as collateral for other risky financial operations. This recycling was conducive to the major banks’ risky financial expansion and the build-up of the Eurozone financial imbalances (Blyth 2013, chapter 3).

This analysis of the two faces of the ECB’s independence shows that central bankers were in favour of market-friendly policies in both economic govern-
ance and financial regulation. Yet, until 2010, the ECB’s influence on these issues was limited, because it did not have the means to persuade elected policymakers to enact economic reforms, nor did it play a central role in financial supervision and regulation.

The ECB’s channels of influence during the crisis

Although financial crises are inherently linked to financial cycles and are not extraordinary events, these unexpected critical junctures can change the balance of power within political systems (Dobry 1992). This potential power shift is linked to ideational changes, which are more likely in times of crisis (Blyth 2002). For example, if the dominant crisis narrative would have highlighted the role played by core Eurozone banks in the build-up of financial imbalances, the likely set of policy prescriptions would aim to reverse the process of financialization. However, these changes are not automatic, because crises can also counter-intuitively reinforce prevailing ideas and dominant political players. The case of the Eurozone crisis is exemplary in this regard, as dominant orthodox political players (such as Germany) managed to impose their crisis narrative, and subsequent policy solutions, against competing explanations (Matthijs and McNamara 2015).

Consequently, the ongoing financial crisis is both a risk and a window of opportunity for the ECB. On the one hand, if the banking sector were to collapse, the ECB would be perceived as a failed regulatory organization and it would lose its current level of autonomy. Similarly, a paradigmatic shift towards economic ideas in which financial mechanisms are contested would weaken the ECB, in part because it was active in promoting financialization before the crisis (see section one). Consequently, the ECB aims to stabilize the collapsing financial system while framing the crisis as fiscal in nature rather than financial. On the other hand, the role played by the ECB as an intermediary between financial and political systems has increased the power of central bankers during the financial crisis (Dyson 2009). Indeed, the ECB’s expertise over financial issues and its monopoly over liquidity supply become crucial strategic resources during times of crisis. These two elements constitute the ECB’s two channels of influence (Fontan 2013). Whereas the former is cognitive, the latter is coercive (on this distinction see Orenstein 2008). The ECB relies on these two channels to control the risks associated with the crisis and to use the crisis as an opportunity to extend its influence on Eurozone governance.
The expertise over financial issues

The ECB has the largest research centre amongst European Monetary Union (EMU) institutions (on the ECB’s strategy of hyper-scientization, see Mudge and Vauchez 2016). It has a practitioner’s point of view on financial developments, because trades are made on a daily basis with financial operators. Moreover, the perceived complexity of financial systems increases the perceived value of the central bankers’ expertise. Recognition of this value enables central bankers to insulate their policies from external criticism and to extend their influence over other policies. Indeed, the scientization of monetary and financial matters since the 1990s has apoliticized the activities of central bankers and granted the ECB increased autonomy in the conduct of its policies and greater recognition for its opinions on non-monetary matters (Marcussen 2009).

Here, this article turns to the semi-directed interviews conducted with EFC agents (see introduction) to show how the ECB relied on the recognition of its expertise in the first phases of the crisis both to frame the crisis as a fiscal and competitiveness crisis and to build alliances in favour of specific policy solutions.

First, an interviewee explains why the EFC agents trusted the ECB’s expertise more than their own supervisors’ analysis to assess financial risks in the context of the creation of the European Financial Stability Fund (EFSF):

My feeling is that the ECB knew how the markets were unfolding. You’ve got the screen on your desk, you look at it, but you don’t have the practitioner’s point of view of how it is developing, you don’t have a realistic view on how this is impacting you through the conference calls with the banking supervisors … they were the ones we relied upon to say ‘things are getting worse but they are not catastrophic’, and then when they said ‘now we’re going to do it over the coming week-end’, everybody knew, this is it. They’ve got the credibility to say it. (Interview 1)

The ECB’s statute of independence complements this recognition of its practical expertise:

The most important reason [for the ECB influence] is the idea that the ECB is independent, lots of institutions are independent, but the ECB is the most independent one, you cannot accuse them of any collusion … there is the idea that if the ECB is saying that, it is true, it is an opinion without pressure from the governments, it is the right figure, there is a sure effect of this aura of independence. (Interview 2)

The Commission is seen as a political body by many when the ECB is more of an expert, people don’t doubt their position, they don’t see a political interest behind it, when they talk, it’s closer to the truth. (Interview 3)

Moreover, its orthodox reputation (see section one) helped the ECB gain confidence from creditor countries such as Germany. Since the crisis was framed as a fiscal crisis, the ECB’s past positions on structural reforms and budgetary consolidation reinforced the positive perceptions of creditor countries on its role:

9 9 May 2010.
So, who’s got the credibility? The ECB, because they got people who were so unpopular like Jürgen Stark,\textsuperscript{10} in case you got budgetary deficit, Jürgen would stand in front of you and say ‘this is a catastrophe’ when we were not taking it seriously. (Interview 1)

Second, its orthodox reputation convinced creditor countries to participate in Eurozone rescue plans. An official from the EFC explained this with the example of the EFSF:

You really need that, to have at least one institution that is credible to other ones when it says now we need to do that.

Q: You mean, credible enough to take the Germans on board?

A: Yes, you need a stable institution to rely on, an anchor of confidence. (Interview 2)

Interestingly, the ECB played a broker role between the Eurozone’s governments during the creation of the EFSF; the debtor countries then recognized this role positively (interview 4), as another official from the EFC explains: ‘In May [2010], when we moved away from traditional orthodoxy during that weekend, Germany, Finland and the Netherlands were brought on board by the ECB’ (interview 3). The ECB was thus well beyond its ‘advisory role’ enshrined in the treaties since it played the traditional ‘broker’ role that the Commission used to endorse during the creation of the euro (Jabko\textsuperscript{2} 2006). As an official from the EFC puts it: ‘The German members of the Committee were saying, there is just one person Merkel will listen to, it is Trichet, nobody else. Not Sarkozy, not Barroso’ (interview 1).

To conclude, the ECB has been relying on the recognition of its expertise to act as a crucial player, along with the German hegemon and other creditor countries, in the crafting of the EU ‘financial rescue-cum-austerity’ answer to the crisis. Blyth (2013) argues that this framing was a hidden bailout of core European major banks.

\textit{The monopoly on liquidity}

In normal times, central banks set interest rates through open market operations\textsuperscript{11} to maintain price stability, a humdrum exercise rarely noticed by most people (Goodhart 2011). Yet, in times of crisis, central bankers become lenders of last resort (LoLR) of both the banking and the sovereign systems and, as such, are at the forefront of the political response to the crisis.\textsuperscript{12} Central banks are at the top of the financial system hierarchy, because they are the first providers of liquidity and have (in theory) unlimited financial resources (Pistor 2013). In crisis times, central banks have the authority to decide which financial contracts should be honoured, and through these decisions they can

\textsuperscript{10} Former member of the ECB executive board (2006–2011).
\textsuperscript{11} In these open market operations, the ECB conducts an auction to loan a certain amount of liquidity to commercial banks at a certain rate (the main refinancing rate) against specified forms of collateral. They are the main central banks’ policy tools.
\textsuperscript{12} The LoLR is the authority that has the resources to act as the ultimate source of credit in an attempt to avoid a liquidity crisis.
impose their will on other financial players. For example, when the ECB determines which financial assets are accepted in its open market operations and at what price, its decisions impact on other traders in the financial system. In particular, the ECB’s acceptance of illiquid collateral, say the government paper of Eurozone countries in financial difficulty, is decisive for ensuring the stability of banks’ and states’ balance sheets (Gabor 2016b; Barthélémy et al 2017).

Moreover, when the financial crisis morphed into a sovereign crisis, the Eurozone’s governance lacked the institutional mechanisms and the political willingness to shelter the more exposed Eurozone states from financial volatility. In addition, the combined effect of decades of budget constraints and bailouts of oversized financial sectors in 2008 and 2009 was the impairment of the Eurozone states’ financial capacity to respond to the crisis (Streeck and Schäfer 2013). Because the European treaties forbid any form of monetary financing,13 the ECB sovereign purchases were initially limited, but they eventually reached the magnitude of the purchasing programmes of other central banks. In the end, the ECB became the LoLR for both the Eurozone banking sector and the Eurozone states (Buitier and Rahbari 2012). The ECB is thus in a unique position to use the conditionality of its monetary support to impose its policy preferences on states and financial institutions, neither of which can rely on other forms of financing.

To conclude, the crisis represents an unprecedented window of opportunity for the ECB to extend its influence on Eurozone governance. The ECB will only be able to benefit from this opportunity if it harnesses the recognition of its expertise to frame the crisis as a fiscal crisis. Its role as the LoLR for states and financial institutions gives the ECB more room for manoeuvre to impose its policy preferences over these two entities. The two next sections will show that the conditions that the ECB exerts in the financial rescue of Eurozone countries are much more stringent than those which it applies to the bailout of financial institutions.

The coercive ECB’s financial rescue of Eurozone member states

From January 2010 onwards, the most fragile Eurozone member states had to rely on either intergovernmental loans or ECB monetary interventions to stabilize their banking systems and the refinancing of their sovereign debt. ECB interventions were either supplementary to intergovernmental loans, or, if member states could not agree on financial rescue mechanisms quickly enough, unilateral. In both cases, the conditionality of ECB interventions took the form of austerity policies whose implementation was tightly controlled by the expert groups of the Troika.14 These interventions can be divided into three categories: its bond-purchasing programmes, its collateral rules and its emergency liquidity assistance (ELA) instrument.

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13 Article 123, Treaty on the Functioning of the European Union (TFEU).
14 The Troika is composed of officials from the IMF, the European Commission and the ECB.
The ECB bond purchasing programmes

Since 9 May 2010, the ECB has implemented three sovereign bond-buying programmes on the secondary markets: the Securities Market Programme (SMP) in May 2010, the Outright Monetary Transactions programme (OMT) in September 2012 and the Quantitative Easing (QE) programme in March 2015. These unconventional measures triggered strong internal criticism and the resignation of two notable orthodox members of the ECB board of governors, Jürgen Stark and Axel Weber. These programmes differ in size, implementation and motivation, but they are all rooted in a common principle: if the ECB intervenes on secondary markets to purchase government bonds, governments must implement a certain number of reforms. This conditionality was exerted in two different forms, the first of which was official and multilateral and the second of which was unofficial and bilateral.

First, the Greek, Irish, Portuguese and Cypriot governments applied for a loan from other Eurozone governments and from the International Monetary Fund (IMF). In exchange, all the main national political parties had to agree on and comply with a set of measures written in a memorandum of understanding (MoU). Once the general principles of the MoU were agreed upon within the European Council (and more specifically the Eurogroup), the writing and supervision of the MoU were delegated to the Troika. The disbursement of the loan and the buying of government bonds by the ECB could both be stopped if the governments failed to implement the reforms. The ECB is thus the only EU institution that provides financial support to Eurozone countries and can directly control the implementation of associated reforms.

In a preliminary opinion for a ruling on the OMT’s legality, the European Court of Justice’s general advocate emphasized that the importance of the ECB’s role in the Troika blurs the limits between fiscal and monetary policies. He concluded that it was fundamental for the ECB to end its involvement in the Troika immediately. In addition, an inquiry of the EP concluded that the ECB was widening the democratic deficit, because its participation in a vast array of reforms—including the liberalization of public health services and professions—extended beyond its monetary responsibilities. Given this conclusion, the EP advised the ECB to restrict itself to the role of ‘silent observer’ in the Troika. The reforms in which the ECB was involved were clearly backed by ‘expansionary austerity’ principles and were aiming to build market confidence through privatization, market flexibilization and budgetary cuts. Furthermore, the EP emphasized that although these reforms had minimal economic results, they triggered severe social and democratic disruptions (see also Stuckler and Basu 2013, chapter 5). Interestingly, it was the ECB and the European Commission, rather than the IMF, that advocated for the severity of these austerity measures (Blustein, 2015), as it was already the case for the Troika groups sent into Eastern and Central Europe in 2008 (Lütz and Kranke 2014). To conclude, the ECB’s determination to impose strict conditionality and

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15 ECJ press release, 14 January 2015. The final ECJ judgement does not replicate the Advocate General’s arguments on the ECB’s participation in the Troika.
17 A member of the ECB’s staff who had been participating to these groups confirmed that the ECB has been consulted on these particular policy areas (interview 5).
participate in the Troika groups was generally unaffected by the IMF’s internal criticism and the warnings from the EP and the European Court of Justice.

Second, this clear conditionality attached to the official EU loans contrasts with the previous unofficial bilateral coercive pressures exerted through the SMP in Portugal, before its rescue in May 2011, and in Italy and Spain from August 2011. Even though there are no official sources that reveal this pressure, an official from the Portuguese government explains that the ECB bond-purchasing programme has been a game-changer:

The ECB put us under pressure as well that we had to speed up our consolidation processes ... Our Finance Minister had always been listening to them and was agreeing most of the time ... But now that the ECB was buying our bonds it was not only the Finance Minister who was listening to them but the Prime Minister as well (Interview 4)

On 4 August 2011, against a background of acute tension over Italian and Spanish sovereigns, the ECB decided to purchase their sovereigns. The following day, letters were sent by the ECB to the Spanish and Italian governments to specify the reforms they must implement as a condition of the bank’s support. In Italy, where the government had undermined some aspects of the reforms late in the legislative process, the ECB considered that the unofficial conditionality had not been respected. On 7 November, Italian sovereign interest rates reached a new record high; nevertheless the ECB undertook only limited buying of Italian bonds in order to keep up the pressure on the implementation process. Later that day, when Silvio Berlusconi pledged to resign, the ECB made bulk purchases of Italian sovereigns (Dinmore 2011). In these three cases, although the elected governments did not sign an MoU and did not request the Eurozone’s financial assistance, the ECB acted as the Eurogroup’s ‘financial arm’ and exerted strong pressure on its domestic policies and politics.

No bilateral pressures on the member states’ economic reforms have been exerted by the ECB under its QE programme as yet. However, its collateral eligibility criteria could lead to such a scenario for Eurozone countries following EU funding programmes and non-programme countries. In the first case, the ECB has not purchase Greek sovereign bonds under its QE programme until now because Greece does not meet the ECB’s eligibility criteria, which is linked to a positive assessment of the implementation of austerity reforms by the Troika for the countries receiving financial assistance. Mario Draghi underlined that, even if Greece were to receive a positive review, the ECB would have to perform its own debt sustainability analysis before starting such purchases. Since the ECB is part of the Troika, it is pretty clear that the conditionality of its QE programme is one of the coercive tools it uses to force Greece’s compliance with the austerity measures.
In the case of non-programme countries, the QE could again be conditional, since government bonds must be given an investment grade by at least one rating agency in order to be eligible in the operations of the ECB. During the Portuguese governmental instability\textsuperscript{21} in November 2015, only one rating company (DBRS Ltd) gave Portuguese bonds an investment grade. If this specific company had downgraded Portugal, Portuguese bonds would not have reached the collateral eligibility criteria and the ECB purchases could have stopped (Mnyanda\textsuperscript{2015}). However, a waiver allowing the ECB to keep buying the bonds could be possible under specific conditions defined unilaterally by the ECB. In short, QE conditionality is not systematic but it is explicit if Eurozone countries are under EU financial programmes or if they lose the confidence of rating agencies.

\textit{The ECB collateral policy}

As early as March 2010, the IMF sought a partial default on Greek debt—a policy choice branded as private sector involvement (PSI)—in order to make the Greek rescue programme sustainable and to avoid excessive social costs. Since the very beginning, the ECB had been the most vocal player against this option (Blustein\textsuperscript{2015, 11}). After a bilateral agreement between France and Germany in late 2010, the Eurozone leaders unanimously agreed on the Greek PSI in May 2011 and considered this option for other countries. Contrary to this agreement, the ECB undermined this policy decision by threatening its partners that it would refuse Greek bonds as collateral in its open market operations (Atkins\textsuperscript{2011}). Such a refusal would have led to a bankruptcy of the Greek banking system and threatened the Eurozone’s stability. Consequently, the ECB won a compromise on the PSI: it would be a one-time option and would not be applied to the bonds owned by the ECB (Wilson\textsuperscript{2011}). Moreover, in February 2015, the ECB decided to refuse Greek sovereign bonds as collateral, because of the disagreement between the newly elected Syriza government and its creditors on the implementation of austerity measures.\textsuperscript{22} Following Gabor and Ban’s (2016) conclusions, the ECB behaved like a ‘shadow bank’, because its collateral practices were pro-cyclical and destabilizing the country’s economy.

Three factors can explain the ECB’s opposition to the PSI, a policy option that is often used in international bailouts but was branded by an ECB policymaker as a ‘strong masochistic tendency’.\textsuperscript{23} The first explanation is ideational: ECB leaders believed that PSI could undermine investors’ confidence. The second is strategic: PSI could endanger the stability of the French and German banks that were heavily exposed to Greek debt (until late 2010). The third is institutional: when central bankers purchased governments’ bonds (from May 2010), they behaved as an investor, as they were reluctant to accept losses on their balance sheets (Mehrling\textsuperscript{2010}). Common amongst these three explanations is the priority given to creditors’ rights at the expense of potential social costs.

\textsuperscript{21} Portugal left its rescue programme after June 2014.
\textsuperscript{22} ECB press release, 4 February 2015.
\textsuperscript{23} Speech of Lorenzo Bini-Smaghi, 6 June 2011.
The ECB used its ELA instrument\textsuperscript{24} to force Ireland, Cyprus and Greece to ask for a financial bailout in November 2010, March 2012 and July 2015, respectively. In the cases of Ireland and Cyprus, the ECB sought a recapitalization of their national banking systems through EU financial support. The ECB’s ‘credible threat’ was to cut off their national banks’ access to the ELA, which would have triggered the bankruptcy of their entire oversized banking systems. In both these cases, the ECB was the only Eurozone player asking for the bailing out of these countries, and it did not ultimately need to resort to this credible threat.

The use of ELA in Greece during the summer of 2015 was different. Even though the ECB did not cut off ELA access or lower the amount allotted to Greek banks, ELA parameters were set to force bank foreclosure and impose capital controls that would influence domestic politics. More precisely, when the Greek government announced a referendum on the terms of a third Eurozone bailout on 27 June, both the deposit withdrawals from and the refinancing needs of the Greek banks rose. Yet, the ECB decided to maintain the ELA’s amount at its former level (€90 billion) and apply a haircut on the Greek bonds used as collateral in these operations.\textsuperscript{25} This decision contrasts with the higher cap on ELA allotments to Greek banks in May 2012 (€125 billion), when bank withdrawals were more limited.\textsuperscript{26} In other words, the ECB did not use ELA to alleviate the financial pressures on the Greek banking system. In effect, this lack of support was conducive to the Greek banks’ foreclosure during the week preceding the referendum vote on the bailout terms. It was only on 16 July 2015, when the Greek government overrode the referendum outcome and agreed on the bailout terms, that the ECB raised ELA amounts to meet the Greek banks’ financing needs. Arguably, the ECB used ELA to force the Greek government to accept the terms of a third bailout.

To conclude, what was striking about the ECB’s use of its monetary instruments was the variety of policy areas in which it exerted direct coercive pressures and the effectiveness of these pressures. The ECB’s role in the Troika demonstrates its clear willingness to get actively involved in reforming policy areas that are beyond its competencies. Moreover, the ECB’s actions regarding PSI and ELA indicate that it can impose its policy preferences, sometimes against the unanimity of the Eurozone states. Finally, the pro-cyclical tendencies of the ECB’s conditionality hampers its financial stability objective. For example, when the ECB used the settings of its collateral framework to pressure the Greek government in February 2015, it increased financial pressures on Greek sovereign debt. These difficulties made it harder for the Greek authorities to regain market confidence. Ironically, these pro-cyclical consequences are similar to the ones caused by downgrades of credit rating agencies, which were criticized by central bankers themselves.\textsuperscript{27}

\textsuperscript{24} The ELA is a monetary instrument that is used by national central banks when they act as an LoLR for their domestic banking system. ELA amounts are capped by the ECB governing Council.

\textsuperscript{25} ECB press release, ‘ELA to Greek banks maintained’, 6 July 2015. Greek banks were using almost exclusively Greek bonds as collateral in the ELA operations.


all these cases, the coercive use of monetary instruments aims to regain market confidence, often at the expense of the interests of the ‘people’ constituency.

The ECB protection of problematic finance

When acting as an LoLR for financial institutions, the ECB’s conditionality is weaker than that of the sovereigns, despite involving similar risks of moral hazard. In addition to lowering its main interest rates to a level close to zero, the ECB has used two monetary instruments to stabilize the financial system: its (Targeted) Long-Term Refinancing Operations ((T)LTRO) and QE. Since the conditionality attached to these instruments was weak, their ‘unintended consequences’ profited financial players through ‘carry-trade’ operations and ‘wealth effects’, respectively. Moreover, despite its new competences of financial supervision, the ECB did not aim to overhaul the financial patterns that triggered the crisis.

The (T)LTRO

The ECB implemented two LTROs with a maturity of three years in December 2011 and January 2012. These open market operations provided over €1000 billion of liquidity (nine per cent of the Eurozone’s gross domestic product [GDP]) for the Eurozone financial system at a fixed rate of one per cent with unlimited ceiling and relaxed collateral requirements.28 They aimed to directly help banks meet their refinancing needs and indirectly help the real economy by providing easier lending conditions. The LTRO measures did stabilize the Eurozone’s financial institutions, but they failed to revive growth and had unintended consequences. Indeed, commercial banks swapped the risky assets they did not want to hold anymore (usually Eurozone ‘periphery’ sovereigns) against liquidity. Insider ECB critics argue that this transfer of (privately held) risky assets to the (public) ECB balance sheet mainly benefited the major banks based in Paris and Frankfurt (Cour-Thimann 2013). Moreover, because the ECB did not control how banks used this liquidity, these banks frequently engaged in controversial carry-trade operations. Banks were borrowing liquidity for three years at a rate of one per cent to purchase sovereign bonds with an equivalent maturity at a higher rate to pocket the difference and boost their profits. In other words, the liquidity created by the ECB did not help the real economy that much overall; instead, it helped banks to maintain their profitability by recycling sovereign debt on repo markets (Gabor and Ban 2016). As a result, senior banking staff benefited from high remuneration. Mario Draghi himself acknowledged these problematic carry-trade operations in front of the EP.29

To address the critics, the ECB implemented the Targeted LTRO (TLTRO) in September and December 2014 with a four-year maturity. TLTRO added conditionality measures to the LTRO: banks had to lend the borrowed liquidities to the real economy, and if they didn’t they would have to reimburse the

28 ECB press release, 8 December 2011.
liquidities before their maturity date and could not participate in additional LTROs.\textsuperscript{30} Yet, because the benchmark was calculated on past loans made by the commercial banks—which were very low at that time—this benchmark could be reached very easily. Even if it was not reached, no penalty would be attached to liquidity misallocations. The TLTRO did not have a great success, however, as European banks were reluctant to borrow liquidity on such conditions. As a consequence, in March 2016, the ECB abandoned the mandatory requirement for banks to return the funds they had borrowed and, thus, the rationale behind TLTRO (forcing banks to lend to the real economy).\textsuperscript{31}

The QE

The QE programme of the ECB aims to revive growth through the purchase of financial assets including sovereign bonds, asset-backed securities and corporate bonds. The ECB started its QE in March 2015 and planned to continue it until at least September 2018. In April 2018, the amounts of bonds purchased under the QE were worth €2.4 trillion. Theoretically, QE programmes boost economic activity through three channels; the wealth effect (a global increase of the bonds’ price), the portfolio effect (a shift towards riskier assets in investors’ portfolios) and a boost on exports (through the depreciation of the currency).\textsuperscript{32} In addition, the QE programme helps to keep sovereign debt yields down, allowing Eurozone countries more budgetary margin of manoeuvre and, thus, potential growth-friendly fiscal measures. Although the associated rise of asset prices saved the financial system from a complete meltdown and mitigated deflationary tendencies, the QE measures taken by the Fed, the Bank of Japan and the BoE in 2009 did not impact on growth dynamics to a significant extent (Borio 2011).

This raises concerns about the cost of stabilizing banks without conditionality. The OECD (2015, 36–37), the IMF (2015) and the Bank of International Settlements (BIS) (2015) argue that central banks should refrain from unconditional stabilization programmes because their negative unintended consequences may exceed their positive outcomes (White 2012). In addition to inflationary and asset bubble risks, the ECB bond purchases have distributive consequences, because their ‘wealth effect’ directly benefits the asset owners who are already the most well off in society (Domanski et al 2016). Moreover, rising asset prices and low interest rates encourage corporate share buybacks\textsuperscript{33} instead of productive investment and economic recovery (BIS 2015, 29). In other words, the lack of both growth perspective and control over banks’ credit policies impact on the outcomes of QE programmes for the real economy.\textsuperscript{34} Finally, the QE has a ‘substitution impact’ in the sense that this form of policy activism occludes alternative strategies such as redistributive fiscal

\textsuperscript{30} ECB press release, 5 June 2014.
\textsuperscript{31} ‘There will be no requirement for mandatory early repayments under TLTRO II’, speech of Mario Draghi, 10 March 2016.
\textsuperscript{32} Speech of Mario Draghi, 22 January 2015.
\textsuperscript{33} Buybacks allow companies to invest in themselves through the purchasing of their own shares in the market. It is an alternative to dividends.
\textsuperscript{34} While the European stock markets’ valuation (Euronext 100) rose by 22.69 per cent between 2011 and 2016, the European GDP remained stable in the same period.
policy or monetary tools with less inegalitarian effects, such as helicopter money.\textsuperscript{35} (Fontan et al 2016).

\textit{The lack of constraints on financial activities}

In order to address the ‘unintended consequences’ of unconventional monetary policy, the BoE advised a stronger regulation of the financial system.\textsuperscript{36} In contrast with the BoE, the ECB sought to minimize the challenges faced by Eurozone banks in terms of both financial supervision and regulation. Even though the ECB has no formal competence in terms of financial regulation, it does exert some influence on the set of legal constraints faced by financial institutions, for two reasons. First, when the ECB became the supervisor of the Eurozone’s banking system in 2014, it acquired coercive powers over banking activities (McPhilemy 2016). Second, the expertise of the ECB on financial issues is highly recognized in Eurozone policy circles (see section two). The following section provides five examples of the protection of problematic financial activities by the ECB.

First, the most important ECB supervisory task was to assess whether the quality of capital held by Eurozone banks would be sufficient in the event of a crisis. The methodology of this ‘comprehensive assessment’ was questionable, because the ECB relied on a ratio comparing bank capital to risk-weighted assets. According to Haldane,\textsuperscript{37} this methodology is too complex and inefficient, especially in a time of crisis, and should be replaced by a simpler leverage ratio.\textsuperscript{38} If this latter ratio had been applied, core Eurozone universal banks would not have passed the test (Braithwaite 2014). In other words, the ECB, among other EU regulators, displays a bias in favour of large Eurozone universal banks in its tasks of financial supervision. For example, Deutsche Bank, the largest German bank, passed the 2014 ECB-led comprehensive assessment easily and the 2016 summer EU stress tests.\textsuperscript{39} This positive assessment is in strong contrast with the financial difficulties faced by Deustche Bank since the beginning of 2016 and its failure to pass IMF and Fed stress tests (Geiger and Tracy 2016).

Second, despite the fact that universal banks are strongly linked to the ‘too-big-to-fail’ problem in the Eurozone, Danielle Nouy, the head of the ECB’s financial supervision arm (Single Supervision Mechanism), defends this banking model. Indeed, she stated that the German and French banking regulation reforms, which are considered to be the most protective of the universal banking models in the Eurozone (Hardie and Macartney 2016), are ‘sensible’ and she ‘would have serious reservations about going beyond that’.\textsuperscript{40} This statement is in strong contrast with the global assessment that universal banking is

\textsuperscript{35} ‘Helicopter money’ consists in the creation of new money by the central bank, which bypasses the financial sector and gives it directly to households and individual businesses without any counterparts (unlike open market operations).

\textsuperscript{36} Speech of Mark Carney, 25 February 2013.

\textsuperscript{37} Speech of Andrew Haldane, 31 August 2012.

\textsuperscript{38} The assumption behind this simplification is that a financial crisis triggers the fall of all the asset prices.

\textsuperscript{39} During this stress test, Deustche Bank’s results were boosted by a special concession agreed by its supervisor, the ECB (Noonan et al 2016).

\textsuperscript{40} Interview of Danielle Nouy with Handelsblatt, 1 April 2015.
a risk for growth and financial stability (Liikanen et al 2012) and the United States (US) and United Kingdom (UK) regulatory efforts which adopted ‘ring-fencing’ measures.

Third, while the Bank of England advised deferring market operators’ bonuses until their retirement, the ECB restricted the non-distribution of dividends to the banks that failed the comprehensive assessment.41 Fourth, the ECB was very hesitant about the proposed European Financial Transaction Tax and it offered its help in 2013 to ‘redesign’ the tax to minimize its potential impact (Gabor 2016a; Kalaitzakе 2017, 719; Kastner 2017, 13). Fifth, the ECB has been at the forefront of the push by public authorities42 to revive the European market of securitization to stimulate growth, despite all the problems created by this class of financial assets in the past (Braun et al 2018 and other articles in the special issue Competition and Change, 22:2).

To conclude, although the ECB had an unprecedented opportunity to rely on its two channels of influence to shape financial sector reforms—as it had done to shape national economic reforms—and reverse the process of financialization, it chose not to do so. An assessment of ECB policies would suggest that financial markets have been not only the cause but also the perceived solution to the crisis. Besides, the ECB continues to shelter the Eurozone’s financial system from a paradigmatic change in the regulations of its activities.

Conclusion

The ECB used the crisis as a window of opportunity to further isolate economic governance from electoral outcomes. To do so, the ECB relied on its two channels of influence: the coercive channel, which consists in the conditionality of ECB monetary interventions, and the cognitive channel, which consists in the ECB’s influence in the Eurozone’s policy circles. This twofold pressure on economic governance contrasts strongly with the almost unconditional help that the ECB has provided to the financial sector.

The research results of this article can be interpreted in two ways. A moderate interpretation would see these results as undermining the comment of Norman Montagu ‘that no Central Bank can be greater than its own State — the creature greater than the creator’.43 Indeed, despite maintaining a high level of independence, the ECB went beyond its official responsibilities as laid out in the EU Treaties by harnessing its increased influence on economic governance. This is demonstrated by the case of Greece. Keeping this imbalance in mind, it can be argued that the ‘Frankenstein’ Eurozone states somewhat lost control of their ‘creature’. A stronger interpretation of these results would identify the ECB as a failed regulatory organization and a driver of post-democratic dynamics. Indeed, because ECB policies isolate macro-economic governance from electoral pressure and fail to sufficiently control the use of

41 Recommendation ECB/2015/2 on dividend distribution policies.
42 ECB and BoE discussion paper, ‘The case for a better functioning securitisation market in the European Union’, May 2014. The ECB has also been buying securitized financial products since December 2014.
43 Quoted in James (2009, 36).
liquidities provided to the financial sector, they amplify the power discrepancy between private financial interests and the preferences of citizens.

**Interviews (conducted by the author)**

1. EFC member 1, Brussels, November 2010.
2. EFC member 2, Brussels, November 2010.
3. EFC member 3, Brussels, November 2010.
5. Member of the ECB, Frankfurt, December 2010.

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