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**Monetary Sovereignty and the ESCB:  
Towards a Multilayered Approach  
to the  
“Euro-Sovereignty” Game in the EMU**

By  
**Alessandra Chirico**

Thesis submitted for assessment with a view to obtaining the degree of  
Doctor Iuris from the European University Institute

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Florence, October 2004







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## INTRODUCTION

*“A word is not a crystal, transparent and unchanged.  
It is the skin of a living thought and may vary greatly  
in color and content according to the circumstances  
and the time in which it is used.”\**

*The emergence of a new configuration of power in Europe built around the  
changing concept of monetary sovereignty*

The aim of the present investigation is an attempt to make sense of the theoretical and institutional transformation occurring within and around the European Union, perceived as a supranational legal order still in *a state of flux*. The inquiry focuses on the complex issues related to the establishment of the Economic and Monetary Union and to the insertion of the European System of Central Banks (ESCB) in the institutional structure of the EU; it is specifically based on the assumption that such an institutional transformation has far-reaching implications both for the nature of the newly emerging European polity and for the way in which it is conceptualised.<sup>1</sup>

In particular, the main focus of the whole scrutiny is on the surrender of monetary sovereignty from the national to the supranational level, with an attempt to shed light on both the nature and articulation of the specific power whose legitimate exercise is at stake. This, of course, touches upon the wider issue of the relevance of the Economic and Monetary Union for the EU's future development, as the structural

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\* O.W. HOLMES, Jr, cited in W.M. Reisman, *Sovereignty and Human Rights in Contemporary International Law*, American Journal of International Law, Vol. 84, 1990, pp. 872-883.

<sup>1</sup> See F. SNYDER, *EMU – Metaphor for European Union? Institutions, Rules and Types of Regulation*, in R. DEHOUSSE (ed.), *Europe after Maastricht. An ever Closer Europe?*, München, 1994. Cfr. also ID., *EMU Revisited: Are We Making a Constitution? What Constitution Are We Making?*, EUI Working Paper, LAW, No. 6, 1998.

imbalance between the monetary and economic pillar of EMU and the ESCB's unique institutional status stimulate debates over the future architecture of the EU.

In order to fully understand the process occurring within the EU today – a process strongly characterised by a persistent tension between national and supranational components -, one should reject the conventional model consacrated by the Westphalian State (or at least should try to go beyond its implications emerging at first sight) in favour of a new, multifaceted model. This would suggest that the question of what are the crucial matters involved here would need a serious reconceptualisation.<sup>2</sup>

In any case, it should be stressed that the adoption of a different, multifaceted model of interpretation must be based on the recognition of the fact that the traditional idea of the existence of a final authority above the State risks to appear contradictory both to positivist lawyers and to the majority of political scientists,<sup>3</sup> since the almost

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<sup>2</sup> It should be remarked that, in the construction of such an interpretative model, not only empirical, discursive and conceptual analysis is needed for understanding European transformation; but also a theoretical and meta-theoretical reflection. This becomes clear if one recalls the insightful words written by J. RUGGIE, *International Structure and International Transformation: Space, Time and Method*, in E.O. CZEMPIEL and J.N. ROSENAU (eds.), *Global Changes and Theoretical Challenges: Approaches to World Politics in the 1990s*, Lexington Books, Toronto, 1989, notably at p. 32, where the author states: "how we think about transformation fundamentally shapes what we look for; what we look for obviously has an effect on what we find; if we look for signs of transformation through the lenses of the conventional structural approach of our discipline we are unlikely to conclude that anything much is happening out there; but we cannot say whether or not that conclusion is correct because the *epistemological biases* of that approach are such that it is ill-equipped to detect signs of transformation" (For the quotation see M. WIND, *IR. Theory meets European Law. Constitutional Battles, Sovereign Choices & Institutional Contingencies in the Legaci of the European Integration Process*, Ph.D. Thesis, EUI, Florence, 1998, p. 4).

<sup>3</sup> See M.R. FOWLER – J.M. BUNCK, *Law, Power and the Sovereign State. The Evolution and Application of the Concept of Sovereignty*, The Pennsylvania State University Press, 1995, p. 2, who argue that the idea of a final authority, namely sovereignty, is "perforated, defiled, cornered, eroded, extinct, anachronistic, and even interrogated". Others have suggested that it has become unbundled, fragmented, transcended, subverted, shared, shifted, pooled, and surrendered. See for an interesting analysis of "the case for transformation of sovereignty" K.J. HOLSTI, *Taming the Sovereigns. Institutional Change in International Politics*, Cambridge University Press, Cambridge, 2004, pp. 135 and ff. All these kind of reflections are a relatively new approach to the idea of sovereignty, strongly affected by the experience of regional integration and global interdependence. To appreciate their originality, it is worth recalling that in 1948 an important post-war IR theorist argued exactly the contrary, namely that "the last and perhaps the most important of the misunderstandings that have obscured the problem of sovereignty in the modern world is the belief that sovereignty is divisible" (...) "We have heard it said time and again that we must surrender part of our sovereignty to an international organisation, that we must share our sovereignty with such an organisation, that the latter would have limited sovereignty while we would keep the substance of it, or vice versa, that there are quasi-sovereign and half-sovereign States". But the conclusion is "we shall endeavour to show that the conception of a divisible sovereignty is contrary to logic and politically unfeasible" (H.J. MORGENTHAU, *Politics among Nations: The Struggle for Power and Peace*, Mc Graw-Hill, Inc, New York, 1948, p. 341).

fifty-year development of Community law – while being a fascinating laboratory - still represents a fundamental empirical and theoretical jigsaw puzzle. This is made clear by the fact that the supranational compromise struck by national negotiators almost fifty years ago transferred substantial powers to the new European institutions, but in strictly limited fields, with the most difficult and divisive issues of national sovereignty and the future role of national institutions deferred to until a later stage. “The European institutions were designed to stress administration and regulation, to minimise the visibility of the political choices at stake, and to operate on the basis of a permissive popular consensus rather than of active or informed participation”.<sup>4</sup> As a result, it has proven even more difficult to maintain this compromise, as the issue areas brought within the European institutions have widened, and as the political and symbolic challenges to the autonomy of the Nation State have become increasingly hard to disguise.

Moreover, the still ongoing constitutional battle among different centres of authority is unlikely to end in the EU being turned into the nicely ordered, State-like entity. Nowadays, in fact, Europe presents itself as a polity that, in its authoritative structures, differs fundamentally from anything seen previously in the modern era. The EU is increasingly becoming a truly multicentric/policecentric polity.<sup>5</sup> Instead of a new political construct modelled in the image of the Nation State, different authoritative orders that overlap, compete and collaborate are emerging step-by-step. “The EU’s three-pillar structure, as developed in the Maastricht Treaty, and the notion of Europe evolving at several speeds add to this picture of power diffusion and constitutional incoherence, but not necessarily fragmentation”.<sup>6</sup> Thus, in order to make sense of this complex reality one must recognise the importance of a conceptual and theoretical innovation that goes beyond traditional thinking both in law and political science.

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<sup>4</sup> W. WALLACE, *Government without Statehood: The Unstable Equilibrium*, in H. WALLACE and W. WALLACE, *Policy-Making in the European Union*, Oxford University Press, Oxford, 1996, p. 442.

<sup>5</sup> As insightfully observed by A. CHRISTENSEN, *Polycentricity and Normative Patterns*, in H. ZAHLE and H. PETERSEN (eds.), *Legal Polycentricity: Consequences of Pluralism in Law*, Aldershot, Dartmouth, 1995, p. 235, “the very notion of Legal Polycentricity forms a sharp contrast to the notion of law as a legal system – a system which like all other modern systems must be free from internal contradictions and thus cannot have more than one centre. This latter idea has been dominating in Western legal thinking since at least the nineteenth century. A significant amount of legal thinking has been aimed at depicting and thus forming the law into a legal system with no internal contradictions”.

<sup>6</sup> M. WIND, *Sovereignty and European Integration. Towards a Post-Hobbesian Order*, Palgrave, Basingstoke, 2001, p. 11.

To begin with, it is worth recalling that one of the current ways of explaining the present situation within the EU is to point to the fact that most, if not indeed all, sovereign governments in Europe have very seriously limited choices in the exercise of their supposedly sovereign competences, because their theoretically important areas for decisions are significantly restricted and hemmed by Treaties, by customary international law, and by the consequences – especially the economic consequences – of the interdependence of all sovereign States.<sup>7</sup>

EMU, for instance, gives a concrete example of such a situation. As a matter of fact, to understand how traditional State sovereignty contends to survive in the current Union's normative and institutional framework, one should start by examining the shared objectives the Member States aspired to achieve with the set-up of EMU. Conceptually, it is easy to see that interstate co-operation will bear no fruit if the Member States arbitrarily reassert their willful autonomy to protect their national interests. Suitable interstate co-operation is possible only when all the parties involved commit themselves to the common enterprise under all circumstances. To this end, the Union has established different institutional mechanisms in which the traditional forces of nationalism compete and collide with the motif of shared objectives.<sup>8</sup>

Furthermore, with the onset of Economic and Monetary Union, the Maastricht Treaty has created a unique, historic asymmetry within the institutional profile of the European Union. On the one hand, a European, supranational monetary order, yet predominantly national sovereignty in most other areas. Notably this situation is due

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<sup>7</sup> The literature on this topic is quite extensive. It is worth recalling the interesting paper by R. JENNINGS, *Sovereignty and International Law*, in G. KREJEN, *State, Sovereignty, and International Governance*, Oxford University Press, Oxford, 2002, pp. 27-44, who – on the same line of reasoning of E. LAUTERPACHT, *Sovereignty – Myth or Reality*, *International Affairs*, No. 73, 1997, pp. 124-142 –, argues that “sovereignty is at least to a large extent a mere idea, even a myth” (p. 31). See also K.J. HOLSTI, *Taming the Sovereigns. Institutional Change in International Politics*, Cambridge University Press, Cambridge, 2004; M. WIND, *Sovereignty and European Integration. Towards a Post-Hobbesian Order*, Palgrave, Basingstoke, 2001; T.L. ILGEN, *Reconfigured Sovereignty. Multi-Layered Governance in the Global Age*, Ashgate, Aldershot, 2003; and A. COLEMAN and J. MAOGOTO, *After the Party, is there a Cure for Hangover? The Challenges of the Global Economy to Westphalian Sovereignty*, *Legal Issues of Economic Integration*, No. 30, 2003, pp. 35-60.

<sup>8</sup> A clear example of this is given by Article 2 EC Treaty which establishes that “The Community shall have as its tasks, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Article 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States”.

to the fact that the governance structure of EMU is based on a contrast between the centralisation of monetary policy in the hands of central bankers at the EC level and the maintenance of responsibility for fiscal policy with national governments.<sup>9</sup> The co-ordination provided for in economic policy is relatively weak, whilst what is to be meant by “economic policy” was left undefined by the drafters of the Treaties. At the same time, the convergence criteria, which were to be used to select which states could start the final transition to a single currency, imposed a straitjacket on the domestic policies of aspirant states. As a result, the present institutional imbalance, matched since the beginning by a fundamental ambiguity about the role to be played by economic policy, creates a peculiar tension that is supposed to leave its mark on the future integration process.

It is against this background that the investigation moves its first steps with an introductory chapter on the concept of sovereignty, adopted as useful perspective to detect the issues involved in the establishment and following development of the EMU. It should be underlined, though, that such a scrutiny on the notion of sovereignty, selected as main starting point, is definitively addressed to the aim of a kind of reconceptualisation of its traditional meaning. This approach is thus meant to be a conceptual tool enabling the reader to appreciate the different nuances of the variable concept of sovereignty as it emerges in a new, fragmented world.<sup>10</sup>

The basic assumption is that, in the present scenario, sovereignty is a highly contentious term: the concept provokes disagreement at any level. Anyway, this does

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<sup>9</sup> On this point see, *inter alia*, C.A.E. GOODHART, *Two Concepts of Money, and the Future of Europe*, LSE Financial Markets Group and ESRC Research Centre, Special Paper Series, n. 96, June 1997; ID., *The Transition to EMU*, in M. ANDENAS, L. GORMLEY, C. HADJEMMANUIL and I. HARDEN (eds.), *European Economic and Monetary Union: The institutional Framework*, Kluwer Law International, London – The Hague – Boston, 1997, pp. 5 – 26. The author underlines the circumstance that the centrality of the link between political sovereignty and fiscal authority, on the one hand, and money creation, the mint and the central bank, on the other, is not operating anymore. “Within the Euro-area, the main political and fiscal powers are, instead, to remain at the level of the Nation state. Historically the Nation States have been able” (...) “to call upon assistance of the money-creating institutions, whether the mint via the debasement of the currency, a Treasury printing press, or the Central Bank. Whenever States” (...) “have joined together in a larger Federal unity, both the main political, the main fiscal and monetary powers and competences have similarly emigrated to the federal level. The Euro-area is not really like that. In particular, the participating Nation States will continue to have the main fiscal responsibilities; none the less, in the monetary field their status will have changed to a subsidiary level, in the sense that they can no longer call upon the monetary authority to create money to finance their domestic national debt. There is to be an unprecedented divorce between the main monetary and fiscal authorities.” (ID., *Two Concepts of Money*, *op. cit.*, p. 4).

<sup>10</sup> For a further analysis on this point, see P. PESCATORE, *The Law of Integration. Emergence of a new Phenomenon in International Relations, based on the Experience of the European Communities*, A.W. Sijthoff, Leiden, 1974. See, in particular, Chapter II - *Refashioning of Sovereignties* – pp. 26 – 55.

not mean that it should be abandoned or neglected. The idea is to “stick with sovereignty”,<sup>11</sup> given that all the difficulties related to its application are not a sufficiently good reason for giving it up. The problem arises with its historical linkage to the Nation State, a linkage which generates a contention that is destructive and paralysing in character. To define sovereignty in a way in which contention serves as a stimulus to discussion rather than a source of paralysis, sovereignty needs to be separated from the State. Having said that, still another problem remains: the possibility to find a workable definition of this concept that fits with the new framework. In principle, it would be necessary to elaborate a flexible definition, suitable to be applied in contexts that do not presuppose the existence of the Nation State.<sup>12</sup>

To begin with, sovereignty may thus be seen as the final capacity to make binding decisions in political and social contexts and to assure the implementation of those decisions. To aid in the application of this definition, it is useful to distinguish between: (i) *formal sovereignty*, which specifies the sovereign through clearly articulated or implicitly understood rules, laws, norms, and social and cultural conventions and (ii) *sovereignty in practice*, a label that reflects the reality of decision-making and implementation. When sovereignty in practice closely corresponds to formal sovereignty, one might expect order and legitimacy to prevail.

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<sup>11</sup> This is the expression figuratively used by J. HOFFMAN. *Sovereignty*, Open University Press, Buckingham, 1998, p.11. Similarly, with a stronger force of persuasion, in 1922 H. Kelsen wrote: “E’ un’idea sostanzialmente errata quella di eliminare il concetto di sovranità dalla moderna dottrina del diritto e dello Stato sol perché uno dei suoi molti significati – che senza nessuna ragione profonda si ritiene l’unico giusto, quello autentico, in genere quello del potere assoluto e illimitato dello Stato – non si concilia con la moderna concezione dello Stato di diritto. Questo modo di vedere disconosce in primo luogo la natura della trasformazione di significato subita dal concetto di sovranità. Il fatto che le formulazioni più recenti del concetto non si accordano con una qualche più antica concezione, anche se è stata per lungo tempo dominante, parla forse più contro questa che quella. Del resto ciò che conta non è una legittimazione storica dell’uso odierno di sovranità. Un concetto necessario deve pur trovare una sua espressione: la terminologia tradizionale ne offre una che nell’uso linguistico generale ha più o meno quel significato reso necessario dalla giusta conoscenza. In questo senso la moderna dottrina del diritto e dello Stato si serve del concetto di sovranità. E così facendo le si pone il compito di giustificare la sua terminologia appunto solo nella misura in cui dimostra che il significato da lei prescelto è il nocciolo autentico e imperituro di tutte le trasformazioni che il concetto ha subito nella storia” (H. KELSEN, *Il problema della sovranità e la teoria del diritto internazionale. Contributo per una dottrina pura del diritto*, edited by A. Carrino, Giuffè, Milano, 1989, p. 8).

<sup>12</sup> See, on the end of the Nation State, C. SCHMITT, *Le categorie del “politico”*, Italian translation by P. Schiera, Il Mulino, Bologna, 1972, where the author argues that “l’epoca della stauialità sta ormai giungendo alla fine” (...) “Con essa viene meno l’intera sovrastruttura di concetti relativi allo Stato, innalzata da una scienza del diritto dello Stato e internazionale eurocentrica, nel corso di un lavoro concettuale durato quattro secoli. Lo Stato come modello dell’unità politica, lo Stato come titolare del più straordinario di tutti i monopoli, cioè il monopolio della decisione politica, questa fulgida creazione del formalismo europeo e del razionalismo occidentale, sta per essere detronizzato” (Ibidem, p. 90).

On the contrary, when sovereignty in practice departs significantly from formal sovereignty, one might expect turbulence and change on the horizon. This definition admits readily that sovereignty is not indivisible but can be and regularly is divided up, parceled out. One institution may be sovereign in one context and a different institution may be sovereign in another. Viewing sovereignty in this manner also allows to argue that, over a spatial/temporal horizon, the concentration of sovereignty may change in a very variable manner.<sup>13</sup>

At the theoretical level, one possible solution to embrace and justify the potential conflict among different centres of authority would be the introduction and application of the notion of multilevel governance,<sup>14</sup> given that it would entail an interesting conception of the EU as such, as representing an institutional experiment where overlapping competences among multiple levels of governments and the interaction of different political actors across these levels are in place. The so-called multilevel polity is in fact multi-centred: it moves away from a single, centralised lawmaker, as in the sovereign State, towards a manifold of power sites. Consequently, here, sovereignty is now “shared” or “pooled”.<sup>15</sup>

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<sup>13</sup> For a further elaboration on his point see T.L. ILGEN, *Reconfigured Sovereignty. Multi-Layered Governance in the Global Age*, Ashgate, Aldershot, 2003, p.10. This view, as applied to the EU as a polity, is shared by T. RISSE, *Sovereignty Puzzles. A Comment on Keohane*, in J.H.H. WEILER, I. BEGG and J. PETERSON (eds.), *Integration in an Expanding European Union. Reassessing the Fundamentals*, Blackwell Publishing, Oxford, 2003, who – notably at p. 235 – derives such an approach from the application of the multi level governance’s theory. He further argues that EU is going far beyond the simple application of the idea of “pooling sovereignty” (an idea which implies the joint exercise of legal authority), but is indeed moving toward a federal system in which sovereignty is divided as well as shared among different level of governance, with different concentration of authoritative power.

<sup>14</sup> For a EU-centric literature on multilevel governance see I. BACHE and M. FLINDERS (eds.), *Multi-Level Governance*, Oxford University Press, Oxford, 2004; T. CHRISTIANSEN, *Reconstructing European Space: From Territorial Politics to Multilevel Governance*, in K.E. JORGENSEN (ed.), *Reflective Approaches To European Governance*, Macmillan, Basingstoke, 1997, pp. 51-68; L. HOOGHE, *Cohesion Policy and European Integration: Building Multilevel Governance*, Oxford University Press, Oxford, 1996; L. HOOGHE and G. MARKS, *Unraveling the Central State, but How? Types of Multi-level Governance*, in *American Political Science Review*, Vol. 97, No. 2, 2003, pp. 233-243; M. JACHTENFUCHS, *The Governance Approach to European Integration*, *JCMS*, Vol. 39, No. 2, 2001, pp. 245-264; F.W. SCHARPF, *Notes Toward a Theory of Multilevel Governing in Europe*, in *Scandinavian Political Studies*, Vol. 24, No. 1, 2001, pp. 1-26; W. WALLACE, *The Sharing of Sovereignty: The European Paradox*, in *Political Studies*, Vol. 47, No. 3, 1999, pp. 503-521; I. PERNICE, *Multilevel Constitutionalism and the Treaty of Amsterdam: European Constitution-Making Revisited?*, *CML Rev* Vol. 36, 1999, 703-750.

<sup>15</sup> As nicely stressed by H. LINDAHL, *Sovereignty and Representation in the European Union*, in N. WALKER (ed.), *Sovereignty in Transition*, Hart Publishing, Oxford, 2003, p. 91, “the multiplication and decentralisation of power-sites in the multi-level polity promotes two features of lawmaking that are the inverted images of the disadvantages of lawmaking in the sovereign state. First, decision are taken much closer to the concrete issues that require regulation. By virtue of its sensitivity to context, lawmaking in a multi-level polity is more effective. Second, direct citizen participation greatly

Having that in mind, one may argue that the logic of multilevel governance can be also legitimately applied to the Economic and Monetary Union, especially if one considers the problems related to the asymmetry of the economic and monetary pillars or those emerging from the analysis of its external dimension (where potential horizontal conflicts between monetary and political authorities may take place), since EMU does not present itself as a realm of hierarchical structures, but rather as the manifestation of a “governance turn”<sup>16</sup>, with the emergence of multiple authorities and shared competences among a variety of parties operating at a variety of levels. As a matter of fact here the term governance simply denotes “policy arrangements” which emerge outside the administrative system of a single Nation State (government), but which, nevertheless, have a significant impact on a globally or regionally defined set of recipients. “Governance” is like “government” in so far as it stand for the regulation of the economy and social relations, while implying a delegation of governmental authority to non-governmental actors and bodies. It is though distinct in so far as it relates European, international, transnational or global activities, which are not exclusively public and involve experts and knowledge-pools. It is again not hierarchical but heterarchical and typically organised in networks.<sup>17</sup>

As a consequence, it seems quite fair to conclude that, indeed, the concept of sovereignty has been involved in this shift, as it has been contaminated by a kind of transfiguration, also determined by the new globalised economic order.<sup>18</sup> In this new

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enhances the legitimacy of lawmaking, as now the citizens themselves engage in lawmaking by way of deliberation. In sum, multilevel governance is shorthand for the compound of decentralisation, horizontality, participation, deliberation and pluralism”.

<sup>16</sup> T.E. AALBERTS, *The Future of Sovereignty in Multilevel Governance Europe – A Constructivist Reading*, JCMS, Vol. 42, No. 1, 2004, pp. 23-46. The author usefully recalls three characterising elements of the notion of multi-level governance which might be applied to EMU. First, rather than being monopolised by national governments, decision-making competences are shared by actors at different levels. As such, supranational institutions have become actors in their own right, playing an independent part in policy-making (rather than functioning merely as agents of national governments). Second, a new mode of collective decision-making has emerged, similarly resulting in loss of control for national governments. Third, the traditional separation of domestic and international politics has been undermined because of transnational organisations. within the EU.

<sup>17</sup> For an extensive and elucidating reflection on the notion of new governance, cfr. C. JOERGES, L.-J. SAND and G. TEUBNER (eds.), *Transnational Governance and Constitutionalism*, Hart Publishing, Oxford, 2004. See also G. DE BURCA, *The constitutional challenge of new governance in the European Union*, *European Law Review*, Vol. 28, No. 6, December 2003, pp. 814-839.

<sup>18</sup> For an interesting investigation of this transfiguration, see R.B.J. WALKER, *State Sovereignty and the Articulation of Political Space/Time*, in *Millennium*, Vol. 20, No. 3, 1991, pp. 445-461. The author rightly observes that “it is the complex and contradictory character of contemporary patterns of fragmentation and integration, including those at work in so many contemporary states, which often

context, for instance, all the authority structures seem far more complex, less top-down in nature than before, flexible and present themselves as cross-cutting networks of governance, a system which involves the institutionalisation of reflexive self-organisation among multiple stakeholders across several scales of State territorial organisation.<sup>19</sup> In a kind of provoking nutshell, the above-described situation may be defined, within the context of EMU, as the *Euro-sovereignty game*, in consideration of the peculiar role played by different actors in the management of the single currency, but also taking into account the symbolic value of money as such in the set-up of Economic and Monetary Union.

Such a situation has two main conceptual implications.

First, the actors involved in the process would be supposed to cooperate as negotiating partners in a complex network, pooling their sovereign authority and other distinctive capacities to help realise collectively agreed aims and objectives on behalf of the network as a whole. They would operate at best as *primus inter pares* in a complex and heterogeneous network rather than as immediate holders of sovereign authority in a single hierarchical command structure.<sup>20</sup> Consequently, “the formal sovereignty of States is better seen as one symbolic and/or material resource among others rather than as the dominant resource”.<sup>21</sup> Indeed, from a multilevel governance

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seems quite at odds with the account of political possibility expressed in the account of state sovereignty that has seemed so elegant and persuasive to the modern imagination”.

<sup>19</sup> For an interesting application of this interpretative model to the EMU, see A. PREDIERI, *Euro, poliarchie democratiche e mercati monetari*, Giappichelli, Torino, 1998. See also the reference to C. KNILL and A. LENSCHOW, *Modes of Regulation in the Governance of the European Union: Towards a Comprehensive Evaluation*, European Integration Online Papers, Vol. 7, No. 1, 2003, available at <http://eiop.or.at/eiop/texte/2003-001a.htm> as applied by J.-V. LOUIS, *The Economic and Monetary Union: Law and Institutions*, CML Rev 41, 2004, pp. 575-608 to the ESCB presented as a “further application of the new modes of regulation based on networking and not on the exercise of unilateral authority” (Ibidem, p. 588).

<sup>20</sup> See, on this point, M. CASTELLS, *End of Millennium*, 2nd edition, Blackwell, Oxford, 2000, who argues that the dispersion of authority and influence among nodes in the European “network State” is also reflected in the complex, variable and changing geometry of European institutions.

<sup>21</sup> B. JESSOP, *Multilevel Governance and Multilevel Metagovernance. Changes in the EU as Integral Moments in the Transformation and Reorientation of Contemporary Statehood*, 2003, available at <http://www.kun.nl/socgeo/n/colloquium/MultilevelGovernanceandMetagovernance.pdf>.

On the symbolic structure of power, it is here worth recalling the intriguing thought of C. LEFORT, *Democracy and Political Theory*, Polity Press, Cambridge, 1988, at p. 225, where the author insightfully observes that “the fact that a polity is organised as one despite (or because of) its multiple divisions and that it is organised as the same in all its multiple dimensions implies a *reference to a place from where it can be seen, read and named*. This symbolic pole proves to be power, even before we examine it in its empirical determinations” (...) “power makes a gesture towards an *outside* (un dehors), whence a polity defines itself. Whatever its form, power always refers to the same enigma: that of an internal-external articulation, a division which institutes a common space” (For the quotation

perspective, sovereignty is better interpreted as a series of specific State capacities instead of as one overarching and defining feature of the State. State involvement would therefore become less hierarchical, less centralised, and less directive in character. Other actors, in turn, will be called to contribute other symbolic and/or material resources to advance collectively agreed aims and objectives.

Second, in contrast to the clear hierarchy of territorial powers associated in theory with the sovereign States, multilevel governance typically involves tangled hierarchies and complex interdependence. Thus the EU can be seen as functioning less as a re-scaled, supranational sovereign State apparatus than as a nodal point in an extensive and tangled web of governance operations concerned to orchestrate economic and social policy in and across many different scales of action with the participation of a wide range of stakeholders.

Having underlined that and adopting a more systematic point of view, one can further argue that, from these reflections, an interesting perspective on the new public international law can be derived. If the role of money within the framework of world financial market is taken into account, this might also lead to an unusual conception of a network-like relationship between national, transnational and supranational forms of legal integration pertaining monetary matters. Considering again the EMU, if one leaves aside for a moment the problem of distribution of law-making/Treaty-making competences among the EU, the Member States, the ECB and the NCB's and, instead, takes into consideration the importance of the systematicity of the reproduction of practical pattern of the networking of relationship among the components involved, then the idea of shifting the focus to a transnational component of mutual co-ordination and reciprocal self-adaptation, including the optional approach of a harmonised institutional co-operation might appear quite plausible, as a third way between the preservation of a national legal order and a relatively homogenous supranational order.

Having that in mind, one of the major issues worth being investigated is thus represented by the question of who is supposed to be the sovereign, bearer of an ultimate claim to a final authority in monetary matters (as a specific field). In

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see H. LINDAHL, *Sovereignty and Representation in the European Union*, in N. WALKER (ed.), *Sovereignty in Transition*, Hart Publishing, Oxford, 2003, p. 97).

addition, another issue at stake is then represented by the further question on how and through which institutions control over monetary sovereignty can be exercised.

As a very first remark, it may be argued that the latter issue (control over monetary sovereignty) is mainly based upon the consideration that supranational monetary institutions (such as the ECB) and their decision-making processes – characterised, in the context of EMU, by a strong technical and epistemic component, cannot be considered as an expression of the totally autonomous power of money,<sup>22</sup> or be perceived as entities able to govern, discipline and auto-direct themselves. That is to say that these institutions and these processes must also be politically acceptable/answerable and accountable, with the aim to find an appropriate institutional balance with all the other institutions and bodies involved in the game. As already underlined, they neither operate in a political vacuum, nor within an intangible sphere of competences. Even the principle of independence of the ECB “does not imply a total isolation from, or a complete absence of co-operation with, the institutions and bodies of the Community. The Treaty prohibits only influence which is liable to undermine the ability of the ECB to carry out its tasks effectively with a view to price stability, and which must therefore be regarded as undue”.<sup>23</sup>

In order to answer these questions, particular attention is thus paid to those categories that characterise the way of structuring the institutional background against which the relationship between money and State sovereignty has been built and developed.<sup>24</sup> As a matter of fact, the transfer of national monetary sovereignty to the

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<sup>22</sup> It should be useful remember the illuminating words of Giuliano Amato on the illusion created by the power of money: “L’illusione è che la moneta possa governare interamente se stessa o, meglio, che la politica monetaria possa da sola governare le vicende monetarie e, quindi, da sola garantire stabilità ed equilibrati rapporti fra le monete. (...) Non è così...in quanto, tanto l’Europa dell’euro, quanto il coordinamento del complessivo sistema monetario internazionale dipendono anche dalle politiche economiche e, più in generale, dalla forza dei loro protagonisti. Ignorare queste istanze potrebbe avere delle gravi ripercussioni”(AMATO, G., *Sistema internazionale e polarizzazioni monetarie*, in *Idee per il futuro del sistema monetario internazionale*, Associazione Guido Carli, CESIFIN, Roma, 1998, 73).

<sup>23</sup> Taken from para. 155 of the Opinion of the Advocate General Jacobs, delivered on 3 October 2002 in Case C-11/00, Commission of the European Communities v. European Central Bank (“OLAF Case”), [2003] ECR I-7147. It should be noted that the principle of independence of the ECB is strongly related to the idea of sovereignty as being “a mantle to ward off external pressure and cement the internal authority” (A. COLEMAN and J. MAOGOTO, *After the Party, is there a Cure for Hangover? The Challenges of the Global Economy to Westphalian Sovereignty*, Legal Issues of Economic Integration, No. 30, 2003, p.38).

<sup>24</sup> There has been a continuing debate about the role and function of money in relation to the State’s power, especially between those who argue that the use of currency was based essentially on the power of the issuing authority (Cartalists) – i. e. that currency becomes money primarily because the coins (or monetary instruments more widely) are struck with the insignia of majesty, and not so much because

Community level has fundamentally changed the economic and monetary constitution under which both European and national economic policies have been conducted. Consequently, in order to investigate all the issues affecting the constitutional building of Community law, the concept of monetary sovereignty has been chosen as the main guiding perspective or lens<sup>25</sup> through which analyse – theoretically and empirically - the organisational structure of the European System of Central Banks, taking into account both the internal and the external dimension.

Undoubtedly, since the very start of its set up, EMU has challenged consolidated assumptions about national sovereignty, legitimacy and identity, since it has always been perceived as bolder, riskier, and more controversial than the single European market, as a meaningful step toward economic integration. In fact, although the Maastricht Treaty falls short of the original and ambitious expectations in the field of politics, it certainly fulfils the intentions laid down in the preamble with respect to Monetary Union. The introduction of the single currency lies, in a sense, in the interstices between the economy and the State in that it combines functional economic elements with institutional political ones.<sup>26</sup> The single currency does away once and

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they happen to be made by gold, silver and copper (or later of paper) – and those who argue that the value of currency depends primarily, or solely, on the intrinsic value of the backing of that currency (Metallists). A conjoint debate exists between those who have argued that money evolved as a private sector, market oriented, response to overcome the transactions costs inherent in barter, and those who again argue that the State has generally played a central role in the evolution and establishment of money. The key relationship in the Cartalists team model is the centrality of the link between political sovereignty and fiscal authority on the one hand and money creation, the mint and the central bank, on the other. The key fact in the present Eurosystem is that that link is to be weakened to a degree rarely, if ever, known before. In fact, a primary constitutional feature of the European Central Bank is to be its absolute independence from government (at any level). Meanwhile, the political and fiscal powers of the different European institutions (Parliament, Commission, etc.) at the matching federal level are far weaker (than has been the case in other previous federal states). “That, in itself, raises a lot of constitutional and political issues, such as what would be happen if the wishes of the Community, expressed through its various (democratic) institutions, should not coincide with either the objectives or the operations of the European System of Central Banks?” Cfr. C.A.E. GOODHART, *Two Concepts of Money, and the Future of Europe*, LSE Financial Markets Group and ESRC Research Centre, Special Paper Series, n. 96, June 1997, p. 4. See also P. SAVONA, *La sovranità monetaria*, Buffetti Editore, Roma, 1975 and J. HICKS, *Una teoria di mercato della moneta*, Il Mulino, Bologna, 1992.

<sup>25</sup> The idea of using the concept of monetary sovereignty in its heuristic value as an useful perspective to orientate the investigation is extensively developed in A. CHIRICO, *La sovranità monetaria fra ordine giuridico e processo economico*, CEDAM, Padova, 2003.

<sup>26</sup> At EU level, two Council Regulations made up the legal framework for the use of the euro as tangible expression of the transfer of monetary sovereignty, namely Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro [1997] OJ L162, and Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro [1998] OJ L139. In particular, Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro provides for: (i) the replacement of the ECU by the euro at a rate of one to one, as from 1 January 1999; (ii) continuity of contracts, so that the introduction of the euro will not affect obligations under contracts unless parties have agreed otherwise; and (iii) the technical

for all with internal exchange rate fluctuations, completes the Single Market and, with a single money for almost three hundred million people, increases the efficiency of currency use in an unprecedented manner. All that, it goes without saying that the transfer of national monetary sovereignty to the European Central Bank<sup>27</sup> represents a partial surrender of political sovereignty, which is rightly perceived by citizens as marking a deep change in the way in which nations consider themselves.<sup>28</sup> As a result, the monetary order established by the Maastricht Treaty - together with the detailed Statute of the European System of Central Banks and of the European Central Bank, "by itself represents a crucial building block for the development of a European statehood".<sup>29</sup> The success of the European Central Bank's monetary policy (so highly denationalised and depoliticised) and the stability of the euro constitute a test case for European integration above and beyond monetary and currency issues.

In particular, by severing the traditional link between money and State sovereignty, the Euro has become "one single currency issued by one central bank in an area of fifteen States which, in this respect, are meant to become one economy".<sup>30</sup>

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rules, including rounding rules, for conversions between participating currencies and the euro. On the other hand, Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro provides that: (i) from 1 January 1999, the currency of participating Member States will be the euro; (ii) there will be a transitional period from 1 January 1999 to 31 December 2001, during which economic agents will be free to use the euro, but will not be compelled to do so. Euro notes and coins will not be available until 1 January 2002.

<sup>27</sup> The statement in the text is in reality truly controversial and hotly debated. See, for a description of the different positions in the doctrine, Chapter Four.

<sup>28</sup> For an interesting elaboration on this point, see G. KOENIG (ed.), *L'euro, vecteur d'identité européenne*, Observatoire des politiques économiques en Europe, Presses Universitaires de Strasbourg, Strasbourg, 2002, where – as highlighted by J.-V. LOUIS in his Book Review published by CML Rev, 41, 2004, p. 266, even though "the development of the euro strengthens the sense of identity, the evolution will only be complete if it leads to a political union of which the euro will be the symbol".

<sup>29</sup> O. ISSING, *European integration at the beginning of the new millennium*, Excerpts from lecture given by Professor Otmar Issing, member of the Executive Board of the European Central Bank, at the Forum Dialogue organised by the Banque Central du Luxembourg on 8 February 2000, <http://www.ecb.int/kev/00/sp000208.htm>, p. 2.

<sup>30</sup> C. NOYER, *The international impact of the euro*, Speech delivered by the current President of the European Central Bank, on the occasion of his visit to the United States, January 2000, <http://www.ecb.int/kev/00/sp000113.htm>, notably p. 1. The starting point on which the Vice-President of the ECB bases his argument is an elucidating consideration about the role of the Euro within the international monetary system, according to which: (...) "it will eventually hinge on the validity of the fundamental idea underlying its creation, namely the idea that important components of sovereignty can be pooled and shared among nations in the pursuit of common economic and political objectives. Such a belief, of course, lends itself to being challenged, as do all innovative concepts. Money has indeed been the most typical expression of state sovereignty for centuries, so why should this not continue in the future? Moreover, although the link between state and money was no longer seen as an intrinsic necessity, does Economic and Monetary Union really work?".

The management of this new currency has been entrusted to the European System of Central Banks (ESCB), which is composed of the European Central Bank (ECB) and the 15 National Central Banks of the Member States of the European Union. This new System, which lies at the very core of EMU, has assumed the tasks and competences attributed to it under the Treaty establishing the European Community,<sup>31</sup> most notably the definition and implementation of the single monetary policy of the Community, by virtue of an unprecedented transfer of monetary sovereignty, to be understood – technically speaking – as the power to adopt and issue a currency as a legal tender within a defined territory and regulate the money supply (on the internal side), and to impose exchange control regimes, uphold restrictions on the movements of capital and current payments, and decide upon the mechanism to determine an exchange rate (on the external side).<sup>32</sup>

In any case, a proper identification of the bearer of sovereignty in monetary matters in the European Union is not that simple or without doctrinal disputes. Is it the Community as such, the ECB or should it be legitimate to think in terms of a “cross border central banking”, a new concept inserted in Article 56 of the Statute of the Bank for International Settlements, when the ECB became a shareholder of this Bank in November 1999?<sup>33</sup> To find a workable answer, it is indeed worth determining

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These questions are far from receiving an exhaustive answer in the short term, given the fact that the Euro will still have to deal with the reality of financial markets and, moreover, because the EMU can be still considered a relatively “young institutional architecture” in the context of the international/global monetary system. None the less, the present work aims to analyse these crucial matters and, hopefully, to find a workable, theoretical solution to the present configuration of the link between money and sovereignty within the framework of the EMU.

<sup>31</sup> See Article 105 EC Treaty.

<sup>32</sup> The internal/external dichotomy is a crucial one, to be applied not only in the case of sovereignty as such, but also in the case of monetary sovereignty. It stems from the traditional doctrine on sovereignty, elaborated by Jean Bodin who offered the first systematic approach to national sovereignty. In his famous work, *Six Books of the Commonwealth*, in 1576, he defined sovereignty – in its internal side – as follows: “Sovereignty is the absolute and perpetual power of a Commonwealth” (...) “For he is absolutely sovereign who recognises nothing, after God, that is greater than himself”. Bodin’s emphasis on absoluteness is clear. Its importance was that it determined who was the sovereign and therefore absoluteness was considered the defining element of sovereignty. On the other hand, the international community was configured and is still based on the notion of supposedly equal absolute sovereigns, therefore creating a dichotomy of absolute power domestically within the Nation-State and limited power beyond the Nation-State’s borders aimed at ensuring non-interference by one sovereign in the affairs of another. As a consequence, what Nation-States mean and what they desire to protect most of all is primarily that within the context of their borders their government has the competence to organise the Nation-State’s domestic management at its own discretion. In other words the value to be preserved is the freedom from external forces, or political independence.

<sup>33</sup> See, on the last point, J.-V. LOUIS, *The Economic and Monetary Union: Law and Institutions*, CML Rev 41, 2004, p. 588.

where the Central Bank of the euro area effectively is (i.e. determining its constitutional position) and which kind of institutional balance can be recognised within the ESCB.<sup>34</sup>

It goes without saying that one of the first questions worth being examined in the analysis of the institutional framework of the ESCB is related to the allocation of competences in the conduct of monetary policy and it can be summarised as follows: “to which body or entity of economic governance has the monetary sovereignty of the Member States been surrendered?”<sup>35</sup> Chiara Zilioli and Martin Selmayr, for instance, after having qualified the ECB as an “independent specialised organisation of Community law” (as opposed to numerous other legal classifications envisaged by different scholars in terms of “Community institution”, or “Community organ”, as “a quasi-institution”, as “a Community body”, and even “an independent actor within the EU”), argue that since 1 January 1999 a complete denationalisation of money occurred. Thus, the ECB is to be considered the sole bearer of monetary sovereignty in the field of EMU. With regard to the different arguments offered to defend their thesis, it is worth noting that the authors directly enter into an ongoing doctrinal dispute about the proper place of the ECB inside the institutional framework of the European Union. They clearly state that, “after the fourth pillar proposal was dropped during the negotiations leading to the Maastricht Treaty, the ECB has certainly not been a separate pillar within the Union, detached from the supranational structure of Community law”,<sup>36</sup> but is “an integral part of the European Union’s first and central pillar”.<sup>37</sup>

In order to support this view the doctrine usually refers to: a) the attribution of *legal personality* ex Article 107.2 EC (extended by some authors also to the sphere of international legal personality by virtue of a combined interpretation of Article 9.1 of

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<sup>34</sup> As a very first remark, it should be recalled that, even though it is clear that the ECB is in a hierarchical position with respect to the NCB’s, nevertheless the empirical studies are in the process of shedding a light on the influence exercised by the NCB’s within the ESCB framework (also through the ESCB Committees), in order to achieve a better understanding of the relationship of checks, balances and interaction between the decision-making bodies of the ECB, the Executive Board and the Governing Council. For a detailed analysis, see Chapter Four of the present work, *Monetary Sovereignty within the Institutional Framework of the ESCB*.

<sup>35</sup> For a detailed analysis of the matter, see Chapter Four of the present work: *Monetary Sovereignty within the Institutional Framework of the ESCB*, notably paragraph 2.

<sup>36</sup> C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.* p. 29.

<sup>37</sup> *Ibidem*, p. 50.

the Statute and Article 266 EC); b) the consideration that the ECB's competences are laid down in *primary Community law*; c) the emphasis placed on the fact that, in order to guarantee that monetary policy for the Euro will in future be de-politicised, Article 108 EC entrenches constitutionally the *far-reaching independence* of the ECB, by prohibiting both the Community institutions and bodies and the Member States from giving it instructions.

From all these considerations the conclusion to be drawn would be that the sovereign powers of the Member States concerning monetary matters have been transferred *directly* to the ECB.<sup>38</sup>

At any rate, in order to investigate the above-mentioned issues, the present thesis claims at falsifying this initial assumption, while verifying also empirically the application of the concept of "monetary sovereignty" within the organisational structure of the European System of Central Banks (what has been called "monetary sovereignty in practice"), considering - as already said - both the internal dimension and the external one. The latter, in particular, leads to surprising and illuminating conclusions.

To complete the picture, it has to be added that the issue of the ECB's appropriate place in EMU appears to be to a large extent a question of one's point of

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<sup>38</sup> On this point, cfr. C. ZILIOI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.*, p. 13 and ff. See also W.H. BUTTER, *Alice in Euroland*, Centre for Economic Performance, LSE, Discussion Paper Series, No. 423, April 1999, notably at p. 14. *Contra, inter alia*, R. TORRENT, *Whom is the European Central Bank the central bank of? Reaction to Zilioli and Selmayr*, CML Rev 36, 1999, pp. 1229 – 1241, who argues that if the thesis of the contested authors was "put forward in a more explicit fashion" (...) "it would appear completely untenable, both politically and legally" (*Ibidem*, p. 1230, footnote 3 at the end). On the same line of reasoning, cfr also F.A. MANN, *The Legal Aspect of Money*, 5<sup>th</sup> edition, Clarendon Press, Oxford, 1992, p. 20, where he explicitly affirms that "sovereignty, as the prerequisite of money control in its widest sense and of the issue of money in particular is vested in the Community".

The issue of the transfer of monetary sovereignty is a complex one. In fact the doctrine has elaborated different views on such a matter arguing that the transfer of monetary competences to the supranational level does not necessarily imply a direct attribution of powers to the ESCB, but rather to the Community as such. See, on this line of reasoning, S. CAFARO, *Unione monetaria e coordinamento delle politiche economiche. Il difficile equilibrio tra modelli antagonisti di integrazione europea*, Giuffrè, Milano, 2001, notably at p. 184 and ff., where the author highlights the fact that there has been "un'attribuzione alla Comunità europea di una sovranità monetaria sostanziale, frutto non semplicemente di un trasferimento dagli Stati membri che compongono la zona euro, ma di un vero e proprio acquisto di un potere di governo della moneta perduto dagli europei diversi anni prima". A significant evidence of the attribution of competences in the field of monetary policy to the Community is given by the field of exchange-rate policy where both the Council and the ECB are called to play a significant role. On this point R. SMITS, *op. cit.*, p. 195, differentiates between an "exclusive Community competence in monetary matters" to be exercised by the ESCB, and a "shared competence" of the ESCB and the Community's institutions with regard to the external aspects of the regulation of money.

departure in terms of theoretical background, in addition to objective reasoning. Besides, it is worth specifying that such analysis is not value free, but it concurs with the belief that the dominant answer to the issue of delegation of public authority,<sup>39</sup> prior to the need to guarantee efficiency of an organ and correctness of its decisions, still, first of all, is its democratic legitimacy.<sup>40</sup>

To coherently approach all these complex issues, the present work is structured as follows. Ideally, even if not formally, it consists of two parts aimed at shedding light on the concept of monetary sovereignty in its theoretical and empirical dimension.

In the first chapters, after having discussed the concept of monetary sovereignty (as a novel sub-category of sovereignty); after having considered the hotly contested asymmetry existing between the two legs of EMU, with its centralisation of monetary policy in the hands of the ECB and the concurrent decentralisation of fiscal policies still governed by the Member States; after having briefly entered into the debate about the institutional profile of the Economic and Monetary Union, a number of crucial notions - such as independence, accountability, transparency or predictability, as part of the exercise of monetary power – are specifically highlighted in consideration of their importance for a comprehensive understanding of the idea of monetary sovereignty in its empirical dimension. The aim is to analyse all these concepts in order to use them, in a second stage, as theoretical tools to detect the issues involved in the practical exercise of monetary authority by the ECB in its relations with the Community's institutions and bodies. In particular, the dialogue between the European Central Bank and the European Parliament provides a privileged setting for their use. The main idea is to point out that, although the above-mentioned terms interrelate and even overlap, they cannot and should not be used interchangeably. Due care should be thus taken to identify their conceptual distinctiveness, to avoid blurring the indispensable debate about the central bank with

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<sup>39</sup> For an innovative theory on the delegation process, P. LINDSETH, *Delegation is Dead. Long Live Delegation: Managing the Democratic Disconnect in the European Market-Polity*, in C. JOERGES and R. DEHOUSSE, *Good Governance in Europe's Integrated Market*, Oxford University Press, Oxford, 2002, pp. 139-163.

<sup>40</sup> To explore this kind of crucial issue, cfr. B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien, 2003.

confusion and misperceptions.<sup>41</sup> In the context of the institutional structure of EMU that emphasises technocracy rather than democracy, fundamental concerns about accountability, transparency, and legitimacy were thus raised.

In the second part of the thesis, devoted to the institutional analysis of the empirical issues linked to the application of the concept of monetary sovereignty within the ESCB, the issue of the governance of the ESCB is thoroughly investigated, arguing that this institution is not properly a federal system in which concurrent competences are attributed to the ECB and the National Central Banks, but that Community law has centralised decision-making within the ESCB exclusively in the hands of the decision-making bodies of the ECB. To this aim it has been considered worth describing the decision-making process inside the ECB concluding that there is a unique relationship of checks, balances and interaction between two truly supranational decision-making bodies: the Executive Board and the Governing Council of the ECB. Such a new institutional framework represents a challenge for the central banking community itself, since the traditional opposition between divergent national and supranational interests in monetary policy formally came to an end on 1 January 1999. In fact, the argument that NCBs Governors form the majority of the Governing Council does not hold weight as these Governors are meant to act, in their monetary policy functions, in the sole interest of the ESCB's objective of price stability in the EU. Moreover, the legal doctrine goes further assuming that inside the ESCB, one should now not try to create new oppositions between the ECB's interest and that of the national central banks<sup>42</sup>. "The principle of *System integrity* rather

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<sup>41</sup> This is the approach suggested by T. PADOA-SCHIOPPA, *An Institutional Glossary of the Eurosystem*, Article by Tommaso Padoa Schiopa, Member of the Executive Board of the European Central Bank, at the conference on "The Constitution of the Eurosystem: the Views of the EP and the ECB", 8 March 2000, p. 1, available at [http://www.ecb.int/key/00/sp000308\\_1.htm](http://www.ecb.int/key/00/sp000308_1.htm)

<sup>42</sup> *Contra* the above-mentioned reconstruction, see F. ALLEMAND, *Le réforme institutionnelle de la Banque centrale européenne dans le contexte de l'élargissement*, available at <http://www.iue.it/OnlineProjects/LAW/eurospectator/documents/2001enlargement.pdf> and R. BALDWIN, E. BERGLÖF, F. GIAVAZZI and M. WIDGREN, *Preparing the ECB for Enlargement*, CEPR Policy Paper n. 6, October 2001. See also the ECB Press Release 20 December 2002 for the future adjustment of the voting modalities within the Governing Council after the enlargement. Such Governing Council's proposal was made in accordance with the ECB's "enabling clause" contained in the Article 5 of the Treaty of Nice that enables the EU to modify the Bank's decision-making procedures without convening a new intergovernmental conference. It specifies that: "According to the current institutional arrangements, the GC consists of six Executive Board members and up to 15 national central bank (NCB) Governors. In order to maintain the Governing Council's capacity for efficient and timely decision-making as its membership increases substantially, the Governing Council agreed that the number of NCB Governors exercising a voting right should not exceed 15. When the number of NCB Governors exceeds 15 they will exercise a voting right on the basis of a rotation system. Each member of the Executive Board will maintain a permanent voting right. In such a system

requires an unequivocal and strong stance of the ESCB as a whole”.<sup>43</sup> The unwritten principle of System integrity is thus not conceived as an instrument to co-ordinate potentially divergent action of a plurality of autonomous legal entities, but as one of the main principles substantiating the organisational structure of the ESCB, which excludes *a priori* the existence of diverging actions and interests, as both the ECB and the national central banks are committed to the same objective (namely, the maintenance of price stability for the euro). Nevertheless, it has to be added that, through the ESCB Committees, the specific interests of the different national central banks (especially the ones representing big countries like Germany, France or Italy) may find a voice that emphasises a kind of tension between the centre and the periphery of the System. Finally, in the concluding part of the chapter, an investigation on the making and implementation of ECB law is more extensively presented, since the regulatory power of the ECB - i.e. the power to adopt different types of legal instruments, including regulations, decisions, recommendations, opinions, guidelines, and instructions – seems to give evidence to the practical significance of the idea of sovereignty (here defined as “the capacity to make binding

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of voting modalities, all member of the GC will continue to attend the meetings in a personal and independent capacity, and the “one member, one vote” principle will continue to apply to NCB Governors exercising a voting right”. Moreover, at any moment in time the NCB Governors with the right to vote will have to be from Member State which, taken together, are representative of the euro area economy as a whole. As a consequence, NCB Governors will not be able to exercise a voting right with the same frequency. NCB Governors will be allocated to different groups. The allocation of NCB Governors to the groups will be based on a ranking of their respective Member States resulting from their share in the euro area total according to a composite indicator of “representativeness”. The principal component of this composite indicator will be the Member State’s GDP. The second component will be the total assets of the aggregated balance sheet of monetary financial institutions (TABS-MFI) within the territory of the Member State concerned. The rotation system will be such that the size of the groups and the NCB Governor’s voting frequencies will be adjusted over time so as to accommodate any sequencing of euro area enlargement up to 27 Member States, i.e. the current EU Member States and the 12 accession countries listed in the Protocol on enlargement annexed to the Treaty of Nice. Once the Treaty of Nice has entered into force, which is expected for 1 February 2003, the ECB will adopt and present a formal Recommendation to give legal form to the adjustment of its voting modalities. It will then be for the EU Council to decide unanimously on an adjustment of the voting modalities in the Governing Council, on the basis of the ECB Recommendation and after taking account of the opinions of the European Commission and the European Parliament. The agreed amendment will then be recommended to the Member States for ratification in accordance with their respective constitutional requirements.

It is clear thus that in such a new system of voting modalities new dynamics will operate between the two decision-making bodies of the ECB. New potential conflicts or tensions between the centre and the periphery cannot be excluded *a priori*, despite the commitment to the same aim that links together all the NCBs’ Governors who are supposed to act, in their monetary policy functions, in the sole interest of the ESCB’s objective of price stability in the Euro area.

<sup>43</sup> C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, p. 82.

decisions in political and social contexts and to assure the implementation of those decisions”) as applied to the ESCB.

The maintenance of price stability as primary objective of the ESCB is then taken into account in the following chapter, together with the other objectives and basic tasks of the ESCB. In addition, the idea is to highlight also the institutional features of the ESCB as they operate in practice.

The last chapter is devoted to an inquiry on the external dimension of EMU and to the international representation of the euro area. It shows how difficult is the adoption of the notion of monetary sovereignty when external relations are at stake. At first glance, the EC Treaty, the Statute of the European System of Central Banks and of the European Central Bank, and the existing *acquis* of Community law on external relations – also built through the jurisprudence of the ECJ - seem to provide for sufficiently clear guidelines to give the euro a strong and unequivocal voice at the international level with the ECB being the natural bearer of external competences in the field of monetary policy. However, such a conclusion can be reached only if one starts from the premise that the ECB, which is internally exclusively competent to “define and implement the monetary policy of the Community” (Article 105. 2 EC Treaty), must also be able to exercise its external competences by virtue of its separate legal personality and its own decision-making bodies. Nevertheless, even if most part of the doctrine supports this thesis (going further arguing that, in the absence of the adoption of internal rules, the Community may be competent to act externally, should the international act be necessary for the attainment of one of the objectives of the Community), the matter is still extremely contentious.<sup>44</sup> To support the idea that the ECB is entitled to keep its prerogatives in terms of sovereignty also in external relations, the legal doctrine recalls the ruling of the *ERTA case* (the doctrine of parallelism),<sup>45</sup> referring to the principle stating that “the system of internal Community measures may not be separated from that of external relations”.<sup>46</sup> Nevertheless, one should also bear in mind that the implied powers doctrine is a

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<sup>44</sup> See, for instance, C.W. HERRMANN, *Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice*, in *European Foreign Affairs Review*, No. 7, 2002, pp. 1-24. The author points out that, even assuming an inseparable link between exchange rate policy and monetary policy, it is not possible to establish a general implied external competence of the ECB as regards monetary matters.

<sup>45</sup> *Commission v. Council (ERTA)* Case 22/70 [1971] ECR 263.

<sup>46</sup> C. ZILIOI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.*, p. 184.

peculiar tool to be applied in cases where no explicit competence is laid down in the Treaty provisions. These provisions should thus be the starting point of every analysis, before the doctrine of parallelism and implied powers can be applied. Assuming such a different approach, it would thus seem contradictory to establish a general rule by using the implied powers doctrine first, and then treat the explicit provisions as “special cases”, in order to inform the interpretation of these provisions by the general rule derived by implication. As a result the chapter is devoted to a thorough analysis of the Treaty provisions disciplining the matter, with a declared intention to shed light on the institutional balance characterising the relationship between monetary and political authority at the Community level in the management of the external relations of the euro area. The search for an institutional balance, in reality, is not only a purely theoretical problem, but seems to be a necessity to implement the strength of euro, as a major currency rivalling the dollar and the yen in the world of the international globalised monetary system.

What finally emerges in the final chapter is that there is a persistent tension between different centres of authority, operating both vertically and horizontally and involving various types of actors: the ECB, the Ecofin Council, the NCBs and the Member States unified by the requested principle of the attainment of the same goal. All of them are called on to demonstrate themselves as an efficient means of coordinating the diverging interests related to the single European currency in the vast field of international monetary co-operation. It goes without saying that the debate over the single voice of the euro mimics this larger debate over the fate of European integration. On one hand, the Member States want to pull forces in order to obtain at the international level the power that they can no longer exercise as individual countries. On the other hand, they often show not to be ready to sacrifice what they have left of individual power at the international level. Relinquishing their last bits of sovereignty may be politically costly for the governments of large Member States, especially as they see their control over the levers of the economy wane under the twin pressures of Europeanisation and globalisation. Yet the issue of external representation, which highlights very clearly the contradictory pulls of the need for an international power and national sovereignty, cannot be postponed indefinitely. If the Member States do not pre-empt likely problems by tackling the institutional question of the single currency’s external voice now, an external event, be it a financial crisis

or EU enlargement, will likely force their end. As the solution devised in the heat of the moment may not be the optimal arrangement, it would be desirable to confront the issue of the euro's international role before it reaches a critical point.

*Some notions on the methodological approach: the Popperian falsification's method*

To support the methodological choice, it should be highlighted again that the present research on the notion of sovereignty, selected as main starting point, is definitively addressed to the aim of a kind of reconceptualisation of its traditional meaning, in order to understand what sovereignty/monetary sovereignty is about. Thus, by virtue of a peculiar method of analysis, characterised by a Popperian process of "falsification" of the traditional categories moving around the consolidated version of the notion of sovereignty, and by focusing on the novel institutional context in which this notion is called to express itself (the so-called post-Westphalian order which recalls old debates, while raising new questions), the remarkable consequences determined on the role and institutional configuration of political and monetary authorities within the Economic and Monetary Union can be finally highlighted. As a result of this approach, in a new scenario, characterised by a high degree of fragmentation, the first theoretical need should be that of a kind of deconstruction of the traditional way of perceiving sovereignty: this process is supposed to lead the analysis "beyond the subject and the granitic structure" of the concept, trying to single out unprecedented aspects related to the link existing between sovereignty and money; a link which is now operating both in theory and in practise in an unknown way under the auspices of EMU, as a new institutional subject, playing its role in an emerging global system.

In order to apply the Popperian method of falsification for a better understanding of the concept of monetary sovereignty, one must primarily outline the basic elements of such a method. In summary fashion, Popper's philosophy of knowledge explains that the search for knowledge begins with guesses and conjectures which must be framed in such a way that they are at least in theory falsifiable. "Their falsifiability assures them of an "empirical content" – that is, when

falsifiable, we know that they are about a real world and different from mere imaginings which do not refer to anything objective and are, therefore, not falsifiable".<sup>47</sup>

Popper's main thesis is that we can learn from our mistakes, since they can develop a theory of knowledge and of its growth. This is a theory that assigns to rational arguments the modest and yet important role of criticising our often mistaken attempts to solve our problems. And it is a theory of experience that assigns to our observations the equally modest and almost equally important role of tests, which may help us in the discovery of our mistakes. Though it stresses our fallibility, it does not resign itself to scepticism, for it also stresses the fact that knowledge can grow, and that science can progress – just because we can learn from our mistakes. The way in which knowledge progresses, and especially our scientific knowledge, are by unjustified anticipations, by guesses, by tentative solutions to our problems, by conjectures. These conjectures are controlled by criticism; that is, by attempted refutations, which include severely critical tests. They may survive these tests, but they can never be positively justified: they can be established neither as certainly true nor even as probable. Criticism of our conjectures is of decisive importance: by bringing out our mistakes it makes us understand the difficulties of the problem that we are trying to solve. This is how we become better acquainted with our problem, and able to propose more mature solutions: in fact, the very refutation of a theory – that is, of any serious tentative solution to our problem – is always a step forward that takes us nearer to the truth. And this is how we can learn from our mistakes.

As we learn from our mistakes our knowledge grows, even though we may never know – that is, know for certain. Since our knowledge can grow, there can be no reason here for despair of reason. And given that we can never know for certain, there can be no authority here for any claim to authority, for conceit over our knowledge. Those among our theories which turn out to be highly resistant to criticism, and which appear to us at a certain moment of time to be better approximations to truth than other known theories, may be described, together with the reports of their tests, as the science of that time. Since none of them can be positively justified, it is essentially their critical and progressive character – the fact

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<sup>47</sup> P. MUNZ, *Our knowledge of the Growth of Knowledge. Popper or Wittgenstein?*, Routledge & Kegan Paul. London, Boston, Melbourne and Henley, 1985, p. 216.

that we can argue about their claim to solve our problems better than their competitors – which constitutes the rationality of science.<sup>48</sup>

The starting point of Popper's falsifiability is thus always a *problem* (in the present case the concept of monetary sovereignty as applied to the multilayered context of EMU) or a problem situation. *Attempted solutions* then follow. These always consist of theories, and these theories, being *trials*, are very often wrong: they are and always will be hypotheses or conjectures. As Popper wrote: "in science, too, we learn by *eliminating* our mistakes, by eliminating our false theories".<sup>49</sup>

Thus Popper firstly builds a three-stage model made up of: (a) problem; (b) attempted solutions; (c) elimination. This critical method alone explains the extraordinarily rapid growth of the scientific form of knowledge, the progress of science.<sup>50</sup> Then he refines the model by adding another stage, thus producing a four-stage model derived from the previous one. The four-stage model may in fact be derived from the three-stage model because what Popper does is to call the first stage "the old problem" and the fourth stage "the new problem". Then he further replaces "attempted solutions" with "tentative theories", and "elimination" with "attempted elimination through critical discussion". So we have (a) the old problem; (b) formation of tentative theories; (c) attempts at elimination through critical discussion, including experimental testing; (d) the new problem that arises from the critical discussion of our theories.

This being so, in the case under examination, we can assume as a first step that monetary sovereignty poses "old problems" to be solved through the formation of tentative theories concerning this concept. We can also assume that monetary sovereignty, as a "working tool", has an explanatory value that must be tested through a critical discussion based on its institutional profile that will generate a new problem. By applying the Popperian method to the concept of monetary sovereignty and by passing mainly through stage three (attempts at elimination through critical

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<sup>48</sup> This, in a nutshell, is the fundamental thesis developed in K. POPPER, *Conjectures and Refutations. The Growth of Scientific Knowledge*, Routledge, London and New York, 1963. Such a thesis may be applied to many topics, ranging from problems of the philosophy and history of the physical sciences and of the social sciences to historical and political problems.

<sup>49</sup> K. POPPER, *The logic and Evolution of Scientific Theory*, in *All life is problem solving*, Routledge, London and New York, 1999, p. 7.

<sup>50</sup> Popper specifies that: "all prescientific knowledge, whether animal or human, is *dogmatic*; and science begins with the invention of the non-dogmatic, critical method".

discussion, including experimental testing) in the second part of the present work - devoted to the analysis of the concept of monetary sovereignty in its empirical context (namely the ESCB) -, one should arrive to a proper definition of the same. The starting question on monetary sovereignty (i.e., whether this is a novel sub-category of the concept of sovereignty), will find an answer, but not before the empirical test. Theory is not sufficient to provide for the final response (the formation of tentative theories, in Popper's thought, is just one step towards the discovery of the relative truth). That's why the Popperian-like method, made up of conjectures and refutations, seems to fit with the purposes of the present investigation.

In conclusion, it should be specified that monetary sovereignty, whose meaning is due to remain still covered at this stage of the present analysis, can only be used as a privileged perspective to investigate several issues occurring in today's European Union. Only the analysis of its empirical dimension may produce a better understanding of its significance, which, up to now, is still to be tested. As a consequence, it has a mere heuristic value.



# CHAPTER ONE

## SOVEREIGNTY IN TRANSITION

*“Se è vero che le teorie e i concetti di diritto pubblico si trasformano sotto la spinta di avvenimenti e di mutamenti politici, è chiaro che la discussione intorno ad essi sorge innanzi tutto in base ai punti di vista pratici del momento e modifica le concezioni precedenti in funzione dello scopo di volta in volta perseguito” (...)*  
*“E’ dunque chiaro che dalla medesima situazione politica di fatto possono derivare differenti tendenze e correnti scientifiche. Di tutti i concetti giuridici, quello della sovranità è il più soggetto all’influsso di interessi attuali”\**

### 1) *The question of sovereignty in the EU and the decline of the Nation State*

Once again the issue of sovereignty has come to the fore. In fact, in contrast with the spirit of the end of history and going beyond the traditional form of the Nation State, new political and institutional subjects (or entities) are claiming different forms of authority directly related to the problem of sovereignty within the framework of the international system.<sup>51</sup> Examples of these claims are given by

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\* C. SCHMITT, *Teologia politica: quattro capitoli sulla dottrina della sovranità*, in *Le categorie del “politico”*, Italian translation by P. Schiera, Il Mulino, Bologna, 1972, p. 43.

<sup>51</sup> There is a remarkable amount of literature on this theme. It is worth recalling, *inter alia*, K. BAGWELL – R.W. STAIGER, *Domestic policies, national sovereignty and international economic institutions*, NBER Working Paper Series, n. 7293, National Bureau of Economic Research, Cambridge, August 1999; D. CARREAU, *Souveraineté et coopération monétaire internationale*, Cujas, Paris, 1970; B. DE WITTE, *Sovereignty and European Integration: the Weight of Legal Tradition*, in A.-M. SLAUGHTER, A. STONE SWEET and J. H. H. WEILER, *The European Courts and National Courts. Doctrine and Jurisprudence: Legal change in its social context*, Hart Publishing, Oxford, Portland, 1998; M.R. FOWLER – J.M. BUNCK, *Law, Power and the Sovereign State. The Evolution and Application of the Concept of Sovereignty*, The Pennsylvania State University Press, 1995; C.T. HARTLEY., *Constitutional Problems of the European Union*, Oxford and Portland, Oregon, 1999 (see, in particular, Chapters 6, 7 & 8, pp. 123 – 179; G. IONESCU, (ed.), *Between Sovereignty and*

different international institutions such as the United Nations or the European Community itself, which recognise and support a novel kind of authority, by virtue of the erosion of the “sanctity of sovereignty”, as this has been traditionally perceived. The latter expression reminds the reader of Carl Schmitt’s theories about the structure of the so-called «*ius publicum europaeum*»,<sup>52</sup> whose conceptual framework is characterised by a very strong connection between sovereignty – “supreme power over citizens and subjects, unrestrained by law” (J. Bodin) – and the Nation State – the holder of the above-mentioned supreme power.<sup>53</sup>

In order to clarify this point – i. e. the role historically played by the sovereign State at the national and international levels -, one should point at a crucial characteristic of its rise related both to the territorialisation of politics and to the territorial caging of social relationships. In so doing it can be argued that the modern State’s project aimed at instituting the State itself as the supreme power across a given

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*Integration*, Croom Helm, London, 1974; D.T. LLEWELLYN, *International Financial Integration. The Limits of Sovereignty*, The Macmillan Press Ltd, London, Basingstoke, Hong Kong, 1980; L. O’DOWD and M. THOMAS, *Borders, Nations and States. Frontiers of Sovereignty in the New Europe*, Avebury, Ashgate Publishing Ltd, Aldershot, 1996; M.S., SOROOS., *Beyond Sovereignty. The Challenge of Global Policy*, University of South Carolina Press, 1986; W.J. STANKIEWICZ (ed.), *In defence of Sovereignty*, Oxford University Press, New York, London, Toronto, 1969; N. WALKER, *Sovereignty and Differentiated Integration in the European Union*, *European Law Journal*, 4, 1998, 355 – 388.

<sup>52</sup> See C. SCHMITT, *Politische Theologie. Vier Kapitel zur Lehre von der Souveränität*, Duncker & Humblot. München-Leipzig, 1922; *Political Theology. Four Chapters on the Concept of Sovereignty*, English version translated by George Schwab, The MIT Press, Cambridge, Massachusetts, and London, England, 1988. It seems worth recalling, in particular, the first chapter, where the famous link between sovereignty and a state of exception is well described. According to Schmitt’s definition “Sovereign is he who decides on the exception”, assuming – in the context of Schmitt’s work, that a state of exception includes any kind of severe economic and political disturbance that requires the application of extraordinary measures. Whereas an exception presupposes a constitutional order that provides guidelines on how to confront crises in order to re-establish order and stability, a state of emergency need not have an existing order as a reference point because *necessitas non habet legem*.

<sup>53</sup> There exists a considerable number of historical presentations dealing with the development of the concept of sovereignty, but they are like textbook compilations of abstract formulas from which definitions of sovereignty can be extracted. By contrast, the original idea that the concept of sovereignty relates to the critical case, the exception, was long ago recognised by Jean Bodin. He stands at the beginning of the modern theory of the State thanks of his work “*Of the True Marks of Sovereignty*” (chapter 10 of the first book of the *Republic*) rather than because of his often-cited definition (“sovereignty is the absolute and perpetual power of a republic”). He discussed his personal concept of sovereignty in the context of many practical examples, and he always returned to the question: “To what extent is the sovereign bound to laws, and to what extent is he responsible to the estates?”. To this last question he replied that commitments are binding because they rest on natural law. Nevertheless, in emergencies, the tie to general natural principles ceases. In general, according to his theory, the prince is duty bound toward the estates or the people only to the extent of fulfilling his promise in the interest of the people; but he is not bound under conditions of urgent necessity. “This is what is truly impressive in his definition of sovereignty; by considering sovereignty to be indivisible, he finally settled the question of power in the state” (SCHMITT, *op. cit.*, 8).

territory with clearly demarcated boundaries sanctioned by international public law.<sup>54</sup> This peculiar configuration determined the fact that public international law was eminently State-made and it was governed by the interests of sovereign States, perceived as autonomous and independent bodies among themselves (Westphalian model). As a result, in compliance with the traditional public international law, if one starts from the assumption that on a given territory only one single sovereignty can be exercised (in other words that there can be only one supreme power), than the only alignments possible between States are those based on a system of co-ordination and co-operation.

On the contrary, the current international/supranational organisations generally rest on a very different structural principle: such organisations undoubtedly provide for a framework of practical co-operation, while formally leaving State sovereignty intact. This is what is meant by Article 2 of the Charter of the United Nations, which states: “The Organisation is based on the principle of the sovereign equality of all its members”. Nevertheless, it should be acknowledged that, in the scenario under examination here (eminently today’s European Union), identifiable with the so-called post-Westphalia world – a world in which the Nation State is no longer the unrivalled unit of political authority and in which national constitutional law and traditional international law, the juridical supports of the Westphalia system, are no longer the dominant forms of public law – some innovative conceptions of sovereignty are emerging and, in so doing, they are putting into being an enormous challenge in terms of reconceptualisation of the traditional legal categories.<sup>55</sup> Despite

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<sup>54</sup> Cfr. again C. SCHMITT, *Der Nomos der Erde im Völkerrecht des Jus Publicum Europaeum*, Greven Verlag, Köln, 1950; *Il nomos della terra nel diritto internazionale dello “jus publicum europaeum”*, Italian version edited by E. CASTRUCCI, Adelphi, Milano, 1991. In the Westphalian system, the sovereignty of nations expresses itself through the control of *geographical territory*. This was a legacy of the feudal principle “*null terre sans seigneur*”. Land was the principal factor of production in the feudal world and its control yielded both economic and political power. On the other hand, the key difference to the claim made in the multi-dimensional post-Westphalia order is that the boundaries are no longer purely *territorial*, but also *functional*. States in the age of “late sovereignty” still may make claims to territorial authority, but non-state polities typically make claims to authority bounded by territory and function. In other words, the political societies, which non-state polities claim to constitute, are no longer just territorial communities but also functional communities. See on this point, N. WALKER, *Late Sovereignty in the European Union*, in *Sovereignty in Transition*, Oxford, Hart Publishing, 2003, pp. 3-32.

<sup>55</sup> On this point, N. WALKER, *Flexibility within a Metaconstitutional Frame: Reflections on the future of Legal Authority in Europe*, Jean Monnet Working Paper, n. 12, 1999, Harvard Law School. See also, N. MAC CORMICK, *Sovereignty, Democracy, Subsidiarity*, *Rechtstheorie* 25 (1994), notably p. 290, where the author states that “Sovereignty and sovereign states, and the definition of law in terms of

of this challenge, however, sovereignty remains a useful legal concept, which continues to have practical consequences in structuring, from the national constitutional perspective, the relation between international organisations and national legal orders. In any case – as pointed out in the Introduction – it should be also acknowledged that its meaning and its importance have considerably varied over time, determining a kind of theoretical turnover with respect to the past.

At first sight, the extent of the afore-mentioned turnover can be perceived focusing on the developments occurred in the field of legal theory. In fact, it is worth remarking that, on the one hand, one of the main errors made in the past has consisted in transforming the Westphalia conception of State sovereignty, which was purely voluntary and contingent (and, moreover, elaborated for achieving practical-political aims), into an absolute legal principle. On the other hand, if one starts from the *a priori* assumption that national sovereignty is unassailable (since the only conceivable bearer is a Nation State, *superiorem non recognoscens*), there can be no possibility of explaining the kind of international relations, real as they are, which develop when the possibility of a division and a “refashioning of sovereignty” is admitted.<sup>56</sup> Yet, as soon as the latter hypothesis is accepted, entirely new structural alignments become possible. Alignments built upon a refashioning of sovereignties permit variations, both from the point of view of structure and of relationships (in terms of hierarchies or heterarchies), far more diverse than those possible under the international law of mere co-operation. Such a refashioning also depends on the nature of the prerogatives surrendered, on the methods of organising them in the context of a new complex and on the definition of the relationship of this complex with the residual sovereignties of the States.<sup>57</sup>

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sovereignty and the state, have been but passing phenomena of a few centuries (...) Despite present problems, Europe is the theatre within which we find the possibility of transcending these concepts”.

<sup>56</sup> For a further analysis on this point, see P. PESCATORE, *The Law of Integration. Emergence of a new Phenomenon in International Relations, based on the Experience of the European Communities*, A.W. Sijthoff, Leiden, 1974. See, in particular, Chapter II - *Refashioning of Sovereignties* – pp. 26 – 55.

<sup>57</sup> In this context, the need for new constitutional arrangements becomes more evident than ever, opening the door to the emergence of different kinds of polities. Thus, most of what is sketched out in the text can be explained by reference to the constitutional concept of federalism, considered as an attempt to give an answer to all the above-mentioned issues, throughout: the combination of variable constitutional choices, design, and institution-building to accommodate both the existing States and the trans-state linkages in a federalist manner. This is usually done by combining self-rules and shared-rules in such a way as to ensure that shared-rule will be confined only to those functions where it is absolutely necessary or clearly more useful to the polities and people involved. In this way federal principles represent an alternative to the modern idea of unassailable sovereignty, which is becoming

In addition, if one focuses on the historical experience of the post-1945 Western Europe, it may be observed that “a doctrinal compromise” emerged, a compromise that was common to various States, between the traditional concept of State sovereignty and the “new need of international co-operation and European integration”.<sup>58</sup> According to this doctrinal compromise, in order to connect different and multilayered levels (national/supranational/sub-national), it was admitted the possibility of a shared exercise of sovereign powers, which started to be dispersed not only horizontally – among the central institutions of the State (namely the legislative, the executive and the judiciary), but also vertically, allowing sub-national and supranational institutions to participate in the exercise of sovereign powers.<sup>59</sup> Through this way, the creation of the European Communities has brought about a genuine refashioning of sovereignties, a redistribution of functions in a complex transcending the individual Member States. In this new European context, States are no longer the sole locus of constitutional authority, but are now joined by other sites of constitutional authority, predominantly at the supra-state level, and the relationship between these State and non-State sites is better viewed as heterarchical rather than hierarchical.<sup>60</sup> As a result, the problem of integration has become a matter of defining spheres of competences and power relationships. With a view to the attainment of the

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obsolete. Nowadays, no State can claim to be the sole master of its own affairs. As a result of this process, the original federal conception of power sharing is becoming even more relevant than before. For a thorough development of these ideas, see D.J. ELAZAR, *Exploring federalism*, Tuscaloosa, University of Alabama Press, 1987; ID., *Constitutionalizing globalization: the postmodern revival of confederal arrangements*, Lanham, Rowman & Littlefield, 1998; K. LENAERTS, *Constitutionalism and the Many Faces of Federalism*, in *American Journal of Comparative Law*, Vol. 38, 1990, pp. 205-263.

<sup>58</sup> B. DE WITTE, *op. cit.*, 285.

<sup>59</sup> The European Court of Justice gave its first *imprimatur* to the above-mentioned theoretical construction in the well-known judgment *Costa v. ENEL* in 1964. In the course of its reasoning in favour of the primacy of Community law, the Court stated: “... by creating a Community of unlimited duration, having its own institutions, its own personality, its own legal capacity and capacity of representation on the international plane and, more particularly, real powers stemming from a limitation of sovereignty or a transfer of powers from the States to the Community, the Member States have limited their sovereign rights and have thus created a body of law which binds both their nationals and themselves” (See, case 6/64, 1964, ECR 585, at 593 – 594).

<sup>60</sup> N. WALKER, *Late Sovereignty in the European Union*, *op. cit.* This phenomenon called *constitutional pluralism* is also connected to the emergence of a strong globalization’s process, by virtue of which central governments have responded to globalisation by voluntarily shifting power upwards to supranational institutions, downwards to sub-national governments and sideways to market forces. The set up of the European Union is the best example of the upward shift. As authority shifts from national capitals to Brussels, Europe is experiencing a sort of “Reverse Westphalia” with the European Commission metaphorically assuming the role of a new “Holy Roman Emperor”. European law takes precedence over national law. European supranationality is extra-Westphalian especially given the fact that the Treaty of Rome, which is the juridical basis for European integration has no provisions for its own repeal and is legally a one-way street.

objectives laid down by the Treaties, a wide range of competences has been conferred upon the common institutions.

Conceptually, in order to grasp all the nuances of these phenomena, one should borne in mind that the problem under discussion here is not simply one of sharing powers, but one of relations of sovereignties. As a matter of fact, the present law of integration rests on a premise quite unknown to the so-called “classical” international public law, namely that of the divisibility of sovereignty. Moreover, if one considers more in detail the law of economic integration (built around the main task of the completion of the internal market)<sup>61</sup> and the recent developments introduced by the Single European Act and by the Treaty of European Union – establishing the Economic and Monetary Union,<sup>62</sup> the issue of the divisibility of sovereignty becomes even more significant, given that one of the most essential types of sovereign power – namely the control over monetary policy, the *ius cudendae monetae* – has been *tout court* transferred to the Community level, in the hands of a technocratic subject. It is surely true that the new “epistemic Community” embodied in the European Central Bank is supposed to be independent of the traditional Community political institutions, namely the Commission, Council and Parliament. Nevertheless, power over monetary policy is not something to be considered in isolation from the overall picture.<sup>63</sup> Instead, it is absolutely necessary to link it to the Community political level,

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<sup>61</sup> It should be highlighted that even the completion of the internal market of the European Union has also contributed to create a political dilemma for Western Europe, from which there is no easy escape. On the one hand, the capacity of Member States to shape their collective fate of their citizens by means of their own policies has been reduced. Aside from the factual constraints and limits to action generated by integration into the world economy and the globalisation of capital markets, the formal policy-making capacities of the Western Europe states have been limited by the guarantee of the four basic freedoms of movements within the internal market – of goods, persons, services, and capital. Thus, the European Nation States have less authority today than they did, for instance, twenty years ago for resolving economic or economically generated problems.

<sup>62</sup> In order to clarify the socio-political background that has led to the European Monetary Union, see, *inter alia*, K. DYSON, – K. FEATHERSTONE, *The Road to Maastricht. Negotiating Economic and Monetary Union*, Oxford University Press, 1999; B. EICHENGREEN – J. FRIEDEN – J. VON HAGEN (eds.), *Politics and Institutions in an Integrated Europe*, Springer – Verlag, Berlin, Heidelberg, 1995; K. GRETSCHMANN (ed.), *Economic and Monetary Union: Implications for National Policy-Makers*, Martinus Nijhoff Publishers, Dordrecht, Boston, London, 1993; R.S. MASERA and R. TRIFFIN, *Europe's Money. Problems of European Monetary Co-ordination and Integration*, Clarendon Press, Oxford, 1984; PADOA SCHIOPPA, TOMMASO, *The road to monetary union in Europe. The Emperor, the Kings, and the Genies*, Clarendon Press Oxford, 1994; T. RISSE, *To Euro or not to Euro? The EMU and Identity Politics in the European Union*, EUI Working Papers, RSC n. 98/9; A. SZÁSZ, *The Road to European Monetary Union*, Macmillan Press LTD, Basingstoke and London, 1999.

<sup>63</sup> The situation described in the text recalls old debates about the dialectic relationship involving the monetary and the political authorities. As already argued by G. BERTI, *Moneta e regime politico (a proposito del dibattito sulla banca centrale)*, in *Amministrare*, No. 1, 1986, p. 67: “nessuno di questi

since the ECB lies at the very heart of the European Union's temple, the first and central pillar that is entirely governed by primary Community law. This means that the surrender of monetary sovereignty from the national to the Community level needs to be appreciated within the variable structure and geometry of the EU,<sup>64</sup> having clear in mind that such a transfer of vital power does not remain without consequences for the overall institutional picture, as it inevitably diminishes the role of national governments to a remarkable degree.<sup>65</sup>

Another issue to be evaluated under the here adopted perspective is that the transfer of monetary power to the European level and the creation of a single common currency are also bound to produce significant psychological and symbolic consequences. Citizens of the Member States have perceived more readily the extent, importance and hopefully the value of European integration.<sup>66</sup> Thus, replacement of

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potrà mai affermarsi come produttore di potenza assoluta nei confronti dell'altro, e quindi il loro incontro non avviene mediante una tacitazione del conflitto ed il superamento in una diversa immagine di potere, o con l'utilizzo di figure artificiose, come fu in effetti quella dell'organo dello Stato persona, che voleva appunto coprire con una sintesi una contraddizione non superata". This view is shared by A. CHIRICO, *La sovranità monetaria fra ordine giuridico e processo economico*, CEDAM, Padova, 2003, p. 9, where it is argued that "le forze sovrane del presente (e fra di esse a pieno titolo la moneta – *rectius* – l'apparato istituzionale di governo della stessa) dovranno dunque convivere e convergere verso finalità comuni, onde nessuna potrà affermare un primato assoluto e prevaricare sulle altre".

<sup>64</sup> See J.A. USHER, *Variable Geometry or Concentric Circles: Patterns for the European Union*, ICLQ, Vol. 46, 1997, pp. 241-268.

<sup>65</sup> From an economic point of view, the most important cost implied in a monetary union, is the loss of an independently conducted monetary policy and, in particular, the loss of the nominal exchange rate as an instrument of adjustment on the national level. This has, of course, not only to do with the notion of national sovereignty but has also great relevance in an instrumental sense. Without the exchange rate instrument, a needed adjustment would have to be carried out entirely by domestic policy changes, in particular in fiscal and wage policy. The literature on this point is absolutely huge. It should be worth recalling, *inter alia*, H. UNGERER, *European Monetary Union: Chances – Risks – Alternatives*, in J. MONAR, W. UNGERER and W. WESSELS, *The Maastricht Treaty On European Union. Legal Complexity and Political Dynamic*, European Interuniversity Press, Brussels, 1993; M. BUTI and A. SAPIR (eds.), *Economic Policy in EMU. A study by the European Commission Services*, Clarendon Press, Oxford, 1998.

<sup>66</sup> See G. KOENIG (ed.), *L'euro, vecteur d'identité européenne*, Observatoire des politiques économiques en Europe, Presses Universitaires de Strasbourg, Strasbourg, 2002. For some critical remarks on the symbolic value of the euro, cfr. B. THÈRET, *Une monnaie sans âme*, *Manière de voir* (Special Issue on *L'euro sans l'Europe*), No. 61, Janvier – Février 2002, p. 19, who minimises significantly the importance of the introduction of the single currency – explicitly defined as "monnaie fonctionnelle" – by stating: "On constatera d'abord que les eurobillets reflètent strictement la dynamique purement économique et financière qui est au principe de leur apparition. Ils exhibent une froide esthétique post-moderne de ponts, de portes ou fenêtres qu'on a pris soin d'épurer de tout trait permettant de les localiser, représentations qui cherchent exclusivement à symboliser la communication, l'ouverture et le passage des frontières. Aucun message écrit: la seule dénomination euro, et la sigle Banque centrale européenne (BCE) en diverses langues; aucun symbole, autre que géographique, de la Communauté européenne; aucune référence politique aux Pères fondateurs et à l'histoire; aucun emblème de garantie souveraine. On est en présence d'une monnaie purement fonctionnelle dans sa nudité économique, d'un simple instrument d'échange qui fait fi du passé et ne le

national currencies and coins by the Euro has represented an extremely meaningful symbol of Union integration.<sup>67</sup> For instance, the euro as legal tender is contributing to identify a different area of interests: the so-called euro-zone - on whose functional mechanisms the present work also aims to focus, within which the function of the single currency as unit of account can play a remarkable role in the development of a European identity “as the euro becomes a single language and a social link”.<sup>68</sup>

As a result of this empirical and theoretical revolution, in the name of a reconceptualisation of old conceptions, which may no longer be taken for granted, some authors have identified a new category: monetary sovereignty<sup>69</sup> (a concept which still needs to be tested), which is only partially related to the traditional meaning of the idea of sovereignty as a unitary and granitic category. This different type of sovereign power (which expresses itself in a very clearly defined area, determined by the specific function that it exercises, i. e. the conduct of monetary

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raccroche pas au futur, faute de pouvoir ou de vouloir s'appuyer sur des symboles communs aux différentes nations qui cherchent pourtant à s'unir. Sa seule dimension collective réside dans son nom: euro, évoquant l'Europe comme le franc évoque la France”.

<sup>67</sup> Nonetheless, as Charles Goodhart points out, in some circumstances one may assist to the public's deep felt concern for the national currency. For instance, the strength of the German public's concern for their currency can be considered legendary, partly because it represents for them a visible reaffirmation of sound finance and low inflation. This issue has been also epitomised in a quotation from the Archbishop of Canterbury, who on 15 February 1993, in an interview with the *Financial Times*, was reported as stating that he gives a general blessing to European integration, (but) draws the line at the idea of monetary union leading to the head of his Church disappearing from English pound notes. He is quoted, *verbatim*: “I want the Queen's head on the banknotes. The point about national identity is a very important one. For me being British is deeply important. I don't want to become French or German”. These words can well explain the above-mentioned concept of symbolism of currencies, well defined by C.A.E. GOODHART, *The Transition to EMU*, in M. ANDENAS, L. GORMLEY, C. HADJIMMANUIL and I. HARDEN (eds.), *European Economic and Monetary Union: The Institutional Framework*, Kluwer Law International, London - The Hague - Boston, 1997, p. 8.

<sup>68</sup> See again G. KOENIG (ed.), *L'euro, vecteur d'identité européenne*, Observatoire des politiques économiques en Europe, Presses Universitaires de Strasbourg, Strasbourg, 2002, p. 105. Cf. also J.-M. SERVET, *L'euro: fenêtres et ponts d'un nomadisme montaire*, in L. PASSERINI (ed.), *Figures d'Europe. Images and Myths of Europe*, P.I.E. Peter Lang, Bruxelles, 2003, pp. 127-145, where the author interestingly highlights that “le lien monétaire est à la fois: intime et individuel (...) et social (à travers la fonctionnalité des échanges et les relations de solidarité d'une part, et les relations de souveraineté impliquant l'Etat comme incarnation du collectif d'autre part). As a result, “le passage à l'euro peut être notamment un moment d'interrogations par les Européens sur leur rapport à la nationalité, à la citoyenneté européenne nouvelle en émergence et aux resurgences de citoyennetés locales alors que les formes institutionnelles de subsidiarité des processus de prise de décision sont en débat” (Ibidem, p. 138).

<sup>69</sup> See J.B. GOODMAN, *Monetary Sovereignty. The politics of central banking in Western Europe*, Ithaca, Cornell University, 1992; P. SAVONA, *La sovranità monetaria*, Buffetti Editore, Roma, 1975; L. BINI SMAGHI, *Monetary institutions and monetary sovereignty in the EMU*, in J. DRIFFILL and M. BEBER (eds.), *A currency for Europe. Currency as an Element of Division or Union of Europe*, Lothian Foundation Press, 1991, 262; R.S.J. MARTHA, *The Fund Agreement and the Surrender Of Monetary Sovereignty to the European Community*, (1993) CML Rev., 749.

policy) should explain why, in a European perspective, EMU has taken on so much importance.<sup>70</sup> In particular, the significance of EMU in the wider architecture of the European Union can be derived from the new role of currency and central banks,<sup>71</sup> which are fast becoming the holders of a specific form of sovereign power.<sup>72</sup> To borrow a very famous expression from Hans Kelsen, one could affirm that the present seat of sovereignty is now in their hands.<sup>73</sup>

Nonetheless, in order to counterbalance this last point, it must be borne in mind that, as a global trend, one may witness a decadence of central banking *tout court*, due to the fact that there is no more a strong link to the national authority of the State.<sup>74</sup> In

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<sup>70</sup> See, in this sense, A. VERDUN, *The Role of the Delors Committee in the Creation of EMU: An Epistemic community?*, EUI Working Paper RSC 98/44, notably p. 6: "The creation of EMU represented a major development in European integration and a substantial departure from formal national sovereignty over monetary policy and would likely affect adjacent policy areas".

<sup>71</sup> See A. CHIRICO, *La sovranità monetaria fra ordine giuridico e processo economico*, *op. cit.*, p. 16. "la crescita, in termini di immagine e di potere, delle banche centrali è da ricondurre al fatto che le stesse – in virtù della loro posizione giuridico-istituzionale – riassumono tutto ciò che allo stesso tempo dipende dalla circolazione monetaria e che influisce su questa circolazione. Le banche centrali rappresentano, infatti, il limite economico-finanziario della funzione di governo politico degli Stati" (...) "Al loro interno, inoltre, si verifica il più importante raccordo tra politica ed economia, dove le ragioni economiche, espresse in procedure monetarie e di regolazione del credito e del risparmio, si convertono in norme limite del potere politico, il quale non può, pertanto, espandere la sua autorità fino al punto da deteriorare l'equilibrio fondamentale di cui, verso l'interno e verso l'esterno, la banca centrale rimane custode". On the relationship between politics and economics in central banking see A. PREDIERI, *Euro, poliarchie democratiche e mercati monetari*, Giappichelli, Torino, 1998, notably at p. 254 where the author clearly states that "la banca centrale è un tecnico che non fa scelte neutrali, ma fa scelte politiche, usando strumenti politici di contenuto tecnico fuori dal modello lineare istituzionale, in una struttura complessa che corrisponde alle strutture profonde della società".

<sup>72</sup> The suggestive analysis made by Dyson *et al.*, who focus on the central bankers in the process leading up to EMU, and analyse why the central bankers were so successful in having the principle of central bank independence taken up in the Treaty should be remembered on this point. They point to the need to take into account the "powerful structural forces" which have shaped central bank performance. Their conclusion is that the crucial factor in explaining central banks' influence in the EMU process should be found in the "structural changes in the nature and structure of capitalism, notably the relationship between EC states and global financial markets and the phenomenon of inflation" (K. DYSON, K. FEATHERSTONE, & G. MICHALOPOULOS, *Strapped to the mast: EC central bankers between global financial markets and regional integration*, *Journal of European Public Policy*, 2 (3), 484).

<sup>73</sup> H. KELSEN, *Il problema della sovranità e la teoria del diritto internazionale*, Giuffrè, Milano, 1989, who – in the Italian edition by A. Carrino – suggestively speaks about "la dimora della sovranità" (p. 23).

<sup>74</sup> Until a relatively few years ago, Central Banks were regarded as an integral part of the Government's central policy-making machine. The expression, "the Monetary Authorities", was coined and used to describe the combined operations of the Central Banks and Treasury, under the political leadership of Chancellor/Treasurer and Prime Minister. The idea that a Central Bank might, or should, be independent of Central Government was simply not considered as a serious issue in most countries. Yet this is now an idea whose time has most certainly come. Central banks in a wide variety of countries, from Venezuela to Chile in South America, through South Africa to New Zealand, have already been given formal constitutional independence from the executive branch of government. Moreover, the statutes of the European Central Bank are closely modeled on those of the Bundesbank,

fact, only some national central banks, such as the Federal Reserve System in U.S. or some central banks groupings, like the ECB and the ESCB in Europe, are able to manage and exercise a real and effective power in terms of control and regulation of the supply of money.<sup>75</sup> Moreover, this power is not a totally discretionary one, since the globalisation process affects it. Having said that, it should be underlined in advance that, for various reasons that will be specified in the following chapters, this novel monetary power seems to be more constrained in the field of external monetary policy than in the field of the internal one, in consideration of the significant impact of the processes taking place in the globalised and even more integrated financial markets.<sup>76</sup> Nevertheless, also in the exercise of its internal competences (*forum*

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historically the most independent of all Central Banks. It should be also remembered that, according to the Maastricht's criteria, Member States of the European Union couldn't have participated in the final stage of EMU and joined the European System of Central Banks until these have been made independent from their executive Governments, no longer subservient and indeed even statutorily prevented from taking any instructions from Government. See, on this crucial point, C.A.E. GOODHART, *Central Bank Independence*, LSE Financial Markets Group, Special Paper Series, n. 57, November 1993; P. BRENTFORD, *Constitutional aspects of the independence of the European Central Bank*, in ICLQ, 47, 1998, pp. 75 - 116; F. BRUNI, *Central bank independence in the European Union*, in *Bank of Japan, Institute for monetary and economic studies*, 18, 1996; M. DEMERTZIS, A.H. HALLETT, N. VIEGI, *Independently Blue? Accountability and Independence in the New European Central Bank*, Centre for Economic Policy Research, Discussion Paper Series, 1842/1998; F. LIPPI, *Central Bank Independence, Targets and Credibility: Political Economic Aspects of Delegation Arrangements for Monetary Policy*, Edward Elgar, Cheltenham, UK – Northampton, MA, USA, 1999.

<sup>75</sup> This “decadence” of the traditional understanding of central banking can be due to the new attitude of establishing monetary unions (governed by different institutional arrangements) in order to counterbalance the forces of the globalisation process. These emerging forms of monetary unions among a group of independent countries, such as the EMU in the EC, or a monetary union among the members of a federal Nation such as the Canada, Germany or the United States have to deal with very peculiar problems. In fact, in order to reach stability and efficiency within their own structure, they require an arrangement to distribute the power over monetary policy between the centre and the individual members of the union itself. As a result, even in the absence of a central government, policy-makers in the monetary union will look at monetary policy from two different perspectives: a unified perspective, considering union-wide aggregates of output, employment and prices as relevant targets of union monetary policy, and a regional or national perspective taking regional or national aggregates as targets and making monetary policy actions dependent on regional or national idiosyncrasies. One important aspect of the central bank constitution (let's say in the post-Westphalian order) then is to define a balance between these two perspectives. For further developments of this argument, see J. VON HAGEN and R. SÜPPEL, *Central Bank Constitutions for Monetary Unions*, CEPR Discussion Paper n. 919, 1994. The authors establish an interesting connection between, on the one hand, the federal states which commonly seek a balance between regional and central interests by appointing representatives of the individual regions together with candidates chosen by the federal government to the central bank council, and, on the other hand, those monetary unions where no federal government exists, in which the central bank council includes country representatives and members chosen in a joint appointment procedure or otherwise representing a more global view of the union (notably the ESCB). In these cases, one can appreciate the institutional changes characterising these new forms of politics (some authors use to speak about “monetary federations”), which are slowly becoming the holders of a new, specific power in the framework of a supranational context.

<sup>76</sup> To fully appreciate the complex framework within which central banks are called to operate today, one may not disregard the crucial role played by financial markets as “formally non-institutionalised” counterparties. In fact, instead of moving toward a natural equilibrium, financial markets, left to their

*internum*), the ECB still has to take into account the policy of the Fed (or of other interlocutors) when it decides on the interest rate.

## 2) *Sovereignty in the EMU and Globalisation*

Sovereignty is typically discussed rather than defined.<sup>77</sup> However, it is still legitimate to affirm, as a starting point, that formal sovereignty – according to the classical model – is a legal concept implying supremacy within a territory and independence of outside authorities in the exercise of State power in every field, including the definition of the main guidelines in the conduct of economic and monetary policies, both internally and externally.

This provided, one should consider that in a world in which many circuits of power operate beyond the direct control of the sovereign State, a trend which is exacerbated by processes of globalisation or trans-nationalisation of productive forces, information exchange, political capacities, social identities etc., sovereignty figures lower and lower in the register of explanatory variables which may be invoked to make sense of that world. Moreover, the limitation of Nation States' political and legal frameworks in tackling phenomena arising from globalisation is increasingly

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own devices. are liable to go to extremes and eventually break down. As a result, they cannot be left to their own devices; they must be supervised, and to some extent, managed by the monetary authorities. As observed by G. SOROS, *On Globalization*, Public Affairs, New York, 2002, at p. 112, "whatever the theory, this fact has been recognised in practice. The history of financial markets has been punctuated by crises, and each crisis has led to an addition to the regulatory framework. This is how central banking and the regulation of financial markets have evolved over time".

<sup>77</sup> Generally speaking, on the one hand, internal or domestic sovereignty represents the working through of the claim to ultimate authority in the internal sphere; it entails the legitimisation of the state *vis-à-vis* competing domestic claimants. It conceptualises the state in the Weberian sense as having an effective monopoly of force over a territory and population, the undisputed right to determine the framework of rules, regulations and policies within a given territory and to govern accordingly. External sovereignty (or, in Krasner's words, international legal sovereignty), on the other hand, involves the basic principles on which modern international public law is based – the division of the political order into fixed, territorially defined, and mutually exclusive enclaves and mutual recognition that each state represents a specific society within an exclusive domain. See on this point, S.D. KRASNER, *Sovereignty: Organised Hypocrisy*, Princeton, Princeton University Press, 1999. An attempt to give a comprehensive definition of sovereignty, despite a fundamental skepticism, is given by N. WALKER, *Late Sovereignty in the European Union*, in *Sovereignty in Transition*, Oxford, Hart Publishing, 2003, p. 34, according to whom sovereignty is: "the discursive form in which a claim concerning the existence and character of a supreme ordering power for a particular polity is expressed, which supreme ordering power purports to establish and sustain the identity and status of the particular polity *qua* polity and to provide a continuing source and vehicle of ultimate authority for the juridical order of that polity".

evident. Of more consequence, reality is ahead of theory in that the transnational markets seem to sustain and develop themselves without having to refer their ordering to the constitutional organisation of the Nation State and to judiciary adjudication. The awareness of a commonalities of fears, like the uncertainty of risk and the growing complexity of transactions,<sup>78</sup> has led public authorities and also private parties to put together mechanisms of trust with a view to creating order and governance among themselves. In this context, the legal significance of relationships, which, for examples, range from relational contracting to complex associations, such as networks, should be established to a high degree. They represent a main source of the regulatory regimes that govern global economies.

In examining the impact of globalisation on State systems, one must analytically separate the constraints imposed on autonomy or effectiveness, from the effects on formal sovereignty. With this approach in mind, it is possible to single out the peculiar role exercised in the field of monetary policy within the framework of EMU. Given the fact that Europe is integrating around money in order to put into being and realise a monetary union (the so called euro area perceived, especially in its external dimension, as a competitor of US dollar and Japanese yen), the extent to which the surrender of monetary sovereignty from the national to the supranational level has affected the unitary concept of formal sovereignty becomes a key question

Hence, three sets of questions need to find an answer. First of all a twofold question, namely: is there really a new configuration of sovereign power (i.e. monetary sovereignty) with respect to the holistic Westphalian tradition, considering that this new, supranational and thus denationalised power finds its roots and its justification in something different from the traditional sources of democratic legitimacy? And why is this power supposed to be something unknown and to open the doors to an innovative conceptual dimension? Secondly, may one argue that this money-based sovereignty is a supreme, autonomous and self-contained power, considering that it expresses itself exclusively in a functionally defined field (that of monetary transactions within and around the euro area), which seems to be significantly detached from the influence of the political sovereignty of the Nation States? Finally, what is the institutional background against which it is operating?

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<sup>78</sup> See G. TEUBNER, "*Global Bukowina: Legal Pluralism in the World Society*", in G. TEUBNER (ed.), *Global Law Without a State*, Aldershot, Dartmouth, 1997, pp. 3-28.

Indeed, to detect the real content of this power, one should also pose another twofold question: who is the bearer of such a power and how significant are the functions and competences conferred upon this new subject?

To fully understand the extent of such questions, one should recall the already sketched issue of divisibility of sovereignty, assuming that sovereignty is no longer a holistic concept, but should instead be seen as an aggregation of different attributions and competences, now relocated at a non-State level. As a result, the original theory of sovereignty about the confluence and consolidation in the hands of a single entity of different attributions must now deal with a movement towards disaggregation and compartmentalisation. Consequently, in the current scenario, there is neither a formal legal unity which may embrace and give a single *corpus* to the various claims to authority previously unified under the label of State sovereignty, nor a conceptual confluence towards the reunification of different spheres of power.<sup>79</sup>

As a very first remark, it is worth noting that whole picture of the background scenario against which the revisited international public law has emerged is becoming even more multifaceted given the presence of new “actors” playing their role under the forces of globalisation.<sup>80</sup> These new actors are linked to each other by increasingly significant and overlapping interconnections: they are represented by international

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<sup>79</sup> For a more extensive elaboration of the concept of sovereignty as a holistic metaphor to make sense of the complex dynamic embracing various claims, which may be actually parceled out, see A. CHIRICO, *La sovranità monetaria fra ordine giuridico e processo economico*, CEDAM, Padova, 2003, pp. 6 and ff. Note that, according to this reconstruction, the idea of sovereignty “si rivela essere fittiziamente copertura unitaria sovrapposta ad una proliferazione disordinata d’impulsi e di energie” (...) “Ad una ricostruzione tetragona del concetto di sovranità parrebbe potersi meglio sostituire una ricostruzione fluida ed astrattamente capace di comprendere quell’esplosione di unità e di sottounità che si avventano simultaneamente in tutte le direzioni possibili”. This line of reasoning is based upon the reflections of G. ZAGREBELSKY, *Il diritto mite*, Einaudi, Torino, 1992 about the so-called “dogmatica fluida” to be applied to constitutional law.

<sup>80</sup> For this actor-centred approach see K. DYSON – K. FEATHERSTONE, *The Road to Maastricht. Negotiating Economic and Monetary Union*, Oxford University Press, 1999. In analysing the birth of the EMU, the authors focus on the role played by the actors (called “negotiators”), without ignoring the institutional background made up of constraints and conditioning influences which structured actors’ roles. Dyson and Featherstone highlight the circumstance that the whole picture has been deeply affected by reigning ideas of sound finances and money which helped to structure, inform and legitimise the ongoing process of building EMU and, at the same time, empowered some negotiators – notably central bankers – rather than others. “Their outlooks were shaped by the institutions in which they operated, by the informal rules governing their behaviour, and in particular by transnational fora like the EC Monetary Committee, the Committee of EC Central Bank Governors, and the management of the European Monetary System”. In this way, ideas of sound finances and money had become institutionalised at the European Level. Moreover the authors highlight how the role of currency policy has been transformed: “from the territorial control of money to strategic interaction of EC states with more powerful market actors; from authoritative action (symbolized by capital control) to a concern with credibility and reputation (symbolized by sound policies)”.

organisations, supranational institutions, as well as financial markets (according to neo-institutional theory)<sup>81</sup>, which operate on a global scale.<sup>82</sup> As a result, the above-mentioned entities have become accustomed to acting beyond the national boundaries, in accordance with the emergence of a global economy -institutionalised through global capital markets and globally integrated financial systems as well as through global trade and global production networks.<sup>83</sup> Furthermore, where markets and business escape national regulatory boundaries or rules of conduct, supranational governance institutions and collective actors have begun to institute common rules. These global institutions and actors are embodied in organisations such as the World

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<sup>81</sup> For the purpose of the present work, it is surely worth stressing the role of financial markets in the Euro-area, not only for a mere theoretical purpose, but also (and most notably) because the Eurosystem itself has an obvious interest in well functioning and efficient financial markets. This is due to the fact that financial markets are the conduits through which monetary policy decisions are channeled into the economy. Furthermore, the significance of the above-mentioned interest for the functioning of financial markets becomes evident in itself by bearing in mind that the economic activity in any market is so fundamentally based on money and credit that, if major disturbances hamper the ability of the financial system to fulfill effectively its basic functions, the whole economic system is affected. As a consequence, in a system as the Eurosystem, dealing with stability issues (in monetary market, bond market, stock market), it can be rightly argued that the market - seen as an institution in a very broad sense, plays a crucial role as mechanism which itself contributes to financial stability. See, on this point, C. NOYER, *The outlook from the euro area economy and its financial markets*, Speech delivered by C. Noyer, then Vice-President of the European Central bank, at the "Cérémonie de remise des Victoires des SICAV" in Paris on 24 February 2000, <http://www.ecb.int/key/00/sp000224en.htm>; R.N. MC CAULEY and W.R. WHITE, *The euro and European financial markets*, BIS Working Paper, n. 41, Basle, 1997; D. FOLKERTS-LANDAU and D.J. MATHIESON, *The European Monetary System in the context of the integration of European financial markets*, IMF Occasional Paper n. 66, Washington, 1989; W.R. WHITE, *Evolving international financial markets: some implications for central banks*, BIS Working Paper n. 66, Basle, 1999; J.A. FRANKEL, *Financial markets and monetary policy*, MIT Press, Cambridge, 1995; W.H. BUITER, G. CORSETTI and P.A. PESENTI, *Financial markets and European monetary co-operation: the lessons of the 1992-93 exchange rate mechanism crisis*, Cambridge University Press, Cambridge, 1998; H.J. JOHNSON, *Global financial institutions and markets*, Blackwell Publishers, Malden, MA, 1999; F.J. FABOZZI, F. MODIGLIANI and M.G. FERRI, *Foundations of financial markets and institutions*, Prentice-Hall, London, 1994; J. LEMMEN, *Integrating financial markets in the European Union*, Edward Elgar, Cheltenham, UK - Northampton, MA, USA, 1998. For an illuminating analysis of the philosophical implications of neo-institutional theory see B. LEONI, *Freedom and the Law*, 3<sup>rd</sup> edition, Liberty Fund, Indianapolis, 1991, who follows and develops the suggestions of the path traced by the thought of Friederich von Hayek.

<sup>82</sup> D.R. CAMERON, *Transnational relations and the development of European economic and monetary union*, in T. RISSE-KAPPEN (ed.), *Bringing Transnational Relations Back in Non-State Actors, Domestic Structures and International Institutions*, Cambridge, Cambridge University Press, 1995; A. VERDUN, *Europe's Struggle with the Global Political Economy. A study of How EMU is Perceived by Actors in the Policy-making Process in Britain, France and Germany*, Ph.D. Dissertation, European University Institute, Florence, 1995.

<sup>83</sup> On this point, cfr, *inter alia*, E.B. KAPSTEIN, *Governing the global economy. International finance and the State*, Harvard University Press, Cambridge, Massachusetts, 1994; L. BRITTAN, *Globalisation vs. Sovereignty? The European Response. The 1997 Rede Lecture and Related Speeches*, Cambridge University Press, 1998; R. AXTMANN (ed.), *Globalisation and Europe. Theoretical and Empirical Investigations*, Pinter, London-Washington, 1998; V. SCHMIDT, *Globalization, Europeanization and the Loss of National Autonomy and Control*, revised version of the paper prepared for a presentation at the American Political Science Association National Meeting, Boston MA, Sept. 3.06.1998.

Trade Organisation (WTO), that countries join; or the World Bank and the International Monetary Fund (IMF),<sup>84</sup> to which countries turn when in need. At this point, it is quite easy to understand why people are witnessing an extraordinary event: the rise of unknown configurations of power and authority,<sup>85</sup> which are affecting the traditional structure of sovereignty, especially in its external dimension.<sup>86</sup>

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<sup>84</sup> Among the other institutions which are most relevant in the international monetary sphere the International Monetary Fund has a fundamental role. Its membership includes all the European Member States; their National Central Banks act as agencies through which the Member States deal with the Fund. Much has been written about the International Monetary Fund and international balances of payments. In the framework of the present work one may attempt only some statements, not by going back to the Fund's founding, or by turning to the initial, often-quoted articles of the Bretton Woods' Agreement, or by turning to statements of its functions, and by reporting on numerous actions of the IMF, the extensions and evolution of its functions, and the case studies of those countries that have received assistance from the IMF. Rather than reviewing all this stuff, it might be interesting making a few general statements about the IMF's missions. To sum up, the significance of this international institution in the present monetary system can be highlighted focusing on the following aspects. First, it is worth recalling that the Fund was to make the old gold-flows mechanism of the interwar period work in the post-World War II world. It was to do so by smoothing out the otherwise harsher aspects of adjustments to payments imbalances (including current and capital accounts). In its early period needs for assistance included emergency needs, current account problems, seasonal difficulties, and assistance with internal stabilisation problems. Second, the Fund was to promote the avoidance of competitive exchange rate depreciation. Third, the Fund was to promote stability or equilibrium in the balance of payments, meaning roughly balance on trade (or current) account and balance below the line in the reserve account.

For a more detailed research on the connection existing between central banking and the "missions" of the IMF, see, *inter alia*, W. FRAZEN, *Central Banking, Crises, and Global Economy*, Praeger, Westport Connecticut, London, 2000; L. BINI SMAGHI and D. GROS, *Open Issues in European central banking*, Macmillan Press Ltd, Basingstoke and London, 2000. The recalled authors underline the circumstance that, in the present scenario (theoretically divided into three main currency areas), the introduction of the euro does not affect the legal position of national central banks *vis-à-vis* the IMF. From an economic point of view, however, all countries in the Euro-zone should now be treated equally. When the IMF needs liquidity in euro, it should obtain it from NCB's in fixed proportions. "In a longer term perspective, it would make sense to use capital shares in the ECB as the key. The claims on the IMF that appear on NCB's books should thus be proportional to their shares in the ECB. This would facilitate the complete pooling of the foreign reserves. This line of reasoning would also suggest that over time the relative quotas of member countries in the IMF should also be proportional to their capital shares in the Eurosystem" (Ibidem, p. 75).

<sup>85</sup> In a quite intriguing way, these new configurations of power and authority are defined as "Empire" by M. HARDT and A. NEGRI, *Impero. Il nuovo ordine della globalizzazione*, Rizzoli, Milano, 2002. The authors draw insightful conclusions with regard to sovereignty by arguing that "negli ultimi decenni abbiamo assistito a un'irresistibile e irreversibile globalizzazione degli scambi economici e culturali. Assieme al mercato mondiale e ai circuiti globali della produzione sono emersi un nuovo ordine globale, una nuova logica e una nuova struttura di potere: in breve, una nuova forma di sovranità. Di Fatto, l'Impero è il nuovo soggetto politico che regola gli scambi mondiali, il potere sovrano che governa il mondo". They also specify that "l'Impero non stabilisce alcun centro di potere e non poggia su confini e su barriere fisse. Si tratta di un apparato di potere decentrato e deterritorializzante che progressivamente incorpora l'intero spazio mondiale all'interno delle sue frontiere aperte e in continua espansione" (Ibidem, p. 13).

<sup>86</sup> "In the international trading system, the pressure of globalisation has led not only to liberalisation, but also to the creation of a supranational dimension in the dispute settlement mechanism. This is a fundamentally new development reflecting the fact that to accommodate globalisation it is necessary to create a degree of supranational decision-making which in turn, requires a shift in the way we conventionally think about national sovereignty and its external dimension" (Sir Leon BRITTON QC,

There is no doubt that the rapidly changing patterns of international economic relations are objectively having a deep impact on the meaning of government and governance and the traditional expressions of sovereignty. As a first consequence of this process, it seems to be unavoidable to look beyond the boundaries of the conventional understanding of sovereignty and accept that more flexible, complex and, above all, international political arrangements need to be found to answer the economic and political demands made by an increasingly integrated international economy. In accordance with this more flexible and multifaceted point of view, regional governance institutions and supranational actors are to be perceived as a concrete way in which national governments have sought to moderate the impact of global forces, and these too have enhanced Nation States' supranational authority and control in exchange for a decrease in national autonomy and control. Among these, the European Union is probably the most advanced, since its goals are much wider than, for instance, those of the North American Free Trade Association (NAFTA) which, with its objective of creating little more than a free trade zone, at best resembles the earliest incarnation of the EU in the EEC, but without the larger European ambitions or institutions.

Furthermore, the evolution of the international economy and the modern capitalist structures is leading to both the *spatial* and *sectoral* segmentation of market relations across national boundaries.<sup>87</sup> Small, specific and specialised groups of business communities are being established. It has to be specified that, for most European countries, such a complex process, implying so radical changes related to globalisation, cannot be considered apart from those related to the regionalization represented by European integration. For EU Member States, European integration (especially considered in the area of co-ordination of economic and monetary policy) has not been simply a force accompanying globalisation – either in the international financial markets, by promoting further liberalisation or in international trade by ensuring a progressive reduction in tariff and non-tariff barriers. It also has been a force in its own right, capable of countering some of the effects of globalisation. As a

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*Globalisation vs. Sovereignty? The European Response. The 1997 Rede Lecture and Related Speeches, op. cit., p. 14).*

<sup>87</sup> See R. BOYER and J.R. HOLLINGSWORTH, *From National Embeddedness to Spatial and Institutional Nestedness*, in R. BOYER and J.R. HOLLINGSWORTH (eds.), *Contemporary Capitalism: The Embeddedness of Institutions*, Cambridge, Cambridge University Press, 1997.

result, it seems legitimate to say that European integration does not simply add to the global a layer of Euro-specific financial market pressures and a set of Euro-generated competitive challenges. It also serves to contain these forces through the discipline of monetary integration and the economies of scale afforded by the Single Market.<sup>88</sup> As such, while Europeanisation has resulted in much greater losses in national autonomy and control for its Member States than other regional governance bodies have for theirs, it has also ensured much greater gains in shared supranational authority and control.<sup>89</sup>

Fundamentally, with globalisation, deregulation, and huge increase of financial markets, the context of operation of EC economic and monetary policies has been radically affected.<sup>90</sup> In particular, rising capital mobility had profound implications for the distribution of political power and for the exercise of State power. The main

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<sup>88</sup> It is extremely interesting reading what is affirmed in a 1989 brochure of the European Commission, in which the Commission described the European Monetary System as intended to achieve the following objectives: "To attain a zone of internal and external monetary stability in Europe (involving both low inflation and stable exchange rates); to provide the framework for improved economic policy co-operation between Member States...; to help to alleviate global monetary instability through common policies vis-à-vis third countries" (Emphasis added). Cfr. European Commission, *The EMS: Ten Years of Progress in European Monetary Co-operation 3*, EC Off'l Pub. Off. 1989.

<sup>89</sup> On this point see V. SCHMIDT, *Globalization, Europeanization and the Loss of National Autonomy and Control*, op. cit., and S. KOBRIN, *The Architecture of Globalization: State Sovereignty in a Networked Global Economy*, in J.H. DUNNING (ed.), *Governments, Globalization, and International Business*, Oxford University Press, Oxford, 1997, pp. 146–171.

<sup>90</sup> In discussing the changing context in which financial stability is pursued today in Europe, it is possible to identify (recalling an interesting distinction made by Tommaso Padoa Schioppa) four major transitions, which have not yet been completed and the full consequences of which are not always foreseeable: the transition from banking to finance, the transition from national to international finance, the transition from paper intensive processes to information technology, and the transition from command to market-friendly methods in public policies. In this context it is worth focusing – even if *incidenter tantum*, on the first issue: the transition from banking to finance, since it is strongly related to the matter of the present work, especially considering the crucial triangle state – market – currency. Thus, it should be remembered that, on the one hand, in continental Europe financial activity was fundamentally based on banks, which played a dominant role in channeling savings towards investments, while on the other hand, in the United States and in the United Kingdom financial markets were much more developed, but even there banks were considered to be the cornerstone of the financial system. Nowadays this is no longer the case. A growing portion of financial flows is currently channeled through markets, a growing share of financial assets consists in negotiable securities or non-banks perform contracts, a growing portion of financial activities. As a result, the theoretical distinction between the three traditional branches of finance – banking, securities and insurance – becomes increasingly blurring. On this point see V. CONTI and R. HAMAUI, (eds), *Financial markets liberalisation and the role of banks*, Cambridge University Press, Cambridge, 1993; R. PORTES, *Global financial markets and financial stability: Europe's role*, Centre for Economic Policy Research, Discussion Paper Series, n. 2298, 1999; M.P. TAYLOR (ed), *Money and financial markets*, Blackwell, London, 1991.

For a more detailed analysis of this complex issue, see, *inter alia*, T. PADOA SCHIOPPA, *The Eurosystem and financial stability*, Speech by T. Padoa Schioppa, Member of the Executive Board of the European Central Bank, at the Belgian Financial Forum, Brussels, 10 February 2000, <http://www.ecb.int/key/00/sp000210.htm>, notably p. 3.

beneficiaries of globalisation and deregulation were the owners and managers of financial assets and multinational firms with internationally diversified assets. As the main players in global financial markets, they accumulated new power to act as tough disciplinarians of inflationary tendencies. Thus globalisation constrained governments to prioritise price stability, to pursue policies based on the requirement of gaining the confidence of the markets, and to focus on market-based measures of performance. Furthermore, common exposure to the harsh disciplines of the global financial markets was important to facilitating an EMU agreement: it induced a process of economic convergence amongst the EC States. This convergence focused around lower inflation, budget deficits, public debt, and a long-term interest rate. They were recognised to be the precondition for stable exchange rates within the ERM and for a successful transition to EMU.<sup>91</sup>

Anyway, in order to draw a much more complete picture, it seems necessary to underline the fact that the idea of an Economic and Monetary Union in Western Europe is not such a recent invention, and, consequently, it is not simply related to the process of globalisation as a kind of direct effect due to a given cause. The Delors Plan and the subsequent implementation of the provisions on EMU in the Maastricht Treaty are rather “the realisation of a long lasting project which, in the form of the Werner Plan, already once before had begun to take concrete shape”.<sup>92</sup> Obviously, when the Treaty of Rome was written, policy-makers did not need to discuss the possibility of establishing a monetary union with a single currency because, at that

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<sup>91</sup> In this context, the significance of the role played by European central bankers in the construction of the EMU emerges. It has been argued that European central bankers helped to diffuse sound policy ideas already by the end of the 70s and the beginning of the 80s as a result of which the entire European policy elite basically agreed about a whole series of macroeconomics causal ideas at the end of the 80s. See, on this specific topic, M. MARCUSSEN, *Central Bankers, the Ideational Life-Cycle and the Social Construction of EMU*, EUI Working Paper, RSC n. 98/33.

<sup>92</sup> F. AMTENBRINK, *The Democratic Accountability of Central Banks. A Comparative Study of the European Central Bank*, Hart Publishing, Oxford, p. 111. The author recalls the circumstance that, even before that time, the co-ordination of economic and monetary policy had been the focus of Community activities. While the original EEC Treaty included provisions on economic policy co-ordination and balance of payments it hardly included any reference to monetary policy, with the exception of Article 104 EEC which called for the establishment of a Monetary Committee comprised of one representative of each central bank and representative of the Treasury of each Member State, as well as two representatives of the Commission. As part of the action programme for the second stage of Customs Union, a committee report in 1962 proposed the establishment of a committee comprised of the governors of the central banks of the Member States in order to exchange information and to consult on monetary matters relating to credit policies, the adjustment of exchange rates and the use of the International Monetary Fund by the Member States.

time, the Bretton Woods system of fixed exchange rates already existed.<sup>93</sup> Bretton Woods came to an end in 1972, but Europe still yearned for currency stability. So the Hanover Summit in 1988 appointed Jacques Delors to produce a report, in order to investigate the question of an economic and monetary union, with “the task of studying and proposing concrete stages leading toward this union”.<sup>94</sup> Furthermore, with a focus on the significance of the Delors Report, it is worth recalling that, within the framework of the ongoing process of European integration, the problem of a choice between the two options of an institutional versus market-led approaches to monetary union, even in consideration of the disquieting slow-down in further

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<sup>93</sup> It may be extremely interesting recalling, even if briefly, the global scenario existing after the Second World War, with a particular focus on the field of international monetary co-operation. At that time, in a climate of political unanimity, several systems were established to foster free and balanced world economy, the most important of which were the United Nations and what are referred to as Bretton Woods institutions, namely the International Monetary Fund and the World Bank. These Bretton Woods institutions were based on the ideas and lessons by John Maynard Keynes and aimed at creating rules for the international economic and monetary system, thereby creating, through international co-operation, stability in the relationships both among the industrialised countries and between the industrialised countries and the developing countries. The basic principles of this process were exchange rate stability in the form of fixed but manageable exchange rate, and the liberalisation of foreign trade and the movement of capital. In Europe the project aiming at integration also started after the Second World War, with the creation of the European Coal and Steel Community. The immediate goal of integration was to agree on the use of key raw materials, thus tying together, above all, the economies of France and Germany, so that the military conflicts could be prevented. This integration project, originally aiming at political goals, was mainly based on the initiative of Jean Monnet, and in the minds of many it already envisaged the far-reaching ultimate goal of a “United States of Europe”. The global system of fixed exchange rate collapsed at the beginning of the 1970s, due to heterogeneous economic developments and the lack of international co-operation and co-ordination of economic policies. Thus sovereign states followed the principle of pursuing their own national interests, although they did participate in co-ordination efforts in different international forums. In an environment where international trade and especially movement of capital were being deregulated, an economic policy stance based on purely domestic conditions can not, however, be consistent with a system of fixed exchange rates. Despite the collapse of the base that the stability of the exchange rates constituted, the IMF has supported efforts to achieve freer trade, freer movements of capital and better co-ordination of economic policies at the international level.

The integration process in Europe has, instead, been on a constantly rising and strengthening trend. The originally mainly political goals have been united with the aims of improving international competitiveness and preventing so-called eurosclerosis. The deepening of integration in Europe increased further as a result of the economic experience in the 1970s and 1980s. “Upon the liberalisation of the movement of capital, the independent economic policies of sovereign national states, together with the fact that monetary policy was combining growth and employment targets, created economic disturbances and considerable interest rate and exchange rate fluctuations. These experiences increased the support for fixed exchange rate within the Community”. Price stability was acknowledged as the primary objective of monetary policy and the independence of monetary policy was regarded as imperative to achieve this stability. (For the quotation, see S. HÄMÄLÄINEN, *Euro, European Integration and World Economy*, Speech delivered by Ms Sirkka Hämäläinen, Member of the Executive Board of the ECB, Turku School of Economics and Business Administration, 50<sup>th</sup> Anniversary, Turku, 17 March 2000, [http://www.ecb.int/key/00/sp000317\\_1en.htm](http://www.ecb.int/key/00/sp000317_1en.htm), p. 2).

<sup>94</sup> Conclusions of the European Council of the Heads of States and Government on 27<sup>th</sup> and 28<sup>th</sup> June, 1988 at Hanover, in *Europa-Archiv*, n. 16, 1988, p. D445.

political integration, was seriously taken into account at the institutional level.<sup>95</sup> The Delors Report and the Maastricht Treaty solved the problem, setting out the creation of an Economic and Monetary Union and a single currency area, which can be legitimately considered as the main engine propelling the Member States towards an ever-closer Union.

Indeed, the approach taken with EMU comprises elements of both co-ordination of national policies and the formulation of Community policies. On the one hand, the Economic Union is characterised by a close co-ordination of the Member States' economic policies on the basis of general guidelines defined by the Council of the EU, and includes surveillance and enforcement mechanisms to ensure the lasting convergence of the national economies. On the other, the Monetary Union is characterised by the transfer/conferral of authority over monetary policy from the level of the Member States to the European level and the ESCB because, unlike the case of economic policy, the continued conduct of separate monetary policies by the Member States in a single currency area was considered not only inconvenient, but also practically impossible, because, with different interest rates set by different central banks in different countries, the movements of capital would have been tremendously caotic and difficult to be monitored.

Nevertheless, despite of such architecture, the pillar of Monetary Union – with its focus on the single currency – has been enhanced much more than the other

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<sup>95</sup> The Delors Report and the Maastricht Treaty were based on the premise that EMU was to be constituted through a new monetary institution. This approach has been contested by some economists, who have argued that competition should also extend to the choice of currencies, and by the UK government, which argued that only competition between national monetary policies could ensure lasting price stability. It should be noted that, according to the Delors report, Economic and Monetary Union implied the need for a transfer of decision-making power from Member States to the Community as a whole in the fields of monetary policy and macroeconomic management. "A Monetary Union would require a single monetary policy and responsibility for the formulation of this policy would consequently have to be vested in one decision-making body. In the economic field a wide range of decision would remain the preserve of national and regional authorities. However such decisions would have to be placed within an agreed macroeconomic framework and be subject to binding procedures and rules. This would permit the determination of an overall policy stance for the Community as a whole, avoid unsustainable differences between individual member countries in public sector borrowing requirements and place binding constraints on the size and the financing of budget deficits". "Economic and Monetary Union form two integral parts of a single whole and would therefore have to be implemented in parallel".

This is to clarify that the report rejected the view that Monetary Union without Economic Union might be sufficient, due to market forces, provided that misbehaving authorities were not bailed out when in difficulty: The constraints imposed by market forces might either be too slow and weak or too sudden and disruptive. Hence countries would have to accept that sharing a common market and a single currency area imposed policy constraints (Cfr. Report on Economic and Monetary Union in the European Community, 1989, notably paragraph 19, 21, 30, 32).

segment, which EMU is composed of. Thus, Europe is integrating around money, as a consequence of the fact that “European monetary union means a common currency: the euro”.<sup>96</sup> In fact, if one assumes that the principal features of a monetary union are the complete liberalisation of capital transactions and a full integration of banking and other financial markets, together with the elimination of margins of currency fluctuation and the irrevocable locking of exchange rate parities, the significance of money in this context turns to be self-evident and absolutely clear. In particular, given the present monetary system set out by the Maastricht Treaty, EMU has led to a fully operational monetary union as soon as the Euro has replaced national currencies in the year 2002.<sup>97</sup> During the intermediate phase (between 1999 and 2002) the Euro has been mainly used among banks and for marketable government debt held in financial markets. This implies that national currencies have retained their identity for consumers until 1 January 2002, but also that in the meantime national currencies and the Euro have been becoming perfect substitutes for each other at the wholesale level.<sup>98</sup> The key to this is that the Euro and national currencies are considered as legally equivalent at the conversion (and not exchange) rates fixed at the start of the Third Stage in 1999. For instance, national payments systems are now linked to each other via a new system, called TARGET – an acronym standing for Trans-european Automated Real-time Gross-settlement Express Transfer system, which is used by the ECB to execute its monetary policy directly into Euro. Such a payment system is composed of two different, interconnected parts (one real-time gross settlement

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<sup>96</sup> D. GROS and N. THYGESEN, *European Monetary Integration*, 2<sup>nd</sup> edition, Longman, New York, 1998, 263.

<sup>97</sup> See Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro, which provides that: (i) from 1 January 1999, the currency of participating Member States will be the euro; (ii) there will be a transitional period from 1 January 1999 to 31 December 2001, during which economic agents will be free to use the euro, but will not be compelled to do so. Euro notes and coins will not be available until 1 January 2002.

<sup>98</sup> To be more precise, it is worth pointing out that the irrevocable fixing of the exchange rates between the eleven members states of the EU participating in the first wave of the single currency took place on 1 January 1999 following upon the adoption by the Ecofin of Council Regulation 2866/98 of 31 December 1998 on the conversion rates between the euro and the other currencies of the Member States adopting the euro. Greece joined the euro area only in 2001 by virtue of the adoption of Council Decision 2000/427/EC of 19 June 2000 in accordance with Article 122.2 EC Treaty on the adoption by Greece of the single currency on 1 January 2001. The remaining Member States and their central banks are in a quite peculiar position as regards the euro; while still being full EU members, they do not participate in a key area of EC policy. The euro notes and coins started to circulate in the euro-zone on 1 January 2002 and by July 2002 the national banknotes and coins in the euro-zone countries were withdrawn from circulation. So the euro was born on 1 January 1999 for eleven, then twelve of the fifteen Member States of the EU. The Governing Council of the ECB now controls interest rates, money supply and exchange rate policy for the 12 countries of the euro-zone.

(RTGS) system operating in each Member State plus the ECB payment mechanism (EPM), thus providing for the link-up of national interbank large-value payment systems. In particular, the common infrastructure/platform allows interbank large-value transactions to be settled through the ESCB. Notably, both domestic and cross-border transfers can be channelled through it. In this way, EMU is now able to transform all the intra-EU transactions into domestic operations. This circumstance represents a remarkable advantage in terms of internal economic costs and, above all, allows EMU to present itself with a potential for a single voice on the international arena.<sup>99</sup>

### ***3) The link between Money and Sovereignty: the chartalist or State money approach***

Before considering the issues related to the concept of monetary sovereignty as such in the EMU, it is worth taking into account the significance of the role played by money in connection to the Nation State in the early Westphalian model as described above. The chartalist or State money approach – which explains the link between money and sovereignty in the Westphalian scenario - can be traced from Adam Smith through to John Maynard Keynes. In this approach, money is a creature of the State. The State defines money as that which it accepts at public pay offices, mainly in payment of taxes.<sup>100</sup>

According to Smith, as long as paper money is redeemed on demand for gold (or silver), it circulates at par with the gold coin. “Whatever is either bought or sold for such paper, must necessarily be bought or sold as cheap as it could have been for gold and silver”.<sup>101</sup> If paper money is not redeemable on demand, then it may

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<sup>99</sup> For a more detailed analysis of these issues, see P. TEMPERTON (ed.), *The euro*, John Wiley & Sons, Baffins Lane, Chichester, 1997. It is worth recalling, in particular, the sections dedicated to *The Foreign Exchange Market* (pp. 129 *et seq.*) and to *The Euro and Financial Markets* (pp. 211 *et seq.*).

<sup>100</sup> For an investigation of the role and the meaning of money, namely as a conventional medium of exchange, means of payment and store of abstract value, money of account, see G. INGHAM, “*Babylonian madness*”: *on the historical and sociological origins of money*, in J. SMITHIN, *What is Money*, Routledge, London and New York, 2000, pp. 16 – 41. To develop such an investigation, see also B. DAVIES, *Maastricht and the Meaning of Money*, E & M Books, London, 1998.

<sup>101</sup> A. SMITH, *An Inquiry into the Nature and Causes of the Wealth of the Nations* (1776), New York, Modern Library, 1937, p. 308.

circulate at a discount. An essentially non-redeemable paper money could actually circulate above par even under a gold standard if it were legally required by the state in payment of taxes, and if the quantity issued were kept somewhat below what could easily be employed in this manner. According to Smith, the key is not really redeemability, nor is it legal tender laws that attempt to render their paper of equal value with gold and silver. It is the acceptance of the paper money in payment of taxes and the restriction of the issue in relation to the total tax liability that gives value to the paper money. Importantly, Smith recognised that this paper money need not to be government fiat currency, for his argument was predicated upon the recognition that paper money is the liability of the banking system. All that mattered was that the state accepted these banknotes in payment of taxes, in which case they could circulate at par, or even at a premium, relative to coinage.

Georg Friedrich Knapp put forward a *State theory of money* similar to, but more general than, what is known as the chartalist approach. This approach is opposed to the metallist view, according to which the value of money derives from the value of the metal standard (e.g. gold or silver) adopted. More generally, according to Knapp, metallists try to deduce the monetary system without the idea of a State. This, he believes, is “absurd” because “the money of a State is that which is accepted at the public pay offices”.<sup>102</sup> According to Knapp, debts are expressed in a unit of value, the unit in which the amount of the payment is expressed and discharged with means of payment, a movable thing that has the legal property of being the bearer of units of value. What then determines which things will act as means of payment to discharge debts? Knapp notices that means of payment are occasionally changed, so that sometimes one type of material will cease to be accepted and another suddenly takes its place. Therefore, while the means of payment may be a definite material, it is not bound to any material: validity by proclamation can occur with the most precious or the basest metals. The fundamental insight here was the recognition that these transactions always require that the State announce a conversion rate (say, so many ounces of gold for so many ounces of silver). The debts were always nominal and were never actually metallic. All debts are converted to the new metal, which proves that all units of account must be nominal. Hence the names chartalist, and more

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<sup>102</sup> See G.F. KNAPP, *The State Theory of Money* (1924), Clifton, Augustus M. Kelley, 1973, p. vii-viii.

specifically, State theory of money, since the proclamation is made by the State.<sup>103</sup> In any case, money always signifies a Chartal means of payment. Every means of payment we call money: the definition of money is therefore a Chartal means of payment. Moreover, chartalism is often identified with the proposition that legal tender laws determine that which must be accepted as means of payment. However Knapp's analysis went further:

“If we have already declared in the beginning that money is a creation of law, this is not to be interpreted in the narrower sense that it is a creation of jurisprudence, but in the larger sense that it is a creation of the legislative activity of the State, a creation of legislative policy”.<sup>104</sup>

And then, what is the nature of this legislative activity that determines what will be the chartalist money accepted within the jurisdiction of the state?

“What forms part of the monetary system of the State and what does not? We must not make our definition too narrow. The criterion cannot be that the money is issued by the State, for that would exclude kinds of money that are of the highest importance; I refer to banknotes: they are not issued by the State, but they form a part of its monetary system. Nor can legal tender be taken as a test, for in monetary systems there are very frequently kinds of money that are not legal tender. We keep most closely to the facts if we take as our test that the money is accepted in payments made to the State's offices. Then all means by which a payment can be made to the State form part of the monetary system. On this basis it is not the issue, but the *acceptation*, as we call it, which is decisive. State acceptance delimits the monetary system. By the expression “State acceptance” is to be understood only the acceptance at State pay offices where the State is the recipient”.<sup>105</sup>

Knapp extended his analysis to include bank money affirming that:

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<sup>103</sup> In Knapp's view, a chartal money is a pay-token. “When we give up our coats in the cloak room of a theatre, we receive a tin disc of a given seize bearing a sign, perhaps a number. There is nothing more on it, but this ticket or mark has legal significance it is a proof that I am entitled to demand the return of my coat. The “ticket” is then a good expression for a movable, shaped object bearing signs, to which legal ordinance gives a use independent of its material. Our means of payment, then, whether coins or warrants, possess the above-mentioned qualities: they are pay-tokens, or tickets used as means of payment. Perhaps the Latin word Charta can bear the sense of ticket or token and we can form a new but intelligible adjective “Chartal”. Our means of payment have this token or Chartal form. Among civilised peoples in our days, payments can only be made with pay-tickets or Chartal pieces”. (See Knapp. *op. cit.*, p. 31).

<sup>104</sup> G.F. KNAPP, *op. cit.*, p. 40.

<sup>105</sup> *Ibidem*, p. 95.

“The bank makes notes and offer them in payment to its customers. Issuing notes is not a special business, but a special way in which the bank endeavours to make its payments. It tries to pay its own notes instead of in money issued by the State, because then with a comparatively small capital it can make greater profits than it otherwise could”.<sup>106</sup>

Acceptability of banknotes in private transactions is not then due to the bank promise to convert these to coinage. In other words, bank money did not derive its value from the gold reserves or specie coin into which it promised redemption. A banknote is a chartal document and the bank issuing it is pledged by law to accept it for a payment of that amount. Whether banknotes are convertible is irrelevant. An inconvertible banknote, then, is not a nullity, but has this in common with the convertible banknote, that it is a till-warrant of the bank. What is important is that the note is a private till-warrant available for payments to the bank, but clearly the customers of the bank can use it for payments between themselves, as they are sure it will be taken at the bank. These customers and the bank form, thus, a private pay community, the public pay community being the State.

What makes banknotes State money? According to Knapp, banknotes are not automatically money of the State, but they become so as soon as the State announces that it will receive them in epicentric payments (namely in payments to the State). If the State accepts notes in payment to the State, then the banknotes become “accessory” and the business of the bank is enhanced for now everybody is glad to take its banknotes since all inhabitants of the State have occasion to make epicentric payments (e.g. for taxes). States often required that banks make their notes convertible to state-issued money, one of the measures by means of which the State assures a superior position to the money which it issues itself, because if the State accepts banknotes in payment, but does not make payments in these banknotes, then the notes will be redeemed, leading to a drain of reserves.<sup>107</sup>

In times of distress, however (frequently during wars that required finance provided by the banks), governments would pass laws ending convertibility, announce that the State would henceforth make payments in terms of the banknotes, and thereby declare that the banknotes were *valuta* money (that is the money accepted by the State

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<sup>106</sup> Ibidem, p. 131.

<sup>107</sup> Note that indeed governments and central banks used redemption or the threat of redemption to discipline banks.

and in which the State makes payments, in which case it becomes the definitive or ultimate means of payment used even in the private pay community). Usually this was for one bank only, the bank which became the central bank.<sup>108</sup> Thus, through the action of the State paper money can become *valuta* money.<sup>109</sup> At this point we have a chartalist, inconvertible, paper money, as do all modern developed countries.

Keynes's account was quite similar. In fact, according to Keynes, the money of account is the primary concept of a theory of money. It comes into existence along with Debts, which are contracted for deferred payment, and Price-Lists, which are offers of contracts for sale or purchase. In turn, "money itself, namely that by delivery of which debt-contracts and price-contracts are discharged, and in the shape of which a store of General Purchasing Power is held, derives its character from its relationship to the Money-of-Account, since the debts and prices must first have been expressed in terms of the latter".<sup>110</sup> He further clarified the distinction between money and the money of account by saying that the money of account is the description or *title* and the money is the thing, which answers to the description.

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<sup>108</sup> Since their birth, the principal function of early central banks was to raise and advance money to governments. Some countries relied on an existing private bank for this purpose; others chartered a new State bank. In either case, the government of the day usually granted special legal treatment – often in the form of note-issuing privileges – in return for the bank's financial support. With time, this support for the government led to the bank's enjoying monopoly, either partial or complete, over note issue. Although the timing of the process varied across Europe, one bank in each country gradually acquired both the benefits and obligations of serving as banker to the government. This privileged position led to the development of strong ties between the central bank and the rest of the banking system. Other banks began to place a large proportion of their reserves on deposit at the central bank (since its notes were considered to be essentially guaranteed) and in times of financial difficulty, they came to rely on it to supply extra liquidity. The central bank thus became not only the government's bank but also the bankers' bank. In the process, it acquired responsibility for enforcing two requirements of the national credit system: maintenance of the convertibility of notes into gold or silver at fixed rates, and provision for a sufficiently supply of credit to meet the needs of the economy and to avoid bank failures.

Note that a debate over the proper role of central banks has persisted from their creation to the present days. Classic works on the topic include W. BAGEHOT, *Lombard Street*, 14<sup>th</sup> ed., London, John Murray, 1915; R.G. HAWTREY, *The Art of Central Banking*, London, Longmans, Green, 1932; V.C. SMITH, *The Rationale of Central Banking*, London, P.S. King, 1936. See also C.A.E. GOODHART, *The Evolution of Central Banks*, Cambridge, MIT Press, 1988; M.H. DE KOCK, *Central Banking*, 4<sup>th</sup> ed., London, Crosby, Lockwood Staples, 1974; J.B. GOODMAN, *Monetary Sovereignty: The Politics of Central Banking in Western Europe*, Ithaca and London, Cornell University Press, 1992.

<sup>109</sup> "At first banknotes and Treasury notes are employed only as accessory money. The mournful hour arrives when the State has to announce that it can no longer pay in the money that was till then *valuta* (say, coined gold) and that those warrants themselves are now *valuta*. (Knapp, *op. cit.*, p. 196).

<sup>110</sup> J.M. KEYNES, *A Treatise on Money* (1930), vol. I, *The Pure Theory of Money*, New York, Harcourt-Brace-Jovanovich, 1976, p. 3.

Following Knapp, Keynes argues that the State determines what serves as the money of account as well as dictates what thing will be accepted as money.<sup>111</sup>

The “Age of Chartalist or State Money” had been reached, when the state claimed the right not only to enforce the dictionary but also to write the dictionary of money.

Privately issued debt – such as that issued by banks – might be accepted in settlement of transaction even if it is not declared by the government to be money; it can circulate side by side with State money. However, the State might “use its chartalist prerogative to declare that the bank debt itself is an acceptable discharge of liability”.<sup>112</sup> Bank money then becomes a Representative Money.

According to Keynes, State money may take any of three forms: *Commodity Money*, *Fiat Money* and *Managed Money*, the last two being sub-species of *Representative Money*. Commodity money is defined as actual units of a particular freely obtainable, non-monopolised commodity, which happens to have been chosen for the familiar purposes of money. Fiat money is representative money, which is created and issued by the State, but is not convertible by law into anything other than itself, and has no fixed value in terms of an objective standard. This is distinguished from managed money, which is similar to Fiat Money, except that the State undertakes to manage the conditions of its issue in such a way that, by convertibility or otherwise, it shall have a determinant value in terms of an objective standard. Managed money is, according to Keynes, the most generalised form of money which can degenerate into Commodity Money on the one side when the managing authority holds against it a hundred per cent of the objective standard, so that it is in effect a warehouse warrant, and into Fiat Money on the other side when it loses its objective standard.

This being so, once it is recognised that the State can “write the dictionary”, it becomes obvious that the nominal value of a commodity (or managed) money cannot

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<sup>111</sup> “The State therefore comes in first of all as the authority of law which enforces the payment of the thing which corresponds to the name or description in the contracts. But it comes in doubly when, in addition, it claims the right to determine and declare what thing corresponds to the name, and to vary its declaration from time to time – when, that is to say, it claims the right to re-edit the dictionary. This right is claimed by all modern States and has been so claimed for some four thousand years at least” (Keynes, *op. cit.*, p. 4).

<sup>112</sup> *Ibidem*, p. 6.

be derived from the value of the objective standard. It is then a small step to a fiat money with no objective standard, because in all three cases the State determines the nominal value of money. This is done when the State establishes what it will accept at public pay offices, as well as the nominal value of the thing accepted.

Another author, Hyman Minsky, presented an interesting view of money that was based on the State money approach. He emphasised the endogeneity of money, that is the view that money is created during the normal processes of a capitalist economy, and is not created and dropped by helicopters (as in Milton Friedman's famous exogenous money story). For the most part, bank money is created as banks make loans.<sup>113</sup> A loan is nothing more than an agreement by a bank to make payments now on the basis of a promise of the borrower to pay later. "Loans represent payments by the bank made for business, households, and government in exchange for their promises to make payments to the bank at some future date".<sup>114</sup> All of this occurs on the balance sheets of banks; the money that is created by a bank is nothing more than a credit to another bank's balance sheet, given that as soon as the borrower spends the created money, a cheque drawn on the first bank is deposited with another. Thus, according to Minsky, there is a pyramid of liabilities with the liabilities of the Central Bank at the top. Bank liabilities are convertible on demand into central bank liabilities, which are used for interbank clearing (as well as for conversion of bank liabilities to cash held by the public, resulting in a net reserve drain).<sup>115</sup> Thus,

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<sup>113</sup> "Money is unique in that it is created in the act of financing by a bank and is destroyed as the commitments on debt instruments owned by banks are fulfilled. Because money is created and destroyed in the normal course of business, the amount outstanding is responsive to the demand of financing" (H. MINSKY, *Stabilizing an Unstable Economy*, New Haven, Yale University Press, 1986, p. 249).

<sup>114</sup> *Ibidem*, p. 230. Many authors have noted that from the early history of banking, the precursors of modern bankers, money lenders, goldsmiths, etc., discovered that they could virtually guarantee ready transformation (convertibility) back into gold, or legal tender fiat currency, of such currency placed with them, while only holding a relatively small proportion of currency reserves against their own note and deposit liabilities. So long as confidence in their ability to maintain convertibility continued, only a small proportion of their customers would be likely to want to withdraw their deposits or to redeem their notes on any one day, so only a relatively small reserve requirement would be needed to meet the occasional excesses of withdrawals over new deposits. The remainder of the currency that they attracted could be lent out to customers, thus gaining a return on the margin between the yield on the assets purchased and the various costs of inducing people to deposit their currency with them.

<sup>115</sup> "The payments banks make are to other banks, although they simultaneously charge the account of the customer. In the receiving bank, the payments are credited to a depositor's account. For member banks of the Federal Reserve System, the interbank payments lead to deposits shifting from the account of one bank to the account of another at Federal Reserve banks. For nonmember banks, another bank – called a correspondent – intervenes, so that the transfers at the Federal Reserve banks are for the account of the correspondents" (MINSKY, *op. cit.*, p. 230-231).

payments among banks occur on the balance sheet of the Fed as banks use “Fed money” (namely reserves) to settle net debits from their accounts. Whereas the public uses bank deposits as money, banks use Federal Reserve deposits as money. “This is the fundamental hierarchical property of our money and banking system”.<sup>116</sup> This is of course the same hierarchical arrangement noted by Knapp (in his public and private pay communities) and by Keynes.<sup>117</sup>

In an argument very similar to that put forward by Knapp, Minsky explained that people accept bank money mainly because they can use it to meet their own commitments to banks. Demand deposits have exchange value because a multitude of debtors to banks have outstanding debts that call for payment of demand deposits to banks. These debtors will work and sell goods or financial instruments to get demand deposits. In other words, bank money has (nominal) value precisely because it can be used to retire debts to banks, and is accepted at bank pay offices. The borrower retires his promise to the bank by delivering bank liabilities at the future date, and the need for bank liabilities in payment for goods and services delivered. Thus, rather than focusing on money as a medium of exchange, the focus is here on money as means of payment, to retire liabilities.

This led Minsky back to the Smith/Knapp recognition that taxes give value to money issued by the government. In fact he argues that: “In an economy where government debt is a major asset on the books of the deposit-issuing banks, the fact that taxes need to be paid gives value to the money of the economy. The need to pay

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<sup>116</sup> *Ibidem*, p. 231.

<sup>117</sup> Note that since the earlier part of the nineteenth century central banks, both in the United Kingdom and in the United States, customarily issued note as well as deposit liabilities. In the course of the nineteenth century, however, the ability of ordinary commercial banks to issue their own banknotes was first restricted (for example by the Peel’s Bank Charter Act of 1844), and then progressively abolished. There is no indication from the historical records that this was motivated by a desire on the part of the authorities to increase their revenue from seignorage by monopolising the issue of currency, though the issue was unlikely to arise in any case under the gold-standard conditions. Instead, the main objective was to strengthen the power of the Central Bank to control monetary conditions within the economy. So long as private banknotes could be freely substituted for state (or Central Bank) issued currency, the Central Bank would have difficulty in restraining monetary expansion during booms, and holders of both the note and deposit liabilities of private banks would be the more likely to be injured by defaults when the boom broke. The solution to this problem was to prohibit commercial banks from competing freely with the Central Bank in the provision of notes, and to require then holding a prudential reserve of currency and deposits with the Central Bank against their deposit liabilities. These bank deposit liabilities are close substitutes for currency in many, or most, circumstances, but by this means the Central Bank enhanced its power to control the growth of such substitutes. For a further explanation of the hierarchical position of the central banks within the banking system of the state, see C.A.E. GOODHART, *Money, Information and Uncertainty*, London and Basingstoke, The Macmillan Press Ltd, 1975.

taxes means that people work and produce in order to get that in which taxes can be paid".<sup>118</sup>

To sum up, the present overview on the chartalist approach to money clearly highlights the persistent link between money and State's power. These two go hand in hand, with the significant implication that, as soon as one of them is affected by a structural modification, the other is necessarily supposed to change.<sup>119</sup> This is in fact what is happening with the experience of a monetary union in Europe, where – especially if one accepts the controversial idea of the existence of a monetary federation<sup>120</sup> – the chartalist approach may find a new and rich ground for application.

#### ***4) Is Monetary Sovereignty a new sub-category of Sovereignty within the sector of EMU? What's its meaning?***

A key issue in recent debates about monetary unions, currency boards, and official dollarisation is indeed monetary sovereignty.<sup>121</sup> A frequent objection to the

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<sup>118</sup> H. MINSKY, *op. cit.*, p. 231.

<sup>119</sup> This is the view of P. SAVONA, *La sovranità monetaria*, Buffetti Editore, Roma, 1975.

<sup>120</sup> This idea is supported by different scholars among which one may recall F. MERUSI, *Governo della moneta e indipendenza della banca centrale nella federazione monetaria dell'Europa*, in *Il Diritto dell'Unione Europea*, No. 1-2, 1997, pp. 89-115 and S. ORTINO, *Introduzione al diritto costituzionale federativo*, UTET, Torino, 1993.

<sup>121</sup> It should be specified, for the sake of clarity, that a monetary union may be defined as a group of two or more States sharing a common currency or equivalent. Although some sources extend the definition to include the monetary regimes of national federations such as the United States or of imperial agglomerations such as the old Austro-Hungarian Empire, the conventional practice is to limit the term to agreements among units that are recognised as fully sovereign States under international law. The antithesis of a monetary union, of course, is a national currency with an independent central bank and a floating exchange rate. In the strictest sense of the term, monetary union means complete abandonment of separate national currencies and full centralisation of monetary authority in a single joint institution. In reality, considerable leeway exists for variations of design along two key dimensions. These dimensions are institutional provisions for (1) the issuing of currency and (2) the management of decisions. Currencies may continue to be issued by individual governments, tied together in an exchange-rate union. Alternatively, currencies may be replaced not by a joint currency but rather by the money of a larger partner – an arrangement generally labeled dollarisation after the United States dollar, the money that is most widely used for this purpose. Similarly, monetary authority may continue to be exercised in some degree by individual governments or, alternatively, may be delegated not to a joint institution but rather to a single partner such as the U.S. Moreover, in political terms, monetary sovereignty may be divided into two categories, depending on whether national monetary sovereignty is shared or surrendered. Unions based on a joint currency or an exchange rate union in effect pool monetary authority to some degree. They are a form of partnership or alliance of nominal equals. Unions created by dollarisation are more hierarchical, a subordinate follower-leader type of regime.

replacement of a national central bank with any of these rival monetary systems is that doing so would reduce national monetary sovereignty and, by extension, national political sovereignty.

Surprisingly, though, despite the growing interest in all these monetary issues, the idea of monetary sovereignty as such has rarely received thorough examination. The great majority of writers who invoke it simply assume it is desirable. In a discussion on exchange rate policies, for instance, the Nobel Prize-winning economist James Tobin has remarked that “while globalisation of financial markets (...) has contributed importantly to the economic progress of developing and emerging economies and can continue to do so, these trends also threaten the monetary sovereignty of those countries”.<sup>122</sup> Tobin and others never define what they mean by monetary sovereignty, nor do they examine the possibility that, for many countries, less monetary sovereignty may bring more economic progress.

Generally speaking, it should be recognised that the idea of monetary sovereignty involves elements of economics, law, and politics. Perhaps, given the difficulties of untangling these elements, those who discuss monetary sovereignty never define it explicitly, though they often talk around the subject informatively.<sup>123</sup> Writings that use terms that might be considered synonyms for monetary sovereignty, such as monetary autonomy and monetary policy independence are generally not relevant. They focus on aspects of the debate over fixed versus floating exchange rates or the degree to which central banks are insulated from political pressures – issues that are only peripheral to discussion of monetary sovereignty.

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<sup>122</sup> J. TOBIN, *Financial Globalization: Can National Currencies Survive?*, Paper prepared for the Annual World Bank Conference on Development Economics, April 20-21, 1998, available at <http://www.worldbank.org>

<sup>123</sup> A number of books and essays by economists and lawyers containing the phrase “monetary sovereignty” in their titles never define it (see, to name but few, P.B. CLARK and G. GRUBEL, *National Monetary Sovereignty under Different Exchange Rate Regimes*, in *The Bulletin*, New York University Graduate School of Business Administration, Institute of Finance, No. 78-79, January 1972; J.B. GOODMAN, *Monetary Sovereignty: The Politics of Central Banking in Western Europe*, Ithaca, New York, Cornell University Press, 1992; D. CARREAU, *Souveraineté et coopération monétaire internationale*, Cujas, Paris, 1970; P. SAVONA, *Alla Ricerca della Sovranità Monetaria. Brve storia della finanza straniera in Italia*, Libri Scheiwiller, Milano, 2000). Nor do legal scholars who discuss the scope of the sovereign’s power over the monetary system (see, for instance, F.A. MANN, *The Legal Aspect of Money*, 5<sup>th</sup> edition, Oxford, Clarendon Press, 1992 and A. NUSSBAUM, *Money in the Law*, Chicago, Foundation Press, 1939).

According to a wide-ranging though not exhaustive search for discussions of monetary sovereignty only four authors who have defined what they mean by monetary sovereignty have been found.<sup>124</sup>

The American economist Kenneth Kurihara wrote: “Monetary sovereignty is an attempt to insulate the domestic economy from the adverse repercussions of a depression elsewhere”.<sup>125</sup> Such a definition was suited to Kurihara’s specific purpose – a review of national monetary policies and international monetary co-operation from the 1920s to the 1940s – but it seems too narrow to be a general definition. People think of monetary sovereignty as having economic and political benefits outside of periods of depression. The Dutch lawyer and government official Rutsel Martha, in fact, gives a broader definition: “Monetary sovereignty refers to a State’s undeniable power, recognised by international law, to regulate its own currency, i.e. the power to issue and designate money with legal tender character, to impose exchange control and exchange restrictions and to select the mechanisms through which the internal and external value of the money is determined and maintained”.<sup>126</sup> Similarly, the Yugoslav economist and government official Dorde Dukic writes: “Monetary sovereignty in its contemporary sense signifies a sovereign right of a State to regulate all matters dealing with money issue and the conduct of monetary policy by the central bank with the purpose of achieving the projected economic policy targets”.<sup>127</sup> Finally the Nobel Prize-winning Canadian economist Robert Mundell says: “Monetary sovereignty can be broken into three parts: (a) the right to determine what constitutes the unit of account, the commodity or token in which price lists are specified; (b) the right to determine the means of payment – legal tender of the discharge of debt; and (c) the right to produce money or else determine the conditions under which it is produced by others”.<sup>128</sup>

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<sup>124</sup> See K. SCHULER, *What use is Monetary Sovereignty?*, available at <http://users.erols.com/kurrency/monsov/htm>

<sup>125</sup> K. KURIHARA, *Towards a new Theory of Monetary Sovereignty*, *Journal of Political Economy*, No. 57, 2, April 1949, p. 165.

<sup>126</sup> R.S. MARTHA, *The Fund Agreement and the Surrender of Monetary Sovereignty to the European Community*, *Common Market Law Review* 30, 4, August 1993, p. 752.

<sup>127</sup> D. DUKIC, *Monetary Sovereignty – Some Theoretical and Empirical Considerations*, *Development and International Co-operation*, vol. 11, No. 21-1, June-December 1995, p. 226.

<sup>128</sup> R. MUNDELL, *Money and the Sovereign State*, Paper prepared for the International Economic Association Conference, Trento, Italy, September 4-7, 1997, p. 14.

From these definitions it can be rightly deduced that monetary sovereignty is a legitimate exercise of authority by the national government, not an illegitimate exercise of raw power that must merely be endured. Monetary sovereignty is recognised as legitimate both internally and externally. If people thought of a national currency as a matter of indifference or as illegitimate, losing monetary sovereignty would not be controversial.

In the Westphalian State monetary sovereignty belongs with the national government rather than any higher or lower level of government, or any body other than the government. The national government has for a few centuries been the most important source of power. Sub national governments derive their powers from national governments, while international arrangements exist by the consent of the national governments involved. One reason for the primacy of national governments is precisely that for ages they have monopolised the power to issue currencies.

Another point to be underlined is that people think of monetary sovereignty as resting with national governments rather than individuals. According to this viewpoint, which is well entrenched in national and international law, individuals have no particular right in the sphere of money that they can assert to block the government's pursuit of its goals. Assets denominated in national currency are in some sense government property, not entirely the property of individuals. Devaluation, exchange control, and other measures that impose losses on people who hold assets in or are paid in the national currency may be undesirable to many citizens, but they are within the rightful power of the national government.

Moreover one usually thinks of a national central bank as embodying monetary sovereignty in the highest degree, because a central bank has more room for discretionary monetary policy than, say, a currency board. Proposals for replacing central banks with currency boards have been characterised as reducing monetary sovereignty even though they would leave national currencies intact. So, monetary sovereignty involves more than just having a separate national currency; it involves exercising, or at least being able to exercise, a discretionary monetary policy independently of other nations.

Many people also think of a floating exchange rate regime as embodying monetary sovereignty to a higher degree than a pegged or fixed exchange rate regime,

and consider that international monetary agreements such as the Bretton Woods system reduce monetary sovereignty by restricting freedom of action in monetary policy. Carried to an extreme, this line of thought suggests that any rules for monetary policy infringe on monetary sovereignty. However, few people go so far; most are willing to distinguish between externally imposed rules and self-imposed rules. Municipal governments lack monetary sovereignty because of externally imposed rules: their governments prevent them from issuing currency. International agreements entered into without coercion, in contrast, are self-imposed rules that nations agree to impose on themselves presumably to promote national interests more effectively within an international framework. Self-imposed rules do not necessarily reduce monetary sovereignty, particularly if a Nation can exit from them at relatively low cost. Thus, according to this view, a Nation always retain the legitimate right to change its monetary arrangements in whatever fashion its government sees fit. Monetary sovereignty trumps all appeals to long-established custom. Therefore, if the United States were to prohibit private ownership of gold, which was legal until 1933 and has been legal again since the end of 1974, it would be a perfectly legitimate exercise of monetary sovereignty.

According to an extreme viewpoint on monetary sovereignty, even under official dollarisation, where a Nation dispenses with locally issued currency and uses foreign currency instead, it retains the ability to reintroduce a national currency. As a practical matter, a truly irrevocable surrender of monetary sovereignty seems to be almost impossible for a Nation: a Nation can break even a monetary arrangement established by an international treaty, though the cost might be considerably high. Theoretically speaking, the charter of the European Central Bank contains no provision for Member States that wish to quit, but observers have been aware from the beginning that what the member Nations have formed, they can dissolve.<sup>129</sup> One of the characteristics of a sovereign Nation is that even when it yields considerable monetary sovereignty by acts of self-limitation, it retains the potential to abrogate those acts and reassert monetary sovereignty to the fullest extent.

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<sup>129</sup> In any case, it should be recalled that Protocol 10 annexed to the Treaty on European Union and to the Treaty establishing the European Community, on the transition to the third stage of economic and monetary union, explicitly states that the High Contracting Parties “declare *the irreversible character* of the Community’s movement to the third stage of economic and monetary union by signing the new Treaty provisions on economic and monetary union”. (Emphasis added).

This view is very controversial, especially in the context of EMU if one assumes that a proper surrender of monetary sovereignty from the Member States directly to the Community level has occurred. This transfer of monetary sovereignty has implied a complete denationalisation of money, with the consequence that, nowadays in Europe, monetary sovereignty is detached from political sovereignty of the Member States.

Part of this process is connected: (i) to the decline of the Westphalian State, (ii) to the interruption of the described privileged link between State sovereignty and money, and finally (iii) to the increasing forces of globalisation. As a matter of fact, one of the hallmarks of globalisation in the present era is the ever-closer integration of national financial markets. Over the last half century, as barriers to international investment have gradually evaporated, capital mobility has accelerated to heights unseen since the days before the First World War. Most informed observers agree that, consequently, the traditional relationship between States, money and markets has been fundamentally altered.<sup>130</sup> But how precisely? What does the globalisation of finance mean for the convention of national monetary sovereignty?

Globalised money, at its most basic, has become a political contest for market loyalty, posing extraordinarily difficult choices for policy makers. When addressing issues of global finance, one is accustomed to think of money as effectively insular. In the past, each currency used to be “sovereign” within the territorial frontiers of a single country or monetary union. On the contrary, in the current scenario, nothing could be further from the truth. A surprising number of monies, today, have come to be employed widely outside their country of origin for transactions either between nations or within foreign states. While the former is usually referred to as international currency use (or currency internationalisation), the latter is typically described by the term currency substitution and may be referred to as foreign domestic use. Reciprocally, an even larger number of monies now routinely face growing competition at home from currencies originating abroad. It is simply wrong

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<sup>130</sup> For an interesting evaluation of the issues sketched in the text, see D. CARREAU, *Le système monétaire international privé*, Académie de Droit International, Recueil Des Cours, Vol. 274, 1998, pp. 313-391, where the author emphasises that the traditional link between money and State sovereignty, by virtue of which the former was “une émanation” of the latter, has largely disappeared. “La souveraineté de l’Etat est aujourd’hui largement battue en brèche, on l’a vu au point d’apparaître comme purement symbolique: tel est les cas des Etats dont la monnaie, pleinement convertible, est largement utilisée pour financer les échanges internationaux” (Ibidem, p. 384).

to deny that several currencies may circulate in the same state. In fact, the phenomenon is increasingly prevalent.

Both currency internationalisation and currency substitution are a product of intense market rivalry – a kind of Darwinian process of natural selection, driven by the forces of demand, in which some monies such as the dollar or, in the past, the Deutsch Mark, come to be viewed as more attractive than others for various commercial or financial purposes. Cross-border circulation of currencies was once a quite common feature of the international monetary system. Nowadays, such practice is still re-emerging, as declining barriers to monetary exchange have greatly expanded the array of effective currency choice. Competition between national currencies is accelerating rapidly. As a result, the domains within which individual currencies serve the standard functions of money now diverge more sharply from the legal jurisdictions of issuing governments. Money has become effectively deterritorialised.

Monetary sovereignty, of course, continues to exist as a constitutive rule. It is the exceptional government that does not still seek to preserve, as best as it can, an effective monopoly over the issue and management of money within its own territory. Anyway, production of money may no longer be an essential attribute of State sovereignty,<sup>131</sup> despite of the fact that, along with the raising of armies and the levying of taxes, it has long been regarded as such.

At this point, it is easy to understand why a monetary monopoly (implied by monetary sovereignty) has been so highly prized. Genuine power resided in the privilege that money represents. Four main benefits were derived from a strictly territorial currency. First, a potent political symbol to promote a sense of national identity; second, a potentially powerful source of revenue to underwrite public expenditures; third, a possible instrument to manage the macroeconomic performance of the economy; and finally, a practical means to insulate the Nation from foreign

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<sup>131</sup> See again D. CARREAU, *Le système monétaire international privé*, Académie de Droit International, Recueil Des Cours, Vol. 274, 1998, p. 371, who explicitly links the end of national monetary sovereignty to the forces of financial markets and to the experiments of regionalisations like monetary unions. On this basis, he put forward the hypothesis according to which “peut-être d’ailleurs est-ce parce que les Etats membres de l’Union européenne ont pris conscience de ce phénomène” – the developments of financial markets and their frontal threat to national sovereignty over money – “qu’ils ont accepté de sacrifier si facilement leur monnaie nationale au profit d’une monnaie unique au titre d’une union économique et monétaire”.

influence or constraint. Within each State, all four advantages privilege the interests of the government in relation to societal actors.<sup>132</sup>

At the symbolic level, a territorial currency is particularly useful to rulers wary of internal division or dissent. Centralisation of political authority is facilitated in so far as citizens feel themselves bound together as members of a single social unit.<sup>133</sup>

A second benefit of a territorial currency was given by seigniorage, the capacity a monetary monopoly gives national governments to augment public spending at will. Technically defined as the excess of the nominal value of a currency over its cost of production, seigniorage represented in the Westphalia system an alternative source of revenue for the State, beyond what can be raised via taxation or by borrowing from financial markets. Public spending financed by money creation, in effect, appropriates real resources at the expense of the private sector, whose purchasing power is correspondingly reduced by the ensuing increase of inflation – a privilege for government if there ever was one. Because of the inflationary implications involved, the process is also known popularly as the “inflation tax”.

A third benefit used to derive from money’s potential impact on real economic performance – say, aggregate output and employment – as well as prices. So long as governments could maintain control of currency supply within their own territory, they had the capacity, in principle at least, to influence and perhaps even manage the overall pace of market activity. Money in fact may be used to promote the broad prosperity and strength of the State as well as the government’s own narrowly drawn fiscal requirements.<sup>134</sup>

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<sup>132</sup> See, on this point, J.-M. SERVET, *L’euro: fenêtres et ponts d’un nomadisme montaire*, in L. PASSERINI (ed.), *Figures d’Europe. Images and Myths of Europe*, P.I.E. Peter Lang, Bruxelles, 2003, pp. 127-145.

<sup>133</sup> Money’s magical virtues serve to enhance a sense of national identity in two ways. First, because it is issued by the government or its central bank, a currency acts as a daily reminder to citizens of their connection to the State. Second, by virtue of its universal use on a daily basis, the currency underscores the fact that everyone is part of the same social entity – a role not unlike that of a single national language, which many governments also actively promote for nationalistic reasons. A common money helps indeed to homogenise diverse and often antagonistic social groups.

<sup>134</sup> Currency territorialisation, in principle, equips the government with two potent policy instruments. First is the money supply itself, which can be manipulated in order to increase or decrease levels of expenditures by domestic residents. The second is given by the exchange rate – the price of home currency in terms of foreign currency – which can be manipulated to increase or decrease spending in the national economy through induced shifts between home and foreign goods. Neither instrument is infallible, of course; nor is either likely to attain a truly sustained impact on economic activity over the long term, if recent theoretical developments are to be believed. But over the shorter time horizons.

Finally, an important benefit is derived in a negative sense from the enhanced ability territorial money used to give the government in order to avoid dependence on some other provenance for this most critical of all economic resources. Currency territoriality, in fact, draws a clear economic boundary between the State and the rest of the world, promoting political authority. The closer government is able to come to achieving national monetary autarchy, the better it will be able to insulate itself from outside influence or constraints in formulating and implementing policy.

That sovereign States might use monetary relations coercively, given the opportunity, should come as no surprise. Money, after all, is simply command over real resources. Thus, in theory, if a State would like to get and affirm political autonomy, it should not rely on someone else's money.<sup>135</sup> But this is exactly the case occurring in a monetary union, within which States are no longer the bearer of their national monetary sovereignty (surrendered, in the case of EMU, directly to the Community level after the complete denationalisation of monetary policy since 1 January 1999).<sup>136</sup>

Having all this in mind, it can be concluded that, to appreciate the value of monetary sovereignty in the context of EMU, a mere application of its conventional and rather technical meaning will not be enough. A part from every kind of economic or monetary consideration, it will prove necessary to look carefully at the legal-

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monetary and exchange rate policies manifest substantial influence as tools for macroeconomic management. It would be an exceptional government that would not wish to retain these weapons in its arsenal as well.

<sup>135</sup> In any case, it must be said that, if there is one area in the economy where the impact of globalisation is not new, this area must be monetary policy. For many decades already, no country with a convertible currency has been able to conduct monetary policy in isolation, as if the external world would not matter. For many small countries, the external factor has often meant that the balance of payments has been a more powerful determinant of monetary policy than domestic policy goals. For larger countries with floating currencies, the external factor has often meant that the exchange rate may have had a more powerful influence on the monetary conditions than the interest rate decisions of the central bank. Thus a part from the existence of monetary unions (as the case for Europe), the mere impact of globalisation strongly affects the monetary policy of different countries. See, on this point, *Monetary Policy in a Global Environment*, Remarks by DR. SINIKKA SALO, Member of the Board of the Bank of Finland at the Seminar "Russia and Globalisation", House of Estates, Helsinki, 1 October 2001. The author notes that: "Because financial markets are now effectively integrated into a single global market, and because money flows with increasing speed from financial centre to another, central banks cannot isolate their domestic economies from international monetary forces". Thus the assumption expressed in the text, namely that a State should not rely on someone else's money in order to affirm its political sovereignty seems to be a provocative paradox.

<sup>136</sup> It should be recalled that according to Article 105(2) TEU: "The basic tasks to be carried out through the ESCB shall be: to define and implement the monetary policy of the Community; to conduct foreign exchange operations consistent with the provisions of Article 111; to hold and manage the official foreign reserves of the Member States; to promote the smooth operation of payment system".

institutional arrangements supporting and governing the subjects supposed to exercise such a power and at their different forms of legitimisation. In fact, if a European monetary sovereignty is to be perceived as the result of a process of delegation of public powers, the compatibility with the axiom that every exercise of public authority must be democratically legitimised must be verified.<sup>137</sup>

### ***5) Monetary Sovereignty reconceptualised in a broader political framework***

It should be now worth contextualising the concept of monetary sovereignty in a broader political and institutional framework, assuming that, as a matter of fact, Europe (the selected scenario) can be finally said to have achieved two fundamental milestones on the road towards its political unification: the introduction of a monetary union and the institution of the European Central Bank. A major advance has been made and, for those fighting for completion of the process (driving to a political union), the outlook is brighter now than at any time in the past.

Having reached this point, people are bound to be asking themselves some crucial questions. Since currency and monetary sovereignty used to be one of the essential attributes of statehood, does this mean that a piece of a European State has, in fact, already been created? Has a transfer of a truly political sovereignty (accompanying that of monetary sovereignty) from the national to the European level already taken place? Can the progress towards the foundation of a European federation now be considered irreversible?

Federalists, in particular, feel that it is imperative to consider these questions as the answers to them will determine the role they play in the phase of the process, which is about to begin.

At the core of the question lies again the concept of sovereignty, which has a real sense, and which is distinct from the general idea of power, only if it is defined as the power to decide in the last instance (thus, in the case of monetary sovereignty, it could be defined as the power to decide in the last instance in monetary matters). And, within a given territory (namely, in the case under analysis here, in the euro area),

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<sup>137</sup> See F. TORRES, *EMU and EU Governance*, Paper presented at the conference *Governing EMU. Political, Economic, Legal and Historical Perspectives*, EUI, Florence, October 2003.

according to the predominant view, there can be only one such subject, as the existence of more than one would indicate the concomitant validity of two or more legal systems and, in turn, mean that, in situations of conflict, the applicability of one or the other of these could, in the last instance, be determined only by violence. Sovereignty would therefore be the prerequisite for the maintenance of peace in society and for the growth of civilisation.

Anyway, in the adopted reconceptualisation of the concept of monetary sovereignty, in the light of the idea of legal pluralism and multi-level governance, there would be the possibility to have more than one seat for sovereignty. One of these would be attributed to the European Central Bank as the guardian of price stability (a value comparable, in monetary matters, to peace and growth of civilisation, since it guarantees macroeconomic stability, low inflation, high employment, etc.); another one should be attributed to the Ecofin Council given its competences, especially in the field of external relations. Finally, and with a provoking hypothesis, a third place might be assigned to market's forces operating in a globalised environment, in consideration of the competitive role they play.<sup>138</sup> As a matter of fact, as already stated at the outset, monetary sovereignty in today's European Union cannot be appreciated in isolation with the process of globalisation. Such scenario implying different seats of sovereignty gives birth to a new, unprecedented situation in which the multiple sites of power do not compete in a hierarchical way, but coexist together under the auspices of legal pluralism. Thus, despite of the institutional arrangement leading to the set up of a European System of Central Banks, which is supposed to represent in itself the centralised *locus* of monetary sovereignty, one should also consider the dispersion of power occurring in the competition with the newly integrated financial markets which, according to the neo-institutional theory, can also play a role as decision-makers.

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<sup>138</sup> As for the interaction with the financial markets see E. DOMINGO SOLANS, *The euro: a driving force in a globalised financial system*, Speech delivered at the Official Spanish-Swiss Chamber of Commerce, Zurich, 11 November 2002, available at <http://www.ecb.int/key/02/sp021112.htm>. The Member of the Executive Board of the ECB affirms that: "In a globalised financial system the existence of a new international currency is of paramount importance. The euro area as a whole is a source of economic and financial stability. The wide use of the euro in global markets and in exchange rate policies four years after its inception means that the euro is exporting stability to the rest of the world. The Eurosystem, its monetary policy and, as a result, the stability of the euro is a relevant driving force, a catalyst, which has enhanced the economic and financial integration of the world economy".

This being so, and going back to the institutional framework, it is worth underlining that the birth of a quasi-European federation (within which monetary sovereignty may find a new, more integrated and stable role), supposed to go on hand in hand with the conferral of sovereignty from the Nations to the European Community, is not only a strictly institutional event but also, and above all, a symbolic dynamic process based on consensus. Such dynamic process is mainly characterised by the fact that all the European citizens, a part from the consensus they gave once for all to the daily management of the single currency, must also be encouraged to recognise their existence as a single people. And it is, in fact, this very act of recognition that will bestow upon the new institutional order that degree of irreversibility, without which speaking about the birth of a new polity would be meaningless.<sup>139</sup> In other words, only through a constituent process the transfer of sovereignty from the national to the European level can come about.

According to some legal doctrine, this process, already on its way, will come to an end after the formal foundation of the federation.<sup>140</sup> It would appear reasonable to consider the direct election of the European Parliament as the starting step of this process, and the creation of the single currency as one of its crucial stages, also for its symbolic value. Nevertheless, the real importance of these two events is represented by the contribution they have made towards raising the awareness among an increasing number of European citizens of their existence as a single people. Moreover, the creation of a single currency is not likely to mark the end of the process, nor will it lose significance with the solemn declaration of the birth of the European federation.

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<sup>139</sup> For a fascinating elaboration of this point, see the sociological study by S. SHANAHAN, *Currency and Community: European Identity and the Euro*, in L. PASSERINI (ed.), *Figures d'Europe. Images and Myths of Europe*, P.I.E. Peter Lang, Bruxelles, 2003, pp. 159-179. The author, in fact, makes it clear that money – like identity – can be seen as a social contract, whose meaning is flexible since it is always embedded in a particular time, space and set of social relations. But money is also a peculiar symbolic medium; “its palpable character and daily utility makes it undeniably concrete”. Three hundred million people of different ages, religions, and races from twelve different national societies now share the euro. “each time they open their wallets they experience a common reality. For this reason, the euro is an unusually apt vehicle for identity construction” (Ibidem, p. 163).

<sup>140</sup> See A. VON BOGDANDY, *The European Union as a Supranational Federation: A Conceptual Attempt in the Light of the Amsterdam Treaty*, in *Columbia Journal of European Law*, 6, 2000, pp. 27 – 54.



## CHAPTER TWO

### *THE IMBALANCE BETWEEN THE TWO LEGS OF EMU*

*“In the third stage of EMU, Member States shall avoid excessive general government deficits: this is a clear Treaty obligation. The European Council*  
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*underlines the importance of safeguarding sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. It is also necessary to ensure that national budgetary policies support stability-oriented monetary policies. Adherence to the objective of sound budgetary positions close to balance or in surplus will allow all Member States to deal with normal cyclical fluctuations while keeping the government deficit within the reference value of 3% of GDP”.\**

*(...) “The Stability Pact restricts the room for manoeuvre enjoyed by national fiscal policy-makers. But this is the price that must be paid for a common currency. Historically, stability between currencies has been possible only when countries have been prepared to relinquish some national sovereignty”.\**

#### *1) The issues at stake*

The “most important problem facing the EMU now”<sup>141</sup> is represented by the well-known asymmetry between economic and monetary policy, an imbalance that gives birth to a striking constitutional challenge in terms of sovereignty, representation and democratic legitimacy of the EU’s economic governance.

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\* Resolution of the European Council on the Stability and Growth Pact, adopted at Amsterdam, 17 June 1997, O.J. [1997] C236

\* H. Siebert, *Financial Times*, 6 August 2002, quoted by M. BUTI, S.C. EIJFFINGER and D. FRANCO, *Revisiting the Stability and Growth Pact: Grand Design or Internal Adjustment?*, CEPR Discussion Paper Series, No. 3692, January 2003, p. 1.

<sup>141</sup> J.-V. LOUIS, *The Economic and Monetary Union: Law and Institutions*, CML REV 41, 2004, p. 575.

Consequently, a first investigation of the issues related to the above-mentioned asymmetry may be helpful to shed light on the complex and fragmented institutional framework within which monetary sovereignty is supposed to express itself.

Economic and Monetary Union (EMU), which was born before the existence of a political union with a characteristic dissociation between political and monetary powers, is a unique policy experiment in the sense that it combines a high degree of centralisation of monetary policy in the European Central Bank (ECB) with, in principle, decentralised policies in other areas of macroeconomic and structural policies, in particular with respect to public finances. “This is, without doubt, an element of weakness of the European construction. There is no European Treasury Minister as there is not yet a European Foreign Minister. Perhaps there will never be such a concentrated power in the Union. What is clear is that the present institutional set up is not satisfactory”.<sup>142</sup>

The above-mentioned decentralisation has been seen as a necessary application of the principle of subsidiarity, but has also been justified in the light of the loss of monetary policy instruments at the national level, as exchange rates become locked permanently and interest rate decisions move to the ECB level. Moreover, if one takes into account the principle according to which governments – on a national level – must be accountable to their constituencies, and that ultimately democratic choice through elections will always have primacy over negotiated intergovernmental coordination, the fact that the conferral of budget policy to the EU-level has been constantly perceived as a truly problematic issue becomes self-evident. What in fact makes such a conferral so difficult is the persistence of a fundamental principle of democracy that states “no taxation without representation”. The democratic principle under examination, as applied to delegation or conferral - should be then translated into the following formula: “no European fiscal policy without representation”, or – in the words of Stefan Collignon – “European collective choice requires a European constituency”.<sup>143</sup>

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<sup>142</sup> J.-V. LOUIS, *The Eurogroup and Economic Policy Co-ordination*, in: J.-V. Louis (ed.), *The Euro in the National Context*, London, The British Institute of International and Comparative Law, 2002, p. 365.

<sup>143</sup> S. COLLIGNON, *Is Europe going far enough? Reflections on the Stability and Growth Pact, the Lisbon Strategy, and the EU's Economic Governance*, LSE and CEP, April 2003.

As a result, on the basis of these reasons, the Maastricht Treaty has left responsibility for fiscal policy at the national level, whilst the Stability and Growth Pact has constrained it by hard co-ordination rule: keep structural deficits in balance.

Looking carefully at EMU leads the observer to reach two preliminary important conclusions on the impact monetary union has produced: the precise meaning EMU has, and the constitutional nature of monetary union (from where one may derive significant sequels for the whole process of European integration). EMU was created as an outstanding roadmap for a political economic orthodoxy that is akin to the monetarist school. Several accounts of the process leading to monetary union in the EU register how monetarist-led EMU is. The main elements constituting the monetarist-led conception of EMU are price stability as the sacred macroeconomic goal attached to EMU, the prominence monetary policy has to achieve such a goal, a secondary role for fiscal policy, and a clear separation of competences between the monetary authority (the ECB) and the fiscal authorities (national governments).

However, in the Maastricht Treaty and in its subsequent introduction in the so-called Stability and Growth Pact (SGP) the decentralised exercise of budgetary policies has become circumscribed. First, the convergence criteria to be applied for judging the readiness of countries for participation in EMU took up the suggestion that there had to be upper binding limits on budget deficits by introducing the much-discussed reference values of 3% for the ratio of the planned or actual government deficit-to-GDP at market prices and 60% for the ratio of government debt-to-GDP at market prices.<sup>144</sup> Second, and much later, an elaborated version of how these budgetary rules were to be applied more permanently after the start of EMU emerged in the form of the Stability Pact. Even more recently, the debate on desirable

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<sup>144</sup> See Article 104.2 EC Treaty, which reads as follows: "The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline on the basis of the following two criteria:

- (a) whether the ratio of the planned or actual government deficit to gross domestic product exceeds a reference value, unless: - either the ratio has declined substantially or continuously and reached a level that comes close to the reference value; - or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;
- (b) whether the ratio of the government debt to gross domestic product exceeds a reference value, unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace".

The reference values referred to in Article 104.2 EC Treaty are specified in Article 1 of the Protocol on the excessive deficit procedure annexed to the Treaty.

features of policy co-ordination more generally among the EMU participants has resurfaced in recognition of the concern that mechanistic application of the budgetary rules of the Stability Pact, though in itself a daunting task, would not constitute an adequate agenda for the Finance Ministers.

This being so, it can be said that in the model for full-scale EMU (Stage Three) agreed at Maastricht (the so-called “Maastricht Consensus”) there is a remarkable peculiarity: this model assigns exclusive responsibility for the monetary policy of participating Member States to the European Central Bank,<sup>145</sup> but leaves fiscal policy in the hands of national authorities, subject to the constraints of the excessive deficit procedure.<sup>146</sup> This second leg of the model (the so-called “E” part of EMU) is thus not institutionally well structured, but it is still based on the application of binding rules, considered necessary when the short-term preferences of different actors are inconsistent with their long-term preferences. In fact, simple voluntary adherence to coordinated policy action (like in the case of the Open Method of Co-ordination) ends up not to be enough to ensure compliance over time as the actors are autonomous and free to withdraw from the agreement at a later stage. Instead, by making a binding commitment to an agreed long-term goal, dynamic consistency between multiple policy plans can be established.

From this picture, one may immediately observe a truly peculiar context of macroeconomic governance<sup>147</sup> exercised by multiple layers of responsibilities

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<sup>145</sup> Such an application of the model follows the so-called Community method of delegation, now called “conferral” in the new Constitution Draft. Such a method transfers policy-making competences to a unified agent (here the ECB). In this case, policy decisions are no longer made by autonomous actors with responsibilities to different constituencies and a need for an *ex ante* co-ordination. Instead the unified authority formulates and implements policies with respect to an enlarged constituency, internalising all the externalities by legally obliging other actors or governments.

<sup>146</sup> See, on this point, B. WINKLER, *Stability and Growth: the Role of Monetary Policy and Other Policy Actors in EMU*, Paper presented at the conference *Governing EMU. Political, Economic, Legal and Historical Perspectives*, EUI Florence, October 2003. The author rightly points out that, while responsibilities for fiscal policies, labour market policies and structural policies – which primarily affect the determinants of output, growth and employment – largely remain rooted at the national level, at the same time the Treaty – in conjunction with the Stability and Growth Pact – subjects national fiscal policies to a set of common rules and surveillance procedures. This reflects the need for a common framework for sound public finance inside the currency union as an essential complement to lasting monetary stability.

<sup>147</sup> As highlighted by B. WINKLER, *op. cit.*, the term “macroeconomic governance” is used loosely to denote the formal and informal set of rules comprising the assignment of policy objectives and responsibilities as well as influencing the behaviour and interaction among various macroeconomic policy actors within a given allocation of tasks. The concept of governance thus includes softer forms of co-operation, social norms, conventions and enforcement beyond the official legal system. For a

interacting at the European, national and sub-national level, where the need to deal with the externalities caused by simultaneous decision-making of different actors becomes “the” issue at stake. The first consequence is that there is to be a major separation of authority over the two key areas of macroeconomic policy.<sup>148</sup> Admittedly, there are some arrangements for policy consultation between the ECB and the Council (in this case, in its composition of economics and finance ministers, or Ecofin, which retains considerable competences in the economic governance under Articles 99, 100, 102, 103.2, 104.6, 104.7, 104.10, 104.14, 107.6 and 111 TEU). For instance, the President of the Council and a member of the Commission may participate in meetings of the ECB Governing Council, but not vote,<sup>149</sup> and the President of the ECB will be invited to Council meetings when matters relating to the ECB’s objectives and tasks are discussed.<sup>150</sup> Moreover, the ECB may submit opinions to the “appropriate Community institutions or bodies or to national authorities” on matters within its competence, and publish them.<sup>151</sup> But its opinions will have no binding force; while, within its own field of competence, the ECB will be totally independent of interference from outsiders, as is well known.<sup>152</sup>

This separation of responsibilities seems to be a fairly novel experience for most participants, with certain notable exceptions. The usual situation in developed economies has been that decision-making authority over both fiscal and monetary policy has resided with Government, as it has ultimate control over all key policy levers. The most important exception since the war has been Germany, where the

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more theoretical approach, A. DIXIT, *On Modes of Economic Governance*, *Econometrica*, No. 71, 2003, pp. 449-481.

<sup>148</sup> It should be underlined that the Treaty itself clearly separates the chapter on monetary policy from the chapter on economic policy. It does not refer to policy co-ordination between monetary and fiscal policy, in contrast to the co-ordination of economic policies among Member States under Article 99 EC Treaty.

<sup>149</sup> Article 113 (1), EC Treaty.

<sup>150</sup> Article 113 (2), EC Treaty.

<sup>151</sup> Articles 105 (4) and 110, EC Treaty.

<sup>152</sup> The cornerstones of the monetary constitution adopted at Maastricht and confirmed in the draft Constitution by the Convention are: central bank independence and the clear focus on price stability. The Treaty has unambiguously assigned to the ECB and the single monetary policy the maintenance of price stability in the euro area as its primary objective (Article 105 EC Treaty). To fulfil its mandate effectively, the Treaty has then granted the ECB and the national central banks of independence from political interference and foresees a clear institutional separation from other economic policy actors. For instance, Article 101 EC Treaty prohibits the monetary financing of public deficits and Article 108 safeguards institutional, personnel, functional and financial independence of the ECB’s decision-making bodies.

Bundesbank has been independent in its pursuit of monetary policy, in accordance with the Bundesbank Act – although the Act itself could, of course, be amended by the German Parliament. There are traditions of central bank independence in some small European countries, most notably Switzerland but also the Nordic countries, and the Netherlands' central bank as considerable policy autonomy. However, until quite recently the central banks of most of the larger EU Member States, including France, Italy, Spain and the UK, have been subject to Government direction or influence. The situation is now changing - not only in Europe but also globally -, as discontent with the seeming inability of elected governments to maintain price stability has become widespread. In Europe, EMU has thus become a catalyst in obliging many governments to make their central banks independent for policy purposes – this being one of the convergence criteria for joining Stage Three.

Finally, the separation of policy responsibilities shows an additional dimension within EMU, in the “dichotomy between the *singleness* of monetary policy, administered centrally by the ECB, and the *multiplicity* of fiscal policies, run separately for each participant”.<sup>153</sup> This feature, reflecting the multicountry character of EMU, could create further problems, as it will be explained. It is to counterbalance this dichotomy that the issue of common fiscal rules has arisen in a multinational context. In the early 1990s, in fact, a clear consensus emerged about the introduction of common numerical rules and a multilateral surveillance mechanism. Compared to institutional or procedural reforms, numerical rules are simpler to evaluate, easier to grasp by public opinion and policy-makers, and faster to implement. Indeed, institutional reforms would have represented a feasible alternative, but only if more decisive steps towards political unification had been taken.<sup>154</sup>

An interesting suggestion in terms of institutional reforms would be that all economic policy competences for – let's say – stabilisation policy become a matter of co-decision with the European Parliament, rather than being monopolised by the Council. This would contribute to the formation of collective preferences across

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<sup>153</sup> C. TAYLOR, *The Separation of Monetary and Fiscal Policy in Stage Three of EMU*, in M. ANDENAS, L. GORMLEY, C. HADJEMMANUIL and I. HARDEN (eds.), *European Economic and Monetary Union: The Institutional Framework*, Kluwer Law International, London – The Hague – Boston, 1997, p. 172.

<sup>154</sup> According to F. BALASSONE and D. FRANCO, *EMU Fiscal Rules: A New Answer to an Old Question?*, Banca d'Italia, 2001, p. 35 “EMU fiscal rules reflect the interaction between the multinational nature of EMU and the lack of a political authority of federal rank”.

Europe through the democratic competition among rival elites for rival policy agendas and the involvement of ordinary citizens in a European-wide policy deliberation. But this is just a perspective *de iure condendo*.

## 2) *On Macro-economic Policy Co-ordination in EMU*

Generally speaking, from the point of view of comparative federalism, a monetary union without a fiscal union constitutes a genuine puzzle. As far as federal experience goes, the suprapstate is either limited to foreign and trade policy or fully-fledged in the sense that it includes a common currency and, as a consequence, a strong element of revenue sharing. One option is to have no monetary union at all; another option is to have monetary union with a parallel fiscal union. In theory, there is no third alternative. Nevertheless, the Maastricht Treaty breaks with the idea of there being no third alternative. Seen from the outside, the current European construct is a full-scale experiment without precedence. The Member States have been firmly determined to have a common currency with no parallel fiscal union.

The Maastricht Treaty on European Union provides for “economic and monetary union”. The verbal symmetry between “economic” and “monetary” is misleading, however.<sup>155</sup> Monetary union necessarily involves a single monetary policy and a single exchange-rate policy for those States that are part of the monetary union; the language of the Treaty reflects this. It provides for “the monetary policy of the Community” to be formulated by the Governing Council of a single Community body: the European Central Bank. “Economic” union has no such precise contours. Indeed, under the influence of American economists “EMU” is often thought to be an acronym for “European Monetary Union”. Here, however, EMU stands for “Economic and Monetary Union”.

A fundamental aspect of economic union is the integration of markets. This is a continuing process, not a big bang as with monetary union. Its essential element is the single market, completion of which was the principal objective of the 1986 Single

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<sup>155</sup> See, on this point, I. HARDEN, J. VON HAGEN, and R. BROOKES, *The European Constitutional Framework for Member States' Public Finances*, in M. ANDENAS, L. GORMLEY, C. HADJEMMANUIL and I. HARDEN (eds.), *European Economic and Monetary Union: The Institutional Framework*, *op. cit.*, p. 142.

European Act. The Maastricht Treaty's contribution to economic union in this sense is limited. The Treaty constitutionalises the abolition of restrictions on movement of capital and payments, but a legal basis for free movement of capital within the Union had already been largely achieved within the previous EEC Treaty framework.

This entire peculiar situation within EMU raises a question that has not yet been discussed to the extent that it deserves. What is it that could possibly make such an unprecedented trajectory sustainable?<sup>156</sup>

As a matter of fact, it has to be recognised that the formation of the EMU has created a framework for economic policy-making in Europe, which is unique in history. While the single monetary policy is oriented towards a union-wide objective, namely the maintenance of price stability, the other policy areas – involving fiscal and wage policies – largely remain the competence of national governments and other national actors, such as the social partners. In fact, within the euro-area, the main political and fiscal powers are to remain at the level of the Nation State. Historically the Nation States have been able “to call upon assistance of the money-creating institutions, whether the mint via the debasement of the currency, a Treasury printing press, or the Central Bank. Whenever States” (...) “have joined together in a larger Federal unity, both the main political, the main fiscal and monetary powers and competences have similarly emigrated to the federal level. The euro-area is not really like that. In particular, the participating Nation States continue to have the main fiscal responsibilities; none the less, in the monetary field their status has changed to a

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<sup>156</sup> It has to be considered that macroeconomic stability is a key element of the socio-economic model of the European Monetary Union. It is a precondition for sustainable economic growth and job creation. The main contribution of the Eurosystem to macroeconomic stability comes through the fulfilment of its primary objective, namely the maintenance of price stability. Compliance with other objectives and tasks of the Eurosystem also contributes to macroeconomic stability. Another fundamental element for the achievement of macroeconomic stability is, of course, compliance with the Stability and Growth Pact, considered as a European Public good, indispensable in an economic and monetary union in which there are still national fiscal policies. It is important to understand why compliance with the SGP makes a significant contribution to macroeconomic stability, equilibrium and dynamism. Beyond certain levels, public deficits and debt would have a negative impact on market interest rates because of the existence of an excessive additional demand for funds and the development of inflation expectations. Public deficits could crowd out private investment and consumption, and hamper economic growth. The idea that who is spending and how expenditure is financed is irrelevant and that what really matters is having an overall amount of total expenditure in order to have economic growth is simply not true, because the economic effects in both cases, public or private spending, are very different. Furthermore, the socio-economic model enshrined in the Maastricht Treaty would prevent any economic policy that was not conducted in accordance with the principle of an open market economy with free competition (Article 4), and a situation of excessive governments deficits (Article 104).

subsidiary level, in the sense that they can no longer call upon the monetary authority to create money to finance their domestic national debt. There is to be an unprecedented divorce between the main monetary and fiscal authorities".<sup>157</sup> Thus the centrality of the link between political sovereignty and fiscal authority, on the one hand, and money creation, the mint and the central bank, on the other, is no longer operating.

Against this background, calls for enhanced macroeconomic policy co-ordination between monetary policy, on the one hand, and fiscal and wage policies, on the other hand, have come about as a result of the perception that the new institutional framework in EMU places constraints on the different policies. More specifically, it is argued that these constraints could be alleviated by setting the available policy instruments in a co-ordinated manner in order to achieve a macro-economic policy-mix at the euro area level that is conducive to fiscal-financial sustainability, macroeconomic stability, higher growth and employment.<sup>158</sup>

The call for a more effective policy co-ordination can be justified on the basis of very concrete examples. To name one of the most significant, it should be recalled that there is an important contingency in which co-operation between the monetary and fiscal authorities is essential. It occurs when the (threat of) a serious banking crisis or financial crisis with systemic implications forces the central bank to act as lender of last resort,<sup>159</sup> and the problem turns out to be, for a significant portion of the banking/financial system, a solvency crisis as well as liquidity crisis. It could happen that recapitalising the insolvent banks or financial institutions with just the financial resources of the central bank would require the central bank to engage in excessive

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<sup>157</sup> C.A.E. GOODHART, *Two Concepts of Money, and the Future of Europe*, LSE Financial Markets Group and ESRC Research Centre, Special Paper Series, n. 96, June 1997, p. 4. See also ID., *The Transition to EMU*, in M. ANDENAS, L. GORMLEY, C. HADJEMMANUIL and I. HARDEN (eds.), *European Economic and Monetary Union: The Institutional Framework*, op. cit., pp. 5 – 26.

<sup>158</sup> Evidently, any co-ordination across policy areas at the euro area level would first require a substantial degree of co-ordination within those policy areas that are still subjects to autonomous decision-making at the individual countries level. On this line of reasoning see W.H. BUTER, *Two Naked Emperors? Concerns about the Stability and Growth Pact and Second Thoughts about Central Bank Independence*, CEPR Discussion Paper Series, No. 4001, August 2003, who clearly states that "both monetary and fiscal policy are subsets of intertemporal public finance. They should be treated in an integrated manner" (Ibidem, p. 2).

<sup>159</sup> On the lender of last resort function in the EMU (assigned to the NCBs members of the ESCB), see R.M. LASTRA, *The Division of Responsibilities Between the European Central Bank and the National Central Banks within the European System of Central Banks*, *The Columbia Journal of European Law*, Vol. 6, No. 2, Spring 2000; T. PADOA-SCHIOPPA, *EMU and Banking Supervision*, Lecture given at the London School of Economics, 24 February 1999.

base money issuance, which would result in unacceptable rates of inflation. As long as the resources of the consolidated general government and central bank are sufficient, the Treasury should either recapitalise the central bank, or should directly recapitalise the banking/financial system. In the usual Nation State setting, a single Treasury or national fiscal authority stands behind a single central bank. Unique complications arise in the EMU where each national fiscal authority stands financially behind its own central bank, but no fiscal authority stands directly behind the ECB. As a result, serious troubles may arise when EMU area domiciled banks emerge that do not have a clear national identity, say banks incorporated solely under European law. As there is no European fiscal authority standing behind the ECB, who would organise and fund the bail-out and recapitalisation of such a European bank? Whether this potential vulnerability will in due course be remedied by the creation of a real supranational fiscal authority at the EMU level that would stand behind the ECB, or by implicit or explicit agreements between the ECB, the NCBs and the national fiscal authorities is as yet unclear.'

This being so, the central message to be affirmed here, however, is that there are no convincing arguments in favour of attempts to co-ordinate macro-economic policies *ex ante* in order to achieve an overall policy mix favourable to growth and employment.<sup>160</sup> On the contrary, attempts that extend beyond the informal exchange of views and information give rise to the risk of confusing the specific roles, mandates and responsibilities of the policies in question. Thereby they reduce the transparency

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<sup>160</sup> It is in this spirit that the European Council, in its Luxembourg resolution, considered a "continuous and fruitful dialogue" between the Council and the ECB, with the involvement of the Commission, as a requirement for the "harmonious economic development of the Community in stage 3 of EMU", and therefore emphasised the importance to fully exploit the communication channels provided for by the Treaty. Nevertheless, as clearly pointed out by B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien/New York, 2003, p. 142 "the dialogue between the ECB and the Ecofin-Ministers is not an *ex-ante*-co-ordination, since – according to the ECB – any interaction in the field of economic policies beyond a non-binding dialogue would conflict with the principle of independence" Moreover, "monetary policy could only react, as a principle, to real developments or proven knowledge as regards the future, and not to the present or expected financial policy". Following this line of reasoning, in a report to the Helsinki European Council, the Ecofin Council agreed that the ECB and the NCBs of the non euro-area countries would "participate in dialogues at either EU or euro-area level but do not engage in any *ex ante* co-ordination of their monetary policies with other policies" (Report by the Ecofin Council to the Helsinki European Council on *Economic Policy Co-ordination: Review of Instruments and Experience in Stage 3 of EMU*, 13123/1/99 REV 1, 29/11/99, para. 2.ii).

of the overall economic policy framework for the general public and tend to prevent the individual policy-makers from being held accountable.<sup>161</sup>

Instead, it will be argued here that national governments and autonomous social partners should design and implement the policies for which they are responsible bearing in mind the overall stability framework provided for in the Maastricht Treaty and the secondary legislation, including the Stability and Growth Pact. As a result, sustainable and prudent fiscal policies and moderate developments in wage costs, which take into account the interdependencies between the latter and the stability-oriented single monetary policy, will already go a long way towards providing favourable conditions for economic growth and employment. Obviously, if national governments and social partners take the single monetary policy's credible commitment to maintain price stability as given when deciding upon their own actions, this will lead to implicitly co-ordinate policy outcomes *ex post*, while at the same time limiting policy conflicts and overall economic uncertainty.<sup>162</sup>

### 3) Responsibilities under the "Maastricht Assignment"

The central legal basis for economic policy co-ordination within EMU is specified in Article 99 (ex Article 103) of the Maastricht Treaty, which states that "Member States shall regard their economic policies as a matter of common concern and shall co-ordinate them within the Council, in accordance with the provisions of

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<sup>161</sup> This is the view expressed by B. WINKLER, *Stability and Growth: the Role of Monetary Policy and Other Policy Actors in EMU*, Paper presented at the conference *Governing EMU. Political, Economic, Legal and Historical Perspectives*, EUI Florence, October 2003, who argues that the clear division of responsibilities and primary policy objectives can be seen as beneficial from the perspective of accountability and transparency. It should enhance performance incentives and facilitate monitoring by the public. "by contrast, more ambitious attempts to co-ordinate policies in view of shorter-run interdependencies would suffer from the general shortcomings of demand management. Activist policy co-ordination exacerbates information requirements regarding the timely identification of the relevant spillovers. It also raises the additional issue of credible enforcement of jointly agreed policies as well as complicating communications and diluting responsibilities".

<sup>162</sup> Such approach is shared by A. ALESINA, J. GALF, H. UHLIG, O. BLANCHARD and F. GIAVAZZI, *Defining a macroeconomic framework for the euro area, Monitoring the European Central Bank*, London, Centre for Economic Policy Research, No. 3, 2001. The authors argue that explicit co-ordination of monetary and fiscal policies may be either unnecessary or harmful: "If the monetary and fiscal authorities keep their houses in order acting on their own, there is no need for explicit co-ordination. If the fiscal authorities deviate from prudent fiscal policies because of a variety of short-run political incentives and constraints, then explicit co-ordination may even be counterproductive".

Article 98”.<sup>163</sup> On the basis of this principle, the framework for the definition of overall economic policy objectives and orientations is provided by the “Broad Economic Policy Guidelines” adopted by the Council each year.<sup>164</sup>

With regard to monetary and fiscal policies, the assignment of responsibilities is defined by the Maastricht Treaty and the Stability and Growth Pact<sup>165</sup> respectively. The Treaty has assigned the maintenance of price stability as the primary objective to the single monetary policy under Article 105. Without prejudice to its primary objective, the single monetary policy shall support the general economic policies of the European Community.<sup>166</sup> Anyway, establishing the appropriate monetary

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<sup>163</sup> Article 98 states that: “Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives of the Community, as defined in Article 2, and in the context of the broad guidelines referred to in Article 99 (2). The Member States and the Community shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4”. Interestingly enough Article 14 of the Draft Constitution has found a “compromise formula” on the attribution of competences between the Union and the Member States in coordinating economic policies. According to its wording “the Union shall adopt measures to ensure co-ordination of the economic policies of the Member States, in particular by adopting broad guidelines for these policies. The Member States shall coordinate their economic policies within the Union”.

<sup>164</sup> See Article 99.2 EC Treaty

<sup>165</sup> The Stability and Growth Pact consists of a Resolution of the European Council adopted in Amsterdam on June 1997 and two Ecofin Council Regulations (No. 1466/97 and No. 1467/97). The idea of having a pact for stability already emerged in the conclusions of the Presidency of the European Council held in Dublin on 13 and 14 December 1996, *Europe*, 15 December 1996 (special edition). As observed by R. SMITS, *The European Central Bank. Institutional Aspects*, Kluwer Law International, The Hague, 1997, p. 86, “the term pact is misleading, in that the pact is not a separate agreement, but a set of rules which it has been agreed to adopt in implementation of the Treaty provisions on multilateral surveillance and the excessive deficit procedure”. These rules are to be adopted pursuant to Article 99.5 and 104.14 EC Treaty.

<sup>166</sup> A monetary policy primarily oriented towards price stability is, in the medium term, the best contribution that the Eurosystem can make for sustainable economic growth. Price stability implies an efficient allocation of resources through an informative relative price mechanism, competitiveness, lower interest rate risk premia, appropriate conditions for investment, and so on. All these factors are preconditions for economic growth. There is clearly no greater stimulant for economic growth than price stability, and nothing is more damaging to economic growth than inflation. Actually, the Statute of the European System of Central Banks and of the ECB refers in its Article 2 to the objectives (in the plural) of the ESCB. It clearly states (repeating the wording of Article 105 of the Treaty) that “without prejudice to the objective of price stability, it shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 of this Treaty”. Among other things, Article 2 of the Treaty refers to “sustainable and non-inflationary growth” respecting the environment and to “a high level of employment and of social protection”. It should be clear that these are objectives of the European Union and not direct objectives of the Eurosystem’s monetary policy. The non-primary objective of the Eurosystem is to support the general economic policies in the Community with a view to contributing to the achievement of these objectives. In conclusion, while economic growth should not be considered an objective for the Eurosystem’s monetary policy, it is also clear that the Eurosystem does have responsibilities relating to economic growth and employment. These responsibilities are indirect, conditional and secondary, but responsibilities nevertheless. In order to assume them, the Eurosystem creates the best monetary conditions to support economic growth and job creation, provided that no risk exists for the compliance

conditions for price stability should be seen as a necessary condition to achieve economic growth and job creation but, unfortunately, according to the prevailing doctrine, it is not sufficient in itself.<sup>167</sup> Other aspects should be taken into account, such as budgetary discipline, moderation of wage developments, economic dynamism and flexibility.<sup>168</sup>

On the other hand, the Stability and Growth Pact provides guidelines for fiscal discipline at the national level by strengthening the excessive deficit procedure of the Treaty and by prescribing sanctions for breaches of the 3 per cent limit of the deficit-to-GDP ratio.<sup>169</sup> It also specifies a commitment to achieving medium-term budgetary positions “close to balance or in surplus” and incorporates multilateral surveillance procedures and the exchange of information in conjunction with medium-term stability programmes submitted by national governments.<sup>170</sup>

Assigning the overriding objective of price stability to the single monetary policy is a prominent example of how to realise the benefits of the basic division of responsibilities provided for by the Maastricht Treaty. The single monetary policy – safeguarded by an independent central bank – enhances the credibility of monetary

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with its primary objective of price stability. See, on this point, ECB, *The Monetary Policy of the ECB*, Frankfurt, 2004.

<sup>167</sup> See, on the same line of reasoning, ECB, *The Monetary Policy of the ECB*, Frankfurt, 2004, p. 43, where it is clearly stated that “assigning monetary policy an objective for real income or employment would have been *problematic*, since, apart from the positive impact of price stability, monetary policy has no scope for exerting any lasting influence on real variables” (...) “It is the task of other economic actors, notably those responsible for fiscal and structural policies, to enhance the growth potential of the economy”.

<sup>168</sup> Economic dynamism and flexibility enable economic activity to adapt to the changing conditions of the environment and enable external shocks to be absorbed.

<sup>169</sup> See Council Regulation No. 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure [1997] OJ L 209/6, notably Article 6.

<sup>170</sup> Regulation No. 1466/97 clarifies the procedures to be followed for an implementation of the surveillance of the SGP, as envisioned in general terms in Article 99 EC Treaty. In particular it establishes that: (a) Member States must submit every year an update to the stability programme (called “convergence programme” for non-EMU members), containing a medium-term objective for the budgetary position, and a description of the assumptions and of the main economic policy measures the country intends to achieve the targets; (b) the Council, on a recommendation from the Commission, delivers and opinion on each programme and its yearly updates and, if deemed necessary, a recommendation. As recalled by J. GALI and R. PEROTTI, *Fiscal Policy and Monetary Integration in Europe*, CEPR Discussion Paper Series, No. 3933, June 2003, p. 4, “there are three possible types of recommendations. First, a recommendation that the programme be adjusted if deemed deficient in some respect. Second, if after approving the programme the Council identifies a “significant divergence of the budgetary position from the medium-term budgetary objective, or the adjustment path towards it”, the Commission can issue a recommendation (early warning), in accordance with Article 103.4 Third, if the divergence persists, the Council can issue a recommendation to take corrective action, and can make the recommendation public”.

policy, increases its transparency and also facilitates its accountability. Similarly, the Stability and Growth Pact provides the right incentives for the conduct of sound and disciplined fiscal policies across all national governments, while preserving sufficient room for manoeuvre for the operation of automatic stabilisers and prudent anti-cyclical policies without infringing the ceiling of the deficit-to-GDP ratio.<sup>171</sup>

While the Maastricht Treaty and the Stability and Growth Pact make provisions for monetary and fiscal policies – either in the form of the single monetary policy or in the form of disciplinary rules for national governments – wage developments largely remain the result of bargaining among autonomous social partners at the national level. It is evident, however, that the social partners – sometimes contrary to their own perceptions – would act in their own interest by ensuring that price stability and a high level of employment are compatible. Given the fact that the relationship between wage developments, productivity growth and price stability plays an important role in this respect, real wage increases, which do not exceed trend productivity growth, will facilitate the maintenance of price stability and simultaneously promote employment. Obviously, in times of high unemployment, when there is a need to stimulate job creation, employment-oriented wage settlements should not fully exploit productivity increases. Moreover, wage settlements should account for sectoral and regional differences in productivity and labour market conditions. With regard to the role of national governments in this context, modest wage settlements in the public sector should set an example for wage developments in the whole economy that are conducive to a high level of employment and consistent with price stability.

If all policy areas concerned respect the aforementioned allocation of objectives and responsibilities and act accordingly, they will already be making the

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<sup>171</sup> At the theoretical level, A. DIXIT and L. LAMBERTINI. *Monetary-fiscal policy interactions and commitment versus discretion in a monetary union*. in *European Economic Review*, 45, 2001, pp. 977-987 -, have recently provided a support for the fiscal policy constraints embodied in the Stability and Growth Pact. When there is a possible conflict of objectives among the monetary and fiscal authorities in a monetary union, constraints on fiscal policy, such as the debt-to-GDP limits stipulated by the Stability and Growth Pact, may be useful in shifting the fiscal reaction function and achieve more desirable policy outcomes. By contrast, if there is a clear agreement on sound and sustainable objectives among the policies authorities, this will already lead to beneficial policy outcomes without imposing such constraints. Against this background, the establishment of the Stability and Growth Pact may be seen as reflecting some skepticism about fiscal authorities' shorter-term intentions. For other studies of the effects of fiscal constraints in a monetary union see R. BEETSMA and H. UHLIG, *An Analysis of the Stability and Growth Pact*, in *Economic Journal*, Vol. 109, 1999, pp. 546-571.

best possible contribution to the Community objectives as provided for by the Broad Economic Policy Guidelines. Of course, an open exchange of views and information between individual policy actors – without any commitment or mandate to take and implement joint decisions – will assist the overall outcome if it manages to improve the understanding of the objectives and responsibilities of the respective policy areas and does not dilute accountability. This exchange of information will be facilitated, for instance, by “Macroeconomic Dialogue” under the European Employment Pact, which was endorsed at the Cologne European Council meeting in June 1999.<sup>172</sup>

Any form of dialogue, however, should clearly be distinguished from an attempt to co-ordinate macroeconomic policies *ex ante*, which would give rise to the abovementioned information, incentive and enforcement problems. Indeed, given the lack of mutual enforcement mechanisms, *ex ante* co-ordination among different policy actors would tend to blust the fundamental responsibilities of the respective policy areas under the Treaty. This, in turn, would distort incentives, reduce the accountability of individual policy actors and ultimately increase uncertainty about the policy framework.<sup>173</sup>

While the ECB is engaged in a regular exchange of views and information with other policy areas in fulfilling its mandate, there are clear limits to the forms such a dialogue can take. Any dialogue must respect the principle of central bank independence enshrined in the Treaty and must be consistent with the Treaty’s allocation of responsibilities.<sup>174</sup> In particular, any form of *ex ante* co-ordination

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<sup>172</sup> The objective of the Macroeconomic Dialogue is to foster a greater understanding of the policy requirements implied by EMU among economic policy-makers, in order to improve the conditions for non-inflationary and employment-generating growth. The twice-yearly dialogue, established in 1999 by the Cologne European Council, brings together representatives of the governments of the Member States, the European Commission, representatives of the social partners at the EU level and the ECB, as well as one national central bank of a non-euro area country.

The Macroeconomic Dialogue forms part of the European Employment Pact, and thus complements both the Luxembourg process (relating to the co-ordination of employment policies) and the Cardiff process (aimed at improving the functioning of capital and product markets). The Dialogue is based on a full respect for the independence of the social partners in the process of wage formation and that of the ECB in relation to the single monetary policy. The recognition of the assignment of separate policy responsibilities and related obligations helps to focus awareness on the fact that it is the task of each policy actor to ensure the successful implementation of policies within its own field of competence.

<sup>173</sup> On this line of reasoning O. ISSING, *On Macroeconomic Policy Co-ordination in EMU*, JCMS, Vol. 40, No. 2, 2002, pp. 345-358.

<sup>174</sup> As nicely argued by W.H. BUTTER, *Two Naked Emperors? Concerns about the Stability and Growth Pact and Second Thoughts about Central Bank Independence*, CEPR Discussion Paper Series, No. 4001, August 2003, p. 31, “central bank independence means that no-one, including a minister of finance (Ecofin or the euro XII group of finance ministers), can instruct and compel the central bank to

involving the ECB that would entail some form of commitment regarding monetary policy, which could compromise the maintenance of price stability, is not compatible with the Treaty.

Against this background, the following section will elaborate on the particular way in which the single monetary policy contributes to non-inflationary growth and a high level of employment within the overall stability framework established under the Treaty.

#### ***4) The contribution of the single monetary policy***

As will be extensively clarified in the following chapters, the single monetary policy is responsible for maintaining price stability in the euro area as laid down in the Maastricht Treaty. To this end, the Eurosystem has adopted a medium-term oriented monetary policy strategy which is forward-looking and enables prompt action to be taken in order to address any potential threats to price stability. Moreover, the Eurosystem's definition of price stability gives a clear quantification of how its mandate will be interpreted by the Governing Council of the ECB which, in turn, will enhance the transparency and effectiveness of the single monetary policy as such.<sup>175</sup>

Theory and empirical evidence confirm that there is no long-term trade-off between price stability and economic growth. Attempting to use monetary policy to gear economic activity above a sustainable level will, in the long run, simply lead to rising inflation, and not to higher economic growth. In the same vein, monetary policy should not try to fine-tune economic developments. An activist monetary policy, which does not take into account both the long and variable time lags of its transmission and the existing rigidities in the labour and goods markets, would only

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pursue a particular course of action. It does not mean that the central bank does not answer the phone when a finance minister rings. Independence is perfectly consistent with regular communication, co-operation in the pursuit of congruent objectives and co-ordination of policies”.

<sup>175</sup> The ECB and the Eurosystem have other objectives and tasks besides price stability and supporting the general economic policies in the Community, which are mentioned in the Treaty. They concern areas such as foreign exchange operations and foreign reserves, payment systems, banknotes, statistics, prudential supervision and financial stability. Fulfilling these objectives and tasks in an efficient way constitutes an additional contribution of the Eurosystem to macroeconomic stability in general and to price stability in particular. Vice versa, a monetary policy mainly focused on price stability and supported by a robust strategy and an efficient operational framework contributes to the achievement of other objectives of the Eurosystem, such as the integration of money and financial markets, the smooth functioning of payment systems and financial stability.

compromise the maintenance of price stability. Instead, by maintaining price stability over the medium term, the single monetary policy makes the best contribution it can to achieving sustainable non-inflationary growth and a high level of employment, thereby supporting the general economic policies in the Community, as required by the Treaty.<sup>176</sup>

Indeed, maintaining price stability over the medium term has beneficial effects on general economic performance – including growth, investment and employment – and it also serves the interests of social justice: in an environment of price stability, the market mechanism will allocate resources efficiently to their most productive uses; confidence in lasting price stability removes the inflation risk premium on interest rates, thereby ensuring low real interest rates, which, in turn, will foster investment, growth and employment; and price stability helps to protect the weakest members of our society, that is to say those most exposed to the cost of inflation.

In maintaining price stability over the medium term, the Eurosystem's stability-oriented monetary policy strategy aims to take advantage of recent advances in economic research on optimal monetary policy, without losing sight of a few fundamental principles, which have been at the heart of monetary economics for a long time.<sup>177</sup> To this end, it comprises two pillars.<sup>178</sup> First, money is accorded a prominent role, which stems from the relationship between money and prices over the medium and long term – the relevant horizon for monetary policy-making. Second, a comprehensive analysis of a wide range of other economic and financial indicators is undertaken which typically determine price developments in the short run. These two pillars, together, provide a robust framework for a broadly based assessment of the outlook for price developments, focusing both on likely future paths of consumer prices in the euro area as a whole and on the balance of risks to price stability.<sup>179</sup>

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<sup>176</sup> See on this point O. ISSING, *How to promote growth in the euro area: the contribution of monetary policy*, in *International Finance*, 3, 2000, pp. 309-327.

<sup>177</sup> O. ISSING, V. GASPAR, I. ANGELONI and O. TRISTANI, *Monetary Policy in the Euro Area: Strategy and Decision Making at the European Central Bank*, Cambridge, Cambridge University Press, 2001. See also ECB, *The two pillars of the ECB's monetary policy strategy*, in ECB Monthly Bulletin, November 2000.

<sup>178</sup> For a more detailed investigation of the stability-oriented monetary policy strategy, see Chapter Five, *Objectives and Basic Features of the ESCB in Practice*, notably paragraph 2.1.

<sup>179</sup> In particular, the first pillar of the ECB's monetary policy strategy, which contains the relevant information about monetary and financial conditions of the economy, allows the ECB to monitor developments relevant for macroeconomic financial stability other than price stability. Having

The two-pillar strategy of the Eurosystem helps to organise all the available information in a manner which permits both the internal decision-making process by the Governing Council to be structured more efficiently and the resulting decisions to be more easily conveyed to the general public. The monetary policy strategy therefore constitutes an important vehicle for communicating monetary policy decisions and explaining the reasoning behind them. In this context, the clear definition of price stability is to be interpreted as an attempt to give a specific benchmark against which the Governing Council can be held accountable.

With its strong and credible commitment to maintain price stability over the medium term, the Eurosystem's monetary policy strategy also gives reassurance about future price developments and thereby provides a firm anchor for inflation expectations.<sup>180</sup> This should be a factor that helps national governments to plan their medium-term budgets in line with the provisions of the Stability and Growth Pact. Sound fiscal policies aiming for a permanent reduction in budget deficits and debt levels will be a means of strengthening the conditions for maintaining price stability. Similarly, lasting wage moderation, which takes into account the high level of unemployment and accounts for sectoral and regional productivity differentials, will also improve the outlook for price developments.

Given the Eurosystem's monetary policy strategy, there should be no ambiguity about how the single monetary policy will respond to developments in fiscal and wage policies to the extent that they will affect the maintenance of price stability. As a result, national governments and wage setters alike should be able to design and implement the policies under their responsibility in a manner that allows for the interdependencies of these policies with the single monetary policy. Obviously, if they take the single monetary policy's credible commitment to maintain price stability as given, this will help to align expectations and condition their

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systematic information related to the liquidity conditions of the system, which of course does not mean or imply targeting the liquidity of the system, allows central banks to pre-empt possible undesirable financial developments which could eventually negatively affect price stability and economic growth. In the perspective of macroeconomic financial stability, the first pillar of the ECB's monetary policy strategy has merits which become evident in particular if it is understood that its scope goes beyond M3 and that it also provides systematic information about a variety of other monetary and financial indicators. See on these issues, ECB, *The Monetary Policy of the ECB*, Frankfurt, 2001.

<sup>180</sup> See on this point, A. CROCKETT, *In search of anchors for financial and monetary stability*, in M. BALLING, E.H. HOCHREITER and E. HENNESSY, *Adapting to Financial Globalisation*, London and New York, Routledge, 2001.

behaviour in a way which will lead to implicitly co-ordinated policy outcomes, while at the same time limiting policy conflicts and overall economic uncertainty.

The ECB – as guardian of stability in a broad sense – continuously raises the awareness and the mutual understanding of the respective roles and the interdependencies of the different policies. In its Monthly Bulletin, for instance, the ECB recurrently calls for modest wage settlement – either by means of moral suasion or, if necessary, by admonition. Similarly, the ECB regularly reminds national governments to reach the medium-term commitments they made within the framework of the Stability and Growth Pact. Wage setters and national governments, in turn, are reassured that monetary policy will respond favourably to appropriate wage and fiscal policies, which allow maintaining price stability over the medium term.

In this context it is important to recall that monetary policy can deliver price stability over the medium term. This, *inter alia*, reflects the existence of some types of economic shocks which monetary policy cannot control without inducing excessively high variability in real activity and interest rates. As a result, it is not always possible to keep inflation consistent with the definition of price stability. In such cases, when previously formed expectations of stable prices cannot be met, it is important for monetary policy to identify the nature of these shocks and explain their consequences to the general public.

### ***5) Monetary and Fiscal Co-ordination in the Euro Area***

The institutions that manage monetary and fiscal policy in Europe are unusual by the standards of other advanced economies, with responsibilities delegated to a wide range of bodies. The Union-wide institutions are largely set up by the Maastricht Treaty, and policy is designed to be largely guided by rules rather than by discretion. As already highlighted, the European Central Bank has been set the objective of maintaining price stability in the medium term, and by Treaty it is allowed to provide its own interpretation of its remit. Fiscal policy is co-ordinated, or at least regulated, through the Stability and Growth Pact, which imposes a ceiling on the level of borrowing except in exceptional circumstances, and also, indirectly sets target

deficits.<sup>181</sup> But subject to the limits imposed by the Pact, there is considerable national discretion. Nevertheless, it is not clear that due regard is paid to the interdependencies of monetary and fiscal policy, or of different national fiscal policies.<sup>182</sup>

Different arguments have been put forward in order to justify the reason why monetary and fiscal policy in the euro area might be better co-ordinated than managed independently. Fiscal policy is believed to have some influence on local inflation rates through its effects on demand. But it is also the case that monetary policy has fiscal implications. First of all, a restrictive monetary policy is likely to depress economic activity. This will reduce tax revenues and may bring national economies closer to breaching any fiscal target. Secondly, heavily indebted economies, and particularly those whose national debt is of short maturity, are bound to find that debt interest payments rise if interest rates are high. Despite these fiscal implications of the actions of the European Central Bank, it is the national governments and not the ECB, which have sole responsibility for keeping borrowing within the permitted bounds. It is not

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<sup>181</sup> The Stability and Growth Pact complements the excessive deficit procedure. On the basis of the Resolution of the European Council adopted on 17 June 1997, the Council adopted two Regulations: the "Council Regulation on the strengthening of the surveillance and of budgetary positions and the surveillance and co-ordination of economic policies" and the "Council Regulation on speeding up and clarifying the implementation of the excessive deficit procedure". These provisions set the framework through which Member States have committed themselves to achieving sound public finances in the medium term. Member States are committed to pursuing the medium-term objective of budgetary positions "close to balance or in surplus". The idea is to allow them to deal with normal cyclical fluctuations while keeping their general government deficit-to-GDP ratios below 3 per cent. Moreover, in a framework of multilateral surveillance, euro area Member States are obliged to submit stability programmes to the EU Council and the European Commission. The non-participating Member States have to submit convergence programmes. Both of these contain the information needed to assess the budgetary adjustments envisaged over the medium term to reach the close to balance or in surplus position.

An essential complement to these ways of promoting stability-oriented fiscal policies is the Treaty's "no bail-out" clause. Article 103.1 (ex Article 104b.1) of the Treaty states: "The Community shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project". This clause ensures that the responsibility for repaying public debt remains national. It thus encourages prudent fiscal policies at the national level.

<sup>182</sup> Further provisions contributing to fiscal discipline are the prohibitions of monetary financing of budget deficits and of any form of privileged access for the public sector to financial institutions. Article 101 (ex Article 104) of the Treaty forbids the ECB and the NCBs to provide monetary financing for public deficits using "overdrafts facilities or any other type of credit facility with the ECB or with the central banks of the Member States". Article 102 (ex Article 104a) of the Treaty prohibits any measure that may establish privileged access to financial institutions for governments and Community institutions or bodies. In addition to increasing the incentives to pursue sound public finance and prudent fiscal policies, these provisions contribute to the credibility of the single monetary policy in the pursuit of price stability.

only the interaction between monetary and fiscal policies, which give rise to concern. In fact, fiscal policies may interact. For instance, Germany's budget balance may depend on the fiscal stance adopted in France. If monetary and fiscal policies are set jointly, then it should be easier to ensure that both inflation and budgetary targets are met. If, on the other hand, policy-makers do not co-operate with each other, then each is likely to set policy taking the behaviour of the others as given. This is likely to be worse all round than the co-operative outcome.

Moreover, there is a popular view of economic policy in the EMU, which holds that monetary policy will be responsible for managing the aggregate EMU economy while fiscal policy will concentrate on smoothing asymmetric shocks affecting the individual states.<sup>183</sup> According to this paradigm, no co-ordination is necessary between monetary and fiscal policy or between the fiscal policies among the individual states. There are however several reasons why this view must be refuted. While monetary policy in the EMU will aim primarily at price stability,<sup>184</sup> there are other macroeconomic policy goals such as external balance and full employment that must be considered. Monetary policy itself would be overburdened with the task of reaching both price stability and external balance and full employment with one policy instrument: this is why the Maastricht Treaty gives the ESCB the relatively narrow mandate it has today.

Thus, the need for an adequate policy mix remains in the EMU.<sup>185</sup> Consider a situation in which the EMU is exposed to rising inflationary pressures and is running an excessive external deficit. Monetary policy could remedy the external problem by lowering interest rates to achieve a devaluation of the euro, but this would run counter the internal demands of monetary policy. Fearing a rise in inflation, the central bankers would, therefore, do nothing or little to address the external deficit. Instead,

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<sup>183</sup> Cfr. R. BEETSMA, X. DEBRUN and F. KLAASSEN, *Is Fiscal Policy Co-ordination in EMU Desirable?*, CEPR Discussion Paper Series, No. 3035, October 2001, where the role of national fiscal policies in stabilising country-specific economic disturbances in the EMU is interestingly discussed.

<sup>184</sup> See M. J. HERDEGEN, *Price stability and budgetary restraints in the Economic and Monetary Union: The law as guardian of economic wisdom*, in CML Rev. 35, 1998, pp. 9 – 32.

<sup>185</sup> Cfr. on this point C. WYPLOSZ, *Economic Policy Co-ordination in EMU: Strategies and Institutions*, Forum Economique Franco-Allemand, Deutsch-Französisches Wirtschaftspolitisches Forum, 4th Meeting, Bonn, January 11 – 12 1999, CEPII, N. 1999 – 04, avril. See also J. VON HAGEN and S. MUNDSCHEK, *The functioning of economic policy co-ordination*, in M. BUTI and A. SAPIR (eds.), *EMU and Economic Policy in Europe. The Challenge of the Early Years*, Edward Elgar, Cheltenham, UK – Northampton, MA. USA. 2003, pp. 173 – 204.

the situation would require a fiscal contraction reducing aggregate demand in the EMU. But fiscal policy makers would fear that the fiscal contraction would result in too low employment in the EMU and prefer a monetary policy adjustment instead. They too would deliver too little adjustment. With no co-ordination among the Member States, each government would also have good reason to wait and see if the other governments undertake unpopular spending cuts – this would re-enforce the tendency for too little adjustment.

This being so, the degree of co-ordination between fiscal and monetary policy necessary in the EMU will largely depend on the ESCB's interpretation of the role of monetary policy. Two basic models are debated today in Europe, one in which monetary policy engages in active aggregate demand management with a view towards low inflation and employment, and another one in which the central bank aims at delivering a monetary framework consistent with price stability by eliminating all monetary policy impulses for inflation. The former concept, which is imbedded in a strategy of inflation targeting implies that central bank would react to all shocks causing movements in the price level. Under this approach, the ECB would aspire to be the powerful manager of the EMU economy who, following the Fed's role model, tries to actively prevent economic busts and booms. The latter approach, on the other hand, represented by the Bundesbank's model of a monetary policy based on monetary targets, would only counteract shocks originating in the monetary sector of the economy, aiming at a much more modest task of holding down destabilising impulses from the monetary side.

The distinction between the two concepts of monetary policy becomes important when one realises that the exogenous shocks affecting output and prices in an economy are themselves the result of the action of other players in the economic policy game.<sup>186</sup> Fiscal policy and the governments are, of course, an important part of that. Specifically, a central bank engaged in active aggregate demand management relieves governments and unions from the need to think about the macroeconomic

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<sup>186</sup> On this point see S. COLLIGNON, *Is Europe going far enough? Reflections on the Stability and Growth Pact, the Lisbon Strategy, and the EU's Economic Governance*, LSE and CEP, April 2003, p. 5 where the author underlines that "because policy preferences are defined in national constituencies, different governments have different preferences and objectives. But at the same time the growing interdependence between national economies within the same monetary framework has led to an increasing range of spillovers into other jurisdictions" (...) "What one Member State does, increasingly affects all others and inconsistent policy objectives would lead to welfare lowering outcomes. The internalisation of these externalities creates the need for policy co-ordination".

consequences of their actions (e.g., a government knowing that it would more easily undertake fiscal expansion, say for electoral purposes, knowing that any adverse macro effects will be prevented by the central bank). Similarly, unions will more easily step up their wage demands if they can rely on the central bank for responding to any unemployment resulting from their policies with a monetary expansion.

In contrast, a central bank refraining largely from active aggregate demand management forces these other actors in the economic policy game to face the consequences of their own actions. It would not respond to a fiscal expansion with either a monetary ease or with a monetary contraction, but rather stick to its medium-term oriented monetary policy. As fiscal policy makers and unions would realise the potential macroeconomic costs of their actions, their behaviour would become more disciplined. A more active central bank obviously would need closer co-ordination with fiscal and wage policies to avoid inefficient outcomes and policy mistakes. But even a more medium-run oriented monetary policy needs co-ordination with other policy actors, although it can be limited to co-ordinating the medium-run orientation of monetary and fiscal policy.

Another approach regarding fiscal policy in the EMU is that the Stability and Growth Pact already provides for sufficient policy co-ordination. It is easy to see that this holds only under special assumptions. Since the Pact limits the extent to which governments can respond to recessions by increasing spending or cutting revenues, it would serve an useful role for co-ordination if, in an uncoordinated equilibrium, national fiscal policies react too much to changes in aggregate demand. Such an assumption can be true only if fiscal spillovers are predominantly negative, such that a fiscal expansion in one EMU State causes aggregate demand in other EMU States to decline. In addition, this requires that fiscal spillovers work predominantly via interest rates. A fiscal expansion in one State may raise EMU interest rates and causes aggregate demand elsewhere to decline. Fiscal spillovers operating through income and import effects, in contrast, are positive. A fiscal expansion in one State leads to an increase in aggregate demand elsewhere, because consumers and businesses in that State buy more of the goods imported from other States. In an EMU with intensive trade links among the Member States, this effect is likely to be larger, but also highly differentiated in consideration of the variable impact of a measure adopted either in

one of the biggest countries or in one of the smallest. Thus, the efficiency of the Stability and Growth Pact as a co-ordination device remains in doubt.

The conclusion is that the EMU faces a co-ordination problem for the fiscal policies of the Member States. To solve this problem, the member governments must agree on the course of the EMU's macroeconomic development they wish to attain and on the combination of fiscal policy instruments to reach this goal.

### *5.1) Co-ordination and the current Institutional Framework*

The problems of co-ordination in Europe are clearly a magnitude larger than in a unitary state, as there one only has to consider a "game" between the central bank and a single fiscal authority. In the euro area, instead, there are currently 12 fiscal authorities and the Commission, all of who have to play to co-ordinate. "There is always the possibility that unrestricted fiscal policies could lead to a "prisoner's dilemma" outcome where all governments borrow more than is optimal".<sup>187</sup>

On the one hand, as already stated at the outset and further specified in the following, the ECB has an explicit objective of ensuring medium-term price stability in the whole euro area. In contrast to most other central banks it has the freedom to set as well as to implement policy targets. This is a stronger degree of independence than in other euro area central banks operating in the past and than in North America and the UK today. Medium-term price stability has been defined by the ECB to be an annual rate of (harmonised) consumer price inflation of between 0-2 per cent per annum. Price rises of up 2 per cent may be consistent with price stability given the expected, but difficult to measure, improvements that can be achieved in product quality.<sup>188</sup>

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<sup>187</sup> R. BARRELL and M. WEALE, *Monetary and Fiscal Co-ordination in the Euro Area*, in I. BEGG (ed.), *Europe: Government and Money. Running EMU: The Challenges of Policy Co-ordination*, The Federal Trust for Education and Research, London, 2002, at p. 74.

<sup>188</sup> Note, for the sake of clarity, that the Governing Council of the ECB announced the following quantitative definition in 1998, stating that: "price stability shall be defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%". See the ECB Press Release entitled *A stability-oriented monetary policy strategy for the ESCB*, dated 13 October 1998, available at [http://www.ecb.int/press/pr981013\\_1.htm](http://www.ecb.int/press/pr981013_1.htm).

Such definition sheds light on the main elements of the stability-oriented monetary policy strategy of the ECB, which concern: (i) the quantitative definition of the primary objective of the single monetary policy, price stability; (ii) a prominent role for money with a reference value for the growth of a

On the other hand, it can be argued that the fiscal structure seems to be inevitably more complicated. The Maastricht Treaty prohibits budget deficits of more than 3 per cent of the GDP and sets out a system of penalties for countries that exceed these limits.<sup>189</sup> The penalties are, however, waived for countries facing severe recessions. In addition, the Maastricht Treaty laid down other fiscal conditions, which countries had to meet as preconditions for participating in the monetary union. These included the 3 per cent deficit limit and also a requirement that the stock of government debt either should not exceed 60 per cent of GDP or that, if it did, countries should be taking active measures to reduce the stock of debt to 60 per cent of GDP.

The Stability and Growth Pact, agreed in 1997, is an arrangement for implementing and monitoring the Maastricht Treaty limits. It requires all the members of the euro area to adopt a medium-term objective of achieving budget close to balance or in surplus. The pact is underpinned by an “excessive deficit procedure”

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monetary aggregate, and; (iii) a broadly based assessment of the outlook for future price developments. As far as the quantitative definition of price stability is concerned, it is worth recalling that the Governing Council has highlighted three main features: (i) “the HICP is the most appropriate price measure for the ESCB’s definition of price stability. It is the only price index that will be sufficiently harmonised across the euro area at the start of Stage Three”; (ii) by focusing on the HICP “for the euro area”, the Governing Council of the ECB made it clear that it would base its decisions on monetary, economic and financial developments in the euro area as a whole. In fact it asserted that “the single monetary policy will adopt a euro area-wide perspective; it will not react to specific regional or national developments”; (iii) an “increase of below 2% is very much in line with most current definitions adopted by national central banks in the euro area.

The ECB’s monetary policy strategy has been further confirmed by the Governing Council on 8 May 2003 in its ECB Press Release available at [http://www.ecb.int/press/03/pr030508\\_2en.htm](http://www.ecb.int/press/03/pr030508_2en.htm). This evaluation, which was carried out after more than four years of successfully conducting monetary policy for the euro area, took into account also the public debate and a series of studies performed by the ECB staff (notably a note - published on the ECB’s website, <http://www.ecb.int/pub/strategy/strategy.htm> – entitled *Overview of the background studies for the reflections on the ECB’s monetary policy strategy* summarises the main conclusions from the background papers.

<sup>189</sup> For an analysis of the concrete *modus operandi* of the system of sanctions under Article 104 EC Treaty and its future feasibility, see J.-V. LOUIS, *The Economic and Monetary Union: Law and Institutions*, CML Rev 41, 2004, notably at p. 578-580. It should be noted that, while Article 104.2 EC Treaty sets forth that “the Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors”, the recent practice of infringement of the rules by the so-called delinquent Member States (Germany and France) and the role played by the Council has emphasised that “the authority of the Commission as the central element of multilateral surveillance of excessive deficits was put at risk, in favour of an intergovernmental approach” (Ibidem, p. 579). For further information about the infringement case of Germany and France, see Council Decision 2003/89/EC of 21 January 2003 on the existence of an excessive deficit in Germany, O.J. [2003] L 034 and Council Decision 2003/487/EC of 3 June 2003 on the existence of an excessive deficit in France, O.J. [2003] L 165.

involving multilateral surveillance and possible penalties. A general government budget deficit above 3 per cent of GDP is considered excessive unless the European Commission judges it to be temporary, and likely to last for only a year, and there are special circumstances. Exemption is granted automatically if there is an annual fall in output of more than 2 per cent, an event experienced only by Finland and two non-participants – the UK and Sweden, in the last forty years.

The Stability and Growth Pact conditions are discussed in the context of the Broad Economic Policy Guidelines that are set each year by the Commission. The latter are adopted by the Council of Ministers, the Union's legislative body, as "at the centre of economic policy co-ordination in the European Union".<sup>190</sup> European Commission's officials advise the Ecofin, the Economic and Financial Affairs Council of the European Union on the specification and implementation of the guidelines and on questions such as whether advice or more strongly-worded warnings should be offered to particular countries. Since the fiscal limits of the Maastricht Treaty apply only to the members of the euro area, and not to the whole of the European Union, the Eurogroup<sup>191</sup> of finance ministers of euro area countries practically handles this aspect of Ecofin business. The Economic Policy Committee and the Economic and Financial Committee are fora enabled to discuss monetary policy with representatives of the ECB and the National Central Banks, thus representing the major forum for co-ordinating such policies. Finally, by virtue of Article 111 EC Treaty, responsibility for exchange rate policy in the euro area is divided between the ECB and the Council, even though the ECB has the sole responsibility for implementing monetary policy.

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<sup>190</sup> See Council of Ministers, *Presidency Conclusions*, Barcelona European Council 15-16 March 2002, Part III, p. 3, available at <http://www.ue.eu.int/en/Info/eurocouncil/index.htm>

<sup>191</sup> The set up of this informal grouping has been decided at the Luxembourg European Council of 13 December 1997, "after dramatic discussion with the British government. This resolution allows the Ministers of the States participating in the euro area, to "meet informally among themselves to discuss issues connected with their shared specific responsibilities for the single currency. The Commission and the ECB when appropriate, will be invited to take part in the meetings". The Eurogroup, which usually meet for two hours before the formal Ecofin meeting, is now convened the day before. It has organised a procedure of "cross examinations" of economic policies and situations. The Group will follow, on a permanent basis, the budgetary situation of participating Member States (Helsinki Report, point 33). This surveillance could result in the activation by the Ecofin Council of the early warning system provided by Regulation 1466/97. So a link exists between the informal and the formal procedures. (J.-V. LOUIS, *The Eurogroup and Economic Policy Co-ordination*, in: J.-V. Louis (ed.), *The Euro in the National Context*, London, The British Institute of International and Comparative Law, 2002, p.357-358).

The Stability and Growth Pact can be seen as a device for ensuring that fiscal policies are co-ordinated in the medium term to ensure that private sector investment is not crowded out by individual governments borrowing too much and pushing up Union wide real interest rates or to avoid weakening the capacity of the European Central Bank to stabilise price level. However, this medium term co-ordination device may reduce the effectiveness of short-term co-operation and there is no evidence that short-term fiscal co-ordination as a tool of demand management is discussed.

The belief that short-term, interventionist, macroeconomic policies were often unproductive has influenced the construction of the new institutions. In particular, the decision to eschew the existence of a powerful central fiscal authority reflects, in part, this view. However, it also reflects the need to construct compromises between individual sovereign states. If fiscal policy is needed to deal with a serious problem that affects all Member States, such as a major recession, then it remains available. It would be in the interests of all to use it and the institutions described above could ensure rapid and effective reactions to problems, although they may not do so, and they are not required to act. Problems that hit individual countries should be able to be dealt with within the confines of the Stability and Growth Pact, but this may need reform and clarification so that countries do have the ability to deal quickly with their own temporary problems.

There have been a number of examples recently where the Commission has felt necessary to comment on fiscal policy both because it was worried that countries might breach the rules of the Stability and Growth Pact and in order to ensure that national fiscal policy supported the ECB's monetary policy.<sup>192</sup>

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<sup>192</sup> As an example of the first type, in early 2002 the increase in the budget deficit in Germany appeared to be a matter of concern, although a significant economic slowdown was underway. As this was a demand shock, it was not clear that the German government had intentionally breached any Treaty commitments over the medium term were not being changed. Indeed, the Stability and Growth Pact is designed to allow deficits to rise when needed. In any case, as far as the sanctions are concerned, it is worth recalling that the decision by the Finance Ministers on 25 November 2003 not to implement the sanctions procedure foreseen by the Stability and Growth Pact in the cases of Germany (and also France) has underlined the political vulnerability of the enforcement of the rules and has prompted a discussion of possible reforms of the Pact. At the same time it is noteworthy that, notwithstanding the procedural dispute with the Commission, both countries concerned committed to reduce their deficits to below the 3% threshold within the timeframe envisaged in the Commission Recommendations. In this way the Pact continues to exert influence, even in a situation in which its legal application is in doubt. On the controversies and proposals to reform the SGP see M. BUTI, S.C. ELFFINGER and D. FRANCO, *Revisiting the Stability and Growth Pact: Grand Design or Internal Adjustment?*, CEPR Discussion Paper Series, No. 3692, January 2003.

In any case, the straightforward way to achieve policy co-ordination in the EMU would have been that to create a common fiscal policy implemented on the basis of a much larger budget at the EMU level. But the Maastricht process showed that the Member States did not want such a solution. Given the basic conditions, policy co-ordination will have to come through a mechanism of joint decision making among participants national governments. Political economy has long shown that policy co-ordination creates a conflict between individual and collective rationality and, hence, incentives to deviate from the common policy.<sup>193</sup> To make co-ordination work, it must therefore be based on binding agreements on co-ordinated fiscal actions. For the EMU, this raises a fundamental difficulty, namely that the current European Treaty provides no basis on which individual member governments can be bound to undertake specific fiscal policy actions. The implication is that a framework for policy co-ordination in the EMU must devise its own mechanism to make agreements on co-ordinated fiscal policy binding. This can be achieved, if deviating from a common agreement carries a significant political or cost in reputation for the deviant government.

Two requirements are essential for this: the agreement and the procedure by which it is reached must be sufficiently visible and transparent to the public, forcing a deviant government to justify its action. Furthermore, the other participants and the observers of the process must be convinced of the high quality of the co-ordinated policy.

These considerations imply that the forum for policy co-ordination in the EMU should be composed of sufficiently senior representatives of the governments of the Member States, and that their meetings should have sufficient public visibility. An informal approach to policy co-ordination that would consist merely of irregular talks and meetings of bureaucrats would not suffice for that purpose. Instead, policy co-ordination should work through an Economic Policy Council for the EMU, consisting of the national ministers of economics or finance or their senior secretaries of State.<sup>194</sup>

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<sup>193</sup> The conflict between individual and collective rationality means that it is better for a government to deviate from a co-ordinated policy, given that the other governments adhere to it. Since this is true for all participating governments, co-ordination is inherently fragile.

<sup>194</sup> This is the view of J. VON HAGEN, *Co-ordination of Economic Policies and Employment*, in A. LAMFALUSSY, L.D. BERNARD and A. CABRAL (eds.), *The Euro-Zone: A New Economic Entity?*, Bruylant, Bruxelles, 1999, pp. 61-75. A forum resembling the imagined Economic Policy Council might be the Economic Policy Committee (EPC) - established in 1974 by way of a Decision of the EU

The role and authority of this Council would be – while mirroring that of the Ecofin Council - to publish detailed assessments of the EMU's macroeconomic stance and to give policy recommendations to all EMU Member States regarding their fiscal policies. Indeed, the reason to justify the existence of such separate body rests again upon the observation that the fiscal limits of the Maastricht Treaty apply only to the members of the euro area, and not to the whole of the European Union.

Since the Economic Policy Council could not issue binding directives for the fiscal policies of the Member States, its influence should be built on reputation, specifically the reputation of giving sound policy advice and of high-quality economic judgements. Building such reputation is impossible if the EPC suffers from institutional weakness and instability. It would require many resources, thus the EPC should be vested with a staff providing economic analysis to make it independent of the European Commission and the ECB. Institutional stability could be achieved by a sufficiently long chairmanship enabling the EPC chair to develop an agenda and a reputation for consistency in policy advice. Coinciding with the terms of most governments, a chairmanship of four years would be preferable.<sup>195</sup>

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Council (74/122/EEC), which is composed of four representatives from each of the Member States and from the European Commission. Since April 1999 the ECB has also been participating in meetings of the EPC as a result of an open invitation. Recently, however, the ECB's membership has been placed on an equal legal footing with that of existing Committee members by virtue of a revised statute of the Committee.

Like the EFC, the EPC is involved in the preparation of meetings of the Eurogroup and the Ecofin Council. Nevertheless, its work focuses particularly on structural reform. The Committee conducts an annual in-depth peer review of economic reforms in Member States and analyses longer-term issues of economic policy, such as the budgetary implications of population ageing.

Moreover, the EPC is closely involved in both the "Cardiff process", which is designed to improve the functioning of product, capital and services markets in the Community, and the "Luxembourg process", which provides a platform for co-ordination among Member States in the area of employment policies. Since the ECB attaches the utmost importance to structural reforms in the Member States as the principal means of combating unemployment and fully exploiting the growth potential of the euro area, the ECB's participation in the EPC offers a useful opportunity to contribute to the Committee's work on structural reform, which is likely to figure even more prominently on the European agenda in the future than is currently the case. As with the Economic and Financial Committee, the ECB's involvement in the work of the EPC is based on a full respect for its independent status.

<sup>195</sup> According to von Hagen, deliberations and recommendations of the Economic Policy Council should always be public to achieve transparency and to force individual governments to argue why they did not follow its recommendations. Moreover, meetings of the EPC should take place in quarterly frequency, to allow the Council to react to current economic developments and make timely recommendations. The chairman of the EPC should be invited to the meetings of the European Council for a report of the EMU economy and to explain its recommendations. This would force the governments to discuss these recommendations in public and reach a public agreement whether to follow them or not. The chairman should also be invited to hearings before the pertinent committee of the European Parliament, namely the one that calls the ECB President to testify. This would raise the status of the EPC in the public debate and give the European Parliament a chance to review and discuss the full macroeconomic picture of the EMU. For a further analysis of this topic, see J. VON HAGEN, *Co-*

This being the situation *de iure condendo*, it should be said that criticisms of the proposal of an Economic Policy Council fear that a Council of the governments co-ordinating fiscal policies would undermine the leadership of the ESCB in matters of EMU macroeconomics, and that this would endanger the ECB's independence. But there are good reasons to suggest that the central bank will be politically weak precisely because of the lack of an institutional counterpart at the European level. First, absent a Council (as political interlocutor), the ESCB will be the only European institution with macroeconomic responsibilities. As such, it will necessarily become the focal point of all dissatisfaction in the EMU with macroeconomic developments. Since high unemployment will remain the EMU's principal economic policy problem for the foreseeable future, this means that the ESCB will be under constant pressure to ease monetary policy. For a while, it may avoid such pressure by pointing to its mandate for price stability and to the fact that a monetary expansion is not the right way to fight high structural unemployment. Like all large institutions, however, the ESCB will eventually yield to sustained political pressure. The ultimate result of the institutional imbalance would then be an undesirably high rate of inflation.

Central banks in national monetary systems can deflect such pressures by reminding the public of the government's responsibility for labour market policies. In the EMU, this would be impossible due to the lack of a central government. The EPC would make the ESCB's position in the public debate easier by forcing the governments to publicly assume responsibility for employment policies. The EPC would redirect public criticism from the central bank to the governments and, thus, help the ESCB to maintain a firm price stability orientation.

Furthermore, other criticisms fear that the Economic Policy Council would exert undue influence on the ECB and pressure towards a too inflationary monetary policy. Ultimately, this critique rests on the simple-minded wish that monetary policy can be "depoliticised" by delegating it to an independent central bank lead by technical experts.<sup>196</sup> A more realistic view, however, must recognise that the EMU does not simply abolish the governments' desire to influence monetary policy in their

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*ordination of Economic Policies and Employment*, in A. LAMFALUSSY, L.D. BERNARD and A. CABRAL (eds.), *The Euro-Zone: A New Economic Entity?*, Bruylant, Bruxelles, 1999, pp. 61-75.

<sup>196</sup> On this point see C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford – Portland Oregon, 2001, who argue that a process of denationalisation and depoliticisation is already operating within the ESCB since 1 January 1999.

own interest. EMU governments will still try to pressure and influence the ESCB regardless of the existence of a centralised political body (like the Economic Policy Council). The issue at hand is therefore not whether or not the ESCB will be exposed to political pressures, but rather whether or not such pressures take place in an orderly framework.

Finally, it can be argued that, outside the framework of an Economic Policy Council, political pressures might still act spontaneously and in an intransparent manner, raising doubts about the ECB's reaction to pressures from individual governments and its credibility. The creation of such a political body (as figured out by von Hagen) would provide an orderly framework for the relations between the ESCB and the governments by structuring their debate and by forcing them to define openly their interpretations of the roles of monetary and fiscal policy in the EMU. By making these relations more transparent, the EPC would strengthen the accountability both of national fiscal policies and of the ECB and, thus, raise the quality and credibility of monetary policy in the EMU.

#### **6) *Methods, principles and actors of policy co-ordination***

Before EMU, policy co-ordination in the EU relied on two main methods: harmonisation of policies based on common rules of behaviour, and delegation to Community institutions. EMU has expanded the scope of co-ordination under both methods. The conduct of the common monetary policy by the Eurosystem is an example for delegation. The fiscal strictures of the Excessive Deficit Procedure and the Stability and Growth Pact are examples for rules-based/knowledge-based co-ordination in EMU. But, in addition to these traditional methods, the Maastricht process and the development of the Union during the 1990s also introduced new forms of co-ordination, which are based on dialogue, the exchange of information, peer pressure and persuasion. The reliance on "soft enforcement",<sup>197</sup> i.e. peer pressure

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<sup>197</sup> See J.-V. LOUIS, *The Eurogroup and Economic Policy Co-ordination*, in: J.-V. Louis (ed.), *The Euro in the National Context*, *op. cit.*, pp. 351-371, where the author writes: "Co-ordination of economic policies is thus a vital requirement, but the commitments subscribed by the Member States as a result of the process of co-ordination are closer to soft law than to hard Community law. As underlined by the Ecofin, "the present political framework allows for different forms of co-ordination" from "dialogue" to "binding commitments", without specifying if these commitments are legal obligations or political

and persuasion, indicates that the EU Member States were unwilling to give up further sovereignty over their economic policies. The scope of policies covered by the existing co-ordination processes ranges from budgetary policies over labour market policies to regulatory policies at the national level.

Policy co-ordination can have a narrow or a broad agenda. With a narrow agenda, co-ordination is limited to monitoring the national economic policies of the Member States and challenging practices that are expected to worsen the quality of the EMU's macroeconomic performance, e.g. with regard to price stability. The Excessive Deficit Procedure is an example for co-ordination under such a narrow agenda. Co-ordination with a narrow agenda leaves the Member States the freedom to choose their policy goals, instruments, and methods of implementation. With a broad agenda, policy co-ordination goes beyond that and develops an explicit framework for cooperative policies. This requires agreement on a set of common policy goals and methods to achieve these goals. Apart from the single monetary policy and the administration of the Single Market, policy co-ordination in EMU today proceeds under a narrow agenda.<sup>198</sup>

Policy co-ordination today is also of an "unconditional" nature in the sense that the participating member governments (and the ECB, where applicable) inform each other about what they intend to do given their expectations about future economic

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undertaking. In its 2001 communication on "Strengthening Economic Policy Co-ordination", the Commission observes that this co-ordination "within the euro area is based on consensus. It does not aim at imposing a decision on a particular Member State but to convince it to apply the policy deemed to be desirable" (COM (2001) 82 final, 7.2.2001). This co-ordination comprises three elements for the Commission:

- a common assessment of the economic situation.
  - agreement on appropriate economic policy responses
  - acceptance of peer pressure and, where necessary, adjustment of policies being pursued.
- (Ibidem, p. 354).

<sup>198</sup> As insightfully observed by J.-V. LOUIS, *The Economic and Monetary Union: Law and Institutions*, CML Rev 41, 2004, p. 586, (...) "economic policy co-ordination as it is organised under the Treaty on the basis of non-compulsory BEPG, multilateral surveillance, peer control and the absence of sanctions (except for the intended dissuasive effect of the "atom bomb" of sanctions under Art.104 on excessive deficit, which still has to prove its effectiveness), was a kind of prefiguration of the celebrated Lisbon "Open Method of Co-ordination", the post-modern way of regulation" (emphasis added). See, for the new modes of regulation KNILL and A. LENSCHOW, *Modes of Regulation in the Governance of the European Union: Towards a Comprehensive Evaluation*, European Integration Online Papers (EioP), Vol. 7, No. 1, 2003, available at <http://eiop.or.at/eiop/texte/2003-001a.htm>; G. DE BURCA, *The constitutional challenge of new governance in the European Union*, European Law Review, Vol. 28, No. 6, December 2003, pp. 814-839; G. DE BURCA and J. ZEITLIN, *Constitutionalising the Open Method of Co-ordination. A Note for the Convention*, Madison/WI-Florence, 2003; B. EBERLEIN and D. KERWER, *Theorising the New Modes of EU Governance*, European Integration Online Papers (EioP), Vol.6, No. 5, 2002, available at <http://eiop.or.at/eiop/texte/2002-005a.htm>

circumstances. What will happen, if these expectations fail to materialise, however, is not part of the various procedures. This limitation is particularly important in the context of co-ordination between monetary and fiscal policy in the EMU, where the key strategic issues involve the short run and development of transparent rules for reaction to shocks could greatly help guide private sector expectations.

According to the above-mentioned Article 99 of the Treaty on European Union, Member States coordinate their economic policies at the EU level within the Council of Ministers with the participation of all 15 Member States and the presence of the European Commission and of the ECB where deemed necessary. The Council of Economics and Finance Ministers (Ecofin) is the relevant one for the discussion and decisions about government deficits, spending and taxation, while the Employment/Social Affairs Council deals with employment and social policies. In the co-ordination procedures established by the Treaty, the Council adopts Economic Policy Guidelines and recommendations by majority voting on a proposal from the Commission. There is also a host of ministerial committees working below the Council to prepare its work (see, for instance, the above-mentioned the Economic Policy Committee and the Financial and Economic Committee). In recognition on the specific co-ordination requirements among participants of the euro area, the 1997 European Council in Luxembourg established the Eurogroup (also known as the Euro 12-Group) of the finance ministers of the EMU Member States. Since the Eurogroup has neither formal decision making authority, nor legislative responsibility, its role is limited to assessing the economic situation and discussing the major policy issues for the euro area.<sup>199</sup> The group is chaired by a minister of a participating EMU Member State holding the EU Presidency, and, in periods when a non-EMU Member holds the EU Presidency, by a minister of the next EMU Member State to hold the EU Presidency. The Eurogroup gathers in connection with Ecofin meetings.<sup>200</sup>

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<sup>199</sup> Despite of the fact that the Eurogroup is neither anchored in the Treaty by means of a legal basis nor disposes of a normative capability, it still “poses a constant threat to the Ecofin Council, which is to remain at the centre of the economic co-ordination and decision making process” (B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien, 2003, p. 146). Yet, observers note that key discussions on economic policy-making and co-ordination are gravitating towards Eurogroup. Indeed, the secret of the success and the efficiency of the Eurogroup lies in the fact that – due to the informal character and the restricted participation – discussions are more intense and more open, allowing the participants to express themselves more freely.

<sup>200</sup> See J. VON HAGEN and S. MUNDSCHENK, *The functioning of economic policy co-ordination, op. cit.*, at p. 185. It should be emphasised that, at the moment, not all of the 15 EU Member States have

The European Commission is present both at Council and Eurogroup meetings. The Commission has the right to set the policy agenda for Council meetings and to provide analysis for multilateral surveillance.

Another forum for discussion is the Economic and Financial Committee (EFC)<sup>201</sup>, which has advisory and preparatory functions for the Council meetings. It consists of representatives of the national administration and the national central banks, as well as to representatives of the European Commission and the ECB. The Treaty itself lays down the ECB's participation in the EFC, stipulating that not only the Member States and the European Commission, but also the ECB shall appoint members of the Committee (each no more than two). Within the limits set by the

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introduced the euro, and the prospect of a large-scale enlargement of the EU is set to prolong a situation whereby the euro area represents only a subset of the EU as a whole. While the Ecofin Council naturally covers the entire EU, there is no provision in the Treaty for a body, which brings together the finance ministers of the euro area Member States. In order to remedy this situation, the Luxembourg European Council, meeting in December 1997, established the Eurogroup as an informal body to allow ministers of the euro area Member States (as well as a member of the European Commission) to discuss issues of common concern with regard to the euro area and the single currency. The ECB is to be invited "when appropriate" – and has, indeed, been invited regularly thus far – to participate in the meetings of the Eurogroup. The informal character of this body allows for an open discussion of all issues relevant to the euro area. The climate of openness and trust is reinforced by the fact that the Eurogroup meetings are restricted to the ministers, the European Commissioner and the President of the ECB only (each with one accompanying person) – in contrast with the usual large number of participants at formal Council sessions.

As a rule, the Eurogroup meets once a month before the Ecofin Council meetings. In some ways, the Eurogroup could thus be regarded as an attempt to establish, at the euro area level, a communication channel comparable with the informal contacts between governments and central banks that traditionally exist within Nation States. Discussions within the Eurogroup are aimed at improving the overall functioning of the euro area economy. To this end, the Eurogroup regularly assesses the overall economic outlook for the euro area, discusses budgetary developments in individual euro area Member States and provides political impulses for further efforts to bring about structural reforms. In addition, the Eurogroup also discusses developments in the euro area exchange rate and the external perception of the euro area as an entity in its own right. The recent decision by the Eurogroup to make its work more visible to the general public by regularly holding press conferences after its meetings should be seen in this context.

The ECB supports these efforts and appreciates the dialogue within the Eurogroup as an effective tool for communication between the monetary and economic policy authorities of the euro area, which allows them to exercise, with full respect for the individual responsibilities assigned to them, their shared specific responsibilities for the single currency.

<sup>201</sup> Article 114 paragraph 2, provides for the creation of the Economic and Financial Committee, as a successor of the Monetary Committee, created by Article 105 of the EEC Treaty. "This Committee plays an important role in the elaboration of all the decisions taken by the Ecofin in economic and financial matters. It is defined by the Treaty as a consultative and preparatory organ for both the Council and the Commission but it is *de facto* more than that. It is very infrequent for a document that has reached a consensus in the framework of the EFC, to be seriously challenged at ministerial level and although its preparatory works are made "without prejudice" of the COREPER's role (see Article 114.1, 3<sup>rd</sup> indent), it is only on very rare occasions, to speak diplomatically, that a substantive discussion takes place there when a EFC document reaches the Council level, except when very important institutional questions are at stake" (...) "The EFC is an essential piece in the process of economic policy co-ordination as it is practised now". J.-V. LOUIS, *The Eurogroup and Economic Policy Co-ordination*, in: J.-V. Louis (ed.), *The Euro in the National Context*, *op. cit.*, p. 362.

consensus agreements of the national governments the EFC has played leading role in the development of the co-ordination process, e.g. by proposing and developing the various procedures reviewed below. While the European Commission and the EFC cover macroeconomic and financial issues, the Economic Policy Committee (EPC), which consists of officials from economics ministries and from NCBs, is primarily concerned with structural policies. It should be recalled that the 1997 European Council in Luxembourg also assigned to the EFC the task of providing “the framework within which the dialogue between the Council and the European Central Bank can be prepared and continued at the level of senior officials from ministries, national central banks, the Commission and the ECB”. As a result of its participation in the EFC, the ECB becomes involved in the discussions on the annual Broad Economic Policy Guidelines, the surveillance of fiscal policies on the basis of Member States’ annual Stability and Convergence Programmes and the preparation of European positions on international issues.<sup>202</sup>

Experience in the EMU and other context suggests that the responsiveness of governments to peer pressure is not the same in all countries. Large countries, in particular, are less likely to react to peer pressure in the desired way, as the wish to be a “good European” typically plays a much weaker role in their domestic politics than in smaller countries.

The effectiveness of recommendations made at the EU level to guide national budgetary policies is limited by several procedural impediments. Although the deadline for the submission of stability or convergence programmes has been moved forward from 1 March to the end of preceding year, national budget processes and the writing of these programmes run on different and loosely connected calendars. In

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<sup>202</sup> The ECB also participates in other activities of the EFC, which range from technical subjects – such as the minting of euro coins – to institutional reform and the external representation of the Community within the context of EMU. Discussions within the EFC also serve to prepare the dialogue between the euro area finance ministers and the ECB, which takes place within the Eurogroup. Thus, a core feature of the ECB’s participation in the work of the EFC comprises the preparation of assessments of the overall economic outlook for the euro area and of exchange rate developments. Moreover, it includes an ongoing review of the sustainability of public finances and the appropriateness of the general orientations of fiscal policy.

Naturally, the ECB’s involvement in the EFC is based on a full respect for its independence. This is reflected in the fact that the ECB may fully participate in discussions and express its views on all issues. However, it should be said that it may not participate in any voting procedures. Moreover, the EFC consciously refrains from discussing the conduct of monetary policy. The same applies to statements on the single monetary policy to be made at the meetings of international organisations and for a (such as the International Monetary Fund or the G7). In line with the division of competences, the preparation and presentation of such statements are the exclusive competence of the ECB.

many EMU Member States, the budget and the stability programme are prepared by different administrative units. Thus, the link between these processes is weak in many countries. A further difficulty in this context is that the procedures for policy co-ordination do not always involve the relevant actors of the national level. This implies that negotiations at the EU level often lead to no more than statements of good intentions to persuade the other actors relevant at the national level.

Article 113 forms the Treaty basis for a dialogue between the Council and the ECB. It foresees the participation of the ECB in Council meetings where matters relating to monetary policy are discussed. In turn, the Council President has the right to participate in meetings of the ECB Governing Council and to submit motions for deliberation by the Governing Council. But note that, not only implies the use of the term “participate” a right to speak and join in deliberations, not simply a right to attend silently, but also the legitimate attempt to convince the Governing Council, the limits to these attempts being posed by Article 108 EC Treaty. Even if the President of the Council is not entitled to vote and cannot properly compel the Governing Council to adopt his proposal, nevertheless, he has an influence on the agenda of the ESCB. With that in mind, to fully appreciate the real impact of such provision, it must be finally stressed that: (i) the President of the Council generally uses this possibility of participation only once during his six-months period at the helm of the Ecofin Council. Finally; (ii) since the President of the EU Council represents all members of the EU, he is not necessarily a good counterpart for the ECB to discuss the policy mix in the euro area.

In addition, it is worth recalling the Cologne Process, an informal macroeconomic dialogue introduced under the German Presidency in 1999. It consists of bi-annual, informal consultations between public authorities and representatives of the social partners without setting objectives. The social partners are represented by their respective organisations at the European level. The dialogue focuses on issues of monetary, fiscal and wage policies. The exchange takes place on a political and technical level between the ECB, Ecofin, the Labour and Social Affairs Council, the Commission and the social partners. Although the dialogue explicitly recognises the necessity of wage policies at the national level to be consistent with price stability in EMU, the forum is unlikely to play a major role in the co-ordination process. This is due to the fact that the EU federations of trade unions and employers unions do not

have the authority to represent common views of their respective partners in all member countries and, therefore, cannot assure the enforcement of any agreements on guidelines for wage policies at the national level. This, in turn, is due to the institutional heterogeneity of social partner organisation in the member countries.

### *7) Processes for macroeconomic policy co-ordination*

Processes for macroeconomic policy co-ordination in the EU include the Broad Economic Policy Guidelines (BEPGs), the process of multilateral surveillance, the Excessive Deficit Procedure and the Stability and Growth Pact and the Cologne process. Finally, the open method of co-ordination, introduced at the Lisbon Summit, aims at coordinating the co-ordination processes with respect to EU goals. The last method is not an additional process alongside with the others but a concept of how to link the existing procedures. Its task is to exploit the fact that the processes are interacting with respect to policy goals such as employment and growth.

According to Article 99 of the TEU, the BEPGs form the centre of economic policy co-ordination process at the Community level. The BEPGs consolidate the different existing processes (Luxembourg, Cologne and Cardiff) and aim at exploiting the synergies between them. The BEPGs also form the reference for the multilateral surveillance procedure, under which the consistency of national economic policies with the BEPGs and the functioning of EMU in general are monitored. The multilateral surveillance procedure includes the possibility to make confidential or public assessments of the policies of individual Member States and to give confidential or public recommendations to their governments. Since 2001, an enhanced framework for preparing and monitoring the implementation of the BEPGs is used that includes explicitly different decision making levels and actors at national and EU level in order to strengthen responsibility for final implementation.

The difference between the EU and EMU matters particularly in this context. The BEPGs do not distinguish sufficiently between economic goods shared among all EU members, such as the Single Market and those shared only among the members of the euro area, such as price stability in the EMU. At the level of the EU, the Internal Market constitutes the reference point for policy co-ordination. As in pre-EMU times,

the co-ordination of economic policies assures that countries do not engage in policies that undermine the smooth functioning of open markets – competitive devaluations being the traditional example. The euro area, however, has a broader need for policy co-ordination.

Fiscal policy remains a national competence for EMU Member States, but under several constraints. EU procedures for the conduct of fiscal policy are the Excessive Deficit Procedure, the Mutual Surveillance Procedure (Article 99 TEU) and the Stability and Growth Pact (Regulations 1466/97, 1467/97, and Council Resolution 97/C236/01-02).

As far as the multilateral surveillance is concerned, it has to be said that it is for the Commission to constantly monitor economic developments. Based upon the data it receives and upon its own analysis, the Commission reports to the Council. Its report covers both the economic policies of the individual Member States and the position of the Community as a whole. The Council, on the other hand, is to monitor the economic developments in each of the Member States as well as the consistency of these States' economic policies with the broad guidelines. Pursuant to Article 100 of the Treaty that “where a Member State is in difficulties or is seriously threatened with severe difficulties caused by exceptional occurrences beyond its control, the Council may, acting unanimously on a proposal from the Commission, grant under certain conditions, Community financial assistance to the Member State concerned” (...) “The President of the Council shall inform the European Parliament of the decision taken”.

In any case, the main rule on government budget financing is the prohibition for the ECB and for national central banks to directly finance government bodies, whether at Community, State or lower level. It is enshrined in Article 101 TEU and concerns both credit facilities, which are forbidden, and the purchase of government debt in the primary market, which is likewise not permitted.<sup>203</sup>

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<sup>203</sup> The rule excluding monetary financing is repeated in the ESCB Statute. Article 21 thereof, which concerns operations with public entities, while allowing the ECB and the NCBs to perform functions as “fiscal agent” for governments, prohibits monetary financing. It also repeats the specification contained in the second paragraph of Article 101, under which the prohibition does not prevent the central banks from providing liquidity to credit institutions which are publicly owned. See on this point R. SMITS, *The European Central Bank. Institutional Aspects*, Kluwer Law International, The Hague, 1997, p. 75 and ff.

In the past, it was not only through direct monetary financing at the central banks that governments used to be privileged compared with private parties operating on the financial markets. A major source of financing derived from “forced” savings, which government measures may impose. For instance, a requirement that a bank or pension fund invest a certain share of its assets in government securities placed the government in an advantageous position relative to other market participants. Article 102 simply prohibits any measure that establishes privileged access for the public sector (again: whether at Community, State or lower level) to financial institutions. In the relevant Regulation<sup>204</sup>, the Council specified that any binding legal instrument adopted in the exercise of public authority, which obliges financial institutions to acquire or hold government liabilities, is prohibited.

The No-Bail-Out-Rule (Article 103 TEU, Article 21 ESCB Protocol) protects Member States from becoming responsible for financial liabilities of other Member States or of public bodies at a lower level than that of the central government against their will. In fact, a Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. The Excessive Deficit Procedure includes the mandate (Article 3 of the Protocol) that the Member States of EMU should implement appropriate institutions at the national level that enable them to fulfil their obligation for maintaining sustainable finances. In contrast to the obligation for all Member States to have independent central banks, there is, however, no explanation of what this obligation means in practice. For members of the EMU, the Excessive Deficit Procedure is an unconditional obligation to avoid excessive deficits. In addition, the Stability and Growth Pact calls for medium-term budgetary positions close to balance or in surplus. The higher the debt – to GDP ratio of a country, the greater must be its efforts to reduce it rapidly. Member States are required to take immediate corrective actions, if they are found to have an excessive deficit. The Excessive Deficit Procedure and the Stability and Growth Pact

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<sup>204</sup> Regulation (EC) No. 3604/93 of 13 December 1993 specifying definitions for the application of the prohibition of privileged access referred to in ex Article 104 A of the Treaty (O.J. 1993, No. L 332/4; *Compendium 1994*, at p. 45).

allow for the imposition of financial sanctions in such cases – a feature that distinguishes them from other co-ordination procedures.

In the context of the Stability and Growth Pact, the EMU members are required to produce annual stability programmes that present the main fiscal decisions and budgetary choices on the path to the medium-term objective for budgetary positions close to balance or in surplus. The Council considers whether the budget – policy strategy and the economic targets continue to meet the requirements of the Stability and Growth Pact and the BEPGs. In order to prevent the occurrence of excessive deficits, the Council may give an early warning in line with Article 99 (4) of the Treaty.

While the combined Excessive Deficit Procedure and Stability and Growth Pact acknowledge the importance of fiscal discipline for the conduct of monetary policy, the set up is still unsatisfactory with respect to the EMU for several reasons. First, the procedures focus on individual member country performance with no regard to the aggregate fiscal policy stance of the euro area as a whole. Implicitly, the set up is based on the assumption that being close to balance is unconditionally the proper contribution of fiscal policy to macroeconomic stability in the euro area. While this may be true in the long run, the above-sketched analysis has showed that stability demands different constellation of monetary and fiscal policy at different stages of the business cycle. Secondly, the procedure focuses narrowly on deficits and debts. In this context of policy co-ordination, the emphasis of the Excessive Deficit Procedure and the Stability and Growth Pact on government borrowing is justified only if one assumes that national fiscal policies affect the macroeconomic performance of EMU and cause horizontal spill-overs predominantly through their capital market effects.

## CHAPTER THREE

### *SOME KEYWORDS AT STAKE: THEORETICAL CLARIFICATIONS ON THE MODALITIES OF THE EXERCISE OF MONETARY POWER*

*“Monetary policy is of such relevance for the setting up of the whole economic framework of a country, and can at the same time be so easily subject to political interest capture, that an effective independence is a quintessential feature of a central bank, as only a highly specialised organisation, sealed from political interference, can ensure the attainment of the set objectives”\**

#### *A short explanatory note*

Moving the focus of the investigation to the monetary framework as such, it should be immediately acknowledged that the increased power and influence of central banks, the greater visibility of their role and their leaders, have inevitably attracted attention on their institutional position, their efficiency, the principles underlying their actions and, in some cases, their place in the democratic way of life. In fact, given that the growing power of central banks at the European level is based on a delegation of public authority within the Community, it is essential to highlight the mechanisms that are supposed to link such a delegation process to the democratic principle. As insightfully stated by B. Dutzler, “the democratic principle answers the

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\* C. ZILIOLI, *Accountability and Independence: Irreconcilable Values or Complementary Instruments for Democracy? The Specific Case of the European Central Bank*, in *Mélanges en Hommage à Jean-Victor Louis*, Vol. II, Éditions de l'Université de Bruxelles, Brussels 2003, p.319.

question of the bearer, the rule of law the question of content, limits and procedure of public authority”.<sup>205</sup>

On such a basis, the present chapter aims at investigating, from a conceptual point of view, the different issues related to the *modus operandi* of the basic features characterising central banking, perceived as the expression of the emerging *locus* of monetary sovereignty. Four main key concepts in the constitutional foundation of central banks are thus taken into account in order to highlight the so-called modalities of the exercise of monetary power, assuming that, in the context of the institutional structure of EMU - that emphasises technocracy rather than democracy-, fundamental concerns about independence, accountability, transparency and credibility were raised.

It should be highlighted that, in the debate about the institutional profile of the Economic and Monetary Union, the above-mentioned important notions (namely, independence, accountability, transparency or predictability) regularly recur. Nevertheless, they have no clear or unequivocal content: although these terms interrelate and even overlap, they cannot and should not be used interchangeably. “Due care should be taken to identify their conceptual distinctiveness, to avoid blurring the indispensable debate about the central bank with confusion and misperceptions”.<sup>206</sup> As a result, before entering into a thorough discussion about their application to the ECB<sup>207</sup>, it is now worth trying to depict their meaning at a general level (building a kind of “glossary” to be then applied to the ESCB), in order to adopt it, in a second moment, within the empirical context of the ESCB.

### ***1) Independence***

Central banking is of cardinal importance in any country because of the legal right normally granted to central banks to create money. As already stated, this money

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<sup>205</sup> B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien/New York, 2003, p. 135.

<sup>206</sup> T. PADOA SCHIOPPA, *An Institutional Glossary of the Eurosystem*, Article by Tommaso Padoa Schiopa, Member of the Executive Board of the European Central Bank, at the conference on “The Constitution of the Eurosystem: the Views of the EP and the ECB”, 8 March 2000, p. 1, available at [http://www.ecb.int/key/00/sp000308\\_1.htm](http://www.ecb.int/key/00/sp000308_1.htm)

<sup>207</sup> Note that a more detailed discussion is further developed in Chapter Five of the present work.

can serve as a means of payment, a unit of account and a store of value. One of the important issues immediately arising after granting this right to a central bank is whether this function should fall under the ultimate control of the executive branch of government – the cabinet and its administrative departments – or whether Parliament should leave this responsibility to be freely executed by an independent, autonomous powerful institution run by unelected people.

The traditional argument in favour of a strong independent central bank is that the power to spend money should in some way be separated from the power to create money.<sup>208</sup> Numerous episodes in the world's economic history testify to a government's potential abuse of its power to create money. Around the third century AD in the Roman Empire, for instance, the silver coins collected by the tax authorities were melted and combined with inferior metals, yielding many more coins to spend on the Caesar's priorities than the initial tax take. With too much money chasing too few goods, the end result was high inflation.

Much the same has happened all too frequently with paper money systems. Many governments have given way to the temptation to reduce interest rates ahead of elections. This may boost spending and employment in the short term, but ultimately it usually causes higher inflation over the long term, unless the capacity of the economy can meet this higher level of demand. This higher inflation, however, only becomes apparent a couple of years later. An elected government concerned about its immediate popularity might be tempted to go for the short-term gains from lower interest rates, even at the risk of promoting somewhat higher inflation further down the road, because some other political party may then have to pick up the pieces.

Central bankers normally operate on a longer-term scale than politicians and therefore do not face the same temptation to relax policy to achieve short-term

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<sup>208</sup> The most important requirement for central bank independence is the prohibition to lend to Government. The existence of a borrower-lender relationship between the monetary authority and the government creates a situation where it is very difficult for the bank to formulate monetary policy avoiding pressures coming from the financing needs of the government deficit. At a national level the prohibition to directly lend to the public sector can sometimes be considered weak, because in direct lending can take place with the central bank buying Government securities on the secondary market beyond the needs of liquidity-control oriented open market operations. The prohibition is more credible with a unified, European monetary policy confronting decentralised government budgets. In fact monetary discipline turns out to be stronger in federal States where fiscal policy is largely decentralised and monetary policy centralised. As far as the Treaty is concerned the prohibition to lend to government is clearly stated in Article 101, paragraph 1 and it is enriched by paragraph 1 of the following Article 102 saying that any measure shall be prohibited that can establish a privileged access of Governments or public bodies to financial institutions.

objectives. By delegating decisions about interest rates and other monetary matters to such an independent institution, with a clearly defined mandate, society can hope to achieve a better inflation outcome over the longer term. The academic and professional authors stress on this point that the political process, with its penchant for short-term solutions and the limited time horizon of the next elections, is not the most adequate mechanism for guarding the stability of the money. A public good like stable prices is best achieved by entrusting its maintenance to an independent body.<sup>209</sup> As vividly described by two researchers at the IMF in their authoritative paper on central bank independence: “(...) the political leadership tends to take too short-term a view on the appropriate stance of monetary policy at any particular time (...). Therefore, (...) monetary stability is more likely to be achieved over time when monetary policy is in the hands of apolitical central bankers who can afford to take the longer time view”.<sup>210</sup> Money, in fact, “should be an element of the constitutional framework of democracy rather than an object of political struggle”.<sup>211</sup> Consequently, it becomes apparent that the case for central bank independence is based on the assumption that a government faces monetary temptations conflicting with a sound, i.e. inflation-averse, monetary policy. In the view of the majority of commentators this conflict can only be solved by the establishment of a monetary authority which is independent from government and thus, from short-term political considerations. Hasse hits the nail squarely on the head in summarising the debate: “the history of monetary policy is the history of its abuse by the government. The history of monetary reforms has thus always been a chronicle of the efforts undertaken to make it more difficult for the government to gain the right to issue money, in order to avoid fiscal inflation”.<sup>212</sup>

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<sup>209</sup> According to F. BRUNI, *The Independence of the ECB and its Political and Democratic Accountability*, in J.-V. LOUIS and H. BRONKHORST (eds.), *The Euro and European Integration*, Euro Institute, Series “European Policy”, Collection “La Cité européenne” N. 21, Peter Lang, Presses Interuniversitaires Européennes, Brussels, 1999, at p. 184: “price stability must be an explicit primary statutory objective of the central bank. It is difficult to imagine an independent agency without a clearly stated primary objective, which is specific to the agency itself: without such an objective other authorities would be allowed to interfere with the agency’s decisions on the grounds that common objectives and trade-offs would have to be managed together”.

<sup>210</sup> M. SWINBURNE and M. CASTELLO-BRANCO, *Central Bank Independence: Issues and Experience*, IMF Working Paper No. 91/58, Washington D.C., 1991, p. 5.

<sup>211</sup> R.M. LASTRA, *The Independence of the European System of Central Banks*, in Harvard International Law Review, Vol. 33, No. 2, Spring 1992, pp. 475-519, at p. 477 as quoted by R. SMITS, *The European Central Bank. Institutional Aspects*, Kluwer Law International, The Hague, 1997, p. 153.

<sup>212</sup> R.H. HASSE (ed.), *The European Central Bank: Perspectives for a Further Development of the European Monetary System*, Bertelsmann Foundation Publishers, Gütersloh, 1990, p. 123.

As a first result, it can be argued that apolitical and independent central bankers are supposed to ignore pressures, whatever its source. In fact, the independence of central banks goes beyond independence from political, executive and legislative power. It also equates with independence from private or collective economic interests, autonomy versus the short-term, frequently imposed by capital markets and, finally, freedom of action *vis-à-vis* the monetary policy of other central banks.<sup>213</sup>

To say the truth such statements about central banks' independence are somehow new if one considers that until a few years ago central banks were regarded as an integral part of the Government's central policy-making machine.<sup>214</sup> The expression, "the Monetary Authorities", was coined and used to describe the combined operations of the Central Banks and Treasury, under the political leadership of Chancellor/Treasurer and Prime Minister. The idea that a central bank might, or should, be independent of central government was simply not considered as a serious issue in most countries. Yet this is now an idea whose time has most certainly come imposing itself as a key value in modern central banking.<sup>215</sup>

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<sup>213</sup> On this line of reasoning, see J.-V. LOUIS, *Indépendance des banques centrales, séparation des pouvoirs et démocratie*, in *Mélanges M. Waelbroeck*, Bruxelles, Bruylant, 1999, notably p. 401. See also, F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et "Accountability Délibérative"*, in *Cahiers de Droit Européen*, No. 5-6, 2003, pp. 549-595, notably p. 556.

<sup>214</sup> Still nowadays some part of the doctrine underlines the link existing between the central bank and the State: see, for instance, W.H. BUTER and A.C. SILBERT, *Designing a monetary authority*, in A.M. SANTOMERO, S. VIOTTI and A. VREDIN (eds.), *Challenges for Central Banking*, Kluwer Academic Publishers, 2001, pp. 173-185. The authors argue that the monetary authority or central bank is an agency of the state. "Delegating monetary policy to a collective of appointed technocrats means opening the door to a principal-agent problem between the government (the principal) and the agent (the independent central bank). To rationalise such a delegated mechanism from a normative perspective, one must recognise that the state itself is an agent of the ultimate principals, the public. In a second-best world, a two-tier principal-agent configuration may produce superior outcomes to the one-stage principal-agent configuration between the citizens and the state" (p. 174).

<sup>215</sup> The reasons behind this choice in favour of independence are nicely summarised by C. ZILIOLI, *Accountability and Independence: Irreconcilable Values or Complementary Instruments for Democracy? The Specific Case of the European Central Bank*, in *Mélanges en Hommage à Jean-Victor Louis*, Vol. II, Éditions de l'Université de Bruxelles, Brussels 2003, pp. 395 and ff., who points out three different sets of arguments: (i) the Parliament and the Government normally do not have the necessary expertise, information and time to shape efficiently objectives related to monetary policy; (ii) the fact that such institutions may be characterised by different political majorities, and hence different priorities, as elections unfold, is in contrast with the need for a persistent and consistent approach to achieve long term objectives; (iii) finally, both the Parliament and the Government may prove too factional to engage in effective and unbiased policy-making: indeed, in seeking re-election, they may fall victim to private interest capture and aid only particular constituencies.

Such a conceptual innovation in favour of independence has a remarkable impact on the institutional level as a new concept of governance - linked to the enforcement of the role played by independent, technocratic, non-majoritarian regulatory agencies – has emerged all over the world. As a matter of fact, central banks in a wide variety of countries, from Venezuela to Chile in South America, through South Africa to New Zealand, have already been given formal constitutional independence from the executive branch of government. Bills for the same purpose have been enacted in France and Mexico. Moreover, the statutes of the European Central Bank are closely modelled on those of the Bundesbank, historically the most independent of all Central Banks. It should be also recalled the fact that other European Community nations cannot participate in the final stages of EMU and join the European System of Central Banks until these have made independent of their executive governments, no longer subservient and indeed statutorily prevented from taking any instructions from governments. Hence all the major European countries are moving towards the degree of constitutional independence already enjoyed by Germany and Switzerland.

Why has this surge of support for the concept of an independent central bank now occurred? The purpose of the exercise is to improve economic performance, and, as might therefore be expected, the basic ideas that have driven the case for independence have been provided by economic theory. As Charles Goodhart recalls, the first of these goes by the somewhat unfortunate name of the vertical Phillips curve.<sup>216</sup> Bill Phillips, a New Zealand economist working at LSE, had earlier discovered in the 1950s that, using historical British data, when unemployment was high, the pressure of demand in an economy being low, then wage and price inflation had also been lower. This suggested that the authorities might be able to choose an optimal combination, or trade-off, between inflation and unemployment. And this is exactly what governments sought to do in the 1950s and 1960s.

Milton Friedman then explained that the problem was that the short run Phillips curve had depended on the existing stage of inflationary expectations. If the supposedly optimal level of inflation that the authorities wanted was above that which had been expected by the public, then the public's real wage and profit outcomes,

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<sup>216</sup> C.A.E. GOODHART, *The Central Bank and the Financial System*, The MIT Press, Cambridge, Massachusetts, 1995, p. 61.

which they had sought to achieve by their price setting agreements, would have been systematically inflated away. They would subsequently revise their inflationary expectations up, and at any given level of unemployment would demand higher wage, or price, increases. In short, if the authorities tried to keep the level of unemployment below the natural rate, which is, broadly, the rate that causes workers to seek that rate of real wage increase that their own productivity increases make available, then inflation will not be constant, but will rise without limit. There is no trade-off in the medium, and long term, between inflation on the one hand, and output, growth and unemployment on the other.

During the immediate post-war decades, when economists and governments had worked on the basis of such an assumed trade-off, the choice of the optimal balance between employment and inflationary objectives was seen, and rightly so, as an essentially political matter. Consequently, instruments of demand management, monetary and fiscal policies, needed to be coordinated and managed to achieve that balanced outcome. Once, however, the concept of the medium term vertical Phillips curve was absorbed, it became apparent that one both could, and should, use monetary policy to control inflation in the medium and longer term without losing any benefits in the way of growth or employment over that same horizon.

But what that implied was that governments should use monetary policy as a medium term instrument to control inflation, while using (quasi automatic) fiscal stabilisers, or supply side measures, to moderate shorter term shocks and cycles, not that the monetary policy instruments should be removed altogether from the hands of Ministers. And this is broadly what happened. Governments in the 1970s and in the 1980s embraced monetary targets and medium term financial strategies for bringing down inflation and moved to “supply side” measures to encourage growth.

This strategy had a mixed success. When sufficiently tough central bankers and Treasurers were in charge, at the Bundesbank, Paul Volcker at the Fed, Geoffrey Howe and Nigel Lawson in the UK, inflation was brought down, but often at a severe short term cost in terms of higher unemployment. These costs were attributed, in large part, to a lack of credibility that the authorities would achieve, and then maintain, a regime of stable prices, of zero inflation. And this in turn was attributed to the short time horizons of politicians, especially in advance of elections. Even though in the longer term expansionary monetary and fiscal policies, lowering taxes and rising

expenditures, would do no good to output and employment, and just rise inflation, in the short run, with expectations given, they would rise employment, induce a feel-good factor, and rise the probability of re-election.

Meanwhile, the problem of credibility had been made worse by the collapse in the stability of the relationships between monetary growth and inflation, is the increasing unpredictability of the velocity of circulation. Previously governments could publicly pre-commit themselves to a series of monetary targets, which would, it was hoped, lead straight through to lower nominal incomes and inflation. But these monetary relationships progressively collapsed during the 1980s in almost all countries. Hence operations to achieve stable prices reverted from being a matter of sticking to publicly announced monetary targets rule back to the more discretionary use of the interest rate instrument for their purpose; that is to say interest rates had to be varied now to try to bring inflation back to its desired, say zero, rate several quarters, perhaps a year or more hence, when the interest rate adjustment would have had its full effect on the expenditures and prices. This exercise requires technical expertise, good models of the economy, discretion, patience and long horizons, none of which government Ministers as a collective, irrespective of personality, party or country, have been renowned for possessing. There is no doubt but that the popularity of the idea of an independent central bank has, as its flip side, a generalised distrust of politicians of all shapes and sizes.

Thus, the theory ran, if there is a need for a credible medium term counter-inflationary policy, a solution would be for the government to delegate the objective of achieving price stability to a separate institution,<sup>217</sup> an autonomous central bank which should have both the requisite longer time-horizon and technical expertise to achieve that objective. Note, in particular, that the central bank is not independent with respect to the objectives that it should fulfil; indeed it may often, as in the case of New Zealand, be tied down rather rigidly to the achievement of a defined outcome. In

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<sup>217</sup> It should be underlined that, in the European framework, such a process of delegation of public authority to an independent institution is based on the so-called principle of "institutional balance" (see ECJ, Case C-70/88, *Parliament v. Council*, [1990] ECR I-2041). This balance was created by the Treaties as a system for distributing powers among the different Community's institutions, assigning to each of them its own role in the institutional structure of the Community order and in the accomplishment of the tasks entrusted to the Community. In particular, observance of the institutional balance means that each of the institutions must exercise its powers with due regard for the powers of the other institutions. This is, thus, a strong theoretical and institutional basis to justify the principle of independence granted to central banks in the exercise of their powers.

that sense the central bank is autonomous with respect to the powers used to achieve its statutorily defined objective, but not independent to choose its objectives. By the same token an autonomous central bank can be more democratically accountable than a subservient central bank.

In any case, the move towards an independent, or autonomous, central bank was not only a matter of theory. A whole series of econometric-statistical tests have shown that countries with more independent central banks have had generally lower inflation rates, led by Germany and the Bundesbank by virtue of the so-called *Stabilitätspolitik*, a “philosophy” representing a cornerstone for the today’s EMU. Recently countries that have adopted independent central banks such as Chile and New Zealand have moved from bottom of their class towards being best performers. Finally, but very important, it has to be considered that the Germans are so enamoured of their independent central bank that they refused to accept a move towards the European System of Central Banks and European Economic and Monetary Union, until all the other Community participants, and the European Central Bank, had installed independence in compliance with the proposed model of *Stabilitätspolitik* in their own central banks.

### *1.1) Elements of independence*

In view of the risks involved in central bank independence, there are usually three constituent elements for central bank autonomy.

Firstly, there should be a clearly spelled out legal and operational framework in which monetary policy is conducted. In the legal framework the central banks independence should be defined to avoid any misconceptions of what the central bank is supposed to achieve. In the monetary policy framework, the central bank must indicate what it is attempting to achieve, what operational variables it will apply and what monetary instruments it will use to achieve its objectives. Because credibility is usually not gained overnight, it is important that a longer-term programme should be drawn up to show how the central bank would fulfil its mission.

A second element for greater autonomy is represented by transparency. The government and the public should continuously be informed of the monetary policy

programme followed by the central bank. Regular discussion between the central bank and the government will be necessary and some form of accountability to parliament will have to be established.<sup>218</sup> It is also important to explain monetary policy decisions regularly to the public together with an assessment of the progress made in achieving stated objectives. Priorities in the programme as well as operational instruments should be clearly spelled out, in order to keep the public well informed about developments and changes in monetary policy.<sup>219</sup>

The third feature for central bank autonomy is the creation of an efficient institutional framework within which decisions on monetary policy and on its implementation can be made, without undue interference by political functionaries. This involves decisions regarding<sup>220</sup>:

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<sup>218</sup> Note that through an extensive interpretation of the wording of Article 113.3 EC Treaty, according to which “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. The President of the ECB shall present this report to the Council and to the European Parliament, which may hold a general debate on that basis, a so-called monetary dialogue between the ECB and the EP may be established and developed. Moreover, “dans la quête de légitimité démocratique, la BCE a fini par reconnaître que: “le Parlement européen est la seule institution composée de représentants directement élus des citoyens européens et joue, par conséquent, un rôle crucial: la BCE doit lui rendre des comptes sur la conduite de la politique monétaire” (...) “En ce sens, les relations de la Banque avec le Parlement européen doivent être considérées davantage qu’un simple obligation statutaire (F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et “Accountability Délibérative”*, in *Cahiers de Droit Européen*, No. 5-6, 2003, p. 576). in order to develop such monetary dialogue, the EP has adopted a strategy of “maximisation” of its prerogatives. An extremely interesting case in point is represented by the procedure of appointment of the President, Vice-President of the ECB, together with the members of the Executive Board, as set forth by Article 112.2 (b) EC Treaty and by Article 11.2 ESCB Statute, where the EP is only to be consulted together with the Governing Council. It has to be noted though that, within the above-mentioned strategy of maximisation, the European Parliament is entitled, by virtue of Article 36 of its internal regulations, to ask for a Hearing of the person to be selected and then appointed, while preparing a detailed questionnaire, including several points concerning a wide range of questions related to: (i) the personal and professional background of the appointee; (ii) more technical inquiries on monetary policy to be implemented; (iii) the functioning of the ECB; (iv) the role to be played by the requirement of democratic accountability. This was actually the case applied to the appointment of President Trichet. (See, on this point, Hearing of M. Trichet, Nominee for President of the ECB, 8 September 2003).

<sup>219</sup> For a further elaboration on this point see again F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et “Accountability Délibérative”*, in *Cahiers de Droit Européen*, No. 5-6, 2003, notably p. 572, where the author recalls the theory related to the notion of deliberative democracy as put forward by J. HABERMAS, *Droit et démocratie. Entre faits et normes*, Paris, Gallimard, 1997. According to Habermas, in fact, “la légitimité démocratique du processus décisionnel exige une procédure délibérative de la prise de décision politique (formation démocratique de la volonté générale) complétée par un processus informel de formation de l’opinion publique” (Ibidem, p. 332).

<sup>220</sup> For the classification that follows in the text see J.-V. LOUIS, *Vers un système européen de banques centrales: projet de dispositions organiques*, Etudes européennes, Editions de l’Université de Bruxelles, Brussels, 1989.

*Institutional independence*, which concerns the legal autonomy of the monetary authority, being an institution separate from the other bodies of Government. An independent central bank should be a separate legal entity. Apart from legal personality, the freedom from instructions from the Government or from any other body (Parliament or other organs of the State or even from the private sector) is also considered an element of independence that ranks as “institutional”. Naturally, the separation from the other State organs cannot be absolute. There will be contacts with those responsible for economic policy, if only to arrive at mutual information and consultation between the central bank and the Government, while accountability mechanisms ensure a measure of democratic legitimacy. Furthermore, judicial scrutiny is inherent in a democracy under the rule of law. With regard to the tasks of the central bank, institutional independence stands for the central banks’ power to formulate monetary policy independently from political institutions and in particular the executive government. In other words, a monetary authority is considered to possess institutional independence when it is free to set the final goals of monetary policy. This has also been referred to as *political or goal independence*.<sup>221</sup> In this context the existence of an explicit and clear legal mandate in the central bank status is often considered as an important element. To be sure, formally speaking, the existence of a monetary policy objective may be considered to infringe the central banks’ independence in its conduct of monetary policy. Yet it is often mentioned in the context of central bank independence because an explicit monetary policy objective, e.g. price stability, is thought to reduce the risk of political pressure on the bank, and ensures that the central bank does in fact follow an inflation-averse monetary policy. In addition, this is considered to be consistent with the rationale for central bank independence, since central banks charged with multiple objectives face policy choices that may require putting aside the objective of price stability. As Amtenbrink notes: “in order to judge the degree

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<sup>221</sup> A. ALESINA, *Macroeconomics and Politics*, NBER Macroeconomic Annual, Cambridge University Press, Cambridge, 1988) on the basis of a study by Bade/Parkin refers to *political independence*. Similarly V. GRILLI, D. MASCIANDARO and G. TABELLINI, *Political and Monetary Institutions and Public Financial Policy in the Industrial World*, Economic Policy, No. 13, 1991, pp. 162-212) who refer to political independence and include elements described below as part of the organisational independence, such as appointment procedures.

of goal independence sometimes a distinction is drawn between *ex ante* and *ex post* interference by government. First, it is observed whether the central bank is free to make its decisions without *ex ante* government interference in the form of instructions, and, secondly, whether decisions are subject to (potential) *ex post* government intervention, in the form of an override mechanism”.<sup>222</sup>

Functional independence, which means the right to decide on all matters regarding monetary policy and price stability. In particular, this element refers to the autonomous decision-making in respect of the instruments that the central bank employs to achieve its objectives. Although the Government may set the limits to the deployment of monetary policy instruments, activating these instruments is the sole prerogative of the independent central bank. Likewise, 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, if it is to be considered a fully-fledged independent monetary authority. Of course, the degree of freedom in the area of exchange rate regulation (traditionally the province of Governments) may vary, with some central banks deciding on the rate of exchange and other only free to regulate foreign exchange matters within the confines of decisions at the political level.

Instrumental independence, which means control over the instruments that affect the inflation process, including in particular the prevention of any direct financing of government deficits. It excludes any obligation to provide the government with overdraft and other types of credit facilities. According to this an independent central bank has to be free to decide whether and under what circumstances it provides its liquidity. Where governments as the fiscal authorities have direct or indirect access to central bank credits they are tempted to finance their expenditures through the central bank and the creation of money. This results in a loss of central bank independence as in that case monetary policy is subordinated to fiscal policy;<sup>223</sup>

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<sup>222</sup> F. AMTENBRINK, *The Democratic Accountability of Central Banks. A Comparative Study of the European Central Bank*, Oxford and Portland, Oregon, Hart Publishing, 1999, p. 19.

<sup>223</sup> This is what F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et “Accountability Délibérative”*, in *Cahiers de Droit Européen*, No. 5-6, 2003, p. 557 classifies under the label of *indépendance économique*, to be understood as “la capacité de la banque centrale d'utiliser, sans subir

Personnel independence, which covers the selection and appointment of Board members with a high professional competence and without an obligation to yield to political and other pressures. The method of the appointment of the decision-making bodies of the central bank and the tenure of office should enable them to oversee the implementation of the central banks tasks without outside interferences.<sup>224</sup> Although the members of the decision-making bodies of a central bank are usually appointed by the organs of the State, the safeguards surrounding their office should prevent the exercise of political influence upon their performance. Likewise, where they are appointed by private shareholders, the latter's influence should not interfere with their autonomous decision-making in respect of monetary policy, which is a function exercised in the public interest and not in pursuit of particular private interests. "The renewal of the mandate of the members of the decision-making bodies of the central bank also comes within the sphere of personal autonomy".<sup>225</sup> There are arguments for restricting the appointments to a single term since that would free the incumbent from political considerations concerning a renewal of his or her term of office. Nevertheless, central banks with Governors or other members of management whose terms of office are renewable may have an autonomous status and a staunchly independent tradition.<sup>226</sup> Finally, the holders of office at the central bank may not be dismissed for reasons related to their policy decisions. In an independent central bank, dismissal is only possible on the grounds of serious matters unrelated to the policy of the central bank and is surrounded by adequate safeguards. Further element of personal independence may be discerned,

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de restrictions de la part de tiers, les instruments de la politique monétaire, et notamment de définir la stabilité des prix et la stratégie monétaire".

<sup>224</sup> All this is clearly stated in Article 112, paragraph 2 (b) of the Treaty and in Article 11 of the Statute of the ESCB. The members of the Executive Board shall be appointed from among persons of recognised standing and professional experience in monetary and banking matters; their term of office, non renewable, shall be eight years; only if a member of the Executive Board has been guilty of serious misconduct the Court of Justice may compulsorily retire him. Article 14 of the Statute of the ESCB dictates similar rules for the mandates of the Governors of national central banks.

<sup>225</sup> R. SMITS, *The European Central Bank. Institutional Aspects*, op. cit., p. 156.

<sup>226</sup> Examples are the Federal Reserve System (members of its Board of Governors serve 14-year terms with the Chairman and vice-Chairman being appointed for 4-year terms: section 10 Federal Reserve Act) and the Nederlandschebank (whose members of the Governing Board are appointed for a seven-year term and are eligible for reappointment).

concerning the salary of the Board members,<sup>227</sup> the incompatibilities of central bank Board tenure with other occupations, whether gainful or not, and the incompatibility of functions assumed posterior to the membership of the central bank Board,<sup>228</sup> and

Financial independence, which refers to the role that the government and/or Parliament plays in the determination of the budget of the central bank: it requires the central bank to have access to adequate financial resources of its own and full control over its own budget. Here, the view is taken that a central bank faced with budgetary control by government is presumably more vulnerable to pressure on monetary policies. Thus, in order to secure independence from government, it is often emphasised that a central bank should have a budget at its own disposal, which is not subject to governmental approval. Here the autonomy of the central bank in terms of the funding of its activities and the exercise of its powers comes into play. As a consequence, the finance of an independent central bank does not come under the budget authority of Parliament, nor are they subject to approval by the Minister of Finance. His influence on the distribution of the central banks profit (if the State is the sole or main shareholder) is circumscribed by law in a transparent way. The authority of State organs to verify the accounts of the central bank may not lead to an influence on its policies. Thus, the functions of a State audit body is limited to the scrutiny of the central bank's, if it applies at all. Finally it can be said that usually, a central bank can secure its financial assets independently from government by the issue of banknotes, open market operations and interests on assets backing compulsory deposits from the commercial banking sector.

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<sup>227</sup> R.M. LASTRA, *The Independence of the European System of Central Banks*, op. cit., p. 486-487, brings this issue forward.

<sup>228</sup> Making central bank Board membership incompatible with subsequent functions may insulate the central bankers from undue influence from private companies, offering a position after the term of office at the central bank as ceased, or from politicians who may promise the central banker a position after their term of office at the central bank. See R.M. LASTRA, op. cit., pp. 487-488.

## 2) Accountability

It has emerged from the discussion above that central bank independence is generally considered desirable from an economic point of view. The implications for the institutional structures of the central bank and its relationship with government have been also outlined. However, central banks do not perform in a vacuum in which only the economic implications of central bank independence matter. From a legal point of view, central bank independence has to be justified against the background of democratic principles rather than economic performance. This is the case for both national central banks as well as, in the European context, the ECB. On the one hand central bank accountability is viewed as a counterweight to central bank independence and as such is often used as an argument against central bank independence. On the other hand central bank accountability may function as a justification for central bank independence. This implies that in principle it is possible to regard democratic accountability and central bank independence either as contrary or complementary concepts. In other words they may be seen as two sides of the same coin.<sup>229</sup>

The completion, at the beginning of 1999, of the European Monetary Union with its institutional arm – the ECB – has transformed the twin issues of accountability and credibility of the ECB from a mere academic discussion into a practical policy issue. The basic dilemma is the following one: on the one hand, both theoretical and empirical research during the last two decades support the view that central bank independence is a desirable institutional device because it is associated on average with lower inflation and no lower growth. The policy recommendation emanating from this rather large body of research is to make the central bank responsible for only one objective, which is price stability, and to endow it with sufficient authority over the conduct of monetary policy to be able to attain this objective. As it will be clarified in the following chapters, the charters of the ECB and of its predecessor – the Bundesbank – reflect this point of view to a large extent.

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<sup>229</sup> See, in this sense, T. PADOA-SCHIOPPA, *An Institutional Glossary of the Eurosystem*, Article by Tommaso Padoa Schiopa, Member of the Executive Board of the European Central Bank, at the conference on “The Constitution of the Eurosystem: the Views of the EP and the ECB”, 8 March 200, p. 1, available at [http://www.ecb.int/kev/00/sp000308\\_1.htm](http://www.ecb.int/kev/00/sp000308_1.htm) and C. ZILIOI AND M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, pp. 49 and ff.

It has been claimed, on the other hand, that total delegation of a major aggregate demand management policy instrument like the interest rate to unelected officials is undemocratic. Furthermore, it has been rightly argued that “justifiée sur le plan économique, l’indépendance de la BCE, particulièrement aiguisée, alimente le déficit démocratique de la politique monétaire de l’UEM. Pour autant, il ne saurait y avoir indépendance sans responsabilité, ni de responsabilité sans légitimité démocratique”.<sup>230</sup> This conception strongly underlies the insistence on accountability embodied in several recent central banks’ charters like the 1989 law of the Bank of New Zealand and the 1997 charter of the Bank of England. On this view, in a democracy, control over major macroeconomic policy instruments should be ultimately managed by “the people” presumably through their elected representatives.

As already seen, nowadays it is widely believed that a high level of central bank independence coupled with some explicit mandate for the bank to restrain inflation are important institutional devices to assure of price stability. It is thought that an independent central bank can give full priority to low levels of inflation, whereas in countries with a more dependent central bank other considerations (notably, re-election perspectives of politicians and a low level of unemployment) may interfere with the objective of price stability. In other words, central bank independence makes a monetary policy directed towards low levels of inflation more credible. Indeed, there is quite some evidence for a negative relationship between central bank independence and inflation. This evidence generally consists of regressions using proxies for central bank independence based on the statutes of the central bank. Popular as the view referred to above may be, the concept of central bank independence has always had its critics. One potential objection towards a completely independent central bank is the lack of accountability. Indeed some authors argue that central bank independence reduces the credibility problem at the cost of placing monetary policy in the hands of unelected officials.<sup>231</sup> According to

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<sup>230</sup> This is the condivisible view of F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et “Accountability Délibérative”*, in *Cahiers de Droit Européen*, No. 5-6, 2003, p. 551, who, on the same line of J. STIGLITZ, *Central Banking in a Democratic Society*, *De Economist*, 1998, 146, No. 2, p. 205, finds astonishing the fact that “un facteur aussi déterminant de ce qui se produit dans la société que la politique monétaire soit placé hors de toute atteinte du contrôle d’organes démocratiquement élus”.

<sup>231</sup> See A. CUKIERMANN, *Central Bank Strategy, Credibility and Independence*, Cambridge, MIT Press, 1992. A. CUKIERMANN, S.B. WEBB and B. NEYAPTI, *Measuring the Independence of Central Banks and its Effects on Policy Outcomes*, *The World Bank Economic Review*, 6, 1992, pp. 353-398.

Cukiermann this becomes more problematic in times of large unexpected economic shocks. Levy goes further and even argues that: “democracy requires that central bank independence be limited so that the makers of monetary policy cannot stray far from the will of the people as embodied in their duly elected representatives”.<sup>232</sup> Moreover, as Fischer puts it: “an important reason to expose central bankers to elected officials is that, just as the latter may have an inflationary bias, the former may easily develop a deflationary bias. Shielded as they are from public opinion, cocooned within an anti-inflationary temple, central bankers can all too easily deny that cyclical unemployment can be reduced by easing monetary policy”.<sup>233</sup> Or in the words of Briault et al.: “delegation of power to an unelected authority might be interpreted as a dilution of democracy: an empowered, but unaccountable, central bank gives rise to a ‘democratic deficit’. Democracy is a compelling – if ultimately intangible – argument for accountability (...). Fischer uses precisely this point to pinpoint a potential danger facing the Bundesbank – the desire to target inflation below its socially optimal level. And, of course, such a danger then applies equally to the European Central Bank, should it come into play”.<sup>234</sup> Briault et al. conclude that there is a problem of a democratic deficit, especially if the central bank is given goal independence, i.e. the scope for the central bank to set the ultimate goals of monetary policy.

Indeed, the basic argument for the democratic accountability of central banks is that delegation of powers to unelected officials can only be acceptable in a democratic society if central banks are one way or another accountable to democratically elected institutions. This can also be considered in terms of fundamental political or even ethical demand for democracy. Still, one should not conclude that delegation of power to unelected officials in itself lacks democratic legitimation. In the case of central banks such a legitimation can be found in the legal basis of the central bank, which generally constitutes an act of Parliament. Yet, this one time act of legitimation cannot replace mechanisms of democratic accountability.

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<sup>232</sup> D.A. LEVY, *Does an Independent Central Bank Violate Democracy*, *Journal of Postkeynesian Economics*, 18, 1995, p. 191.

<sup>233</sup> S. FISCHER, *The Costs and Benefits of Disinflation*, in J.A.H. DE BEAUFORT WIJNHOLDS, S.C.W. ELFFINGER and L.H. HOOGDUIN (eds.), *A Framework for Monetary Stability*, Dordrecht/Boston/London, Kluwer Academic Publishers, 1994, p. 293.

<sup>234</sup> C.B. BRIAULT, A.G. HALDANE and M.A. KING, *Independence and Accountability*, Paper presented at the Seventh International Conference of the Institute for Monetary and Economic Studies, Bank of Japan, Tokyo, October 1995, BoE Working Paper Series, No 49, April 1996.

Against this background, the relationship between accountability and central bank independence becomes truly important. It is very often thought that an independent central bank cannot be very accountable and vice versa. In fact, Nolan and Schaling have come up with the following view.<sup>235</sup> They argue that for a given target level of inflation the optimal degree of central bank accountability is higher the lower is the degree of central bank independence. However, according to Eijffinger and de Haan such a trade-off does not exist in the longer run.<sup>236</sup> A central bank, continuously conducting a policy that lacks broad political support, will sooner or later be overridden. Using an indicator of central bank accountability as recently developed by Briault et al. and the Eijffinger – Schaling index for independence, Nolan and Schaling report a significant negative relationship between central bank accountability and central bank independence.

But what does exactly democratic accountability mean?

The common notion of democracy is that of the government by the people. The principle of the sovereign power of the people by itself requires that any political power has to be legitimised through the people. The people in fact are the holder of the *pouvoir constituant*. In a democratic system the people not only hold the power but they also exercise it; government *by* the people. In a direct or participatory democracy the people exercise that sovereign power themselves by taking all the necessary decisions through plebiscites. Since such concrete decisions constitute original exercise of sovereign power by the people, no further legitimation is required. On the contrary, the representative democracy is characterised by the delegation of the sovereign power of the people to a group of representatives, i.e. Parliament, entrusted with the exercise of the State power, expressed primarily through the creation of laws. From this point of view representative democracy is a form of legitimation of rule. The legitimation is renewed in regular intervals through elections. At the same instance the electorate may decide to withdraw his confidence when the representative is no longer thought to express its will. Elections are more than a repeating legitimation of State power. They are at the same time a mechanism by which the

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<sup>235</sup> C. NOLAN and E. SCHALING, *Monetary Policy Uncertainty and Central Bank Accountability*, Bank of England Working Paper Series, No. 54, 1996.

<sup>236</sup> S.C.W. EIJFFINGER and J. DE HAAN, *The Political Economy of Central-Banking*, Princeton Special Paper in International Economics No. 19, 1996.

representatives are held accountable by the electorate for their past performance. In this context the term democratic accountability can be defined in general as a mechanism, existing between holders of delegated power and those who have the formal power to replace them. Hence, accountability includes everything that those who have delegated the power find relevant to their decision whether to continue or withdraw its confidence. Elections have to be considered as the ultimate source of democratic accountability of State power in a representative democracy, whereby democratic accountability amounts to more than the control of the State power, since the electorate can also sanction those to whom it has delegated powers by revising its delegation.

This being so, in order to highlight the concept of accountability in its inner significance for the purposes of the present inquiry, it can be said that the Oxford English Dictionary defines accountable as “obliged to give a reckoning or explanation for one’s actions; responsible”, thus this implies a notion of accountability as answerability. The latter is defined as: “legally or morally obliged to take care of something or to carry out a duty; liable to be blamed for loss or failure”.

According to this meaning, accountability may in particular be applicable to relationships where the principle has charged somebody else with the exercise of a certain task, thereby giving up the basic control.<sup>237</sup> Control and accountability (read answerability) arguably concern different standards and/or qualities. Browder describes accountability on an abstract level as a mechanism applicable in the relationship between a holder of power and those who have the power to review: “for the party who is accountable, the heart of the matter is to explain as rational as possible the results of efforts to achieve the specific task objectives. For the party in

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<sup>237</sup> On this point it’s worth recalling the considerations of D.D. DUNN on the relationship between principal and agent with reference to the notion of accountability. In its contribution *Mixing Elected and Non-Elected Officials in Democratic Policy Making: Fundamentals of Accountability and Responsibility*, in A. PRZEWORSKI, S.C. STOKES and B. MANIN, *Democracy, Accountability and Representation*, Cambridge University Press, Cambridge, 1999, pp. 297 – 325, the Author writes: “Implicit but very important in the definition of responsibility is the requirement that principals provide sufficient definition of agents’ duties so that definition may guide agents’ actions as well as provide a basis for principals to appraise agents’ actions through accountability mechanisms. Overall, responsibility suggests an empowerment of agents by principals through assignment of authority, an acceptance of the responsibility of that authority by agents, and discretion to act on that authority”. As a consequence, the requirement that agents be accountable to their principal for the way they act on their responsibilities by exercising authority and carrying out their duties indicates the interrelationship of accountability and responsibility (See on the latter point G.E. CAIDEN, *The Problem of Ensuring the Public Accountability of Public Officials*, in J.G. JABBAR and O.P. DWIVEDI (eds.), *Public Service Accountability*, West Hartford, Conn., Kumarian Press, 1988, pp. 17 – 38.

charge of reviewing, the major objective will be to the matching of performance and attainment levels against their expectations as expressed in the task specifications and making a determination of their level of confidence in the steward and his efforts".<sup>238</sup> John Uhr notes that accountability "defines the boundaries within which officials responsibilities are acted out".<sup>239</sup> Agents consider or anticipate the consequences of their actions as they exercise discretion. Without accountability their discretion would be unfettered and might lead to unresponsive actions. Accountability seeks to assure that agents will take their responsibilities seriously and act on those responsibilities in a way that principals will approve. Further, well-defined responsibilities provide to agents guidance to inform their discretion and provide principals a basis on which to judge agents' actions.

Thus it is clear that accountability of central banks is more than just the degree to which central banks explain or make visible their policies to Parliament and/or the public. For instance, the definition of Demertzis et al. focuses on performance;<sup>240</sup> they define accountability as meaning that policy makers can and will be held to account for the economic performance of the targets in their care, i.e. policy makers will be held responsible for how close the indicators of economic performance come to the target values set.

On the other hand, in de Haan et al.'s view the concept of central bank accountability is more articulated, presenting three main features:<sup>241</sup>

- (i) Decisions about the *ultimate objectives* of monetary policy;
- (ii) *Transparency* of actual monetary policy;
- (iii) Who bears *final responsibility* with respect to monetary policy.

In a democratic society, elected politicians should decide on the *ultimate objectives* of monetary policy because they have democratic legitimation. It is questionable whether it is legitimate in a democratic system to leave the decisions of

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<sup>238</sup> L.HJR BROWDER (ed.), *Emerging Patterns of Administrative Accountability*, Mr Cutchan Publishing Corp., Berkeley, Cal., 1971, p. 2.

<sup>239</sup> J. UHR, *Redisigning Accountability: From Muddless to Maps*, in *Australian Quarterly*, 65 (2), 1993, pp. 1- 16, at p. 4.

<sup>240</sup> M. DEMERTZIS, A. HUGHES HALLET and N. VIEGI, *Independently Blue? Accountability and Independence in the New Central Bank for Europe*, Mimeo, 1998.

<sup>241</sup> J. DE HAAN, F. AMTENBRINK and S.C.W. EUFFINGER, *Accountability of Central Banks: Aspects and Quantification*. Center for Economic Research, Discussion Paper Series, N. 98/54.

the objectives of monetary policy in the hands of an independent institution, which is not subject to elections or ministerial responsibility. Indeed, it can be concluded that in a democracy, a central bank cannot both be independent *and* free to determine its own objectives. Furthermore, these objectives should be clearly defined. For instance, the primary objective of the ECB, as described in primary Community law, is to maintain price stability. At the same time, the ECB has also, without impairing this primary objective, to support general economic policies in the Community. Although many central bankers would consider an inflation rate between zero and two per cent consistent with price stability, one may wonder whether a somewhat higher inflation rate is still in accordance with the mandate of the ECB.<sup>242</sup> More fundamentally, the objective of price stability has different interpretations: price level constancy versus zero inflation. Depending on which interpretation is chosen, monetary policy has to smooth out random shocks to the price level or not. Fischer has shown that the objective of long run price level constancy implies a strategy for monetary policy that provides low uncertainty as regards the price level for the long run but comparatively high uncertainty for the short run, while the objective of zero inflation yields lower price level uncertainty for the short run but high and rising uncertainty for the long run.<sup>243</sup> So, there is some room for manoeuvre for the ECB with respect to the goals of monetary policy. More fundamentally, it is up to the ECB to decide under what circumstances policies, which support general economic policies in the Community, impair the primary objective of price stability. In other words, the ECB has too much goal independence. Where a central bank has both instruments and goal independence the body charged with holding the central bank accountable is not provided with an effective statutory yardstick to evaluate the performance of the bank, and thus to hold the bank accountable for its conduct of monetary policy.

The choice of a single objective also simplifies the monitoring of central bank performance. As Lastra puts it: “performance control is facilitated, first, by the existence of one goal rather than multiple ones (or by their unambiguous ranking),

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<sup>242</sup> The EMI states: “while theory does not provide a precise definition of price stability and while measurement problems exist, there has been a broad consensus among central banks for several years that a range of zero per cent – two per cent inflation per annum would be appropriate” (See European Monetary Institute, *The Single Monetary Policy in Stage Three: Elements of the Monetary Policy Strategy of the ESCB*, Frankfurt, 1997, p. 12).

<sup>243</sup> S. FISCHER, *The Costs and Benefits of Disinflation*, in J.A.H. DE BEAUFORT WIJNHOLDS, S.C.W. EIJJINGER and L.H. HOOGRUIN (eds.), *A Framework for Monetary Stability*, Dordrecht/Boston/London, Kluwer Academic Publishers, 1994, pp. 31 – 42.

and secondly, by the existence of a clearly stated and narrowly defined statutory goal. The announcement of a single goal (or a primary goal), rather than several unranked goals, enables authorities and public opinion to control performance more effectively. It is easier to control a narrowly defined target than a broadly defined objective...”.<sup>244</sup> The difficulties resulting from multiple objectives may be avoided to some extent by the introduction of a clear hierarchy according to which any secondary objectives may only be pursued as long as they do not conflict with the primary objective.

The statutes of many central banks are rather vague in terms of final objectives, or contain various (possibly conflicting) objectives without giving indications as to their prioritisation. For instance, before the introduction of the euro, the Bundesbank had a prime objective (formally referred to as defence of the value of the currency) that is not very specific. Even more vague was the objective of the Dutch Central Bank (to regulate the value of the Guilder in a welfare enhancing way). The Federal Reserve System faces multiple objectives that may be conflicting. According to Section 2A (1) sentence 1 of the Federal Reserve Act: “the Board of Governors of the Fed and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable process and moderate long-interest rates”. Neither the Federal Reserve Act nor any other law provides for any hierarchy. A good example of a clear prescription of objectives is the Reserve Bank of New Zealand, which has as its primary objective: the pursuit of price stability. The Governor of the Reserve Bank of New Zealand has to agree with the government a tight target range for inflation. In this so-called Policy Target Agreement (PTA) the concept is clearly defined and a target range for the inflation rate is provided. Such a contracting approach, as modelled for instance by Walsh, is often considered as a way to achieve accountability.

Moving further with de Haan’s analysis, it should be recalled that transparency is also a very important element of accountability.<sup>245</sup> As Lastra puts it: “accountability

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<sup>244</sup> R.M. LASTRA, *European Monetary Union and Central Bank Independence*, in M. ANDENAS, L. GORMLEY, C. HADJIMMANUIL and I. HARDEN (eds.), *European Economic and Monetary Union: The Institutional Framework*, London, Kluwer Law International, 1997, p. 324-325.

<sup>245</sup> It should be noted though, that “la transparence, instrument de la politique monétaire, participe à la réalisation des missions du SEBC et ne saurait en conséquence être confondue avec l’accountability,

requires that the central banks, at the very least explain and justify their policies or actions, and give account for the decisions made in the execution of their responsibilities".<sup>246</sup> Whatever other arrangements concerning democratic accountability may exist, their scope is limited without transparency because information concerning the behaviour of the central bank is crucial for the evaluation of its performance. Borrowing Alan Greenspan's words it can be thus said that: "in a democratic society all public policy making should be in the open, except when such a forum impedes the primary function assigned to an institution".<sup>247</sup>

Transparency represents the level of disclosure of information by a central bank or an independent government body with respect to its activities and decisions, and hence the possibility for the citizens to gather a thorough understanding of the central bank or independent agencies and make an evaluation. Transparency within the framework of non-majoritarian institutions has been characterised as requiring constantly available and timely information – made available, to the maximum extent permitted by the need to preserve confidentiality, through disclosure procedures and on the basis of codes of transparency – which both identify the decisions made by the revealing party and explains the reasoning behind, thus refining the perception of the recipient of monetary policy choices and of the impact of the latter on its political, economic and social choices.

Moreover, the transparency of the central bank policy is connected to the issue of whether and to what extent decision-making bodies of the bank are required to publish minutes of their meetings and/or the (reasoned) decisions they have taken. Where the reasons for a certain monetary policy decision lay open and the proponents and opponents of a particular decision become known, it is easier to make a judgement and to hold central bank officials and, in case of a participation on the monetary policy board of the bank, government officials accountable for their behaviour. Moreover, a central bank should be required to report in regular intervals on its past performance and future plans for monetary policy in accordance with the

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facteur de légitimation démocratique" (See, for this clarification, F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et "Accountability Délibérative"*, in Cahiers de Droit Européen, No. 5-6, 2003, p. 559).

<sup>246</sup> Ibidem, p. 323.

<sup>247</sup> A. GREENSPAN, *Statement before the Committee on banking, Finance and Urban Affairs, U.S. House of Representatives, October 13 1993*, pp. 1100-1107.

monetary objective. This is even more important where a clear monetary objective is missing because in such cases the central bank can only be judged on the basis of its own statements. As follows from the quotation from Greenspan, sometimes there may be sound policy reasons not to reveal everything. Still, only those matters of policy-making should remain closed which are really essential (one can think of interventions on exchange markets). To this end it would be useful if explicit rules were provided for in the legal basis of a central bank laying down the conditions under which minutes and decisions may be withheld. The envisaged new Bank of England Act sets a positive example in this respect, as it regulates such conditions profoundly.

With respect to the final responsibility for monetary policy, it can be stated that three issues are crucial: the relationship with Parliament, the existence of some kind of override mechanism and the dismissal procedure for the central bank governor.

The relationship between the central bank and Parliament has to play a major role in any evaluation of the democratic accountability of the central bank itself. It has been argued that Parliament always holds the ultimate responsibility for monetary policy since it can change the legal basis of the bank. Parliament's legislative power can function as a mechanism of what the Roll Report <sup>248</sup> in a broader context describes as *ex ante* control whereby Parliament sets the rule with which the central bank must comply. Moreover, it can also in principle function as a mechanism of *ex post* accountability because Parliament may decide to change the legal basis of the bank as a reaction to a certain behaviour.<sup>249</sup> A closer look reveals the diversity in the legislative procedure applicable in the different constitutional systems. On the one hand, a difference between single and dual chamber parliamentary systems can be observed. In parliamentary systems with two chambers the procedure for amending the legal basis is more complex. Firstly, two chambers rather than one chamber will examine the legislative proposal. Secondly, if the second chamber does not agree with the first chamber, the hurdles for the legislation to be adopted are higher.

The existence of some kind of override mechanisms has been described as recognition of the government's ultimate responsibility for monetary policy.

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<sup>248</sup> E. ROLL et al., *Independent and Accountable, A New Mandate for the Bank of England*, The Report of an Independent Panel Chaired by Eric Roll, Centre for Economic Policy Research, October 1993.

<sup>249</sup> As far as the ECB is concerned here, see *supra* footnote 218.

However, in examining override mechanisms attention has to be paid to the type of override mechanisms and the procedure for its application. Generally, three types of override mechanisms can be distinguished, including (in descending order): the right to issue instructions, the right to approve, suspend, annul, or defer decisions, and the right to censor decisions on legal grounds. Especially, the first one may enhance the accountability

The simple fact that government can override the central bank does not necessarily add to the democratic accountability of monetary policy. Rather, the conditions under which an override mechanism can be applied should be laid down in detail. The necessity for detailed provisions on the conditions under which the central bank can be overridden increases with the seriousness of the override mechanism. Override mechanisms can build a bridge between the central bank and the democratically elected institutions, i.e. Parliament and executive government. The override mechanism can function as a tool to hold the central bank accountable on a continuous basis by providing the government with the possibility to intervene. However, at the same time it has to be ensured that the mechanism is not used as a tool for undesired political influence by the executive government. The procedure for the application for the override mechanism itself needs to be transparent. The decision to apply the override mechanism should be made public. Furthermore, the procedure to apply an override should provide for some kind of review (like a possibility for the central bank to appeal) to make sure that the override is being used carefully.

The dismissal procedure can account to a mechanism of *ex post* accountability if a central bank official can be dismissed on grounds of bad performance in terms of realising stated objectives.<sup>250</sup> Supporters of independent central banks emphasise the importance of long and non-renewable terms for central bank officials. However, short tenure may enhance the accountability of the central banker *vis-à-vis* the appointing body by giving the latter a chance to review the track record of the former in regular and short intervals. With respect to dismissal, the most important question is therefore whether and under what circumstances central bank officials can be dismissed. Dismissal may function as a sanction for poor performance by linking the

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<sup>250</sup> The appointment of central bank officials may be considered less important for democratic accountability. It can be argued that it amounts to an *ex ante* mechanism of control by choosing the persons entrusted with the power over monetary policy. Yet, the appointment of central bank officials may be better described as a mechanism of democratic legitimation rather than accountability.

tenure of central bank officials to policy results, i.e. meeting the predetermined monetary policy target. This is the case for the Reserve Bank of New Zealand where the PTA between the governor of the Bank and the Minister of Finance lays down the policy targets that the former has to achieve. Inadequate performance can result in the dismissal of the governor. In contrast, the President of the ECB can only be dismissed if he no longer fulfils the general conditions required for his performance or in case of serious misconduct.

### 3) *Transparency*

Public sector institutions have been undergoing significant changes over the past decade. One of the most important changes, as already stated, has been the move to greater accountability. Public institutions are now required to be more open and to provide more information about their operations - or, to use a word currently in vogue, to be more transparent.<sup>251</sup>

Nowhere has this move towards greater transparency been more dramatic than among central banks in the major industrial countries. Traditionally, central banks had been rather closed, almost mysterious, institutions. In fact, central bankers were once notorious for being inscrutable, since in the past and until recent years, central banks around the world operated largely in secrecy, which was mainly unquestioned. Mystique encapsulated much of the tradition and wisdom of the way central banks related to the public. This reflected the view that financial markets needed to be surprised if monetary policy was to have a significant effect. In recent years, the philosophy behind monetary policy in most major countries has been moving in the other direction. Not only does this reflect the need for accountability, but also the fact that central banks have come to appreciate that transparency can actually lead to better policy outcomes. Transparency, in fact, is a matter of mutual trust among the different

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<sup>251</sup> It should be recalled that the Treaty of Amsterdam is particularly responsive to the need for more transparency. At a very prominent place, the Treaty on the European Union states that it is about a Union in which decisions are taken not only as closely as possible to citizens, but also "as openly as possible" (see Article 1.2 TEU, ex Article A, as amended by the Treaty of Amsterdam). Access to the European Parliament, Council, and Commission documents is now provided for under Article 255, subject to limits on grounds of public or private interest to be determined under an Article 251 EC Treaty procedure within two years of the entry into force of the Treaty of Amsterdam.

actors, adopted in order to stabilise general expectations of the public and of financial markets. Moreover, it has been argued on this point that the adoption of a cooperative model oriented towards issues like predictability, stable expectations, rational exchange of information is better functioning than a competitive model.

As a matter of fact, recently various central banks, including the Bank of England and the Reserve Bank of New Zealand, have embraced transparency. To make transparency effective entails effort by monetary authorities to build public understanding of the objectives of policy and the policy process. Promoting public understanding involves authorities being active in developing and conveying information using the various means available to disclose information, and tailoring the message according to the needs of particular audiences. For instance, the European Central Bank has made a considerable effort to become transparent. There are regular press conferences, a monthly bulletin is being issued and the President of the ECB appears before the European Parliament four times each year. Recently, the ECB also started to publish staff projection of inflation. However, this seems to stand in sharp contrast to press reports, which often suggest that the ECB has not been very successful in explaining its policies to financial market participants.

In any case, one may wonder why increased transparency is viewed as such an important issue. It is worth saying that “in a democratic society, a high degree of transparency and accountability in monetary policy making reinforces the legitimacy of the central bank and consolidate the public support for its price stability mandate. Moreover, transparency imposes discipline on policy makers and is a means to ensure a general understanding of the monetary policy strategy. In turn, this may add to the credibility and thereby the effectiveness of monetary policy hence facilitating the central banks’ effort to attain its statutory objective”.<sup>252</sup>

This being so, it can be said that there are various benefits in transparency of monetary policy. First, as already highlighted, democratic accountability of central banks requires transparency. Whatever other arrangements concerning democratic accountability may exist, their scope is limited without transparency because information concerning the behaviour of central banks is crucial for the evaluation of its performance. Second, transparency of monetary policy making may enhance the

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<sup>252</sup> O. ISSING, *The Euro Area and the Single Monetary Policy*, Oesterreichische Nationalbank, Working Paper No. 44/2001, p. 3.

effectiveness and credibility of monetary policy by providing the private sector with a clear description of the considerations guiding monetary policy decisions, moreover transparency about the policy-making process makes the monetary policy transmission mechanism generally more effective, in part by ensuring that market expectations can be formed more efficiently. By providing the public with adequate information about its activities, the central bank can establish a mechanism for strengthening its credibility by matching its actions to its public statements.<sup>253</sup>

Geraats shows, for instance, that opaqueness about economic forecasts damages the reputation of a strong central bank that is averse to inflation.<sup>254</sup> Most observers would probably also agree that it is important that monetary policy is predictable in the short and medium run as this contributes to market stability. Predictability is enhanced by systematic decision-making by the policy maker and by public understanding.

Moreover, although the term transparency is often used in the context of central banks, it is not always very clear what it amounts to. Transparency of monetary policy can be defined as the extent to which central banks disclose information that is related to the policy making process. It is a multifaceted concept that could pertain to any aspect of economic policy-making. Thus, it seems natural to use a conceptual framework for transparency that reflects the different stages of the decision-making process. Following Geraats<sup>255</sup>, one can distinguish five aspects of transparency: political, economic, procedural, policy and operational transparency. Each of these aspects may give rise to different motives for transparency.

(i) Political transparency refers to openness about policy objectives. This comprises a statement of the formal objectives of monetary policy,<sup>256</sup> including an explicit prioritisation in case of

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<sup>253</sup> For a detailed analysis of the issues described in the text, see BLINDER, A., GOODHART, C.A.E., HILDEBRAND, P., LIPTON, D. and WYPLOSZ, C., *How do Central Banks Talk?*, ICMB, International Center for Monetary and Banking Studies, Geneva, 2001.

<sup>254</sup> P.M. GERAATS, *Why Adopt Transparency? The Publication of Central Bank Forecasts*, CEPR Discussion Paper 2582, October 2000.

<sup>255</sup> *Ibidem*.

<sup>256</sup> All central banks have formal objectives for monetary policy. However, Japan, Switzerland and the United States do not achieve the full score of one on this item because they have multiple objectives without a prioritisation. The latter is important because objectives can be conflicting. The other central banks identify price stability as their main objective.

potentially conflicting goals, and quantitative targets.<sup>257</sup> Political transparency is enhanced by institutional arrangements, like central bank independence, central bank contracts and explicit override mechanisms, because they ensure that there is no undue influence or political pressure to deviate from stated objectives.<sup>258</sup>

(ii) Economic transparency focuses on the economic information that is used for monetary policy. This includes 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 banks' actions are likely to reflect anticipated developments.

(iii) Procedural transparency is about the way 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 is achieved by the release of minutes and voting records.

(iv) Policy transparency 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. The latter is relevant because monetary policy actions are typically made in discrete steps: a central bank may be inclined to change the policy instruments, but decide to wait until further evidence warrants moving a full step.

(v) Operational transparency concerns the implementation of the central banks' policy actions. It involves a discussion of control errors in achieving the operating targets of monetary policy and (unanticipated)

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<sup>257</sup> The specification of quantitative target for the main objectives of monetary policy is popular. Only the Bank of Japan and the Federal Reserve do not have one. All other central banks have an inflation target that could be set by the central bank (like in the case of the ECB), the government, or be based on a joint agreement.

<sup>258</sup> Note that political transparency does not need to be under control of the central bank, but is often determined by political authorities (government or legislature). For instance, Anglo-Saxon central banks typically do not have goal independence and lack the ability to set their own quantitative targets.

macroeconomic disturbances that affect the transmission of monetary policy.

Finally it must be remarked that the concept of transparency is closely related to accountability. In fact, some degree of transparency is a necessary condition for accountability. Whereas transparency refers to mere information disclosure, accountability concerns the explanation of one's actions and the possible repercussions when the policy outcomes fall short of the objectives. In particular, as far as the ECB is concerned it should finally highlight that, by making public and explicit its monetary policy strategy, the Eurosystem set itself apart from a number of central banks around the world. As a matter of fact, the central banks of the other major world currencies do not have a publicly disclosed strategy. Even within Europe, the Bundesbank's openly communicated policy framework of monetary targeting was more an exception than the rule. The Eurosystem, instead, has decided to make public and explain its strategy "because it believes that the effectiveness of monetary policy is enhanced if it is understood by the markets, the media and the public at large. In this respect, the Eurosystem's transparent mode of monetary policy-making indeed represents a "new European type of central banking",<sup>259</sup> indeed more compatible with the above-described interaction of the different parties involved in the Euro-sovereignty game.

#### 4) *Credibility*

As already seen, in recent years the practice of central banking around the world has been profoundly affected by two trends. The first is toward granting central banks greater independence *vis-à-vis* other branches of their governments. This trend is clearly expressed in the current European Union's plan for a single currency: the Maastricht Treaty prescribes the creation of a monetary authority, the European System of Central Banks (the ESCB), that would be formally independent of any

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<sup>259</sup> T. PADOA-SCHIOPPA, *An Institutional Glossary of the Eurosystem*, Article by Tommaso Padoa Schiopa. Member of the Executive Board of the European Central Bank, at the conference on "The Constitution of the Eurosystem: the Views of the EP and the ECB", 8 March 200, p. 6, available at [http://www.ecb.int/key/00/sp000308\\_1.htm](http://www.ecb.int/key/00/sp000308_1.htm)

other European government or institution.<sup>260</sup> The second trend influencing the nature of central banking is for countries to formally state that a central bank's sole objective should be to ensure price stability. New Zealand, for example, in its Reserve Bank Act of 1989, stated that the Bank's monetary policy should be "directed to the economic objective of achieving and maintaining stability in the general level of prices".<sup>261</sup> Likewise Article 105 EC Treaty establishes that "the primary objective of the ESCB shall be to maintain price stability".

These two trends have an underlying unity: they can be seen as social responses to a more fundamental problem of central bank credibility called the time inconsistency of monetary policy. The theory of time inconsistency stresses that monetary authorities are often tempted to promise low inflation now and to try to surprise the public with unexpectedly higher inflation later. However, such promises will not be believed because economic agents, understanding the authorities' incentives, realise that the promises will not be honoured. Instead, economically plausible outcomes have the property that monetary authorities are not able to systematically surprise the public. This property implies that the monetary authority cannot profit from reneging on its announcements. In fact, it can only lose by doing so: expected and realised inflation will often be higher than if the monetary authorities had made a binding promise. This consequence is known as inflation bias.<sup>262</sup>

At this point it should be explained how the creation of some institutions can be interpreted as social responses to time inconsistency. A society may try to ameliorate inflation bias by providing appropriate incentives for its monetary

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<sup>260</sup> As insightfully underlined by F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et "Accountability Délibérative"*, in *Cahiers de Droit Européen*, No. 5-6, 2003, p. 551, notably footnote 12, this situation represents a turnover with respect to the so-called "Westminster model", where the Parliament has the very last source of democratic legitimacy. As already sketched, the traditional mechanism of political control rests upon the principle according to which every central bank is hierarchically subordinated to the Executive. On the contrary, with the advent of a new system of central banking almost all over the world, "le principe de l'indépendance rompt cette chaîne de responsabilité en exigeant l'autonomie de la banque centrale vis-à-vis du gouvernement, et donc vis-à-vis du parlement". Such a trend may also be interpreted as an implication of the end of the Westphalian, State-centred model of organisation of public authority.

<sup>261</sup> Section 8, Reserve Bank of New Zealand Act of 1989.

<sup>262</sup> See F. LIPPI, *Central Bank Independence, Targets and Credibility. Political Economic Aspects of Delegation Arrangements for Monetary Policy*, Edward Elgar, Cheltenham, UK – Northampton, MA, USA, 1999.

authorities to adhere to promises; institutional arrangements may be designed to reduce the gains to the authorities from creating unexpected inflation. One approach is to structure the compensation of central bankers so as to punish them if inflation is outside some target range, as in New Zealand. Alternatively a society may try to constrain the policy instruments available to the monetary authorities in order to make engineering inflation surprises more difficult. A country's commitment to fix its exchange rate can be understood in this way. For either approach to work, it is necessary that the monetary authorities be insulated from the rest of the government. Hence central bank independence emerges as a necessary condition for institutional solutions to time inconsistency.

Further theoretical analyses imply that such institutional mechanisms may not be necessary, however. In particular, because monetary authorities are typically engaged in a long-term relationship with the public, they can develop a reputation for honouring commitments. The fear of losing a reputation for future "honesty" is an important incentive that may deter a central bank from "cheating" today. Recent studies have shown that this incentive may be powerful enough to make socially optimal outcomes attainable, even in the absence of any institutional constraints. Institutional approaches and concerns about reputation are both plausible solutions to the time inconsistency problem, even if both have weaknesses according to existing theory.

But why credibility matters in monetary policy? One can try to answer this question analysing the institutional approach, first. Fundamentally, money represents a promise. It requires trust by the users of money in the issuer of money to honour this promise. Money is built on trust, but in turn trust must be built on solid foundations. The promise must be made credible and this – at least in relatively modern times – is the job of central bankers.

A promise always concerns the future. When somebody makes promises in everyday life, when the time comes to make good on his promises there is a danger that he finds either his mind or the situation having changed. Perhaps he might have simply forgotten what he said in the past or would like to change his plans under the pressure of a myriad of more pressing concerns. This is all very human. It also pretty much describes the core of the much-discussed problem of credibility in monetary policy. As a result, a good monetary constitution that can be expected to durably

deliver on the promise of stability needs to take human frailty and imperfection into account. Like elsewhere in public life, in monetary policy one should and cannot simply rely on good intentions, blind trust or unquestioned authority.

Thus the question is: can we trust in central banks and can we expect them to be credible in making good on their promises of price stability? There is today a broad consensus that stable money is too important to be left to the day-to-day political process, which inevitably will always have to balance different objectives, conflicting interests and short-term pressures. If stable money is regarded as a common good for the benefit of all and if it is seen as a precondition for long-term prosperity and social justice then it makes sense for society to create an independent institution that stands above the fray of day-to-day politics and can pursue this objective with minimum distraction. This is the basis for central bank independence.

If price stability, by contrast, were regarded as just one out of a long list of political and economic objectives – rather than as a common goal and a precondition for the successful pursuit of other objectives – then there would be no legitimacy for entrusting this task to independent central banks. Making value judgements when trading-off different objectives and balancing conflicting interests is the legitimate job of elected politicians with a popular mandate and not of appointed technocrats.

An independent central bank thus presupposes a broad consensus on the “quasi-constitutional” nature of the common good of price stability. Assigning the central bank a clear overriding objective also imposes limits on its discretionary exercise of power and makes it easier for the public to hold the central bank accountable for its mandate. This is important to keep in mind if one entertain the possibility that while money is too important to be left to the politicians, one could similarly concur with Poincaré that “money is too important to be left to central bankers”<sup>263</sup>. In other words, why should one trust central bankers more than politicians? Friedman trusted neither of the two and advocated a constitutional rule for constant money growth as his preferred solution of the long-standing debate on “Rules versus authorities in monetary policy”. His concerns reflect what can be

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<sup>263</sup> For the quotation see M. FRIEDMAN, *Should There be an Independent Monetary Authority?*, in L.B. YEAGER (ed.), *In Search of a Monetary Constitution. Inflation: Causes and Consequences*, Cambridge, Harvard University Press, 1962.

regarded as a healthy distrust of the unfettered “rule of men” as opposed to the “rule of law” which he much prefers – in line with the long tradition of British liberal thinking. Moreover, Friedman was quite sceptical on central bank independence and asked whether it was really tolerable in a democracy to have so much power concentrated in a body free from any kind of direct, effective political control.

This is why it is important to stress that if an independent central bank is assigned a clear and limited mandate, this represents a constraint on the discretionary exercise of power by the government but also by the central bank itself. In the absence of a complete and universally applicable rule for monetary policy an independent central bank which focuses firmly on the single overriding goal of price stability is the closest realistic and credible substitute for a literal “rule of law”. In particular, such a central bank does not have the discretion to pick and choose at will among several objectives. A clear commitment to a single overriding objective is the key to credibility and it is also the key for accountability, i.e. the obligation to constantly justify and explain policies to the general public.

Institutions themselves represent a set of rules. They are a way to reduce reliance on individual moral behaviour in the pursuit of desirable objectives. They clearly delineate the power of individuals and limit their discretion in the exercise of power. As a consequence, institutions – if designed appropriately – should in general prove to be more reliable and durable carriers of trust and reputation than can be expected for individuals. At the same time, the institutional solution of an independent central bank allows for greater flexibility than the adoption of any strict mechanical rule. Friedman himself, in the essay mentioned above, acknowledged that one “cannot dispense fully with the rule of men” since “no law can be specified so precisely as to avoid problems of interpretation or to cover explicitly every case”.<sup>264</sup>

A high degree of accountability and transparency can, nevertheless, help to monitor the conduct of monetary policy and to establish appropriate incentives for the behaviour of central banks. Explicit performance contracts for individual central bankers have been suggested as one way of providing such incentives and of reducing the reliance on trust in individual ethical behaviour. For example, salaries of central

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<sup>264</sup> O. ISSING, *Should we have Faith in Central Banks*. Speech delivered at the St. Edmund’s College Millennium Year Lecture, Cambridge, 26 October 2000, available at <http://www.st-edmunds.cam.ac.uk/Papers/issing.html>, p. 7.

bank governors could be linked in some way to the measured inflation rate or they could be dismissed if a certain inflation threshold is reached. One difficulty with this approach is the one pointed out already by Friedman. It will in general not be possible to specify a written contract which can cover all possible contingencies and which could be verified unambiguously *ex post*.

Moreover, there are limits to the extent to which the behaviour of individuals inside an institution can be monitored and verified precisely from the outside. Ultimately, the assessment of performance can only be based on observable and verifiable outcomes of decisions, which – however – will also be affected by many other exogenous influences. Especially in cases where decision-making is done by committee – as is the case for the majority of independent central banks – it is rather difficult to disentangle individual contributions and responsibilities with respect to the common decisions taken.

Delegating authority and placing trust in institutions that are assigned a clear objective seems preferable to relying on the discretion and good faith of individuals, on the one hand, and imposing strict mechanical rules, on the other hand. Any institution is more than the mere sum of individuals. This is the very reason for the existence of institutions – otherwise there would be no need for them. Institutions instil and reflect a sense of common purpose and responsibility. They provide a discipline on individual behaviour within such an institution. At the same time they provide support and strength to the individuals making up the institution. The strength of an institutional approach is particularly evident in the case of independent central banks. In this context there are great merits in decision-making by committee. On the one hand, it allows diverse experiences, arguments and point of views being brought to the table. On the other hand, there is a shared responsibility for the common decisions taken. It is not a single individual but the entire institution that is behind these decisions. Both aspects are crucial for a strong and independent central bank.

For these reasons accountability and transparency are both more easily and more appropriately implemented in the relationship between the public and the central bank as an institution, rather than primarily with respect to individual central bankers. In this relationship the public acts as a principal who delegates the tasks of monetary policy to the central bank as its agent. The act of delegation can be one-off, of a constitutional nature, or it can be periodically renewed. In both cases it is crucial that

the central bank can be held accountable for its performance by the public. This can be achieved in different – more or less formal – ways. Even if no explicit contractual elements and specific sanctions are incorporated in this relationship, the delegation of decision-making authority to an independent central bank establishes a kind of quasi-contractual relationship. The delegation of authority represents an act of trust on the part of the public and it represents a promise and an obligation on the part of the central bank to fulfil its mandate.

As a consequence it can be said that properly designed institutions provide the basis for trust and confidence. However, this trust must be earned, maintained and confirmed through action over time. Like individuals, institutions become carriers of reputation as a function of their past behaviour. This reputation forms the basis for expectations of future behaviour.

In the case of the European Central Bank, the institutional preconditions for credible and successful monetary policy are in place. The ECB is built on trustworthy institutional foundations. As a new institution, however, it started out without a track record and thus cannot rely on an established reputation. The statutes and institutional set-up of the ECB have worked very well to date and the Governing Council of the ECB has taken its monetary policy decisions in full independence. However, to firmly establish trust and reputation takes time. Trust is deepened and reputation is built when it is tested in difficult circumstances and when it is maintained over an extended period of time. Until a sufficient track record is established, the ECB – by necessity – has to rely primarily on the strength of its institutional set-up and the force of its arguments to win the trust of the public.

As a new institution it is unsurprising that the ECB has been subject to an extraordinary degree of public scrutiny and, indeed, criticism in its young life. Over time any public institution, which is based on a sound constitutional foundation, can only benefit from being open to outside advice and from being exposed to criticism and debate. This creates desirable incentives for constant improvement and helps the institution to strengthen its commitment to fulfil its mandate in the best possible way. An open, frank and fair dialogue is particularly crucial in the process of developing understanding and a bond of trust between a young institution like the ECB and its principal, whom it ultimately serves, i.e. the European public. This process of trust-

building requires some patience and indeed good faith on both sides. Not blind faith, but perhaps some good will.

### ***5) Concluding remarks with a specific, preliminary focus on central banking in the EMU***

After having outlined the so-called modalities of the exercise of monetary power and the basic principles underlying the action of central banks as such, with the declared aim to shed light on the most important mechanisms meant to link the delegation of public authority occurring in the monetary field to the generally accepted democratic principles, it is now worth going back to EMU, the selected scenario of the whole investigation.

As already specified in the Introduction, the advent of the single currency and of the ESCB, as a peculiar, quasi-federal form of central banking, have opened an entirely new chapter for Europe's economic and monetary constitution as well as for the evolution of central banking as such. With this assumption in mind, "it would be a fallacy to believe that this regime shift – fundamental as it is – represents a "one off" event".<sup>265</sup> On the contrary, the current process of adaptation to this new set-up is going to imply a dynamic, though certainly not uncontroversial, evolution. While the institutional profile of the Eurosystem, its mission and independence, should be considered as a given in this process, the fluidity of the entire evolution should not be underestimated, as Europe's new central bank is also supposed to be embedded in the wider process of European integration.

The Eurosystem (a user-friendly expression adopted by the ECB to indicate the composition in which the ESCB performs its basic tasks)<sup>266</sup> has achieved an advanced stage of integration, not only in terms of policy action, but also in terms of attitude, outlook, and identification of its constituent units. However, the achievement of a

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<sup>265</sup> T. PADOA-SCHIOPPA, *An Institutional Glossary of the Eurosystem*, Article by Tommaso Padoa Schioppa, Member of the Executive Board of the European Central Bank, at the conference on "The Constitution of the Eurosystem: the Views of the EP and the ECB", 8 March 2000, available at [http://www.ecb.int/key/00/sp000308\\_1.htm](http://www.ecb.int/key/00/sp000308_1.htm), notably at p. 8.

<sup>266</sup> For the sake of clarity, note that the Eurosystem comprises the ECB and the national central banks of the 12 Member States that have adopted the euro.

similar capacity for a coherent action and a unified collective vision is still underway on the part of economic policy-makers. Since the strength of a currency – and the public’s confidence in it – is closely related to the political structure that supports it, the current imbalance and the Eurosystem’s institutional loneliness will need to be reconsidered more in detail in the following chapters. As the European Union proceeds towards its objective of an “ever closer Union”, the Eurosystem’s interrelations with economic actors, political institutions (both at the national and supranational level), the media and the public at large will be supposed to evolve soon, in order for them to gain more weight in what has been here defined as the Euro-sovereignty game.

Finally, the still to be articulated discussion of the ESCB’s institutional profile, its independence, its accountability, transparency and credibility (which partially mirrors the issues described in the present chapter) intends to provide an assessment of the *status quo* and of the major issues at stake. Nevertheless, a forward-looking perspective necessarily also implies making use of information that will become available in due course. As the EU, its institutions and its common currency evolve, certain aspects of the terms defined and discussed in the current analytical context might well become subject to a justified re-interpretation.

## CHAPTER FOUR

### *MONETARY SOVEREIGNTY WITHIN THE INSTITUTIONAL FRAMEWORK OF THE ESCB*

*“Whereas monetary sovereignty should be indivisible, and monetary policy should have a uniform and central direction, it is argued that this could not have been achieved under a truly federal structure where the component entities of the system retained powers in the field of decision-making and implementation of such decisions”\**

#### *1) The internal structure of the ESCB*

The Treaty establishing the European Community and the Statute of the European System of Central Banks and of the European Central Bank, which is annexed to the Treaty as a Protocol and forms an integral part of the Treaty, establish the European System of Central Banks (ESCB),<sup>267</sup> conceived as a federal and

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\* B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien/New York, 2003, p. 4.

<sup>267</sup> See Article 8 EC Treaty. According to C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, p. 53, “at first glance, the ESCB seems to be a rather complex system”. As recalled by the authors, “at the beginning of the 1990s, when the drafters of the EC Treaty and of the Statute had to make up their minds about the organisational structure of the new central banking system for the forthcoming single currency, there were essentially two alternatives: either to create a unitary structure by dissolving the existing national central banks and replacing them by a new European Central Bank; or to create some type of dualist structure which would be based both on the existing national central banks and the new European Central Bank” (Ibidem, p. 55). The choice was in favour of a two-level organisational structure, with a strong centralised organisation that guarantees a uniform definition and implementation of monetary policy throughout the currency area for which the ECB is responsible. Such a decision might be justified on the basis that most of the provisions related to the ESCB were drafted by the Committee of Governors, an advisory body of the Community, which was composed of Governors of the national central banks of the Member States. The maintenance of the NCBs inside the ESCB was seen as an opportunity to found the new system on the experience, the traditions and the reputation of the NCBs some of which belong to the oldest central banks in the world. A further evidence of such an institutional choice is given by the Delors Report where it is stated: “la nouvelle institution communautaire (le SEBC) doit intégrer en son sein les banques centrales existantes” (point 32 as quoted by J.-V. LOUIS, *Monnaie (Union économique et*

decentralised system.<sup>268</sup> The Treaty and the Statute assign specific objectives and tasks to the ESCB, which is composed of the European Central Bank (ECB) and the national central banks (NCBs) of the 15 Member States of the European Union (Article 107.1 TEU).

Unlike the ECB and the national central banks, the ESCB has no legal personality and no decision-making bodies of its own. However, since the objectives of the ESCB are assigned to it by the Treaty, its 16 members have common aims. It is, however, the task of the ECB and its decision-making bodies to decide how they should be achieved, i. e. directly or through the national central banks.

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*monétaire*, Rép. Communautaire Dalloz, février 2000, p. 24). The author even justifies the preference given to the name ESCB, namely arguing that “l’appellation «Système européen de banques centrales» et non pas «Système de banque centrale européenne» a prévalu parce qu’elle faisait apparaître que la BCE et les banques centrales nationales sont partie intégrante du Système ».

It is worth mentioning another interesting conceptualisation on the structure and governance of the ECB and ESCB. According to a report of the House of Lords of the United Kingdom (see Select Committee on the European Union, *Is the European Central Bank working?*, Published by authority of the House of Lords, London – The Stationery Office Limited, October 2003), “the EC Treaty established three levels of governance within the ECB in connection with the single currency. These levels can be conceived of as a set of concentric circles. First, at the centre, forming the inner circle, there is the full-time Executive Board of the ECB, which is comprised of the President, the Vice-President and four other members (Article 112.2 (a)). Second, moving outwards away from the centre, there is the Governing Council of ECB, which normally meets twice a month and comprises the Executive Board members and the Governors of the national central banks of the countries in the euro area (Article 112.1). Finally, representing the outside circle, is the General Council of the ECB, which meet four times a year; its membership comprises the President and Vice-President of the ECB plus the Governors of the national central banks of all EU Member States” (Ibidem, p. 9).

<sup>268</sup> See J.-V. LOUIS, *A legal and Institutional Approach for Building a Monetary Union*, CML Rev., 35, 1998, p. 50; ID., *L’Union économique et monétaire*, in *Commentaire Mégret, Le Droit de la CEE*, 2<sup>nd</sup> edition, Etudes Européennes, Editions de l’Université de Bruxelles, Vol. 6, Brussels, 1995, pp. 57 – 58 ; P. LAGAYETTE, *Répartition des rôles au sein du SEBC*, in *Aujourd’hui l’ecu / The ecu today*, special edition, June 1992, 4.

On the dispute about the application of the notion of federalism to the ESCB see C. ZILIOI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, pp. 58 and ff.. The authors assert that it is not possible to apply the categories related to the organisational structure of federal states since they presuppose not only a two-level organisation (as in the case of the ESCB), but also a true division of powers between these two levels. In fact, “from a legal point of view, the federal nature of a state is maintained only if both the federal level and the level of its component entities” (...) “have substantial powers in the field both of the decision-making, in particular legislation, and of the implementation of such decisions” (...) “Therefore, both the federation and the component entities in a federal state perform legislative and executive tasks, not as tasks *delegated* to them by the federal level of governance, but as *autonomous* tasks which belong to them by virtue of their own statehood and of which they cannot be deprived” (Ibidem, p. 59). As a consequence, it can be argued that there is no hierarchy between the different levels of governance. This is not certainly the case of the ESCB, which is strongly characterised by a hierarchical organisation (see *infra* paragraph 4 of the present chapter).

*Contra* S.C.W. EUFFINGER, *The Federal Design of a Central Bank in a Monetary Union: The Case of the European System of Central Banks*, Oesterreichische Nationalbank, Wien, Working Paper 64, 2002. See also F.A. MANN who, in the context of the Delors Committee Report writes that establishing a monetary union would “require an enormous surrender of (monetary) sovereignty to a body the character of which is obscure, but would inevitably involve federation” (see for the quotation R. SMITS, *The European Central Bank. Institutional Aspects*, Kluwer Law International, The Hague, 1997, p. 194, footnote 185).

To enhance transparency and to enable the public to comprehend the complex structure of the European central banking system more easily, the Governing Council of the ECB decided to adopt the term “Eurosystème” as a user-friendly expression indicating the composition in which the ESCB performs its basic tasks. The Eurosystème comprises the ECB and the national central banks of the 12 Member States that have adopted the euro. On the first day of stage three of EMU (1 January 1999), these Member States transferred their sovereignty<sup>269</sup> with regard to monetary policy to the Eurosystème. Such a statement has been usually justified on the basis that the ECB is not to conduct monetary policy *for* the Community, but *of* the Community,<sup>270</sup> a distinction that is thought to imply that the competence to conduct and implement monetary policy has not been transferred from the Member States to

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<sup>269</sup> For the sake of clarity, it is worth specifying that the expression “sovereignty” might end up to be, in this context, an ambiguous one. As already sketched in the first part of the present work (namely in the Introduction), the concept of sovereignty can be seen as a product of the legal imagination and, beyond that, of a political ideology emerging in a particular territorial and historical context. It implies the application of the notion of *suprema potestas*, an attribution which qualifies its holder as the bearer of the ultimate authority in a holistic sense (see, for these considerations B. DE WITTE, *Sovereignty and European Integration: the Weight of Legal Tradition*, in A.-M. SLAUGHTER, A. STONE SWEET and J.H.H. WEILER (eds.), *The European Court and National Courts – Doctrine and Jurisprudence. Legal Change in Its Social Context*, Hart Publishing, Oxford, 1998, pp. 277-304). Having taken that for granted, one can move further considering another aspect of the notion of sovereignty, which leaves aside the so-called holistic theory (focused on the legal philosophical construct) and takes into account a different approach that can be defined as an “aggregated approach”, meant to highlight the various components of sovereignty (its “bits and pieces”), analysed – this time – as an element of positive constitutional law. In order to clarify this different view, it might be helpful recalling the wording of the Permanent Court of International Justice (cfr. Case of the S.S. *Wimbledon*, PCIJ Ser. A, No. 1, 1923) or of the ECJ (cfr., *inter alia*, *Costa v. ENEL*, Case 6/64 [1964] ECR 585; see also paragraph 21 of Opinion 1/91 (EEA Agreement) [1993] ECR I-6079), where the notion of *sovereign rights* (in the sense of exclusive competence in a particular area) is introduced. For instance, in the course of its argument in favour of the primacy of Community law, the ECJ stated: “by creating a Community of unlimited duration, having its own institutions, its own personality, its own legal capacity and capacity of representation on the international plane and, more particularly, real powers stemming from a *limitation of sovereignty or a transfer of powers* from the States to the Community, the Member States have *limited their sovereign rights* and have thus created a body of law which binds both their nationals and themselves” (Ibidem at p. 593. Emphasis added. For the quotation see B. DE WITTE, *op. cit.*, p. 284).

This different reconstruction can be well applied to the matter under analysis in the text (the transfer of monetary power to the Community level). In any case it has to be said that the choice between the two approaches (the one that speaks about sovereignty *tout court* and the one that rather points out the restriction upon the exercise of the sovereign rights of the State in the field of monetary policy is a political one, hidden behind the logic of legal interpretation. Most of the scholars prefer to rely on the first one. Nevertheless, also the second one is worth an explicit reference, since it tends to mirror the general structure of the way in which Community law has evolved.

<sup>270</sup> See the wording of Article 105.2 EC Treaty in association with Article 3 ESCB Statute.

the Community, but directly to the ECB.<sup>271</sup> It is therefore held that the ECB is outside the Community's non-contractual liability.<sup>272</sup>

As pointed out by the ECB in its Opinion of 19 September 2003 on the draft Treaty establishing a Constitution for Europe (CON/2003/20),<sup>273</sup> under the acronym "ESCB" two realities coexist. On the one hand, ESCB refers to the ECB and the NCBs of all the EU Member States. On the other hand, and by the effect of other provisions, "ESCB" also refers to the ECB and the central banks of only those EU Member States, which have adopted the euro. This second concept is different from the first one, since it embodies the exclusive competence for defining and conducting monetary policy, including the issue and the overall management of the euro, the management of the official reserves of the Member States that have adopted the euro, and promoting the smooth operation of payment systems. "The action necessary to carry out this competence require a high degree of harmonisation of procedures, instruments and infrastructure, and a single decision-making body with regulatory capacity".<sup>274</sup>

According to Article 105 TEU, "the primary objective of the ESCB shall be to maintain price stability". Without prejudice to the objective of price stability, the ESCB is required to "support the general economic policies in the Community with a

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<sup>271</sup> See footnote 33.

<sup>272</sup> C. ZILIOI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, notably p. 45, where the authors argue that "as Article 108 EC excludes the possibility of the Community institutions and bodies to direct the ECB in its activities, it would be quite absurd to hold the Communities liable for injury caused in the course of the performance of the ECB's tasks". The conclusion to be drawn would be thus that the ECB would have to pay from its own resources for such injury.

<sup>273</sup> Published in the O. J. C 229/7, 25 September 2003.

<sup>274</sup> ECB Opinion of 19 September 2003 (CON/2003/20), paragraph 14 at the end. At this point, it should be underlined that the EU Treaty has created these two realities by introducing in the EC Treaty and in the Statute Articles that distinguish between which provisions apply to one composition or to the other. This legislative technique does not serve the aim of clarity and comprehension of the EC Treaty. In order to distinguish the second concept of ESCB, the Governing Council of the ECB – as already briefly sketched – adopted and has been using since 1998 the term "Eurosystem" in its communications with the public. Recently, with a view to simplify and make the Constitution more accessible for European citizens and, in so doing, to bring the Union's institutional framework closer to the general public, the ECB suggested that the historic reform that the draft Constitution represents would be an opportunity to introduce the term "Eurosystem" into the Constitution. This could be done in Article I-29 (1), where the second sentence could be replaced by the following: "The European Central bank, together with the national central banks of the Member States which have adopted the Union currency, the euro, shall constitute the Eurosystem. The Eurosystem shall conduct the monetary policy of the Union". (For the quotation see ECB Opinion, paragraph 14, 2<sup>nd</sup> indent).

view to contributing to the achievement of the objectives of the Community, as laid down in Article 2”, such as the promotion of a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance and a high level of employment and of social protection. While pursuing its objectives, the Eurosystem is required to act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4. Should there be any conflict between the objectives to be assessed by the ECB, the objective of price stability will always be paramount; the other objectives are dealt with according to the weighting that the ECB considers appropriate.

The Treaty and the Statute confer the following basic tasks upon the Eurosystem:

- to define and implement the monetary policy of the Community;
- to conduct foreign exchange operations consistent with the provisions of Article 111;
- to hold and manage the official reserves of the Member States;
- to promote the smooth operation of payment systems;
- to issue banknotes with legal tender status within the Community;<sup>275</sup>
- to approve the volume of issuance of the euro coins by the Member States which have adopted the euro.<sup>276</sup>

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<sup>275</sup> See Article 106.1: “The ECB shall have the exclusive right to authorise the issue of banknotes within the Community. The ECB and the national central banks may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community”. See also Article 16 of the Statute, which reads as follows: “In accordance with Article 106.1 of this Treaty, the Governing Council shall have the exclusive right to authorise the issue of banknotes within the Community. The ECB and the national central banks may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community. The ECB shall respect as far as possible existing practices regarding the issue and design of banknotes”.

<sup>276</sup> See Article 106.2: “Member States may issue coins subject to the approval by the ECB of the volume of the issue. The Council may, acting in accordance with the procedure referred to in Article 252 and after consulting the ECB, adopt measures to harmonise the denominations and technical specifications of all coins intended for circulation to the extent necessary to permit their smooth circulation within the Community”.

In addition the Eurosystem shall:

- contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system;<sup>277</sup>
- be consulted on any proposed Community act and on any draft legislation of national authorities which falls within its field of competence;<sup>278</sup>
- collect statistical information necessary for fulfilment of its tasks;<sup>279</sup>
- be represented in the field of international co-operation and participate in international monetary institutions.<sup>280</sup>

## *2) The European Central Bank and its place in the Community institutional set up*

Many scholars have been investigating the issue of the nature of the European Central Bank as “bearer of monetary sovereignty in the European Community”<sup>281</sup> since 1 January 1999 (a date which, with the establishment of monetary union, marks the beginning of a progressive de-nationalisation and de-politicisation of monetary law). There are, consequently, different views on this point. However, despite such a

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<sup>277</sup> Article 105.5, 105.6 TEU and Article 25 of the Statute. In particular the latter states that: “The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system. In accordance with any decision of the Council under Article 105.6 of this Treaty, the ECB may perform specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings”.

<sup>278</sup> Article 105.4 and Article 4 of the Statute, according to which “the ECB shall be consulted: - on any proposed Community act in its fields of competence; - by national authorities regarding any draft legislative provision in its field of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 42”. Moreover, “the ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence”.

<sup>279</sup> See Article 5 ESCB Statute.

<sup>280</sup> Article 111 TEU and Article 6 of the Statute, which clarifies that “in the field of international co-operation involving the tasks entrusted to the ESCB, the ECB shall decide how the ESCB shall be represented. The ECB and, subject to its approval, the national central banks may participate in international monetary institutions”.

<sup>281</sup> On the same line of reasoning cfr. P. LEINO, *The European Central Bank and Legitimacy. Is the ECB a Modification of or an Exception to the Principle of Democracy?*, Harvard Jean Monnet Working Paper 1/2001, who at the very beginning of his paper argues that “the European Central Bank acts as *the sovereign within the sphere of Community monetary policy*” (emphasis added).

heterogeneity of categorisation, one can identify two main questions - used as main starting point for the various investigations - which need to receive an answer: (a) the question related to the proper place to be attributed to the ECB inside the organisational structure of the European Union; (b) the legal nature/configuration of the ECB within the European constitutional order.

As observed by C. Zilioli and M. Selmayr, these two questions have “triggered an impressive number of extremely divergent statements in legal writings”.<sup>282</sup> In fact, the ECB has been classified as “Community institution”<sup>283</sup> or “Community agency”,<sup>284</sup> as “quasi-institution”,<sup>285</sup> as a “Community body”,<sup>286</sup> but also as “a Community within the Community”,<sup>287</sup> as “the Central Bank of the European

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<sup>282</sup> C. ZILIOLI and M. SELMAYR, *op. cit.*, p. 7.

<sup>283</sup> In this sense cfr. the original interpretation by M. SCHWETZER and W. HUMMER, *Europarecht*, 5<sup>th</sup> edition, Neuwied/Kriftel/Berlin, 1996. A different nuance on the matter is given by S. CAFARO, *Unione monetaria e coordinamento delle politiche economiche. Il difficile equilibrio tra modelli antagonisti di integrazione europea*, *op. cit.*, p. 214, where the ECB is defined “istituzione sui generis” in consideration of the well defined field of competence of the same, whose attributions are pretty different from those of the Community institutions if one considers that “certamente la BCE, pur essendo più indipendente della Commissione e beneficiando di una potestà normativa paragonabile a quella del Consiglio, ha un ambito di competenza circoscritto alla sola politica monetaria, a differenza di Consiglio, Commissione e Parlamento le cui competenze coincidono con quelle della stessa Comunità”

<sup>284</sup> R. SMITS, *The position of the European Central Bank in the European constitutional order*, Inaugural Address, 4 June 2003, available at <http://www.uva.nl/actueel>, where he specifies that he considers the ECB “as an independent agency for the performance of monetary policy attributed to the Community level of government and for the execution of several other tasks within the overall price-stability objective”. According to Smits it is possible to compare these independent agencies to those operating within the framework of Nation State-based structures. In both cases (namely at the national and supranational level), “reasons of effective and efficient operation in pursuit of distinct policy areas have been valid arguments for giving these public-sector bodies the status of separate entities” (Ibidem, p. 19). No one would question their belonging neither to the State, nor to the Community from a constitutional viewpoint, naturally acknowledging the fact that they are liable for their own acts and omissions although their members may be considered politically or even legally accountable for losses which these separate legal entities cannot bear but society nevertheless wishes to see covered.

<sup>285</sup> J. CLOOS, G. REINESCH, D. VIGNES and J. WEYLAND, *Le Traité de Maastricht – genèse, analyse, commentaires*, 2<sup>nd</sup> edition, Bruylant, Brussels, 1994. The four authors see the ECB as «pas une institution communautaire, mais une quasi institution ou une institution communautaire sui generis» (Ibidem, p. 236).

<sup>286</sup> J. PIPKORN, *Legal Arrangement in the Treaty of Maastricht for the Effectiveness of the Economic and Monetary Union*, CML Rev Vol. 31 (Part I), 1994, pp. 263 – 291.

<sup>287</sup> I. PERNICE, *Das Ende der währungspolitischen Souveränität Deutschlands und das Maastricht-Urteil des BverfG*, in O. DUE, M. LUTTER UND J. SCHWARZE (eds.), *Festschrift für Ulrich Everling*, Baden Baden, 1995.

Community, no more, no less”,<sup>288</sup> or as “an independent specialised organisation of Community law”<sup>289</sup>, or as “an independent sub-organisation of the Union”.<sup>290</sup>

As a very first remark it should be argued that, in order to understand properly the legal nature of the ECB within the European constitutional order, one should take into account not only what the legal writing has to say, but also the letter of the law and its interpretation by the courts.

As far as the first element of the analysis is concerned, it must be recalled that the ECB is not listed in Article 7.1 EC Treaty among the institutions through which the Community carries out its tasks, but it is established by reference to the separate Article 8. The different place in the Treaty is not without relevance; on the contrary it highlights the fact that the ECB has to be perceived as a *quid novi* with regard to the institutions of the EC. In fact, whenever Community institutions act under the EC Treaty (with a competence extending to all the fields of activity of the Union), they do not act for themselves, but always as representatives and thus in the name and on behalf of the legal person EC: they are the arms through which the EC is able to act and to achieve its political aims.<sup>291</sup> Against this background, the ECB cannot be

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<sup>288</sup> R. TORRENT, *Whom is the European Central Bank the Central bank of? Reaction to Zilioli and Selmayr*, CML Rev Vol. 36, 1999, 1229 – 1241. The same definition has been given by the Advocate General Jacobs in his Opinion (delivered on 3 October 2002) on the Case C-11/00, *Commission of the European Communities v. European Central Bank (“OLAF Case”)*, [2003] ECR I-7147 at para. 60. Almost on the same line of reasoning see R. SMITS, *The position of the European Central Bank in the European constitutional order*, *op. cit.*, p. 20, who applies the qualification of “Central Bank of the European Community” to the ESCB (thus to the combination of the ECB and the NCBs of participating Member States), rather than to the ECB as such.

<sup>289</sup> C. ZILIOLO and M. SELMAYR, *op. cit.*, p. 29. According to the authors, the ECB is a “supranational organisation within the Union’s first and central pillar, and independent from, albeit associated with, the existing three Communities”. Thus, they see the relationship between the EC and the ECB as one of “association” rather than “subordination”. Moreover, their predominantly international law view makes them see a body set up by the Treaty serving the States which have relinquished monetary sovereignty. Following their view of the EU as a “layered international organisation”, the authors emphasise that the transfer of monetary sovereignty from the Member States took place to the ESCB immediately without even passing through the Community institutions.

On this point (namely the transfer of monetary sovereignty), it should be worth reading some interesting remarks made by R. SMITS, *The position of the European Central Bank in the European constitutional order*, Inaugural Address, 4 June 2003, where he says: “In my perception, these authors thus fail to acknowledge that, although ESCB competences clearly are central in EMU, there are other agents that have acquired powers in the field of monetary union. The Council’s competences to act under Article 123 (4) EC Treaty, the provision on the introduction of the single currency, or under Article 111, on the exchange-rate regime in respect of non-EU currencies, are cases in point”.

<sup>290</sup> A. VON BOGDANDY, *The Legal Case For Unity: The European Union as a Single Organisation with a Single Legal System*, CML Rev, 1999, at p. 904.

<sup>291</sup> As recalled by C. ZILIOLO and M. SELMAYR, *op. cit.*, p. 15, this organic dependence of the Community institutions on the legal person for which they are acting has been stressed by the ECJ

qualified as an institution.<sup>292</sup> In fact the Treaty has conferred upon the ECB legal personality distinct from that of the European Community by virtue of Article 107.2 EC Treaty and Article 9.1 ESCB Statute; the ECB has so-called decision-making bodies to act in its name and on its behalf; those bodies have been granted original powers under the Treaty to adopt legally binding measures; the accounts of the ECB are not to be examined by the Court of Auditors, with the exception of the provision regarding the examination of the operational efficiency of the management of the ECB;<sup>293</sup> the ECB is to act independently of the Community institutions in the execution of its tasks.<sup>294</sup>

The above-mentioned issue (whether the ECB can be considered as an institution or not) has been deeply discussed in the context of the “OLAF Case”,<sup>295</sup> whose judgment - delivered by the ECJ on 10 July 2003 – is, on this point, extremely illuminating.<sup>296</sup> In this case the Commission sought and obtained the annulment of

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which once stated expressly that “only the Community has legal personality, and its institutions do not” (Joined Cases 7/56 and 74/57, *Algeria v. Common Assembly of the ECSC*, 1957, ECR 81, 57).

<sup>292</sup> In the Treaty the ECB is never referred to as a Community institution, but always as something apart. Cfr., for instance, Article 111.3, second subparagraph, EC Treaty, according to which Community agreements on monetary regime and foreign exchange regime matters shall be binding “on the institutions of the Community, on the ECB and on the Member States”. Under Article 234, first subparagraph (b), EC Treaty, the ECJ has jurisdiction on the validity and interpretation of acts “of the institutions of the Community and of the ECB”. On the same line see also Articles 232 and 288 EC Treaty.

<sup>293</sup> Cfr. Article 27.1 and 27.2 ESCB Statute, according to which: “the accounts of the ECB and national central banks shall be audited by independent external auditors recommended by the Governing Council and approved by the Council. The auditors shall have full power to examine all books and accounts of the ECB and national central banks and obtain full information about their transactions. The provision of Article 248 of this Treaty shall only apply to an examination of the operational efficiency of the management of the ECB”. Such a provision highlights the financial independence of the ECB whose resources are therefore completely separated from the budget of the original three Communities.

<sup>294</sup> Article 108 EC Treaty. As rightly written by the Advocate General Jacobs in his Opinion (delivered on 3 October 2002) on the Case C-11/00, *Commission of the European Communities v. European Central Bank* (“OLAF Case”), [2003] ECR I-7147 at paragraph 150: “that provision establishes, according to its wording, a principle of central bank independence. It is (...) clear that the independence thus established is not an end in itself; it serves a specific purpose. By shielding the decision-making process of the ECB from short-term political pressures the principle of independence aims to enable the ECB effectively to pursue the aim of price stability and, without prejudice to that aim, support the economic policies of the Community as required by Article 105.1 EC”.

<sup>295</sup> Case C-11/00, *Commission of the European Communities v. European Central Bank*, [2003] ECR I-7147 concerning the conflicting competences of the European Anti-Fraud Office (OLAF) – established by the Commission (cfr. Commission Decision 1999/352/EC, ECSC, Euratom of 28 April 1999 – OJ 1999 L 136, p. 20) to protect the financial interests of the Community – and of the Anti-Fraud Committee of the ECB – established by the ECB to protect its own financial interests.

<sup>296</sup> Interesting insights can be found in the Opinion of the Advocate General Jacobs (*supra*, footnote 22) and in the analysis of the case made by R. SMITS, *The position of the European Central Bank in the*

Decision No 1999/726/EC of 7 October 1999<sup>297</sup> by which the ECB established an Anti-Fraud Committee responsible for the monitoring of activities of the Directorate for Internal Audit of the ECB aimed at prevention of fraud and other illegal activities detrimental to the financial interests of the ECB. The Commission – supported by the Council, the European Parliament and the Netherlands Government – submitted that the Decision was contrary to Regulation 1073/1999 of the European Parliament and of the Council of 25 May 1999 concerning investigations conducted by the European Anti-Fraud Office (OLAF).<sup>298</sup> The ECB replied that Decision No 1999/726/EC pursues the same aim as Regulation 1073/1999 without being contrary to it and that the Regulation should have been interpreted so as to be inapplicable to its activities. In the alternative, it asked the Court to declare the Regulation inapplicable pursuant to Article 241 EC Treaty for lack of legal basis, breach of an essential procedural requirement, and violation of the independence of the ECB and the principle of proportionality.

As it is clear, this case raises a number of important issues concerning, in particular, the scope of Community competence to adopt measures under Article 280 EC Treaty aimed at combat fraud and other illegal activities affecting the financial interests of the Community, the obligation of the Community institutions and the Member States to respect the independence of the ECB, and the duty to consult the ECB on proposed Community acts falling within its fields of competence laid down in Article 105 EC Treaty. Anyway, for the sake of the internal consistency of the present analysis, all these issues will not be discussed here. Instead, the focus will be put only on a specific matter brought before the Court: the interpretation of Article 1(3) of Regulation 1073/1999, saying that, in order to step up the fight against fraud, corruption and any other illegal activities detrimental to the Communities' financial interests, OLAF must be able to conduct internal investigations in all "the institutions, bodies, offices and agencies established by, or on the basis of, the EC and Euratom Treaties".

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*European constitutional order, op. cit.* For an analysis of the case in relation with the investigation on the legal status of the ECB within the Community constitutional framework, cfr. B. DUTZLER, *OLAF or the Question of Applicability of Secondary Community Law to the ECB*, March 2001, available at <http://eiop.or.at/eiop/texte/2001-001a.htm>

<sup>297</sup> ECB/1999/5, OJ 1999 L 291, p. 36.

<sup>298</sup> OJ 1999 L 136, p. 1.

On this specific point the ECB has argued that, while it “accepts that it does not exist in a legal world distinct from that of the Community, and that the Community legislature may adopt general measures applicable to the ECB”, it was not to be put in the same category as “other bodies”.<sup>299</sup> On the other hand, both the Advocate General and the Court based their findings that the ECB is a “body” established under the EC Treaty on three main considerations: (i) the fact that the authors of the provisions on EMU chose to integrate these provisions in the EC Treaty and did not conclude a separate Treaty on EMU;<sup>300</sup> (ii) the fact that the secondary objective for the ECB is to “support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2”; (iii) the fact that the ECB “is bound by Community law and subject to the jurisdiction of the European Court of Justice”.<sup>301</sup>

It follows from those considerations that the ECB forms an integral part of the Community framework, not, thus, “as a third party to the Community, but as an

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<sup>299</sup> This description of the ECB’s reasoning is taken from para. 55 of the Opinion of the Advocate General Jacobs in Case 11/00.

<sup>300</sup> See Opinion of the Advocate General Jacobs in Case 11/00, *Commission v. European Central Bank* [2003] ECR I-7147 para. 57, where it is pointed out that “while the Member States considered the possibility of establishing the provisions on monetary policy and the ESCB in a separate “monetary pillar” under the Treaty on European Union, they chose to integrate those matters in the EC Treaty. The establishment of a monetary union was thus added to the tasks of the Community mentioned in Article 2 EC, the ECB was established by Article 8 of the EC Treaty, and all of the provisions governing its constitutional position were placed in the EC Treaty and in the Statute, which as a protocol to that Treaty forms part of primary Community law”.

On the so-called “fourth pillar” proposal see J.-V. LOUIS, *Union monétaire et Union politique, Le rôle du juge*, in *La tutela giurisdizionale dei diritti nel sistema comunitario – Congresso di Venezia dell’U.A.E.*, Brussels, 1997, p. 585; V. DI BUCCI, *La corte di giustizia, l’unione economica e monetaria ed il passaggio alla moneta unica*, in *Scritti in onore di Federico Mancini*, Vol. II: *Diritto dell’Unione Europea*, Giuffrè, Milano, 1998, p. 307; C. BAILLEUX BANERJEE, *La France et la Banque Centrale Européenne*, Presses Universitaires de France, Paris, 1999, 310 (according to whom the “fourth pillar” concept originated in the French treasury); C. ZILIOLI and M. SELMAYR, *op. cit.*, p. 10. This monetary pillar was meant to be placed inside the temple of the European Union as something in between the existing Community law structures and the fields of intergovernmental co-operation in foreign and security policy matters and in justice and home affairs. During the negotiations many arguments were taken into account in order to support such a proposal. Zilioli and Selmayr rightly recall the one according to which there was a sort of reluctance by some Member States at the idea of communitarising the field of monetary policy so closely linked to the idea of national sovereignty. In contrast to such a communitarisation, the “fourth pillar” approach “would have been compatible with giving the European Council (...) a pivotal role as regards monetary policy and thus have kept the ultimate control on monetary policy for the Member States” (Ibidem).

<sup>301</sup> An interesting investigation on this point is provided by P. CRAIG, *EMU, the European Central Bank, and Judicial Review*, in P. BEAUMONT and N. WALKER (eds.), *Legal Framework of the Single European Currency*, Hart Publishing, Oxford, 1999, pp. 95-115.

instrument of the Community set up to achieve its objectives".<sup>302</sup> Still, the particular position of the ECB within that framework – which distinguishes it from, on the one hand, the institutions and, on the other hand, the agencies and offices created by secondary Community law – is that of a body/organisation located in the very heart of the European Union's temple: in its first and central pillar, entirely governed by supranational Community law.<sup>303</sup> Again, the ECB is subject to the general principles of law that form part of Community law and promotes the goals of the Community set out in Article 2 EC through the implementation of the tasks and duties laid upon it.<sup>304</sup> However, despite the above-described location of the ECB within the EU constitutional framework, it has to be highlighted that the ECB retains a peculiar position, given its monopoly over money in Europe: in fact, it has been given sovereign powers in the field of monetary policy in consideration of the exclusive tasks it has been entrusted with. As already sketched out, the ECB has been rightly established by primary Community law as the specialised organisation for the conduct of monetary policy. "In this sense, one can even qualify the ECB, from a functional perspective, as a new Community within the European Union's central pillar which stands on an equal footing with the original three Communities".<sup>305</sup>

It has to be further specified that, in promoting the goals of the Community, the ECB is also entitled to act externally. The fact that the ECB has legal personality

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<sup>302</sup> B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien/New York, 2003, p. 86.

<sup>303</sup> Very recently, in the draft Treaty establishing a Constitution for Europe, the ECB has been placed under the Title of "Union's Institutions" (Title IV, Article II-29), but, interestingly enough, the provision that lists the Union's institutions does not include the ECB. Because of its specific institutional features, the ECB needs to be differentiated from the "Union's institutions" and this justifies the fact that Article I-18 does not list the ECB. Having said that, it is worth recalling that, in order to increase the clarity, consistency and soundness of its institutional status, the ECB – in its Opinion of 19 September 2003 on the draft Treaty establishing a Constitution for Europe, CON/2003/20, O.J. C229/7, at para. 11 – recommended that the heading of Title IV would be changed to "The Institutional Framework of the Union". This expression would encompass the constellation of institutional bodies, namely: (i) the Union's institution as listed in Article 7 EC Treaty; and (ii) the ECB, Court of Auditors and the advisory bodies.

A part from these considerations of "institutional architecture", it has to be clarified that the transfer of the provisions on the ECB and the ESCB from the EC Treaty to the Constitution will not entail any changes to the substance, and that the tasks, mandate, status and legal regime of the ECB and of the ESCB remain substantially unchanged.

<sup>304</sup> See F. AMTENBRINK and J. DE HAAN, *The European Central Bank: an independent specialised organisation of Community law – A comment*, CML Rev 2002, notably p. 68; ECB Monthly Bulletin, October 2000, *The ECB's relations with institutions and bodies of the European Community*, pp. 49 – 64. Here the ECB describes its role as being that of contributing to the achievement of the objectives of the Community through its mandate to maintain price stability.

<sup>305</sup> C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.*, p. 30.

under public international law implies that it is in a position, *inter alia*, to conclude, in matter relating to its field of competence, agreements under public international law and to participate in the work of international organisations such as the International Monetary Fund, the Bank for International Settlements or the Organisation for Economic Co-operation and Development. Moreover, in each Member State the ECB enjoys the most extensive legal capacity accorded to legal persons under the respective national law. It may therefore acquire or dispose of movable and immovable property and may be party to legal proceedings.

In addition, the ECB enjoys in the territories of the Member States such privileges and immunities as are necessary for the performance of its tasks, under the conditions laid down in the Protocol on the privileges and immunities of the European Communities.<sup>306</sup> Further details are stipulated in the Headquarters Agreement between the ECB and the Federal Republic of Germany concerning the seat of the former; in particular, the members of the Executive Board enjoy the privileges, exemptions, immunities and facilities granted to all diplomats accredited by the German Federal Government in accordance with the Vienna Convention on Diplomatic Relations of 18 April 1961.

On the basis of what has been said so far, one may thus legitimately conclude that the ECB is definitively an integral part of the European Community. A further evidence of such a statement is given by the consideration that the ECB is subject not only to the Court of Justice's power of review, but also, as regards the efficiency of its management, to a control by the Court of Auditors, as provided for in Article 27.2 of the ESCB Statute.<sup>307</sup> Moreover, the ECB is required to submit an annual report on the activities of the ESCB and on monetary policy, in particular to the Parliament, whose competent committees may also hear the President of the ECB and the other members of its Executive Board, as provided for by Article 113.3 EC Treaty.

After having recalled all these aspects concerning the general framework of Community law and going back to the internal structure of the ESCB, it has to be said

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<sup>306</sup> See Article 291 EC Treaty: "The Community shall enjoy in the territories of the Member States such privileges and immunities as are necessary for the performance of its tasks, under the conditions laid down in the Protocol of 8 April 1965 on the privileges and immunities of the European Communities. The same shall apply to the European Central Bank, the European Monetary Institute, and the European Investment Bank".

<sup>307</sup> Same reasoning is applied by J.-V. LOUIS, *Monnaie (Union économique et monétaire, Rép. Communautaire Dalloz*, février 2000, p. 24, para. 162.

that the ECB has been established as the core of the Eurosystem. The overall responsibility to ensure that the tasks of the Eurosystem are carried out either by its own activities or through the national central banks is attributed to the ECB. In taking its decisions on the way in which the tasks of the ESCB are to be carried out – adopting a centralised or a decentralised approach – the ECB adheres to the principle of decentralisation.<sup>308</sup> This principle stipulates that, to the extent deemed possible and appropriate, the ECB shall have recourse to the national central banks to carry out operations that form part of the tasks of the Eurosystem. It is for the ECB (Governing Council) to evaluate – on the basis of a costs-benefits analysis - the possibility and appropriateness of decentralising operations. Where, taking into account the objectives of the Eurosystem, operations can be carried out more effectively if they are handled directly by the ECB, the Statute entitles the ECB to act in a centralised manner. In any case, it should be underlined that the principle of decentralisation applies to operations only, while decisions and legislative activities remain centralised.<sup>309</sup> Anyway, in order to ensure that the centralised approach does not hamper the smooth functioning of the Eurosystem, the national central banks, as operational arms of the ECB, have to act in accordance with ECB Guidelines and ECB Instructions. To ensure compliance by the national central banks with these legal instruments, the ECB is empowered to take any steps that are deemed necessary – which may extend to bringing a matter before the Court of Justice of the European Communities.

### 3) *Decision-making bodies of the ECB*

The process of decision-making in the Eurosystem is centralised through the decision-making bodies of the ECB, namely the Governing Council and the Executive

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<sup>308</sup> As observed by J.-V. LOUIS, *supra*, footnote 33, at para.200: « la mise en oeuvre du principe de décentralisation ne signifie pas que la BCE n'ait aucune tâche opérationnelle. Ainsi, par exemple, les procédures d'adjudication utilisées pour les opérations principales de refinancement se réalisent, en collaboration, par les BCN et la BCE, sous la direction de celle-ci. En outre, la BCE peut aussi effectuer, à titre exceptionnel, des opérations de réglage fin (fine tuning) et des crédits croisés (swaps) en devises. Dans ce dernier cas, il appartiendra au conseil des gouverneurs d'autoriser ces opérations ».

<sup>309</sup> On this point ZILIOLI and SELMAYR, *op. cit.*, p. 67 introduce the notion of *decisional centralism*, an institutional choice driven by the need to deal with the indivisibility of monetary policy.

Board. As long as there are Member States which have not adopted the euro the General Council exists as a third decision-making body.

*The Governing Council* comprises all the Member of the Executive Board and the Governors of the national central banks of the Member States that have adopted the euro.<sup>310</sup> It is the primary decision-making body of the ECB. Each Governor sitting in the Council enjoys a dual capacity, acting both as a Chief Executive of his/her NCB and as Member of the Governing Council. As a member of the Governing Council the Governor acts in his/her personal capacity and as the representative of his/her NCB. Each Governor contributes to the work of the Governing Council through his/her personal participation but in such a way that the Eurosystem can benefit from the work done in his/her NCB.<sup>311</sup>

With regard to the objectives and tasks entrusted to the Eurosystem, the Governing Council is responsible, in particular, for:

- adopting the Guidelines and taking the Decisions necessary to ensure the performance of the tasks entrusted to the Eurosystem under the Treaty and the Statute;
- formulating the monetary policy of the euro area, including intermediate monetary objectives, key interest rates and the supply of reserves in the Eurosystem, taking the necessary decisions and adopting the Guidelines needed for its implementation;
- deciding on the use of other operational methods of monetary control;
- adopting the Regulations concerning the calculation and determination of the required minimum reserves;

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<sup>310</sup>Article 112.1 EC Treaty and Article 10.1 ESCB Statute

<sup>311</sup> "It is quite simply not appropriate to consider the participation of the Governors of NCBs in the Governing Council as protection of national interests in the decision-making process of the ECB. The Governors do not represent their own NCB. Indeed, the participation of Governors from countries of very different size provides an element of independence and, even more, of cohesion. Even though Governors are not appointed according to a common procedure but according to separate national procedures, the mandate of each Governor is protected, under the statute for the duration of his term of office. His removal during his term of office (which shall be not less than five years) is subject to Community procedure and, eventually, to a judgment by the Court of Justice of the European Communities". See, for the quotation, Y. MERSCH, *The role of the Central Banks in Euroland. Institutional aspects*, Speech delivered by the Governor of the Banque central du Luxembourg at the European Banking & Financial Forum 2000, Prague, 28 March 2000, available at [http://www.bcl.lu/html/en/discours\\_prague/discours\\_prague.html](http://www.bcl.lu/html/en/discours_prague/discours_prague.html)

- adopting Regulations to ensure efficient and sound clearing and payment systems within the Community;
- issuing Guidelines for operations of the national central banks and the Member States with remaining foreign reserve assets;
- taking the necessary steps to ensure compliance with ECB Guidelines and Instructions and defining any necessary information to be provided by the national central banks;
- fulfilling the advisory role of the ECB;
- adopting the Rule of Procedure which determine the internal organisation of the ECB and its decision-making bodies;
- authorising the issuance of euro banknotes and the volume of issue of the euro coins within the euro area;
- establishing the necessary rules for the standardisation of the accounting and reporting of operations undertaken by the national central banks;
- taking the decisions necessary to bring an action before the Court of Justice,<sup>312</sup> notably to bring a dismissal of an NCB Governor before the Court.<sup>313</sup>

It emerges from these competences that the Treaty and the Statute assign to the Governing Council the power to take the most important and strategically significant decisions for the Eurosystem. In the words of René Smits: “the Governing Council is the supreme decision-making body on all matters relating to the tasks of the System. The Treaty reserves for it all strategic monetary policy decisions”.<sup>314</sup>

In particular, when taking monetary policy decisions, the Governing Council normally acts by a simple majority of the votes cast by the members who are present in person. Each member has one vote. The principle of “*one person, one vote*” reflects the status of all the members of the Governing Council, including the Governors of

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<sup>312</sup> Article 35.5 ESCB Statute.

<sup>313</sup> Article 14.2, 2<sup>nd</sup> indent ESCB Statute which specifies that “a Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct. A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Governing Council on grounds of infringement of this Treaty or of any rule of law relating to its application (...)”.

<sup>314</sup> R. SMITS, *The European Central Bank. Institutional Aspects, op. cit.*, p. 95.

the national central banks of the Eurosystem, who are appointed in their personal capacity and not as representatives of their Member States. In the event of a tie, the President has the deciding vote.

For some decisions on financial matters relating to the status of the national central banks as shareholders of the capital of the ECB, the votes in the Governing Council are weighted according to the national central banks' shares in the subscribed capital of the ECB. The votes of the members of the Executive Board are zero-weighted. In the case of "shareholders matters", a Governor who is unable to participate may appoint an alternate to cast his/her vote.<sup>315</sup>

Finally, according to the Statute, the Governing Council has to meet at least ten times a year. Current practice, as disciplined by the Rules of Procedures, is for the Governing Council to meet every two weeks in Frankfurt.

*The Executive Board* is composed of the President and the Vice-President of the ECB and four other members who have been appointed from among persons of recognised standing and professional experience in monetary and banking matters. The appointment procedure confers a high level of legitimacy on the Executive Board's decisions; the appointments have to be made by common accord of the Governments of the Member States at the level of the Heads of State or Government, on a recommendation from the EU Council after it has consulted the European Parliament and the Governing Council of the ECB. The term of office of the members of the Executive Board shall be eight years and shall not be renewable. Only nationals of Member States may be members of such a decision-making body.<sup>316</sup>

The main responsibilities of the Executive Board are:

- to implement monetary policy in accordance with the Guidelines and Decisions laid down by the Governing Council;
- to issue the necessary Instructions to national central banks for the implementation of the Guidelines and Decisions of the Governing Council;

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<sup>315</sup> Article 10.3 ESCB Statute.

<sup>316</sup> Article 112.2 EC Treaty and Article 11 ESCB Statute that specifies that the members of the Executive Board shall perform their duties on a full-time basis. No member shall engage in any occupation, whether gainful or not, unless exemption is exceptionally granted by the Governing Council.

- to be responsible for the current business of the ECB;
- and to execute certain powers delegated to it by the Governing Council, including those of a regulatory nature.

The Statute stipulates that implementation of the monetary policy is a competence exclusive to the Executive Board and consequently, as a matter of interpretation, is not at the disposal of the Governing Council.

These responsibilities of the Executive Board justify its status as the primary operational decision-making body of the ECB, responsible for its current business.<sup>317</sup> The power of the Executive Board to adopt ECB Instructions addressed to the national central banks enables the Eurosystem to react and adapt to quickly changing conditions in the money and capital markets, to address specific cases and to deal with matters of urgency.

The Executive Board normally acts by a simple majority of the votes cast by the members who are present in person. In the event of a tie, the President has the casting vote. Current practice is that the Executive Board meets at least once a week.

*The General Council* is composed of the President and the Vice-President of the ECB and the Governors of the national central banks of all 15 Member States of the EU. It can be defined as a “transitory body” or “temporary organ” performing those tasks taken over from the European Monetary Institute which, owing to the fact that not all Member States have adopted the euro, still have to be performed by the ECB in Stage Three of Economic and Monetary Union.<sup>318</sup> Therefore, the General Council is primarily responsible for giving advice in the necessary preparation for irrevocably fixing the exchange rates of the currencies of the Member States that have not yet adopted the euro. Moreover, the General Council contributes to particular activities of the ESCB, such as the ESCB’s advisory functions and the collection of

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<sup>317</sup> As observed by C. ZILIOLI and M. SELMAYR, *op. cit.*, p. 84, “current business is of decisive importance as monetary policy may require decisions to be taken every day, every hour, sometimes every minute, in particular in cases of need of emergency measures”. This is also stressed by P.J. SLOT, *The Institutional Provisions of the EMU*, in D. CURTIN and T. HEUKELS (eds.), *Institutional Dynamics of European Integration. Essays in Honour of Henry G. Schermers*, Dordrecht/Boston/London, 1994.

<sup>318</sup> See Article 47.3 ESCB Statute. As emphasized by R. SMITS, *The European Central Bank Institutional Aspects*, Kluwer Law International, The Hague, 1997, p. 97: “the General Council has been introduced to provide a forum in which the monetary policy co-operation between the single currency area and the other monetary jurisdictions in the Community can take place”.

statistical information.<sup>319</sup> Moreover, the General Council shall contribute to fulfilling the reporting commitments of the ECB under Article 15 of the Statute by providing the Governing Council with comments on the annual report prior to its adoption. Such a transitory body shall also contribute to the standardisation of accounting rules and the reporting of operations under Article 26.4 of the Statute by providing the Governing Council with comments on the draft rules prior to their adoption. Finally, it shall contribute to laying down the conditions of employment of the staff of the ECB by providing the Governing Council with comments on the draft conditions of employment prior to their adoption.

The President of the ECB has to inform the General Council of the decisions taken by the Governing Council.

Neither the Treaty nor the Statute provides for a minimum number of meetings of the General Council. Current practice is that the General Council meets every three months in Frankfurt.

Although *the President* of the ECB is not a decision-making body and thus should not be discussed under this heading, a word is in order on this subject. He/she is to chair the decision-making bodies of the ECB.<sup>320</sup> Moreover, the President represents the ECB externally,<sup>321</sup> both in the area of legal commitment<sup>322</sup> and of political accountability for the activities of the independent ESCB.<sup>323</sup>

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<sup>319</sup> According to Article 6.3 of the Rules of Procedures of the General Council of the European Central Bank: "the contribution of the General Council to the statistical tasks of the ECB shall consist in: - strengthening the co-operation between all the national central banks of the European Union with a view to supporting the ECB's tasks in the field of statistics; - contributing to the harmonisation, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics by all the national central banks of the European Union; - providing the Governing Council with comments on draft ECB Recommendations in the statistical field, under Article 42 of the Statute, prior to their adoption.

<sup>320</sup> Article 13.1 (concerning the permanent decision-making bodies) and Article 46.1 (concerning the General Council) ESCB Statute.

<sup>321</sup> Article 13.2 ESCB Statute.

<sup>322</sup> Article 39 ESCB Statute. It is worth recalling that the ECB may further be committed by two members of the Executive Board or of the staff, if duly authorised by the President.

<sup>323</sup> Article 113.3 EC Treaty.

### 3.1) *The voting structure*

Voting in the Governing Council is regulated by Article 10.2, 10.3, 11.3, 14.4, 20 and 41.2 of the ESCB Statute.

As already stated, at the moment (namely before the envisaged enlargement of the euro area) the Governing Council consists of the six members of the Executive Board and the twelve NCB Governors of the euro area. The Governing Council usually operates by consensus, but if there were a vote on monetary policy, each member of the Governing Council would have one vote (making 18 votes in total), and the decisions would be taken by simple majority, with the President having a casting vote.<sup>324</sup>

Except in case of a teleconference, members of the Governing Council should be present in person. The Rules of Procedure may provide that a member who is prevented from voting for a prolonged period may appoint an alternate as a member of the Governing Council. Thus, no delegation of voting from one member to another has been provided for.

It should be recalled that there is a *quorum* of two-thirds of the members of the Governing Council. This requirement can be overruled if the *quorum* is not met, with the President of the ECB convening an extraordinary meeting.<sup>325</sup>

The absence of a Governing Council member may affect the *quorum* but not decision-making itself if the *quorum* is met: it is the members present whose votes are

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<sup>324</sup> Article 10.2, 2<sup>nd</sup> paragraph ESCB Statute. However, there are several exceptions to this simple majority requirement: (a) there is the special voting arrangement under Article 10.3. It implies weighted voting among the NCB Governors only, in accordance with the relative weight of the NCB concerned as a shareholder in the ECB. The weights of the votes of the members of the Executive Board shall be zero. This rule applies to decisions on financial matters. These are divided into decisions, which can be taken by normal majority, and decisions which require a qualified majority. In particular, the adoption of such a qualified majority decision requires at least two-thirds of the subscribed ECB capital and at least half of the shareholders in favour; (b) there is the two-thirds majority requirement under Article 20 (on other instruments of monetary control) and 14.4 (on a finding that non-ESCB functions performed by an NCB interfere with the objectives and tasks of the System). Here, the votes are not weighted and every member's vote counts; (c) unanimity is required in the Governing Council for a recommendation to amend the ESCB Statute through the simplified procedure (Article 41.2 ESCB Statute); finally, there is another instance in which the Executive Board members' opinions do not count (as seen under Article 10.3). They are debarred from voting in the Governing Council when it fixes their terms and conditions of employment (Article 11.3 ESCB Statute).

<sup>325</sup> Article 10.2, 3<sup>rd</sup> paragraph ESCB Statute.

counted. Thus, “it is not possible for one or two members to frustrate decisions by their absence from meetings”.<sup>326</sup>

The normal voting rule is *one man, one vote*. This was seen as strengthening the federative structure of the System where the members of the Community appointed governing body and the Governors of the NCBs would decide together.<sup>327</sup> Also, this principle emphasizes that the NCB Governors do not represent their State, but act in an individual capacity.<sup>328</sup> Their voting behaviour, although certainly influenced by their background and, possibly, by regional input into their considerations, should be directed towards price stability in the interests of the Community as a whole. “The relative importance of the votes of the NCB Governors gives the voice of the regional members of the Governing Council a lot of weight compared to the voice of the ECB’s management”.<sup>329</sup>

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<sup>326</sup> R SMITS, *The European Central Bank. Institutional Aspects*, Kluwer Law International, The Hague, 1997, p. 99.

<sup>327</sup> The Committee of Governors indicated that the composition and voting procedures of the ESCB reflect the System’s “federative structure”. It saw the “one person, one vote” principle as strengthening the decision-making process. It should “be oriented exclusively towards the requirements for the Community as a whole”. See, *Europe*, Document, No. 1669/1670, 8 December 1990, at p. 22. On page 14 of this document, the Commentary even states that monetary policy decision-making “is conditioned by the need to direct such decisions to the requirements of the Community as a whole rather than to regional considerations”.

This can be explained on the basis of the “indivisible character of most of a central bank’s tasks”. In particular – in the words of ZILIOLI and SELMAYR, *op. cit.*, p. 56 –, “an efficient monetary policy is possible only if it is determined by a centralised organisation which guarantees a uniform definition and implementation of this policy throughout the currency area for which a central bank is responsible. Central banking, by definition, seems to require centralised organisational structures, and thus is entrusted even in federal states to a federal authority”.

<sup>328</sup> J.-V. LOUIS, *Commentaire Mégret, Le Droit de la CEE*, 2<sup>nd</sup> edition, Etudes Européennes, Editions de l’Université de Bruxelles, Vol. 6, Brussels, 1995, p. 66.

<sup>329</sup> R. SMITS, *op. cit.*, p. 100. On the complex nature of checks and balances between national and supranational interests inside the Governing Council, see also the provoking observations of R. E. BALDWIN, E. BERGLÖF, F. GIAVAZZI and M. WIDGREN, *Eastern enlargement and ECB reform*, Swedish Economic Policy Review, 8, 2001, p. 29. In particular they argue that the ECB was designed to be very independent. “but the actual structure is not the most natural to meet this goal”. Technocrats would run a completely independent central bank. Instead, the supreme ECB’s decision-making body includes members who are politically appointed in their home nations. “Of course, oaths are sworn and decrees are signed stating that the governors are independent experts when sitting on the Council. A Panglossian observer would be satisfied with this, a Machiavellian observer would laugh. The truth is probably somewhere in between”.

### 3.2) *The reform of the voting modalities of the Governing Council*

In order to complete the picture of the above-described background scenario, it has to be said that recently the EU has been preparing itself for the substantial enlargement to take in new Member States from Central, Eastern and Southern Europe. On 1 May 2004 ten new countries (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia) have in fact joined the EU. Increasing the EU's membership to the presently envisaged 27 countries<sup>330</sup> will have a deep impact on the operation of its institutions and bodies,<sup>331</sup> including the ECB.<sup>332</sup> Although the new Member States have joined the EU with the status of a "Member State with a derogation",<sup>333</sup> they are indeed committed to the eventual adoption of the euro. Once they have demonstrated their capability to fulfil the

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<sup>330</sup> There are in fact two more countries (Bulgaria and Romania) who are still negotiating their accession and have been given the prospect of entry into the EU in 2007.

<sup>331</sup> For a comprehensive overview of the issues related to enlargement as constitutional agenda-setter for the European Union, see B. DE WITTE, *The Impact of Enlargement on the Constitution of the European Union*, in M. CREMONA (ed.), *The Enlargement of the European Union*, Oxford University Press, Oxford, 2003, pp. 209-252, where the author clearly argues that "a central goal of recent and upcoming institutional reforms of the Union is to prevent the EU from becoming paralysed by a brutal expansion of its membership". Such an issue is then defined as the issue of "the Union's decision-making capacity", whereby capacity is understood as being the "probability that a political system, given the diversity of interests to which it is exposed, will be able to take decisions" (Ibidem. p. 212).

<sup>332</sup> For a comprehensive analysis of the matter see ECB, *The Eurosystem and the EU enlargement process*, Monthly Bulletin, February 2000, pp. 39 – 51; F. ALLEMAND, *Enlargement Report: La réforme institutionnelle de la Banque Centrale Européenne dans le contexte de l'élargissement*, in J.-V. LOUIS and A. P. KOMNINOS (eds.), *The Euro. Law, Politics, Economics*, British Institute of International and Comparative Law, 2003, pp. 419 – 462. See also ID., *L'audace raisonnée de la réforme de la Banque Centrale Européenne*, in *Revue du Marché commun de l'Union européenne*, June 2003, pp. 391-398. For a critical economic analysis see also P. DE GRAUWE, *Challenges for Monetary Policy in Euroland*, JCMS, Vol. 40, No. 4, 2002, pp. 693-718, where the author underlines the fact that the enlarged EMU represent a challenge for the goal to realise an Optimal Currency Area, given that with a larger group of members the probability of asymmetric shocks will increase significantly. In fact, some countries may experience a boom and inflationary pressures, while at the same time others experience deflationary forces. Moreover, in such a context, the power to set interest rates – transferred to the common central bank – must be exercised having in mind the need to fine-tune interest rate to cater for different national economic conditions.

<sup>333</sup> As remarked by Y. MERSCH, *The reform of the Governing Council of the ECB*, BIS Review 16/2003, p. 2: "All the new members will, upon joining the EU, automatically have the statute of countries with a derogation, that is to say with a clear commitment to join the euro area at a later stage. According to a position published by the ECB, the adoption of the euro is considered the result of a complex convergence process, rather than a mere exchange rate measure. Hence unilateral euroisation is considered unacceptable. The accession countries have to respect the convergence criteria set by the Maastricht Treaty in terms of inflation, public finance and interest rates and are expected to achieve high levels of real and nominal convergence, meaning that their economic structure and inflation levels have to converge to EU levels. In addition, they have to participate for at least two years in ERM II".

Maastricht convergence criteria in a sustainable manner, they will adopt the euro.<sup>334</sup> Therefore, the Governing Council of the ECB will also have to be prepared for a potentially significant increase in the number of Member States of the euro area and for the resulting participation of the Governors of the respective NCBs in the Governing Council. This will thus imply the adjustment of voting modalities within such a decision-making body.<sup>335</sup>

As a consequence, in response to the challenge to maintain the Governing Council's capacity for efficient and timely decision-making even as its membership increases substantially, the Treaty of Nice contains an ECB "enabling clause".<sup>336</sup> This takes the form of a new Article 10.6 of the Statute of the ESCB and of the ECB, which allows for an adjustment of the voting modalities in the Governing Council of the ECB as laid down in Article 10.2 of the Statute.

According to Article 10.6 of the Statute, Article 10.2 of the Statute may be amended by way of a unanimous decision of the EU Council, meeting in the composition of Heads of State or Government, either on the basis of a Recommendation from the ECB, and after consulting the European Commission and

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<sup>334</sup> The Maastricht Treaty lays down a very specific procedure for joining the EMU, which also involves meeting specific targets over specified time periods (so-called "reporting periods"). Once a country has joined the EU it can also join the post-euro Exchange Rate Mechanism, and this starts the reporting period clock running. The Treaty specifically requires that compliance with the Maastricht criteria be evaluated on the basis of data from the year preceding the evaluation. However, the reporting period for the fifth main criterion – ERM membership without devaluation – is two years. What this means is that the evaluation cannot be undertaken until a two-year track record exists. This means, thus, that the convergence evaluation must wait at least until the second accession anniversary. After two years pass, the Commission and the ECB need about two months to produce the final data and write their "Convergence Reports". These documents assess the suitability of a EU Member State for EMU membership based on compliance with the EMU-related *acquis* and the Maastricht economic convergence criteria. It should be recalled that the relevant *acquis* mainly involves central bank independence, capital mobility, and banking and financial stability, things that the newcomers will have established by the time they join the EU. The Council of Ministers then deliberates the reports for at least a month.

<sup>335</sup> Currently, the Governors of the acceding country central banks attend meetings of the General Council of the ECB with the status of observers. They will not join the Governing Council until they adopt the euro.

<sup>336</sup> Although the EU leaders did not decide the nature of ECB reforms in Nice, they recognised the problem and envisaged a workable solution by putting an "enabling clause" in the Treaty. This allows the ECB's decision-making process, enshrined in the Maastricht Treaty, to be changed without convening a new intergovernmental conference. In fact the Treaty of Nice opened the door to a "single issue" intergovernmental conference (IGC). The ECB institutional structure is set in the Treaty on the European Union, so changing it would normally entail another IGC. "A full-scale IGC might have delayed enlargement, and it would have put the ECB structure into the bubbling caldron of political trafficking. The Nice solution will, at least to some extent, ensure that ECB reform is considered in a politically uncluttered setting" (R. E. BALDWIN, E. BERGLÖF, F. GIAVAZZI and M. WIDGREN, *Eastern enlargement and ECB reform*. Swedish Economic Policy Review, 8, 2001, p. 17).

the European Parliament (EP), or on the basis of a Recommendation from the Commission, in which case the ECB and the EP are consulted. Article 10.6 of the Statute also prescribes that the ECB Recommendation should be adopted unanimously by the Governing Council. In a declaration annexed to the Final Act of the Intergovernmental Conference preparing the Treaty of Nice, the governments of the Member States expressed their expectations that a Recommendation within the meaning of Article 10.6 would be presented as soon as possible after the Treaty enters into force.

Following the conclusion of the Intergovernmental Conference, the Governing Council extensively discussed possible options for a reform of its voting modalities and on 3 February 2003 unanimously adopted the ECB Recommendation for a Council Decision on an amendment to Article 10.2 of the Statute of the European System of Central Banks and of the European Central Bank (ECB/2003/1), which was presented to the EU Council on the same day.<sup>337</sup> On 21 March 2003 the EU Council, meeting in the composition of Heads of States or Government, adopted the Decision on this amendment to the Statute (2003/223/EC), which has now to be ratified by the Member States in accordance with their respective constitutional requirements.

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<sup>337</sup> The ECB proposal came in for a large amount of criticism and was adversed by the European Parliament. In fact, it should be recalled that in its plenary session on 13 March 2003 the European Parliament adopted a resolution on the ECB Recommendation, on the basis of a report from the Committee on Economic and Monetary Affairs. In its resolution, the European Parliament gave a negative opinion on the ECB Recommendation on the grounds that the proposed rotation model had been criticised for being complex, even taking into account the difficulty of the task, given the limits imposed by Article 10.6 of the Statute. As an alternative proposal, the European Parliament favoured a two-stage approach. It proposed that, for the time being, the *status quo* should be retained, meaning that all members of the Governing Council should continue to participate in decision-making with full voting rights and that decisions would continue to be taken by simple majority. However, a more comprehensive reform should be envisaged by the Convention of the future of Europe and proposed to the next Intergovernmental Conference for adoption. Such a comprehensive reform should – in the view of the European Parliament – distinguish between *operational decisions*, to be taken by an “enlarged Executive Board of nine members adequately representing the euro area economy”, and *strategic and general monetary policy decisions* to be taken by the Governing Council. (For a more complete picture of the issues referred to above, see European Parliament, Committee on Economic and Monetary Affairs, *Draft Report on the proposal for a Council decision on an amendment to Article 10.2 of the Statute of the European System of Central Banks and of the European Central Bank*, Provisional 2003/0803(CNS), 24 February 2003.

### ***3.2.1) The limits imposed by the “enabling clause”***

When designing a suitable new voting system, the Governing Council was bound by the limits imposed by the “enabling clause”. These restrict the reform to a change of the voting modalities as laid down in Article 10.2 of the Statute. As a result, any adjustment of the voting modalities had to be without prejudice to the right of all members of the Governing Council to be present during the Governing Council meetings (Article 10.1 of the Statute), and to participate in the discussions. Moreover, any adjustment of the voting modalities was not to have any implications for voting on decisions taken under Articles 28, 29, 30, 32, 33 and 51 of the Statute (Article 10.3 of the Statute). More fundamental reform options, such as changes to the composition of the Governing Council or a different distribution of tasks between the Executive Board and the Governing Council were, therefore, outside the scope of the enabling clause.

### ***3.2.2) Five guiding principles***

In order to maintain the Governing Council’s decision-making capacity in an enlarged euro area, the Governing Council agreed that the number of Governors exercising a voting right would have to be smaller than the overall number of Governors in the Governing Council. In the judgement of the Governing Council, a rotation system represents an equitable, efficient and acceptable way in which to allocate voting rights among Governors within the Governing Council.

The Governing Council took the view that the members of the Executive Board should maintain a permanent voting right, given their special status as the only members of the Governing Council who are appointed at the European level by a Treaty procedure and who operate solely in the euro area context and for the ECB, the competence of which spans the whole euro area. Moreover, the President, a member of the Executive Board, also has the casting vote in the event of a tie in the Governing Council.

In designing the precise features of the rotation system, the Governing Council was guided by the following fundamental principles:

- “one member, one vote”,<sup>338</sup> “ad personam participation”,<sup>339</sup> “representativeness”, “automaticity”,<sup>340</sup> “transparency”<sup>341</sup>.

Having highlighted the “fundamental principles”, one should recognise a particular importance to the third one (representativeness) for the present reasons. In fact, the introduction of a rotation of voting rights could lead to situations in which the group of Governors with a voting right are from Member States which, taken together, might be perceived as not being sufficiently representative of the euro area economy as a whole. The new voting system, therefore, should be designed in a manner that would safeguard against such outcomes. Thus, in order to achieve representativeness,

<sup>338</sup> As already outlined in the ECB’s Opinion on the enabling clause of 5 December 2000 (CON/00/30), the Governing Council considers the “one member, one vote” principle to be fundamental to its decision-making. While a rotation system necessarily implies that there will no longer be permanent voting rights for all the member of the Governing Council as the number of Governors increases, this principle should nevertheless be retained and apply to those members of the Governing Council who exercise a voting right. This rules out any reform proposals based on weighted voting.

<sup>339</sup> It is worth noting that all members of the Governing Council should continue to participate in the Governing Council’s meetings, and do so in a personal and independent capacity, irrespective of whether they have the right to vote or not. Therefore – according to what is stated in the ECB Monthly Bulletin, May 2003, p. 76 – “any new voting system based on constituencies or country groupings, where governors select a representative who acts and votes on behalf of the country group/constituency, or based on the delegation of voting in a rotation system, would not be compatible with this principle”. This principle has been taken into account in order to try and guarantee that members participate in a personal and independent capacity and make their own personal judgment without being influenced by national interests. Having pointed out that, it is worth underlining that the Governing Council, so far, seems to have focused on aggregates for the euro area in reaching its conclusions. The rotation system, however, establishes nationality as the basis for who has a vote at any one time; thus the NCBs Governors will be given different voting rights according to the economic importance of the Member States that they represent. According to a report of the House of Lord of the United Kingdom (see Select Committee on the European Union, *Is the European Central Bank working?*, Published by authority of the House of Lords, London – The Stationery Office Limited, October 2003) at p. 41: “there was a concern that, by giving up the principle of equality of Member States, the proposal threatens to undermine the theory that all members of the Governing Council should forget the particular interests of their home country and act only in the interest of the euro area”.

<sup>340</sup> Given that the sequencing of future euro area expansions is uncertain, the new voting system should be sufficiently robust as to avoid the need to change the rules every time a new Member State enters the euro area. Therefore, the rules of the new voting system should be stipulated in such a way as to allow the system to automatically adjust to the entry of new Governors into the Governing Council in the process of euro area enlargement.

<sup>341</sup> On 19 December 2002, President Duisenberg wrote to Pat Cox, President of the European Parliament, and emphasised that “the Governing Council sought to design a rotation scheme which is transparent so that its main features and functioning can be communicated easily”. The agreed reform cannot properly be described as transparent, however; its functioning is definitely difficult to communicate because it is so complicated.

In order to appreciate the importance of the principle of transparency, it should be recalled that there is a widespread opinion according to which the Governing Council requires broad and ongoing public support in Europe. One consequence of this situation is that “citizens need to be able to trust in and easily understand the workings of this system” (See, for the quotation, *Consequences of the modification of the Governing Council rules*, Briefing paper for the Economic and Monetary Affairs Committee of the European Parliament, 7 February 2003).

Governors might not be able to exercise the voting right with the same frequency, with Governors from the larger Member States having the right to vote more frequently than those from smaller Member States. At the same time, any reference to the country from which a Governor comes should be made exclusively for the purpose of determining the frequency with which he/she exercises the voting right. Although the introduction of considerations of representativeness marks a departure from the existing provisions for voting in the Governing Council, this is solely motivated by the need to accommodate the impact of enlargement on the ECB's decision-making. For all Governors exercising the voting right at any point in time, the "one member, one vote" principle should apply. Consequently, this differentiation should not affect actual substantive decision-making, but should only be relevant in the process of determining who votes when.

### 3.3) *The new voting system*

Under the new voting system, the number of Governors with a voting right will not exceed 15. This number is implicit in the institutional *status quo*. Currently, the Treaty stipulates that the members of the Executive Board and the Governors of the NCBs of the Member States form the Governing Council. Since no adjustment of the Maastricht provisions was undertaken at the time of the 1995 enlargement (when the EU expanded to 15 Member States), this implies 15 voting rights for NCB Governors. Each of the six members of the Executive Board retains a permanent voting right.

In line with the principle of representativeness, Governors will exercise their voting right with different frequencies, depending on an indicator of the relative size of the economy and financial sector of their respective Member State within the euro area.<sup>342</sup> A rotation system based on groups guarantees that this differentiation between

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<sup>342</sup> This country ranking should be based on a composite indicator consisting of two components: GDP mp and TABS-MFI. The first component represents the share of a Member State in the aggregate gross domestic product at market prices of the Member States, which have adopted the euro. The economic weight of a Member State as reflected in its GDP mp is an appropriate component as the impact of central bank decisions is greater in Member States with larger economies than in those with smaller economies. At the same time, the size of a Member State's financial sector also has a particular relevance for central bank decisions, since the counterparties of central bank operations belong to this sector. A second component is therefore introduced, namely the share of a Member State in the total

Governors in terms of their entitlement to exercise a voting right follows certain clear and transparent rules.

In order to ensure a smooth introduction of the rotation system, it will be established in two stages. In principle, the system for the rotation of voting rights will start operating as soon as the 16<sup>th</sup> Member State enters the euro area, first on the basis of two groups. Once the number of euro area countries has increased to more than 21, there will be three groups.

During the first stage, Governors will be allocated to two groups according to the following rules:

- the first group is composed of five Governors from the euro area countries that occupy the highest positions in the country ranking. This group shares four voting rights;
- the second group is composed of all other Governors. This group shares eleven voting rights.<sup>343</sup>

As soon as the 22<sup>nd</sup> Member State enters the euro area, the system will operate on the basis of three groups, according to the following rules:

- the first group is composed of the five Governors from the euro area countries that occupy the highest positions in the country ranking. This group shares four voting rights;
- the second group is composed of half of all Governors, rounded up to the nearest full number, selected from the subsequent positions of the country ranking. This group shares eight voting rights;

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aggregated balance sheet of the monetary financial institutions (TABS-MFI) of the Member States which have adopted the euro.

As regards the choice of the relative weights of the two components of the composite indicator, a 5/6 weight for GDP mp and a 1/6 weight for TABS-MFI appears suitable in order to ensure that the financial component is sufficiently and meaningfully represented.

<sup>343</sup> This allocation of voting rights to the two groups might be changed if there are 16, 17 or 18 Governors in the Governing Council. This temporary adjustment might become necessary in order to ensure that the voting frequency of the Governors in the first group is not lower than the voting frequency of those in the second group, as called for by the principle of automaticity. As a result, the Governors in the first group would – temporarily – have a voting frequency of 100%. Whether or not this issue will arise at all depends on the sequencing of future euro area enlargement, that is, whether a number of countries will enter the euro area at the same time, or whether they will enter one by one. In any case, should the Governing Council so decide, by a two-thirds majority of all its members – both those with and those without a voting right – such a situation could be avoided altogether by postponing the start of the rotation system until the date on which the number of Governors exceeds 18.

- the third group is composed of the remaining Governors, who share three voting rights.

#### 4) *The legal position of the NCBs within the System and the division of responsibilities with regard to the ECB*

The national central banks (NCBs) are legal entities set up by the laws of their respective States, while being – at the same time – an integral part of the ESCB. Thus they can be considered in terms of entities sharing a double nature:<sup>344</sup> on the one hand they can act as national authorities which still exercise national competences; on the other hand they are entitled to perform functions of a higher organisational level within the ESCB.<sup>345</sup> In particular, even though, from a mere formal point of view, national central banks keep in touch with the institutional structure of the Member States by virtue of their legal personality, which originates in national law, “they are *functionally disconnected* from the institutional framework of the Member States

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<sup>344</sup> This doctrine – called *dédoublement fonctionnel* – applies to all multi-level organisations, whether they are unitary or federal, and says that within such organisations, officials of the sub-entities may simultaneously become officials of the higher organisational level whenever they act to perform functions of that level. The speculation on the *dédoublement fonctionnel* was initiated by G. SCELLE, *Le phénomène juridique du dédoublement fonctionnel*, in SCHÄTZEL and SCHLOCHAUER (eds.), *Rechtsfragen der Internationalen Organization, Festschrift für Hans Wehberg zu seinem 70. Geburtstag*, Frankfurt, 1956, pp. 324 and ff. As recalled by ZILIOLI – SELMAYR, *op. cit.*, p. 76, footnote 104, as an example of *dédoublement fonctionnel* Scelle mentions the French Préfet, which is at the same time an agent of central government and a departmental official. Moreover Scelle specifies that: « Ce phénomène pourra se définir ainsi : les agents dotés d'une compétence institutionnelle ou investis par un ordre juridique utilisent leur capacité fonctionnelle telle qu'elle est organisée dans l'ordre juridique qui les a institués, mais pour assurer l'efficacité des normes d'un autre ordre juridique privé des organes nécessaires à cette réalisation, ou n'en possédant que d'insuffisants » (ID., *op. Cit.*, p. 331). Some interesting remarks on this doctrine can be found in A. CASSESE, *Remarks on Scelle's Theory of "Role Splitting". Dédoublement fonctionnel in International Law*, available at <http://www.ejil.org/journal/Vol1/No1/art10.html>. According to this author, the reason to apply this doctrine is to be found in the absence of “specifically international rulers and agents” (“gouvernants et agents spécifiquement internationaux”). As a result, on the basis of such a *vacuum*, national members of the executive as well as state officials fulfill a dual role: they act as State organs whenever they operate within the national legal system; they act *qua* international agents when they operate within the international legal system.

<sup>345</sup> This view has been recently officially confirmed by the ECB in its Decision of 3 June 2004 concerning the terms and conditions for European Anti-Fraud Office investigations of the European Central Bank, in relation to the prevention of fraud, corruption and any other illegal activities detrimental to the European Communities' financial interests and amending the Conditions of Employment for Staff of the European Central Bank (ECB/2004/11). The ECB, in fact, point out that “the members of the ECB's General and Governing Councils who are not also members of the ECB's Executive Board exercise, in addition to their ESCB functions, national functions” (Ibidem, p. 3, para. 7. Emphasis added).

whenever they act to fulfil their tasks within the ESCB”.<sup>346</sup> On the contrary, it is possible to identify a close link between the ECB and the NCBs, which is stressed by the statutes of the NCBs the content of which, though formally having the character of national legislation, is in essential parts determined by Community law. In fact, with the entry into the third stage of EMU, the Member States are no longer free to draft their national central bank statutes, but have to ensure that they comply with the requirements of Community law.

As a consequence of the requirement of legal convergence, the national laws that apply to the national central banks have been amended in order to be compatible with Community law;<sup>347</sup> in particular they have to comply with the requirement of independence, which is necessary for the smooth functioning of the ESCB.<sup>348</sup> Thus, despite their separate legal personality, the national central banks of the Eurosystem are integral parts of it and, as such, subject to the regulatory regime of the ECB; they are therefore functionally subordinate to the ECB.<sup>349</sup> As a result, the national central

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<sup>346</sup> C. ZILIOI – M. SELMAYR, *op. cit.*, p. 77 who assert that such a situation is determined by the application of the principle of independence (as set out in Article 8 EC Treaty). Namely, the prohibition on giving instructions must be interpreted, from a functional perspective, as drawing “an insurmountable line between the national central banks and their respective Member State”.

<sup>347</sup> According to the process of legal convergence, as set out by Article 109 EC Treaty, “each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation including the statutes of its national central bank is compatible with this Treaty and the Statute of the ESCB”. In so doing, national authorities also had to ensure the smooth integration of their NCBs in the ESCB, and to eliminate any incompatibility with the Treaty and the Statute in other legislation. For a detailed analysis of the role played by the EMI in the process of legal convergence see J.-V. LOUIS, *A Legal and Institutional Approach for Building a Monetary Union*, CML Rev., 35, 1998, pp. 33 – 76. The author rightly remarks that the Treaty did not impose any particular method in order to put into being the adaptation of national legislation to Community law. Such an adaptation “may be achieved by references to the Treaty and the Statute, by the incorporation of provisions thereof, by the simple deletion of incompatibilities or by a mixture of those methods” (*Id.*, p. 47).

<sup>348</sup> As remarked by R. MEHNERT-MELAND, *Central Bank to the European Union*, Kluwer Law International, The Hague, 1995, p. 77, the statutes of the national central banks must, in particular, provide that the term of office of a Governor of a central bank is at least five years (ESCB Statute, Article 14.2). As briefly recalled *supra*, footnote 40, a Governor may be relieved from office only if he or she no longer fulfills the conditions required for the performance of his or her duties or if he or she has been guilty of serious misconduct. A decision to this effect may be referred to the Court of Justice by the Governor concerned or by the Governing Council on grounds of infringement of the Treaty or of any rule of law relating to its application. Such proceedings must be instituted, as the case may be, within two months of the publication of the decision or of its notification to the Governor or, in the absence thereof, of the day on which it came to the knowledge of the latter.

<sup>349</sup> It is worth noting that within the complex structure of the ESCB, central banking functions of the Community are not properly exercised by the ECB, but rather by the System as such (and so also by the NCBs which are an integral part of it) under the supervision of the ECB. As remarked by J.-V. LOUIS, *Le Système européen de banques centrales: les rapports entre banques centrales nationales et banque centrale européenne*, Colloque internationale *La monnaie unique et les pays tiers*, Zurich, 2000, p. 30 : « La BCE n’est pas une banque centrale supplémentaire. Elle est au sommet de la hiérarchie ».

banks have to comply with the internal legal instruments adopted by the Governing Council or the Executive Board.<sup>350</sup>

As integral parts of the Eurosystem, the national central banks act as “operating arms” of the ESCB,<sup>351</sup> carrying out the tasks conferred upon the Eurosystem in accordance with the rules established by the ECB in a “collective manner”.<sup>352</sup>

At this regard, it has to be noted that the set-up of the Eurosystem not only provides for centralised and coherent decision-making but also offers the institutional and organisational “machinery” for a consistent application of the principle of decentralisation.<sup>353</sup> Accordingly, the NCBs play an indispensable role in the conduct of the tasks and functions of the Eurosystem.<sup>354</sup> It would be thus possible to assert

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<sup>350</sup> See Article 14.3 ESCB Statute: “The national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB (...)”.

<sup>351</sup> C. ZILIOI and M. SELMAYR, *op. cit.*, p. 66. At this regard, there are several classifications in the doctrine. R. SMITS, *op. cit.*, p. 94 argues that the NCBs “are no longer acting as bodies of their own States, but are held to have emancipated from a status as agencies of their States to that of organs of a Community body”. In the same direction is J.-V. LOUIS, *A Legal and Institutional Approach for Building a Monetary Union*, *op. cit.*, p. 55, according to whom the national central banks “formally remain organs of the Member States, although they are agents of the ESCB in the realisation of the tasks pertaining to it”.

<sup>352</sup> W. F. DUISENBERG, *The European Central Bank, the Eurosystem and the European System of Central Banks*, Speech delivered by Dr. Willem F. Duisenberg at the ceremony to inaugurate the new building of the Banque centrale du Luxembourg. Luxembourg 18 May 2001, p. 2.

<sup>353</sup> *Contra* C. ZILIOI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.*, p. 12 et ff. who strongly point out that “the decision-making process inside the ESCB is *centralised* at its supranational level as it is governed exclusively by the decision-making bodies of the ECB. The national central banks (...) “are hence not representing national interests inside the ESCB, but are conceived as the operating arms of the ECB which have to act in accordance with its guidelines and instructions”. As a consequence of such a theoretical reconstruction the author speak about *decisional centralism*. On the same line of reasoning, W.H. BUITER, *Alice in Euroland*, Centre for Economic Performance, LSE. Discussion Paper Series, No. 423, April 1999, p. 17, where the author clearly states that “in the ECB and ESCB there is no role for national central banks in the formulation, design and implementation of monetary policy. Monetary policy is made by the ECB Governing Council. The NCB staffs may influence the opinion of their Governors, but decisions are made centrally”. Moreover, Buitter recalls that all policy actions that have monetary consequences (open market operations, foreign exchange sales and purchases, changes in lending and borrowing rates) have to be authorised centrally. As a consequence (a pretty strong one), he even affirms that “the role of each NCB is to be a *minority shareholder of the ECB*, to provide research support for the national Governor and to act where necessary as national branch bank of the ECB for the operational implementation of decisions” (emphasis added).

On the issue of decentralisation it makes sense underlining the fact that all the contrasts emerging from the different theoretical reconstructions can be justified in consideration of the political implications of the matter. In fact, on the basis of different interpretations, one might try to identify a larger (or smaller) slice of power/competences attributed to the actors involved (namely the ECB and the NCBs).

<sup>354</sup> See, on this point, Article 12.1, 6<sup>th</sup> sentence of the Statute (*Responsibilities of the decision-making bodies*), which provides that: “To the extent deemed possible and appropriate and without prejudice to

that there is a presumption that the operational activities of the System, which have been decided upon by the ECB, take place at a decentralised level. Usually (but also while raising many controversies), for some commentator, this provision might relate to the principle of subsidiarity.<sup>355</sup> It is true that according to the Treaty (namely Article 5.2) this principle applies only in areas “which do not fall within the exclusive competence of the Community”.<sup>356</sup> However, although monetary sovereignty/monetary competences have been definitively transferred from the Member States to the ECB, “the implementation of monetary policy decisions is conducted on a “shared” basis within the Union”.<sup>357</sup> For instance, for the implementation of monetary

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the provisions of this Article, the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB”.

<sup>355</sup> According to R. SMITS, *The European Central Bank. Institutional Aspects*, *op. cit.*, p. 112, “the view that subsidiarity is at work is widespread among central bankers themselves, but is generally rejected by learned writers on the subject”. To name but few, it is worth mentioning H. J., HAHN, *The European Central Bank: Key to European Monetary Union or Target*, CML Rev, 28, 1991, p. 799; J. CLOOS, G. REINESCH, D. VIGNES and J. WEYLAND, *Le Traité de Maastricht – genèse, analyse, commentaires*, 2<sup>nd</sup> edition, Bruylant, Brussels, 1994, p. 221; S. CAFARO, *Unione monetaria e coordinamento delle politiche economiche. Il difficile equilibrio tra modelli antagonisti di integrazione europea*, *op. cit.*, p. 208, who points out that “il decentramento” (...) “non ha nessun rapporto con il principio di sussidiarietà. Quest’ultimo, infatti, opera come criterio di ripartizione dei compiti fra Comunità e Stati Membri in caso di competenza concorrente dei due livelli di governo. Viceversa, la politica monetaria non è in alcun modo competenza concorrente e il livello di governo interessato è solo quello centrale: il decentramento, quindi, non riguarda il momento decisionale, ma esclusivamente l’esecuzione delle decisioni adottate”.

For a general investigation on the principle of subsidiarity, S. CASSESE, *L’aquila e le mosche. Principio di sussidiarietà e diritti amministrativi nell’area europea*, *Il Foro Italiano*, 1995, pp. 375 and ff.; CONSTANTINESCO, *Who’s Afraid of Subsidiarity?*, YEL, 1991, pp. 33 and ff.; PETERSON, *Subsidiarity: A Definition to Suit Any Vision?*, Parliamentary Affairs, 1994, pp. 116 and ff.

<sup>356</sup> For a definition of “exclusive competences”, see now the Draft Treaty establishing a European Constitution, as adopted by the European Convention on 13 June and 10 July 2003 and submitted to the President of the European Council in Rome on 18 July 2003, notably Article I-12, under the Title “Union competences”, which interestingly lists - in its first indent - “monetary policy, for the Member States which have adopted the euro” as an area for which the Union shall have exclusive competence to establish the competition rules necessary for the functioning of the internal market. Moreover, parallel to the provision of Article 5.2 EC Treaty, Article I-11.1 of the Draft Treaty, while listing the different categories of competences, specifies that “when the Constitution confers on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of acts adopted by the Union”.

<sup>357</sup> Y. MERSCH, *The role of the Central Banks in Euroland. Institutional aspects*, *op. cit.*, at p. 4 (here there is no need to specify that Y. Mersch is the Governor of the Banque Central du Luxembourg, thus he is clearly trying to defend the interests and the role played by NCBs within the System.

*Contra* CASSESE – *op. cit.* – who mentions monetary policy as an example of an exclusive and absolute competence. Along the same line of reasoning is ZILIOLI and SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, pp. 70- 71, who exclude the application of the principle of subsidiarity for decision-making and implementation inside the ESCB. In particular they argue that “the exclusiveness of the ECB’s competences relates not only to monetary policy in the narrow sense of Article 105.2, first indent, EC, but extends to all tasks assigned to the ESCB, i.e. to monetary policy in the encompassing sense of Ch. 2 of the Title VII of the Third Part of the EC Treaty. As an example,

policy the NCBs are responsible for maintaining relations with their counterparts, which are local credit institutions.<sup>358</sup> A centralised approach is not necessarily ruled out, but any decision in this field has to be taken by the ECB on a case-by-case basis according to the discretion of its decision-making bodies. The operations required to implement decisions of the ECB are conducted at national level under national legislation. Contrary to other operations in the field of payment and security settlement systems there is so far no “remote access” for the credit institutions. These must make use of the facilities provided by their own central bank. In the event of a default on a part of a credit institution, the sanction procedure is initiated by the relevant NCB, on behalf of the ECB.

In the run-up to Stage Three of Economic and Monetary Union, many observers felt that the decentralised monetary policy framework would become too complex and inefficient. However, these concerns have not been borne out by experience, not least because highly developed information technologies make decentralisation entirely feasible. “Making use of the NCBs’ considerable experience in dealing with their national counterparties has been, and continues to be, a real benefit to the whole system”.<sup>359</sup>

Having said that, it should be recalled that an example of concrete application of the principle of decentralisation is given by the so-called TARGET system.<sup>360</sup> Such a system provides for the link-up of national interbank large-value payment systems. The common infrastructure/platform permits interbank large-value transactions to be settled through the ESCB. Both domestic and cross-border transfers can be channelled through it. In particular, in accordance with the above-mentioned decentralisation principle, all the facilities are offered by the NCBs, the ECB (which does not manage

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in the field of payment systems, the ECB has exclusive competence to adopt regulations under Article 22 of the Statute” (Ibidem, footnote 77, p. 70).

<sup>358</sup> On this point R. SMITS, *op. cit.*, p. 112 is very clear affirming that: “a requirement that operations carried out in the exercise of exclusive Community competences are to be effected at national level, only provides for a *practical working arrangement* which put emphasis on local, instead of central, performance of Community tasks” (emphasis added).

<sup>359</sup> ID., p. 2. See also, on this point, P. ZAMBONI and C. SANTINI, *The Bank of Italy in the European System of Central Banks*, in *Intern. Journal of Publ. Admin.*, 23, 2000, pp. 205-228.

<sup>360</sup> Note that the acronym TARGET stands for Trans-european Automated Real-time Gross-settlement Express Transfer system. For an overview see *The TARGET System*, report by the Working Group on EU Payment Systems to the Council of the EMI, May 1995 and ECB, *The TARGET service level*, July 1998.

a payment system of its own) hooking up with TARGET through the interlinking mechanism. “Thus the question of access does not arise at the central level (which is not existent), but at NCB level”.<sup>361</sup>

To conclude, it should be recalled that the Statute allows the national central banks to continue to perform non-Eurosystem functions on their own responsibility unless the Governing Council finds that such functions interfere with the objectives and tasks of the Eurosystem.<sup>362</sup> For instance, one of the main activities assumed by NCBs outside the Eurosystem is that of prudential supervision. In this field the ESCB has an advisory function and has to contribute to the stability of the financial system. The Treaty also provides for the possibility of assigning to the ECB specific tasks in prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.<sup>363</sup>

##### *5) The role of the ESCB Committees*

Through various Committees which are, as a rule, chaired by a representative of the ECB, representatives of the national central banks assist in the work of the ESCB.<sup>364</sup> The mandates of the Committees are laid down by the Governing Council.

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<sup>361</sup> R. SMITS, *The European Central Bank. Institutional Aspects*, op. cit., p. 301.

<sup>362</sup> Article 14.4 ESCB Statute: “National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB”.

<sup>363</sup> In the long run one might imagine that certain functions developed with success at one national level might encourage the NCBs of other countries to develop them. Discussions have already begun, for instance, concerning certain central bank services such as: credit registers; databases on annual accounts; research and analysis of national economy; fight against money laundering; investment advisor and manager for governments or other public bodies; communication.

<sup>364</sup> The Committees of the ESCB are composed of representatives of the ECB and of the NCBs of participating Member States, i.e. those Member States which have adopted the euro. The NCBs of each non-participating Member State may also appoint a representative to take part in the meetings of an ESCB Committee whenever it deals with matters that fall within the field of competence of the General Council. The ESCB Committees have been formed to assist in the work of the ESCB/Eurosystem. The reports prepared by the ESCB Committees, in line with their clearly defined mandates, reflect the range of opinions expressed by their members.

The ESCB Committees, most of which are chaired by a representative of the ECB, do not have any decision-making powers as such, but *contribute* to the preparation of the decisions to be taken by the decision-making bodies of the ECB within their field of competence. Both the Governing Council and the Executive Board have the right to request ESCB Committees to undertake studies of specific topics.

The Committees report to the Governing Council via the Executive Board, with the exception of the Banking Supervision Committee that reports directly to the Governing Council. The various ESCB Committees provide a tight network of professional, as well as human, connections between NCBs and the ECB. In the work of these Committees, expert knowledge and specific national experience are brought together, so as to provide input into the deliberations of the Eurosystem decision-making bodies. As a result, it should be highlighted that the work of the ESCB Committees is only preparatory. They help the decision-making bodies of the Eurosystem, but they are not part of these bodies and they do not take any binding decisions. In the words of Yves Mersch, “the Governing Council remains” – in their respect – “sovereign”.<sup>365</sup>

As a very first remark, it is worth clarifying that the Committees of the ESCB are not mentioned in the EC Treaty, in the Statute or in any other Community primary law.<sup>366</sup> In particular, there is no provision comparable to Article 202, 3<sup>rd</sup> indent or Article 211, 4<sup>th</sup> indent of the EC Treaty on which the Community’s Committee system is based. However, a special provision is dedicated to them in secondary law. Article

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The following ESCB Committees have been established: Accounting and Monetary Income Committee (AMICO); Banking Supervision Committee (BSC); Banknote Committee (BANCO); External Communications Committee (ECCO); Information Technology Committee (ITC); Internal Auditors Committee (IAC); International Relations Committee (IRC); Legal Committee (LEGCO); Market Operations Committee (MOC); Monetary Policy Committee (MPC); Payment and Settlement Systems Committee (PSSC); Statistics Committee (STC). In addition a Budget Committee has been established to assist in matters related to the budget of the ECB.

<sup>365</sup> Y. MERSCH, *The role of the Central Banks in Euroland. Institutional aspects*, Speech delivered by the Governor of the Banque central du Luxembourg at the European Banking & Financial Forum 2000, Prague, 28 March 2000. available at [http://www.bcl.lu/html/en/discours\\_prague/discours\\_prague.html](http://www.bcl.lu/html/en/discours_prague/discours_prague.html), p. 4.

<sup>366</sup> So far hardly anything has been written on the role of ESCB Committees in legal academic writing. Two German writers have made public their apprehensions that the national central banks might exert a too strong influence on the decision-making bodies of the ECB which could impair the independence of the ECB itself. M. Selmayr, WM 1999, has argued that: “with a view to the small number of ECB employees the danger cannot be dismissed that the national central banks with its extensive staff (about 50.000) will gain strong influence on the decisions of the decision-making bodies of the ECB via the ESCB Committees and thereby the ECB personnel might gradually be reduced to mere secretariat activities for these Committees”. Along the same line of reasoning M. Seidel, EuZW 2000, 552 at pp. 553 and 554 has taken the following view: “The respective Committee members sent by NCBs are subject to instructions of their NCBs; the representatives of the ECB are also bound by instructions (...). The establishment of Committees and their activity without a doubt restrict the ECB’s freedom of action and articulation (...). The Committee system of the ESCB may be prescribed and warranted by the structure of European currency framework; however, it is to be feared that the stronger the particular organisation of the ESCB becomes. it might be assessed by the public as endangering or even impairing the independence of the ECB. From this perspective it follows that the ESCB’s Committee system without a doubt amounts to a constitutional weakness of the European Monetary Union”.

9 of the Rules of Procedures of the ECB assigns ESCB Committees the task of assisting in the work of the ESCB along the following lines:

- the Committees' task is defined by the mandates laid down by the Governing Council;
- the Committees are composed of representatives of the ECB and of the NCBs of each participating Member State;
- if matters within the field of competence of the General Council are dealt with, representatives of NCBs of non-participating Member States may also participate in meetings. Representatives of the Commission or other Community bodies may be invited to attend meetings;
- the reporting of ESCB Committees to the Governing Council shall in general be made via the Executive Board;
- secretarial assistance is provided by the ECB;
- special rules apply to the Banking Supervision Committee, which is also composed of representatives of national supervisory authorities. It is not obliged to report via the Executive Board when acting as a forum for consultation on issues not related to the supervisory functions of the ESCB.

### ***5.1) Role of ESCB Committees in the decision-making process***

In accordance with Article 9 of the Rules of Procedure and Committees' mandates, it is acknowledged that ESCB Committees exert an advisory role by assisting the decision-making bodies of the ECB. With the exception of three legal acts in the statistical field,<sup>367</sup> there are no other existing legal acts that provide for a

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<sup>367</sup> It should be noted that among the legal acts adopted by the Governing Council there are three legal acts in the statistical field which contain provisions on a simplified amendment procedure providing for a procedure entailing the involvement of the Statistics Committee as follows: "*Taking account of the views of the Statistics Committee, the Executive Board of the ECB shall be entitled to make technical amendments*" (...), "*provided that such amendments neither change the underlying conceptual framework nor affect the reporting burden*". On this point see: Article 6 of ECB Guideline of 11 May 2000 on the statistical reporting requirements of the ECB in the field of balance of payments statistics, the international reserves template and international investment position statistics (ECB/2000/4); Article 4 of ECB Recommendation of 11 May 2000 on the statistical reporting requirements of the ECB in the field of balance of payments statistics, the international reserves template and international

role of ESCB Committees in the decision-making process delegated by the Governing Council to the Executive Board. Article 17.3 of the Rules of Procedures further provides that the Governing Council may delegate its normative powers to the Executive Board for the purpose of implementing its regulations and guidelines in which it, *inter alia*, shall specify the limits and scope of the delegate powers.

In this context, the question is whether the delegation of powers from the Governing Council to the Executive Board in a legal act can be made subject to the Executive Board having to follow a certain procedure. In particular, it has to be examined whether any of the Committee procedures, especially those used on the general Community level – advisory committees, management committees and regulatory committees procedures – could also find a similar counterpart on the ESCB level.

The current version of the ECB Rules of Procedure and the mandates adopted by the Governing Council on their basis only provide for the assistance of ESCB Committees, a wording that seems to preclude any active role in the decision-making process, except for an advisory role. As a consequence, it has to be examined whether the Rules of Procedure could be interpreted or changed in such a way so as to permit those procedures applied on the general Community level. However, although the ECB enjoys organisational autonomy, any changes of the Rules of Procedure are limited to the extent permitted by primary law governing the relations within the ESCB.

In order to be able to provide an answer to those questions, the following aspects need to be taken into account:

a) *Institutional differences in general Community and ESCB decision-making process.*

The comitology system known in the general Community framework<sup>368</sup> could not be applied directly to the ESCB without prior critical assessment and possibly

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investment position statistics (ECB/2000/5); Article 13 of ECB Guideline of 13 November 2000 concerning certain statistical reporting requirements of the ECB and the procedures for reporting by the NCBs of statistical information in the field of money and banking statistics (ECB/2000/13).

<sup>368</sup> Under the Treaty establishing the European Community, it is for the Commission to implement legislation at the Community level (Article 202, 3<sup>rd</sup> indent of the EC Treaty, former Article 145. See also Article 36.2 of the Draft Treaty establishing a Constitution for Europe where it is specified that “where uniform conditions for implementing binding Union acts are needed, those acts may confer implementing powers on the Commission, or, in specific cases duly justified and in the cases provided

adaptation, since the institutional circumstances differ considerably. As a consequence it is not possible establishing a perfect comparison between the two different systems, but only a slightly analogy, useful as a working hypothesis.

First of all, it could be argued that such a comitology system would undermine the institutional balance established by primary law. Yet, the separation between executive and legislative powers is not as apparent between the Governing Council and the Executive Board as it is between the Council and the Commission. In

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for in Article 39, on the Council of Ministers”). In practice, each legislative instrument is due to specify the scope of the implementing powers granted to the Commission and how the Commission is supposed to use them. It should be underlined that, under this framework, the Commission is not completely free to shape policy outcomes when implementing EU legislation. In order to retain some measures of control, the Council usually provides for the establishment of a committee to which the Commission must submit drafts of measures it intends to adopt under the delegated powers. As a consequence, an elaborate system of committees, known as “comitology”, where national experts issue opinions on the Commission’s proposed implementation measures has been designed and enforced within the EC institutional architecture.

According to P. CRAIG and G. DE BURCA, *EU Law. Text, Cases and Materials*, Oxford, 1998, the Comitology system has been enacted in consideration of the fact that the Council “was wary of the federalising tendencies of the Commission” and was therefore “unwilling to delegate power to the Commission without the existence of some institutional checks designed to ensure the formal representation of the Member States interests” (Ibidem, p. 139).

Under some procedures, comitology provides for a separation of powers where the legislators (the Governments) can scrutinize the executive (the Commission); moreover, under other procedures, comitology has created a fusion of powers where the member governments enforce their wishes on the Commission, and hence exercise both legislative and executive authority.

The committees, which are forums for discussion, consist of representatives from Member States and are chaired by a Commission official. They enable the Commission to establish a dialogue with national administrations before adopting implementing measures. The Commission ensures that they reflect as far as possible the situation in each country in question.

In order to conclude this brief excursus on the comitology system, it is worth recalling that the Single European Act attempted to put the comitology system on a more regular footing by making provision for a framework-decision establishing the principles and rules to be followed. The first comitology Decision dates back to 13 July 1987. In order to take into account the changes in the Treaty – and, in particular, Parliament’s new position under the co-decision procedure –, but also to reply to criticism that the Community system is too complex and too opaque, the 1987 Decision has been replaced by the Council Decision of 28 June 1999 (O. J. L 184, 17.7.1999, pp. 23 – 26). The new Decision ensures that the Parliament can keep an eye on the implementation of legislative instruments adopted under the co-decision procedure. In cases where legislation comes under this procedure, the Parliament can express its disapproval of measures proposed by the Commission or, where appropriate, by the Council, which, in Parliament’s opinion, go beyond the implementing powers provided for in the legislation. Moreover, the Decision clarifies the criteria to be applied to the choice of committees and simplifies the operational procedures. The Committees base their opinions on the draft implementing measures prepared by the Commission.

For a thorough analysis of the matter, see R. H. PEDLER and G. F. SCHAEFER, *Shaping European Law and Policy: The Role of Committees and Comitology in the Political Process*, European Institute of Public Administration, Maastricht, 1996 and T. CHRISTIANSEN and E. KIRCHNER, *Committee Governance in the European Union*, Manchester University Press, 2000; K. LENAERTS and A. VERHOEVEN, *Towards a legal framework for executive rule-making in the EU? The contribution of the new comitology Decision*, CML Rev, 2000, pp. 645 – 686; G. HAIBACH, *Comitology: A Comparative Analysis of the Separation and Delegation of Legislative Powers*, MJ 4 (1997), pp. 373 – 385; C. JOERGES and J. NEYER, *From Intergovernmental Bargaining to Deliberative Political Processes: The Constitutionalisation of Comitology*, European Law Journal, Vol. 3, No 3, September 1997, pp. 273 – 299; E. VOS, *The Rise of Committees*, European Law Journal, Vol. 3, No 3, September 1997 210 – 229.

particular, the relationship between the Council and the Commission is different from the interplay of the Governing Council and the Executive Board.<sup>369</sup> The Council shall delegate the implementation of Community policy to the Commission according to Article 202, 3<sup>rd</sup> indent and Article 211, 4<sup>th</sup> indent of the EC Treaty, whereas there is no comparable provision applicable to the Executive Board, although Article 17.3 of the Rules of Procedure enables the Governing Council to delegate normative powers for the purpose of implementation. The Executive Board is only accorded an overall implementing power with respect to monetary policy. As regards the other ESCB tasks listed in Article 105.2 of the EC Treaty, the Executive Board is not the body generally responsible for implementation; in fact, according to Article 12.1, 6<sup>th</sup> sentence of the Statute, this task should – to the extent deemed possible and appropriate – be carried out by the NCBs.

Secondly, in the ESCB framework there is no organ comparable to the European Parliament participating in the legislation process.

*b) No delegation in fields for which the Executive Board is competent by primary law.*

Naturally enough, any procedure either advisory or beyond may not be decided by the Governing Council in areas for which the Executive Board is already responsible by primary law. The following powers cannot be taken away from the Executive Board by the Governing Council and thus can also not be subjected to any Committee procedure:

- the Executive Board shall implement monetary policy in accordance with the Guidelines and Decisions laid down by the Governing Council (Article 12.1 *sub* paragraph 2 of the Statute);
- it is responsible for the current business of the ECB (Article 11.6 of the Statute);

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<sup>369</sup> With regard to the degree of independence accorded to these different bodies, it should be clearly said that the members of the EU Council are not at all independent. They represent the governments of the Member States (Article 203 EC Treaty) and they may also delegate their powers to other representatives of their respective Member States (Article 207 EC Treaty). Such a delegation is possible even to a representative of another Member State. Such elements for delegation are missing with regard to the members of the decision-making bodies of the ECB.

- the annual accounts of the ECB shall be drawn up by the Executive Board in accordance with the principles established by the Governing Council (Article 26.2 of the Statute);

- it shall draw up a consolidated balance sheet of the ESCB (Article 26.3 of the Statute).

c) *Duration and scope of delegation from the Governing Council to the Executive Board.*

Any delegation of competences from the Governing Council to the Executive Board is not final, but can be taken away again. As a consequence, it could be maintained that delegation may also be made subject to a certain procedure involving an ESCB Committee, provided that the institutional principle guaranteed to the decision-making bodies are not violated. This conclusion can also be based on Article 17.3 of the Rules of Procedure, which provides that the Governing Council has to decide on the scope and limits of delegation to the Executive Board. Inserting a Committee procedure into the delegation may be considered as being part of the scope and limits of delegation.

d) *Principle of independence*

It is necessary to examine whether the principle of independence would conflict with any delegation subject to a participation of ESCB Committees, which prescribes a role going beyond an advisory role. Unlike the Executive Board members and the members of the Governing Council who enjoy personal independence guaranteed by Article 108 of the EC Treaty and Article 7 of the Statute, the members of the ESCB Committees consist of ECB and NCBs representatives who are not granted an independent personal status, but have to obey instructions by their superiors.

In the Köster case<sup>370</sup> it had been argued that, under the given circumstances of the case in question, the management committee procedure constituted an

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<sup>370</sup> Case 25/70, Einfuhrstelle v. Köster [1970] ECR 1161. Acting under Article 37.2 EC Treaty, which empowers the Council to legislate in the field of agriculture, the Council passed a regulation setting out the general principles for the organisation of a common market of cereals. This regulation also made provision for the detailed rules to be laid down in measures to be adopted by the Commission under the management committee procedure. A basic objection against such a procedure was raised. It was argued that this constituted an unwarranted restriction of the decision-making power of the Commission and jeopardised its independence. The Court, however, pointed out that the management

unwarranted restriction of the decision-making power of the Commission and jeopardised its independence. However, the ECJ held that the management committee cannot itself take decisions; if it disapproves, the only consequence would be that the Commission has to communicate the measures to the Council.

Yet, the ECJ could not apply the same line of reasoning in the special case of the ESCB as neither the situation in the EU Council and the Governing Council of the ECB nor in the Commission and the Executive Board can be compared especially as regards the degree of independence. The members of the Commission may have the duty to act neutrally, but they do not enjoy the high institutional degree of personal independence accorded to both the members of the Executive Board and the Governing Council as the decision-making bodies of the ESCB. Furthermore, the members of the EU Council represent the Governments of the Member States (Article 203 of the EC Treaty) and as such are not granted any independence. As a consequence, the EU Council Members may even delegate their powers to other representatives of their Member States (see Article 207 of the EC Treaty).

The following conclusions may be drawn.

First, it can be argued that the Governing Council cannot, by delegating power, waive part of the personal independence guaranteed to it and the Executive Board by Community primary law. The ESCB Committees members are representatives of the NCBs and are under a duty to comply with instructions of their superiors / their national central banks. However, each member of the decision-making bodies of the ECB is independent in his/her decisions, which also entail independence from decisions taken by decision-making bodies of NCBs. This follows from Article 108 of the EC Treaty and Article 7 of the Statute according to which members of the ECB's decision-making bodies shall not seek or take instructions from any other body including NCBs.

Moreover, it can be asserted that a delegation of powers by members of the ESCB decision-making bodies to a Committee consisting of ECB and NCBs representatives is not provided for by the Treaty and the Statute for the reason that the

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committee procedure could not itself take decisions; if it disapproved of a proposed measure, the only consequence was that the Commission was obliged to communicate the measures to the Council, which could then substitute its own measure for that of the Commission.

legislator thought that a Committee system involved in the decision-making process would not comply with the principle of independence.

The argument can also be supported by the provisions on the voting procedure in the Governing Council. It follows from Article 10.2 of the Statute that only the members of the Governing Council may cast a vote. Only if the member is prevented from voting for a prolonged period may an alternate be appointed as a member of the Governing Council. This alternate is appointed by the member himself and thus the internal ECB or NCB hierarchy does not necessarily have to be involved. Another exception is included in Article 10.3 of the Statute, which enables the Governor who is unable to be present to nominate an alternate to cast his/her weighted vote. However, the general rule is that there can be no delegation in the decision-making process.

*e) Voting structure and procedures of the ESCB Committees.*

Due to the specific nature of the ESCB, its composition of ECB and NCBs is reflected in the Governing Council. If ESCB Committees ever took on tasks in the decision-making process, it would follow as a consequence that the voting structure of the Governing Council would have to be mirrored as it is in the Community Committees that reflect the voting structure of the Council. Since the Council is only made up of representatives of Member States, in both management and regulatory Committees it is only the representatives of the Member States who have the right to vote, whereas the chairman – a Commission official – does not participate in the voting.

With respect to the voting structure in the ESCB Committees, it follows that the representatives of the ECB would in general have to be accorded six votes, while the representatives of one NCB have one vote, thereby reflecting the general voting structure in the Governing Council. If this was the case, it might follow as a consequence that the Governing Council's different voting procedures according to Article 10.2 and 10.3 of the Statute would need to be applied on the ESCB Committees' level, too.

*6) Regulatory power of the ECB and the so-called “making and implementation of ECB’s law”: a further evidence of the empirical application of monetary sovereignty within the ESCB.*

One of the most remarkable features of the constitution of the international organisations is the possibility granted to them to adopt a wide range of legal instruments that they use to regulate, organise and steer the activities and operations to be carried out to fulfil their tasks. This significant competence to adopt binding and non-binding legal acts sheds a light on the role such organisations play in the creation and implementation of law. Thus, assuming that sovereignty may be seen – in a narrow and specific way - as the capacity to make binding decisions in political and social contexts and to assure the implementation of those decisions, one may conclude that the conferral of such a competence to the European Community, for instance, and to the ECB as well, is a sign of the recognition of their sovereign powers.

As far as the Community is concerned, Article 249.1 (ex Article 189) EC Treaty – “the model for Article 110, ex Article 108A”<sup>371</sup> - sets forth that “in order to carry out their tasks and in accordance with the provisions of this Treaty, the European Parliament acting jointly with the Council, the Council and the Commission shall make regulations and issue directives, take decisions, make recommendations and deliver opinions”. Accordingly, Article 110.1 EC Treaty and Article 34.1 ESCB Statute also list those legal acts which the ECB’s decision-making bodies may adopt and by which they may impose obligations or grant rights to all those who are or may come within the scope of the ESCB’s tasks.<sup>372</sup> They include regulations, decisions,

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<sup>371</sup> J.-V. LOUIS, *A Legal and Institutional Approach for Building a Monetary Union*, CML Rev, 35, 1998, p. 54. On the same line of reasoning see also R. SMITS, *The European Central Bank. Institutional Aspects*, Kluwer Law International, The Hague, 1997, p. 102.

<sup>372</sup> According to A. MALATESTA, *La Banca Centrale Europea. Gli aspetti istituzionali della banca centrale della Comunità europea*, Giuffrè, Milano, 2003, p. 110, the attribution of this kind of powers to the ECB “rappresenta probabilmente la caratteristica più significativa dell’attuale integrazione monetaria comunitaria”. Moreover, compared to the powers conferred upon the Community, “alla BCE, unica tra gli organismi di diritto comunitario, è stato affidato un potere normativo pieno ed assoluto, in particolare di adottare atti vincolanti per gli Stati membri e per gli individui soggetti alla sua giurisdizione, *per certi versi più ampio* anche rispetto a quello di cui sono dotati le istituzioni comunitarie ai sensi dell’art. 249 del trattato CE. Rispetto a queste ultime, infatti, la BCE dispone di un analogo potere di produzione del diritto, ma è abilitata ad esercitare lo stesso da sola, senza il concorso di nessuna tra le altre istituzioni, che non sono chiamate a partecipare alla formazione delle norme né a

recommendations and opinions and so parallel the legal acts which are listed in the above-recalled Article 249 EC Treaty and which the Community institutions may adopt to fulfil their tasks.<sup>373</sup>

As a matter of fact, the Treaty establishing the European Community and the Statute of the European System of Central Banks and of the European Central Bank confer upon the ECB the competence to participate in the legislative process. According to a classification identified by the ECB itself, the latter can be divided into three specific areas of authority: first, the ECB's right to initiate amendments to the Statute and the adoption of complementary Community legislation;<sup>374</sup> second, the ECB's advisory role in drafting Community and national legal acts;<sup>375</sup> and third, the ECB's competence to adopt ECB legal acts and other ECB legal instruments.<sup>376</sup>

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titolo consultivo, né a maggior ragione di codecisore" (Ibidem, p. 112). Similarly J.-V. LOUIS, *A Legal and Institutional Approach for Building a Monetary Union*, CML Rev, 35, 1998, p. 58-59.

<sup>373</sup> It should be highlighted that in the ECB's catalogue there is no reference to the directives. Article 249.3 EC Treaty defines a directive as a legal act which shall be "binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods". There are two interesting justifications to explain such an apparent *lacuna*. (i) The first – put forward by C. ZILIOI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, pp. 101 and ff – is based on the assumption that a directive is the "ideal instrument of two-stage legislation: the general rules and objectives are laid down in the directive itself by the Community institutions, while it is for the national authorities, in particular for the national legislature, to implement the directive by means of the national legal order". The instrument of the directive thus requires, by its very nature, legislative powers both at the Community level and at the level of the Member States. As a result, the absence of directives within the catalogue of the ECB's legal acts can be seen as a reflection of the centralisation of decision-making powers within the ESCB, where all national legislative competences have passed definitely and irrevocably to the Community level. (ii) The second reconstruction is provided for by A. MALATESTA, *La Banca Centrale Europea. Gli aspetti istituzionali della banca centrale della Comunità europea*, Giuffrè, Milano, 2003, pp. 113 and ff and is based on the consideration that a directive is not a workable instrument to be used in monetary matters where very detailed and precise instructions need to be given.

<sup>374</sup> The ECB has the right to initiate – or to be consulted on – the amendment of specific Articles of the Statute and the adoption of legislation complementary to the Treaty and required by the Treaty in specific areas related to the tasks of the ESCB. These areas encompass, for instance, statistics, accounting, open market and credit operations, minimum reserves, clearing and payment systems, and external operations. It has to be recalled, however, that the right of initiative is shared with the Commission.

<sup>375</sup> As already pointed out in the previous chapters, the legislative bodies of the European Community (the Council of the European Union, the European Parliament, the Commission) and the Member States of the EU are required to consult the ECB in respect of any proposed Community act and any draft legislative provision drawn up by national authorities which fall within the ECB's field of competence. This includes draft legislative provisions relating to prudential supervision of credit institutions and to the stability of the financial system. Furthermore, the ECB may, on its own initiative, submit Opinions to the appropriate Community institutions and bodies or to national authorities on matters falling within its field of competence. Finally, Article 48.2 (ex Article N) of the Treaty on European Union states that the ECB is also to be consulted should institutional changes be made in the monetary area. As a result, the ECB's advisory role ensures that no Community legal act within its field of competence is adopted

As far as the third element is concerned, it is worth saying that the ECB has been explicitly granted the power to adopt Community legal acts and other ECB legal instruments. In line with the principle of limited powers – by application of which the ESCB and the ECB act within the limits of the powers conferred upon them by the Treaty and the Statute – the regulatory power of the ECB is restricted to the objectives of fulfilling the tasks assigned to the ESCB.<sup>377</sup>

As a consequence, in order to carry out the tasks entrusted to the ESCB, the ECB, in accordance with the provisions of the Treaty and under the conditions laid down in the Statute, makes Regulations to the extent that this is necessary to implement its designated tasks and, in specific cases, as determined by the EU Council; takes Decisions necessary to enable the tasks of the ESCB; makes Recommendation, and delivers Opinions.

According to the Treaty and the Statute, all measures taken by the ECB and intended to have legal effect are open to review or interpretation by the European Court of Justice, whatever their nature or form.

#### *6.1) ECB law intended to produce external legal effects*<sup>378</sup>

- *ECB Regulations*

In order to carry out the tasks entrusted to the ESCB, the ECB shall, in accordance with the provisions of the EC Treaty and under the conditions laid down in the ESCB Statute, make Regulations to the extent necessary to implement the tasks defined in Article 3.1, first indent, Article 19.1, 22 and 25.2 of the ESCB Statute and

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without its being involved. All this certainly underlines the special status of the ECB as an independent body within the Community framework, vested with its own, exclusive competences.

<sup>376</sup> See ECB Monthly Bulletin, November 1999, pp. 53 and ff.

<sup>377</sup> See Article 8 (ex Article 4a) EC Treaty for the principle of limited attribution of competences to the ESCB.

<sup>378</sup> According to a classification provided for by C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, pp. 91 and ff., ECB law can be considered as made up of two main categories: ECB law intended to produce external legal effects and ECB law intended to produce legal effects among the component parts of the ESCB. The same classification is adopted in the present chapter.

in cases which shall be laid down in the acts of the Council referred to in Article 107.6 EC Treaty.<sup>379</sup>

As stated in the first sub-paragraph of Article 110.2 EC Treaty and in Article 34.2 ESCB Statute, ECB Regulations are general in the scope of their application, binding in their entirety and directly applicable in all euro area Member States without the need for implementation in national law. For instance, in the field of statistics, the ECB Regulation concerning the consolidated balance sheet of the Monetary Financial Institutions sector imposes direct reporting obligations on specified reporting agents.<sup>380</sup>

As with the Regulations adopted by the legislative bodies of the Community, ECB Regulations must state the reasons on which they are based. In order to be binding on third parties, they must be published in the Official Journal of the European Union in all official Community languages. Unless otherwise specified, ECB Regulations enter into force on the twentieth day following the date on which they are published.

ECB Regulations are adopted by the Governing Council of the ECB and are signed on its behalf by the President. The Governing Council may decide to delegate its authority to adopt the Regulations to the Executive Board of the ECB, but in so doing it must specify the limits and scope of the powers thus delegated. In matters having legal effect on third parties, notification of such delegation must be given to the parties concerned, or details of the delegation published if it is appropriate to do so. In addition, it should be recalled that, as pointed out in Article 34.3 ESCB Statute, the ECB shall be entitled to impose fines or periodic penalty payments on undertakings for failure to comply with obligations under its regulations and decisions. All this within the limits and under the conditions adopted by the Council under the procedure laid down in Article 42 ESCB Statute.

As a final, but extremely important remark, it has to be underlined that ECB Regulations enjoy – as integral part of Community law – supremacy over all kinds of

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<sup>379</sup> As rightly observed by J.-V. LOUIS, *A Legal and Institutional Approach for Building a Monetary Union*, CML Rev, 35, 1998, p. 59, the ECB has no general competence to adopt a regulation in order to realise its objectives and tasks. Article 34.1 ESCB Statute clearly lists the cases in which regulations may be taken and the list is exhaustive. As a result, the “extraordinary” power to enact legislative acts in the material sense granted to the ECB finds here an important limitation.

<sup>380</sup> See Regulation (EC) No. 2819/98 of the European Central Bank of 1 December 1998.

national laws, including constitutional law. By virtue of their direct applicability, they not only apply independently of any measure of reception into national law, but “a national transposition of ECB Regulations is even prohibited as it might conceal their Community law nature from those subject to them and also the exclusive competence of the ECJ to rule on their validity and their interpretation”.<sup>381</sup>

- *ECB Decisions*

ECB Decisions are binding in their entirety upon those to whom they are addressed and take effect upon notification. The ECB may decide to publish its Decisions in the Official Journal, in which case they are published in all official languages. ECB Decisions may be addressed to any legal and natural person, including the euro area Member States.

ECB Decision must state the reasons on which they are based. They may be adopted by the Governing Council or by the Executive Board in their respective spheres of competence.

- *ECB Recommendations and Opinions*

ECB Recommendations and ECB Opinions are non-binding legal acts. They may be adopted by the Governing Council or by the Executive Board in their respective domains of competence. ECB Recommendations and Opinions may be published in the Official Journal, in which case they are published in all official Community languages.

There are two types of ECB Recommendations. First, as mentioned above, ECB Recommendations can be the instrument by which the ECB initiates legislative procedures at the Community level, leading to the enactment of complementary legislation. Second, ECB Recommendations can also, in the traditional sense of the term, be instruments by which the ECB provides the impetus for action to be taken (not only of a legal nature); they may be addressed to any legal or natural persons, to Community institutions or to Member States.

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<sup>381</sup> C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, p. 92.

ECB Opinions are delivered whenever the ECB is consulted by the Community institutions<sup>382</sup> or by the Member States in accordance with the Treaty or the Statute,<sup>383</sup> or on the ECB's own initiative whenever deemed appropriate by the ECB with regard to matters falling within its field of competence. From the purpose of the consultation process, it becomes clear that the consulting authority is required to await the ECB Opinion and to take it seriously into consideration before any decision on the substance. Non-compliance with the requirement to request an ECB Opinion, for instance, could be considered by the ECJ as a procedural defect which would render such legislation inapplicable and which could be invoked by all individuals to which such legislation would apply.

### ***6.2) ECB law intended to produce legal effects among the component parts of the ESCB.***

The ECB's regulatory powers are not limited to the adoption of the aforementioned legal acts, which – even though are mainly intended to produce external legal effects –, automatically also bind all components parts of the ESCB. In addition to that, the ECB may also adopt legal instruments that are of internal relevance to the

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<sup>382</sup> Consultation of the ECB by the Community institutions is foreseen in Article 105.4, first indent, EC Treaty. Under this provision, consultation of the ECB is compulsory for any proposed Community act in its field of competence. This is a very broad obligation which extends to all Community institutions and bodies whenever they intend to adopt an act intended to produce legal effects, in particular regulations, directives, recommendations and opinions. The consultation of the ECB is thus today an integral part of the Community legislative process whenever it relates to legal acts in the field of EMU or when it has an impact on the institutional structure of the ECB, as this also falls within the competence of the ECB.

As recalled by C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, p. 100, in some cases, the obligation for the Community institutions to consult the ECB is explicitly laid down in the Treaty, for example as regards amendments of the Protocol on the excessive deficit procedure (Article 104.14, 2nd subparagraph EC Treaty), the negotiation and conclusion of agreements concerning monetary and foreign exchange regime matters (Article 11.3 EC Treaty), or the decision to abrogate a derogation of a Member State which has not yet adopted the single currency (Article 123.5 EC Treaty).

<sup>383</sup> The EU Council set out the limits and the conditions of such a consultation in Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions. According to this decision, national authorities shall consult the ECB in particular on draft legislative provisions on currency matters, on means of payment, on national central banks, on collection, compilation, and distribution of monetary, financial, banking, payments systems and balance of payments statistics, on payment and settlement systems and on rules applicable to financial institutions in so far as they materially influence the stability of financial institutions and markets.

Eurosystem and meant to govern the Eurosystem, maintaining and preserving its integrity, without having a direct legal effect upon third parties.

As already pointed out, each of the Eurosystem's constituent bodies, i.e. the national central banks of the Member States, participating in the euro area and the ECB, retains an individual legal personality. As a consequence, taking this unique structure into account, it becomes clear that the ECB must be supposed to have at its disposal the internal legal instruments necessary to allow the Eurosystem to operate efficiently as a single entity with a view to achieving the objectives of the Treaty.<sup>384</sup> This is the reason why the ESCB Statute stipulates that the national central banks of the Eurosystem are an integral part of the ESCB and must act in accordance with the Guidelines and Instructions of the ECB.<sup>385</sup>

ECB Guidelines and Instructions are special types of legally binding instruments, the introduction of which has been necessary on account of the special structure of the Eurosystem as outlined above. They are formal legal instruments, and have the objectives of ensuring that the tasks entrusted to the Eurosystem are carried out within its internal organisation and are in line with the internal division of competences. As part of Community law, ECB Guidelines and Instructions, as well as ECB Regulations and Decisions, will, in accordance with the rule of supremacy, prevail over pre-existing and subsequent national legislation falling within the scope of their applicability. It is the task of the Governing Council to ensure compliance with ECB Guidelines and Instructions. In this undertaking, the Governing Council will be supported by the Executive Board, which will make provision for the drafting of regular compliance reports.

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<sup>384</sup> On this point, C. ZILIOLI and M. SELMAYR, *op. cit.*, p. 104, insightfully underline the fact that the ESCB has to be considered as a *monist legal system*, which consist of only one legal order, not of the ECB's legal order and the 15 legal orders of the national central banks, which would require implementation of ECB law.

<sup>385</sup> See, on this point, Article 14.3 ESCB Statute which reads as follows: "the national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB. The Governing Council shall take the necessary steps to ensure compliance with the guidelines and instructions of the ECB, and shall require that any necessary information be given to it". This Article makes clear again that: (i) the NCBs are agents of the System in the implementation of tasks related to it; (ii) the principle of hierarchy and decentralisation are key features of the ESCB. Moreover, in the words of -V. LOUIS, *A Legal and Institutional Approach for Building a Monetary Union*, CML Rev, 35, 1998, p. 52, "without the possibility for the ECB to address guidelines and instructions to the NCBs, in a decentralised system, monetary policy would be nationalised at the level of its implementation" and a single monetary policy would be impossible to maintain.

The formal requirements for the adoption of ECB Guidelines and ECB Instructions are not specified in the Treaty or by the Statute, but rather are laid down in the Rules of Procedure of the European Central Bank and follow general principles of Community law. Given their nature as legal instruments, the legal effects of which are internal only, there are no obligations under Community law to publish them. Nonetheless, the ECB has published parts of the ECB Guidelines which are of interest to operators in the market and to the general public at large. This, in turn, contributes to enhance the transparency of the Eurosystem's activities.

- *ECB Guidelines and ECB Instructions*

Following the structure established by the Statute, in accordance with which operations forming part of the tasks of the Eurosystem are to be carried out by the national central banks whenever appropriate and possible, ECB Guidelines are designed to be legal instruments by which the policy of the Eurosystem is defined and implemented. "They are the tools with which the ECB can ensure the integration of the NCBs into the System and concern the power of the ECB to ensure compliance by the NCBs with decisions taken centrally".<sup>386</sup> They contain the general framework and the main rules, which require implementation by the national central banks. Taking into account the differences in the financial market structures and in the legal systems of the euro area Member States, ECB Guidelines have been conceptually designed in such a manner as to allow, as far as possible, an appropriate decentralised execution of monetary policy operations, while – at the same time – fully respecting the requirements of a single monetary policy in the euro area. As a result, monetary policy is implemented either by means of contracts to be concluded between the national central banks and their counterparties or by means of regulatory acts addressed to the counterparties, depending on the legal regime of each of the national central banks.

As ECB Guidelines are legal instruments that are internal to the system and are addressed to the NCBs only, they are not intended to directly or individually affect the

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<sup>386</sup> R. SMITS, *op. cit.*, p. 104. See also J.-V. LOUIS, *op. cit.*, p. 55, who states that "the systematic interpretation of the Statute implies that guidelines and instructions are the typical instruments for the relations between the ECB and the NCBs". They thus illustrate the degree of integration which will be achieved within the ESCB.

legal rights of counterparties. In particular, in accordance with the Rules of Procedure of the European Central Bank, ECB Guidelines are adopted by the Governing Council and thereafter notification is sent to the national central banks of the ESCB. If it is expressly decided to publish them, publication will be in the Official Journal in all official Community languages. In any case, there is no legal obligation to publish them, a situation which may affect the transparency of the whole decision-shaping process.

The Governing Council may decide to delegate to the Executive Board its regulatory power to adopt ECB Guidelines. In so doing, the Governing Council must specify the limits and scope of the delegated competences.

On the other hand, ECB Instructions are adopted by the Executive Board. They do not of themselves have a policy objective, but rather are designed to ensure implementation of monetary policy Decisions and Guidelines by giving specific and detailed instructions to the national central banks of the Eurosystem.

Even though they may be considered to have a lower hierarchical status than other Community legal acts, ECB Instructions constitute an important part of the legal framework, which is legally binding on the national central banks of the Eurosystem, and they are judicially enforceable.<sup>387</sup> By contrast with Community Regulations, Decisions, Opinions and Recommendations, the concepts of which have been already sketched out, ECB Guidelines and Instructions are new legal instruments that have been designed to cope with the special features of the Eurosystem.

To complete the picture it should be finally added that, besides ECB Guidelines and Instructions, the ECB has the competence to adopt internal Decisions which have a normative value within the system and which address matters of internal organisational or administrative nature. It has to be said that there are no explicit addressees, still these Decisions are legally binding on the Eurosystem.

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<sup>387</sup> *Contra* J.-V. LOUIS, *A Legal and Institutional Approach for Building a Monetary Union*, CML Rev, 35, 1998, p. 56, who argues that “the possibility for the ECB to address such instructions directly to the implementing organs is a right which is not recognised under Community law with respect to the Commission, for example, even in the field of the most integrated common policy, the Common agriculture policy” (emphasis added). If one compares the “instructions” of the Commission to the competent administrative organs to the case of the ESCB, it becomes immediately clear that the link between the ECB and the NCBs is much closer. “NCBs are the constitutive parts of a system which transgresses the barrier between what is Community and what is national. *The dédoublement fonctionnel*” (...) “has never been pushed so far”.

As a very final remark, it is worth highlighting that the regulatory powers of the ECB reflect the particular status of the ESCB/Eurosystem within the overall Community framework. By equipping the ECB with the competence to adopt Regulations, Decisions, Recommendations and Opinions and thus making the ECB a “*Community legislator*”, the Treaty and the Statute emphasise that conferring tasks upon the Eurosystem is not sufficient. Thus, in order to make the System truly operational and efficient, these tasks need to be complemented by the legal instruments necessary for them to be implemented both at the Community level and at the level of the Member States. At the same time, these regulatory powers reinforce the independence of the ECB as such. Moreover, by virtue of its competence to adopt ECB Guidelines and Instructions, the ECB has been given the necessary legal instruments at its disposal to make the System properly functional.

## CHAPTER FIVE

### *OBJECTIVES AND BASIC FEATURES OF THE ESCB IN PRACTICE*

*“In a democratic society, a high degree of transparency and accountability in monetary policy making reinforces the legitimacy of the central bank and consolidates the public support for its price stability mandate”\**

#### *Introduction*

Now that the basic institutional features of the ESCB have been sketched, all the other elements characterising the System can be taken into account. In particular, it will be worth investigating the precise formulation of the objectives and basic tasks of the European monetary authority and all the institutional peculiarities, which make the ESCB unique in a sense. Such an approach is justified on the basis of the assumption that, “it is through the clear objective of maintaining price stability and the exact formulation of its tasks that a central bank is given the legal power to effectively pursue a strong currency, i.e. an inflation free environment”.<sup>388</sup> The clarity of its mandate facilitates an assessment of the central bank’s proper exercise of the public function as guardian of the currency and bearer of monetary sovereignty.

As already seen in the previous chapter, the objectives and the basic tasks of the ESCB are laid down in Article 105 EC Treaty and corresponding provisions of the ESCB Statute. Other tasks and functions are also given in these, and in other articles. Their contents, and their place in Community’s primary law, will be discussed below.

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\* O. ISSING, *The Eurosystem: Transparent and Accountable or “Willem in Euroland”*, Journal of Common Market Studies, Vo. 37, No. 3, September 1999, p. 13.

<sup>388</sup> R. SMITS, *The European Central Bank. Institutional Aspects*, Kluwer Law International, The Hague, 1997, p. 178.

According to Article 105 EC Treaty, the first provision of Chapter 2,<sup>389</sup> and Article 2 ESCB Statute "the primary objective of the ESCB shall be to maintain price stability". Without prejudice to the objective of price stability, the ESCB is required to "support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community, as laid down in Article 2", such as the promotion of a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance and a high level of employment and of social protection.<sup>390</sup> While pursuing its objectives, the Eurosystem is required to act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4. Should there be any conflict between the objectives to be assessed by the ECB, the objective of price stability will always be paramount; the other objectives are dealt with according to the weighting that the ECB considers appropriate.

The Treaty and the Statute, while providing the framework for the ESCB's activities, confer the following basic tasks upon the Eurosystem:

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<sup>389</sup> Article 105 is part of Title VI which was inserted by Article G (25) of the Maastricht Treaty. It replaced Chapter 1 (itself inserted by the Single European Act in 1987), Chapter 2 (on cyclical policy) and Chapter 3 (on the balance of payments) of the former EEC Treaty with a new title on Economic and Monetary Union.

<sup>390</sup> It may be noted that the policies (plural) *in* (and not *of*) the Community are to be supported. This way of phrasing the secondary objective of the ESCB was chosen because the Community, under the Economic and Monetary Union, does not have a single economic policy which the ESCB is to support, but a set of mutually coordinated and consistent policies (See *supra* Chapter II). Legally speaking, the absence of a single economic policy for the Community may give the ESCB more freedom of action, as it is under no constraint to support a specific policy. Economically speaking, though, the absence of stricter policy co-ordination may make the task of the ESCB to maintain price stability more difficult to perform, since the impact of its monetary policy decisions may vary from State to State, being more effective in Member States whose fiscal policies are in line with anti-inflation goals and going against the trend in other States whose policies may be at odds with the Community's strategy for the pursuit of the proper economic policy. "it is in this context that calls for an economic Government of Europe, and for stricter co-ordination of fiscal policies, are particularly relevant" (R. SMITS, *op. cit.*, p. 188). The above-quoted author recalls on this point that an "economic Government for Europe" has been a consistent theme of French politics in respect of EMU. Former French Prime Minister Edouard Balladur has given voice to the view that the ECB should have a strong counterweight, which would ensure that Europe has the capacity to act decisively on the economic front. J.-V. LOUIS has likewise questioned the effectiveness of the provisions adopted in respect of economic policy co-ordination (see his remarks on a "European economic Government" in *Le lien entre les conférences intergouvernementales sur l'union économique et monétaire et sur l'union politique*, in J. MONAR, W. UNGERER and W. WESSELS (eds.), *The Maastricht Treaty on European Union – Legal Complexity and Political Dynamics*, European University Press, Brussels, 1994, pp. 163-172.

- to define and implement the monetary policy of the Community;
- to conduct foreign exchange operations consistent with the provisions of Article 111, thus in the context of the Community's exchange rate policy;
- to hold and manage the official reserves of the Member States;<sup>391</sup>
- to promote the smooth operation of payment systems;
- to issue banknotes with legal tender status within the Community;<sup>392</sup>
- to approve the volume of issuance of the euro coins by the Member States which have adopted the euro.<sup>393</sup>

In addition the Eurosystem shall:

- contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system;<sup>394</sup>

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<sup>391</sup> It is worth specifying that the official reserves of the Member States are to be held and managed by the ESCB. These reserves are nowadays entrusted to the NCBs. This will remain so to a large extent. Only a part of these reserves has been transferred to the ECB. This transfer took place on the basis of the key of NCBs' contributions to the ECB capital (see Article 30.1 ESCB Statute). This arrangement ensures an equitable distribution, among the Member States, of the charge of pooling the reserves. The income derived therefrom is to be distributed among the NCBs on the basis of Article 33 on the ECB's profits.

The ESCB is thus empowered by the Treaty and the Statute to make full use of the official reserves. Whatever the position as to legal ownership, the third indent of Article 105.2 makes abundantly clear that the System can undertake all activities, which are necessary for or conducive to the fulfillment of its basic tasks in the context of its primary objective. It should be finally noted that the verbs "hold" and "manage" are wide and include any relevant operation.

<sup>392</sup> See Article 106.1: "The ECB shall have the exclusive right to authorise the issue of banknotes within the Community. The ECB and the national central banks may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community". See also Article 16 of the Statute, which reads as follows: "In accordance with Article 106.1 of this Treaty, the Governing Council shall have the exclusive right to authorise the issue of banknotes within the Community. The ECB and the national central banks may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community. The ECB shall respect as far as possible existing practices regarding the issue and design of banknotes".

<sup>393</sup> See Article 106.2: "Member States may issue coins subject to the approval by the ECB of the volume of the issue. The Council may, acting in accordance with the procedure referred to in Article 252 and after consulting the ECB, adopt measures to harmonise the denominations and technical specifications of all coins intended for circulation to the extent necessary to permit their smooth circulation within the Community".

<sup>394</sup> Article 105.5, 105.6 TEU and Article 25 of the Statute. In particular the latter states that: "The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of

- be consulted on any proposed Community act and on any draft legislation of national authorities which falls within its field of competence;<sup>395</sup>
- collect statistical information necessary for fulfilment of its tasks;<sup>396</sup>
- be represented in the field of international co-operation and participate in international monetary institutions.<sup>397</sup>

As a final remark, it should be underlined that not all of these tasks are the exclusive responsibility of the Eurosystem. As a consequence, the ECB is supposed to maintain working relations with the relevant Community institutions and bodies in order to achieve the desired objectives.

A first field in which the above-mentioned process expresses itself is represented by the collection of statistics. The ECB uses a wide range of economic and financial data to support the conduct of its monetary policy and the fulfilment of other tasks of the Eurosystem. By agreement with the European Commission (Eurostat), money and banking statistics are the responsibility of the ECB at the EU level; responsibility for balance of payments statistics and related statistics, and for financial accounts statistics, is shared by the ECB and the European Commission. However, price and cost and other economic statistics are the responsibility of the European Commission. Article 5 ESCB Statute, in fact, requires the ECB, in collecting the statistical information needed for the performance of the tasks of the Eurosystem, to co-operate with Community institutions, national authorities and international organisations. The ECB and the European Commission also co-operate closely on all matters of common statistical interest, including any initiation of, or

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the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system. In accordance with any decision of the Council under Article 105.6 of this Treaty, the ECB may perform specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings”.

<sup>395</sup> Article 105.4 and Article 4 of the Statute, according to which “the ECB shall be consulted: - on any proposed Community act in its fields of competence; - by national authorities regarding any draft legislative provision in its field of competence. but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 42”. Moreover, “the ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence”.

<sup>396</sup> See Article 5 of the ESCB Statute.

<sup>397</sup> Article 111 TEU and Article 6 of the Statute, which clarifies that “in the field of international co-operation involving the tasks entrusted to the ESCB, the ECB shall decide how the ESCB shall be represented. The ECB and, subject to its approval, the national central banks may participate in international monetary institutions”.

consultation on, relevant Community legislation, through bilateral contacts as well as their respective committee structures, which also involve the Member States.

A second field is given by the issuance of euro banknotes and coins, as set forth by Article 106 EC Treaty, pursuant to which the ECB has the exclusive right to authorise the issuance of euro banknotes, while the Member States may issue euro coins, subject to approval by the ECB of the volume of issuance. In addition, the ECB acts as an independent assessor of the quality of the euro coins. Consequently, the ECB is involved in ongoing consultations with the Mint Directors Working Group and other specialised multilateral fora. Naturally, the ECB is particularly concerned about public confidence in the new currency and hence about protecting the euro banknotes and coins against counterfeiting. In order to guarantee effective protection across national boundaries too, the ECB maintains close working relations with Europol, Interpol and the European Commission. Finally, preparing the European citizens for the introduction of the euro banknotes and coins requires a combined communication effort, bringing together the initiatives of the ECB and of the euro area national central banks – the Euro 2002 Information Campaign – with those of the European Commission and individual euro area Member States.

The last most important field in which there is a considerable involvement of the ECB is specified in Article 105.5 EC Treaty, which confers upon the ESCB the task of contributing “to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system”. In practice, this contribution currently consists in promoting co-operation between central banks and supervisory authorities on policy issues of common interest in the field of prudential supervision and financial stability. This objective is pursued by way of the Banking Supervision Committee, established by the Governing Council of the ECB and comprising representatives of the national central banks and supervisory authorities of the Member States and of the ECB. The ECB itself also has advisory tasks in this field, which are laid down in Article 105.4 EC Treaty and in Article 25.1 ESCB Statute. Moreover, the involvement of the Eurosystem and the ECB in such a field requires co-operation with other relevant fora operating in Europe.

## 1) Price stability as the primary objective of the single monetary policy: in search for a definition

Having sketched the list of tasks of the ESCB, it is worth now going into detail in its analysis. Thus the first element to be taken into account is the definition of price stability as the primary objective of the ECB, and of the single monetary policy for which it is responsible.<sup>398</sup>

It has to be underlined that the Treaty assigns this objective to the ECB for appreciable reasons. Decades of practical experience and a large number of economic studies suggest that monetary policy will contribute most to improving economic prospects and raising the living standards of citizens by maintaining price stability in a credible and lasting way within a low-inflation environment.<sup>399</sup> Moreover, as a clear-cut task and a single ultimate objective, the maintenance of price stability can also be

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<sup>398</sup> See Article 4.2 TEU which reads as follows: “Concurrently with the foregoing, and as provided in this Treaty and in accordance with the timetable and the procedures set out therein, these activities shall include the irrevocable fixing of exchange rates leading to the introduction of a single currency, the ECU, and the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to *maintain price stability* and without prejudice to this objective, to support the general economic policies in the Community, in accordance with the principle of an open market economy with free competition”.

<sup>399</sup> See ECB, *The Monetary Policy of the ECB*, Frankfurt. 2004, pp. 42 and ff.. A similar consideration can be found in R. SMITS, *The European Central Bank. Institutional Aspects*, *op. cit.*, notably p. 123.

It is worth highlighting that there are several ways in which price stability – in the sense of avoiding both prolonged inflation and prolonged deflation – contributes to achieving high levels of economic activity and employment.

First, price stability allows changes in relative prices to be more easily observed, since they are not obscured by fluctuations in the overall price level. As a result, firms and consumers can make better informed consumption and investment decisions, thus allowing the market to allocate resources more efficiently. By helping the market to guide resources to their most productive uses, price stability raises the productive potential of the economy. Second, if investors are reassured that price stability will be maintained in the future, they will not demand an “inflation risk premium” to compensate them for the risks associated with holding assets over the longer term. By reducing such risk premia in the real interest rate, monetary policy can contribute to the allocative efficiency of the capital market and give incentives to invest. This in turn fosters economic growth. Third, the credible maintenance of price stability also make it less likely that individual and firms will divert resources from productive uses in order to hedge against inflation. For example, in a high inflation environment there is an incentive to stockpile real goods since they retain their value better than money or some financial assets in such circumstances. Putting goods into stockpiles is not an efficient investment decision, and therefore hinders economic growth. Fourth, maintaining price stability prevents the considerable and arbitrary redistribution of wealth and income that arises in inflationary as well as deflationary environments. As environment of stable prices thereby helps maintain social cohesion and stability.

All these arguments suggest that a central bank which maintains price stability makes a substantial contribution to the achievement of broader economic goals, such as higher standards of living, high levels of economic activity and better employment prospects. This conclusion is supported by economic evidence, which demonstrates that economies with lower inflation appear, on average, to grow more rapidly in real terms in the long run.

considered a prerequisite for severing the link with other organs of Government: in fact, only for the single purpose of achieving price stability and with its tasks well-defined it is acceptable to take central banking out of the realm of day-to-day politics and entrust the management of monetary affairs to a separate institution.

However, although it clearly establishes the maintenance of price stability as the primary objective of the ECB, the Treaty does not give a precise definition of what is meant by price stability.<sup>400</sup> Pursuant to Article 121.1, first indent EC Treaty, a high degree of price stability will have to be achieved. This is defined as “a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability”. This phrase indicates that the three best performing States set the standard for price stability.<sup>401</sup>

Moreover, in order to fully understand the meaning of the Treaty’s expression, it has to be said that the term used denotes *internal* price stability (namely the volume

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<sup>400</sup> It should be highlighted that the fact that the EC Treaty does not include a clear definition of price stability gives the ECB relatively free hands to both define and implement the objective. In particular, according to D. GROS and N. THYGESEN, *European Monetary Integration, From the European Monetary System to European Monetary Union*, Longman, London, 1992, p. 408, “if the ESCB had indeed repeated the listing of objectives set for the Community in general, regular political reassessments of the relative weight of the different objectives would have become legitimate. Such reassessments are essentially political decisions, which could not be delegated to an institution outside the centre of the policy-making process. A simple and single-valued objective is therefore arguably the only basis on which monetary policy could be delegated to the ESCB and subsequently monitored by the political authorities and the public”. Almost on the same line of reasoning see B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien/New York, 2003, p. 31, where the author even states that “the lack of a definition of price stability, or of criteria for its measurement in the EC Treaty is obvious. This is quite common for economic objectives, which as general, lasting principles aim at demarcating limits, within which actual policy should be pursued” (...) In particular, “due to their character as points of orientation guiding the policies of the Community, in case of lack of coherency, not desired consequences, or of a change of values, they may be adjusted by the political institutions which decide on priorities and contents. As a result, the ECB emerges as the competent body to realise this sub-goal of the Community, specifying the objective according to economic criteria”.

<sup>401</sup> Protocol (No. 6) on the convergence criteria referred to in Article 121 (ex Article 109j), in Article 1, makes clear that the relevant Member State’s price performance should be sustainable and its average rate of inflation not higher than 1½ percentage points above that of, at most, the three least inflationary States. As recalled by R. SMITS, *op. cit.*, p. 124, there is a dispute as to how the reference value is to be calculated: as the average of the three best performing States or of the best performing of these three. The latter interpretation would set the reference value at a relatively low level. Smits openly states that he prefers the reading that the average of the three best performing States should be taken as a “benchmark”, with one qualification. In fact, the words “at most” indicate that the level of inflation used as the criterion for price stability is not to take into account the inflation of the third best-performing State if this has an inflation rate far higher than that of the two best performing States, “since taking on board its performance would lead to an unacceptably high level”. An interesting contribution to the above-mentioned dispute is given by J.-V. LOUIS, *L’Union économique et monétaire*, in *Commentaire Mégret, Le Droit de la CEE*, 2<sup>nd</sup> edition, Etudes Européennes, Editions de l’Université de Bruxelles, Vol. 6. Brussels, 1995, p. 137.

of goods and services which can be obtained for one euro), as opposed to external purchasing power (the strength of the currency in terms of third currencies). It is clear that the ECB is to strive for the former: it is in fact internal price stability that it should maintain.<sup>402</sup> Here, the Treaty and the Statute are unequivocal. The objective is not “safeguarding the currency” as such<sup>403</sup> nor the stability in terms of third currencies.<sup>404</sup>

At the same time, the Governing Council also explicitly stated that price stability “is to be maintained over the medium term”. This reflects the consensus that monetary policy cannot fine-tune developments in prices or inflation over short horizons of a few weeks or months. Changes in monetary policy only affect prices with a time lag, and the magnitude of the eventual impact is uncertain. This implies that monetary policy cannot offset all unanticipated disturbances to the price level. Some short-term volatility in inflation is therefore inevitable.

The Governing Council announced a quantitative definition of price stability for a number of reasons. First, by clarifying how the Governing Council interprets the goal it has been assigned by the Treaty, the definition helps to make the monetary policy framework easier to understand (i.e. it makes monetary policy more transparent). Second, the definition of price stability provides a yardstick against which the public can hold the ECB accountable. Deviations of price developments from price stability can be identified, and the ECB is required to provide an explanation for sustained deviations from this definition and to clarify how price stability will be re-established within an acceptable period of time.<sup>405</sup> Finally, the

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<sup>402</sup> The focus on internal price stability has been made clear in a recent Opinion of the European Central Bank of 19 September 2003 on the draft Treaty establishing a Constitution for Europe (CON/2003/20), where the ECB clearly states that “price stability yields confidence in the long-term value of the euro and translate into low and stable long-term interest rates, which in turn foster a high level of investment and, ultimately, growth and employment. Price stability also avoids an ad hoc redistribution of wealth as a result of price increases”. It is thus unequivocal that there is no reference by the ECB to stability in terms of third currencies.

<sup>403</sup> As with the Bundesbank, which is entrusted with the “*Sicherung der Wahrung*” (section 3 of the Bundesbank Act). As rightly observed by R. SMITS, *op. cit.*, p. 184, footnote 156, “the terms of the German Central Bank Act leave doubt as to whether the mark’s internal or external value is to be protected”. In practice, the provision has been interpreted as requiring internal price stability being sought.

<sup>404</sup> See on this point J.-V. LOUIS, *L’union conomique et montaire*, in *Commentaire Megret, Le Droit de la CEE*, 2nd edition, Etudes Europennes, Editions de l’Universit de Bruxelles, Vol. 6, Brussels, 1995, p. 58.

<sup>405</sup> See R. SMITS, *op. cit.*, p. 186 on the existing checks on the ECB’s auto-interpretation. Namely, on the one hand the European Court of Justice may be called upon to determine whether the level of price

definition is intended to guide expectations of future price developments. The ECB's overriding commitment to maintain price stability should give the public and financial markets good reasons to expect that in the medium term inflation will lie within the range deemed compatible with price stability. Stabilising longer-term inflation expectation in this way should help to prevent firms, trade unions and individual agents involved in the wage and price-setting process from incorporating higher rates of inflation into their decisions, which, in turn, would make the maintenance of price stability more difficult. The definition of price stability therefore helps to build up credibility and increase the effectiveness of the single monetary policy.<sup>406</sup>

It should be underlined that the definition of price stability has a number of noteworthy features.

First, neither prolonged inflation nor prolonged deflation is consistent with the definition. The phrase "below 2%" clearly delineates the upper boundary for the rate of measured HICP inflation that is consistent with price stability. At the same time, the use of the word "increase" in the definition shows that deflation (i.e. declines in the level of the HICP) is incompatible with price stability.<sup>407</sup>

Second, the definition identifies a specific price index – namely the HICP for the euro area – as the one to be used to assess whether price stability has been achieved and maintained. This index has been harmonised across the various countries in the euro area. Its use is consistent with the public's usual focus on consumer prices. The HICP covers a wide range of consumer expenditure.<sup>408</sup>

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stability achieved is within the limits of the law. Also on the other hand, the political bodies of the Community, and most prominently, the European Parliament, may set the ECB's performance against their standards for stable prices. In particular, it may call the President to task when there is variation between what MEPs perceive as an inflation-free economy and what the monetary authority has achieved.

<sup>406</sup> See ECB, *The Outcome of the ECB's evaluation of its monetary policy strategy*, Monthly Bulletin, June 2003.

<sup>407</sup> See *ibidem*, p. 80, where it is specified that such a definition of the boundary "insures the economy against the possibility of monetary policy reaching a situation where it can no longer adequately respond with its policy rate to negative shocks owing to the zero lower bound on nominal interest rates".

<sup>408</sup> On the definition of the HICP, it should be recalled that the conceptual work on the harmonisation of national consumer price indices has been carried out by the European Commission (Eurostat) in close liaison with the national statistical institutes. As key users, the European Monetary Institute and, subsequently, the ECB have been closely involved in this work. The HICP data released by Eurostat are available from January 1995 onwards. Estimated backdate, which are not fully comparable with HICP data from 1995, are available for the overall HICP and its five main components from 1990. Four of these components relate to good prices. Together these accounted for 61.9% of the HICP, while the

Third, the definition implicitly acknowledges the potential existence of imperfections in the measurement of this price level using the HICP. A number of economic studies have identified biases in the measurement of consumer price indices (CPIs). These mainly arise from changing spending patterns and improvements in the quality of the goods and services included in the basket used to define a particular index. Such measurement biases cannot always be fully corrected in the construction of consumer price indices. They typically cause CPIs to overstate slightly the true rate of inflation. The HICP for the euro area is a relatively new concept and long runs of back data do not exist. As yet there is no conclusive evidence as to the magnitude of a potential bias in the HICP. Eurostat, the European Commission agency responsible for this area of statistics at the EU level, has attempted to avoid a measurement bias in the HICP by setting appropriate statistical standards for the national statistical institutes

Fourth, by implicitly making the HICP measurement bias the lower boundary of the range deemed consistent with price stability, the ECB's definition allows only positive rates of true inflation. It thus creates a "safety margin" which helps to ensure that negative rates of true inflation are avoided. Avoiding deflation is important because once it occurs, deflation may become entrenched as a result of the threat it poses to financial stability.

Fifth, price stability is assessed using the HICP for the euro area, indicating that decisions regarding the single monetary policy aim at price stability in the euro area as a whole.

To conclude, it has to be said that the ECB's definition of price stability is in line with the definitions used by most NCBs in the euro area prior to the transition to Monetary Union. Moreover, when adopting the broad economic policy guidelines in July 1995 the EU Council indicated that a value of 2% would be the maximum rate of inflation compatible with price stability. It should be emphasised that the ECB's definition is intended to be a lasting quantification of the primary objective of the single monetary policy.

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services component accounted for 38.1%. The main idea behind this breakdown is to identify different economic factors. For example, developments in the energy component are closely related to oil price movements. Food prices are divided into processed and unprocessed foods, because prices for the latter are influenced by factors such as weather conditions and seasonal patterns with less of an impact on processed food prices. For a detailed analysis see ECB, *The Monetary Policy of the ECB*, Frankfurt, 2001, pp. 40 and ff.

### *1.1) The transmission mechanism of monetary policy*

To begin with, it is worth underlining that there is no proper definition of what exactly constitutes monetary policy. The concept of “monetary policy” was apparently considered to be so clear that no Treaty definition was required. As argued by René Smits, “a definition of the fundamental concept of monetary policy may only be derived”, as a matter of interpretation, “from the permitted operations”.<sup>409</sup> The endowment with the capacity to entertain financial relations with the commercial banks, for which the ECB and the NCBs may open accounts, to conduct open market operations and foreign exchange transactions, and to impose minimum reserves (Articles 17-19 and 23 ESCB Statute) forms an indirect description of what monetary policy is about.<sup>410</sup>

Having said that, it must be also highlighted that, as the Governing Council is responsible for taking monetary policy decisions aimed at the maintenance of price stability, it is crucial that the ECB develops its own view about how monetary policy affects developments in the price level, given the state of the economy. The process through which monetary policy decisions affect the economy in general, and the price level in particular, is known as the transmission mechanism of monetary policy.<sup>411</sup> It

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<sup>409</sup> R. SMITS, *op. cit.*, p. 196. The method the author uses to arrive at an understanding of the notion of monetary policy is based on the attributed competences. It is thus an inductive one. However, it is submitted that this somewhat elusive characterisation cannot be the exclusive method of defining “monetary policy” as such. Should the attributed instruments not be sufficient for the monetary authority to achieve its objective of price stability, other instruments would have to be given to the ECB for the proper exercise of its basic tasks. These instruments would then also qualify to define the concept of monetary policy. It is in fact submitted that the monetary policy of the Community constitutes all activities and operations that are, or can be, undertaken by the ESCB and that are, or may be, conducive to the stability of the European currency. As a consequence, based on this comprehensive approach, monetary policy means the conduct of the kinds of operations permitted in the ESCB Statute.

<sup>410</sup> For an overview of the monetary policy instruments and procedures of the ECB, cfr. ECB, *The monetary policy strategy of the ECB and the operational framework of the Eurosystem*, available at <http://www.ecb.int/about/monetarypolicy.htm>

<sup>411</sup> The ECB has highlighted the importance of the monetary policy transmission mechanism by reference to its monopoly over the supply of the monetary base, given that it is the sole issuer of banknotes and the sole provider of bank reserves. By virtue of this monopoly, the central bank is able to influence money market conditions and steer short-term interest rates. In particular, in the short run, a change in money market interest rates induced by the central bank sets in motion a number of mechanisms and actions by economic agents, ultimately influencing developments in economic variables such as output or prices. This process – the monetary policy transmission mechanism – is

is well established, both theoretically and empirically, that any monetary policy action takes considerable time to affect the economy and that the precise impact is difficult to estimate. In other words, the impact of monetary policy on prices is subject to long, variable and uncertain lags.<sup>412</sup>

In the long run, monetary policy determines the nominal value of goods and services – that is the general price level. Movements in the price level indicate how much the purchasing power of money has changed over time. Related to this finding is the assertion – which is generally accepted in the economics profession – that inflation is ultimately a monetary phenomenon. In other words, prolonged periods of high monetary growth are typically associated with high inflation. This relationship has been confirmed in a very large number of economic studies, covering various periods, countries and datasets. In this respect, the “neutrality” of money is a general principle underlying standard economic thinking. It states that changes in the money supply can in the long run only have an impact on nominal and not on real output, unemployment or real interest rates. Real income is in the long run essentially determined by supply-side factors (i.e. technology, population, growth, the flexibility of markets and the efficiency of the institutional framework of the economy). Monetary policy can therefore only contribute to long-run growth by maintaining price stability. However, monetary policy decisions can influence real variables in the short term.

These key characteristics of monetary policy transmission represent the constraints within which any central bank, including the ECB, must operate in its pursuit of price stability. The effects of monetary policy on real income and the price level are reflected in the way the Treaty has allocated objectives and responsibilities to different policy-making authorities. Since monetary policy influences the price level over the medium term, price stability is a feasible objective for the single

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complex and, according to the ECB itself, “there is no unique and undisputed view of all the aspects involved”. (ECB, *The Monetary Policy of the ECB*, Frankfurt, 2004, p. 41).

<sup>412</sup> The economy is continuously subject to largely unforeseeable shocks that also affect price developments. At the same time, monetary policy can only affect price developments with significant time-lags. Moreover, such lags are variable and, like most economic relationships, highly uncertain. Therefore, it would be impossible for any central bank to keep inflation at a specific point target at all times or even to bring it back to a desired level in a very short time. “Monetary policy is ill-equipped to fine-tune economic developments or control prices at short horizons. Instead, monetary policy needs to act in a forward-looking manner and can only maintain price stability over longer periods of time. This is the core of the ECB’s medium-term orientation” (ECB, *The Outcome of the ECB’s evaluation of its monetary policy strategy*, Monthly Bulletin, June 2003, p. 82).

monetary policy. By contrast, assigning monetary policy an objective for real income or employment would have been misguided, since monetary policy has very limited scope to have a lasting influence on real variables. Indeed, only through the pursuit of price stability can monetary policy have positive effects on economic growth in the long run. It is the task of fiscal and structural policies – but also of those involved in the wage-bargaining process – to enhance the growth potential of the economy.

### *1.2) Channels of monetary policy transmission*

The preceding section has outlined in general terms the impact of monetary policy on a number of key macroeconomic variables. However, it is also important to highlight how monetary policy exerts these effects, since a number of transmission channels exist.<sup>413</sup>

The long chain of cause and effect linking monetary policy decisions with the price level starts with a change in ECB interest rates, specifically the rates offered on the main refinancing operations and on the standing facilities.

The banking system demands money issued by the central bank (known as “base money”) to meet the demand for currency in circulation, to clear interbank balances and to meet the requirements for the minimum reserves that have to be deposited with the central bank. Given its monopoly over the creation of base money, the central bank is in a position to exert a dominant influence on money market conditions and thereby steer money market interest rates. Changes in money market rates in turn affect other market interest rates, albeit to varying degrees.

The announcement and implementation of monetary policy decisions can affect expectations about the future course of monetary policy – and this in turn has an influence on longer-term interest rates, inflationary expectations and wage and price setting, as well as asset prices and the exchange rate.

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<sup>413</sup> Central banks face a complex transmission process from their own monetary policy actions to changes in the general price level. This transmission mechanism of monetary policy is characterised by the existence of several distinct channels, each with long, variable and not fully predictable lags. Because the transmission mechanism is complex, the preparation, discussion and presentation of monetary policy decisions must be placed in a coherent clarifying framework. This is the role of the monetary policy strategy.

As stated above, the level of output in the long run is independent of the stock of money. Therefore, excessive monetary growth must ultimately lead to inflation. In simple terms, if there is too much money chasing too few goods the general level of prices will eventually have to rise, because private agents will want to spend the excess balances at some point. While this description is obviously a very stylised and simplified account of the mechanisms involved, it provides the essence of a view of monetary transmission where attempts by economic agents to reduce excessive holdings of money lead to greater demand for goods and thus to higher prices to clear the market. High money growth may also directly influence inflationary expectations and therefore also price developments. Similarly, low monetary growth may lead to deflationary expectations and price developments. In addition, money growth may be a reflection of current demand pressures in the economy, making money a good summary indicator of economic developments. For all these reasons, developments in monetary aggregates contain useful information for monetary policy and can show good leading indicator properties with regard to future price developments. These properties are one important reason for assigning a prominent role to money in the conduct of monetary policy, even if the precise structure of the transmission mechanism is a matter of some uncertainty.

Moreover, changes in interest rates induced by monetary policy decisions may also affect the exchange rate, *inter alia* by influencing international capital flows. This will normally affect inflation in three ways. First, exchange rate movements may directly affect the domestic price of imported goods. If the exchange rate appreciates, the price of imported goods tends to fall, thus helping to reduce inflation directly, insofar as these products are directly used in consumption. Second, if these imports are used as inputs into the production process, lower prices for inputs might, over time, feed through into lower prices for final goods. Third, exchange rate developments may also have an effect via their impact on the competitiveness of domestically produced goods on international markets. If an appreciation in the exchange rate makes domestically produced goods less competitive in terms of their price on world markets, this tends to constrain external demand and thus reduce overall demand pressure in the economy. All other things being equal, this would tend to reduce inflationary pressures. The importance of these exchange rate effects will depend on how open the economy is to international trade. The exchange rate channel

of monetary policy transmission is less important for a large, relatively closed currency area like the euro area than for a small open economy.

The transmission mechanism of monetary policy is thus a complex web of economic interactions. Despite the best efforts of economists working in academia, in research institutes and in central banks, it remains imperfectly understood. Indeed, the level of uncertainty facing the ECB may even be somewhat greater than that faced by many other central banks, since the ECB is responsible for an entirely new currency area. Moreover, institutional and behavioural changes following the introduction of the single currency at the beginning of 1999 may have changed the relationships between different economic variables. As more information and research results become available over time, a more detailed understanding of monetary policy transmission in the euro area will develop.

## *2) The analysis of risks to price stability in the ECB's stability oriented monetary policy strategy*

Against the background of the preceding discussion, the challenge faced by the ECB can be stated as follows. The Governing Council of the ECB has to influence conditions in the money market, and thereby the level of short-term interest rates, such that – through the effects on the price level via the monetary policy transmission process – price stability is best maintained over the medium term.<sup>414</sup>

The monetary policy strategy of the ECB aims to meet this challenge. It is intended to provide a comprehensive framework within which decisions on the appropriate level of short-term interest rates can be taken. Rather than focusing on a specific situation, the ECB has adopted a lasting strategy to ensure that a consistent

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<sup>414</sup> It must be specified that the transmission lags make it impossible in the short run for monetary policy simply to offset unanticipated shocks to the price level. Thus, some short-term volatility in inflation rates cannot be avoided. In addition, owing to the complexity of the transmission process, there is always a large element of uncertainty surrounding the effects of monetary policy. For these reasons, a medium term orientation of monetary policy is important. Such an orientation will avoid excessive activism and the introduction of unnecessary volatility into the real economy, while nevertheless ensuring that price stability is maintained over the medium term. Such a medium term orientation is consistent with the ECB's statement that "price stability is to be maintained over the medium term".

and systematic approach to monetary policy decisions is taken over time.<sup>415</sup> Such consistency helps to stabilise inflation expectations and build the credibility of the ECB.

The main element of the ECB's monetary policy strategy is its definition of price stability. The strategy ensures that the Governing Council receives all the relevant information and analysis needed to take monetary policy decisions to ensure the maintenance of price stability in a systematic and organised manner. Finally, the strategy must provide a framework for explaining monetary policy decisions to the public in a clear and transparent manner.

### *2.1) The two pillars of the ECB's monetary policy strategy*

Before illustrating the main features of the monetary policy strategy adopted by the ECB (already sketched out in Chapter Two), it is worth saying that a number of other monetary policy strategies are, or have been, pursued by other central banks around the world. Several of these were considered by the EMI and the ECB before the decision was taken to choose for the stability-oriented two pillar strategy.

One such strategy is monetary targeting. In practice, this means that a central bank changes official interest rates in an attempt to either speed up or slow down monetary growth to a specific and pre-announced rate. This target rate is derived so as to be compatible with price stability. Such a strategy rests on two premises. First, a stable relationship between money and the price level should exist over the medium term. If so, then a path consistent with price stability can be derived for the money stock. Second, the money stock should be controllable by monetary policy over a limited time horizon. Taken together, these conditions imply that the central bank can use changes in official interest rates to successfully target the money stock to its

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<sup>415</sup> Owing to the lags in the transmission process, changes in monetary policy today will only affect the price level after a number of quarters or even years. This means that central banks need to ascertain what policy stance is needed today in order to maintain price stability in the future, after the transmission lags unwind. In this sense monetary policy must be forward-looking.

prescribed path and thereby – owing to the stability of the money-to-price relationship – indirectly maintain price stability.<sup>416</sup>

While central bank experience with this approach influenced the design of the ECB's strategy, the ECB decided not to adopt monetary targeting. This decision acknowledged the existence of information in macroeconomic variables other than money that is important for monetary policy decisions aimed at price stability. Furthermore, some uncertainties about the empirical properties of money in the euro area exist due to the possibility of institutional and behavioural changes associated with the transition to Monetary Union, and – more generally – by the possibility that special factors might temporarily distort monetary developments. It may therefore be difficult to rely only on monetary analysis.

Another strategy is direct inflation targeting.<sup>417</sup> Here, rather than using money to guide monetary policy decisions, this approach focuses on developments in inflation itself relative to a published inflation target. Central banks using this approach communicate monetary policy decisions in terms of a more or less mechanical reaction to deviations in a forecast for a particular measure of inflation from a specific inflation target at a particular horizon. The central bank's forecast for

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<sup>416</sup> It is worth recalling that during the 1970s many major central banks moved toward targeting monetary aggregates to facilitate the control of inflation. Reasons for this shift, which occurred in the years after the first oil price rise, were generally pragmatic rather than a reflection of strong monetarist views within central banks. One consideration was the difficulty of interpreting nominal interest rates as an indicator of the stance of monetary policy in a period of high inflation. A second consideration was the necessity to adjust interest rates more flexibly; because interest rate changes became endogenous in the context of the achievement of monetary targets, needed adjustments could be made more easily and earlier. Thus, monetary targeting provided a framework permitting the authorities to raise interest rates until they were appropriately restrictive. For a further investigation on this topic, see the study by P. ATKINSON, A. BLUNDELL-WIGNALL, M. RONDONI and H. ZIEGELSCHMIDT, *The Efficacy of Monetary Targeting: The Stability of Demand for Money in Major OECD Countries*, OECD Economic Studies, No. 3, Autumn 1984.

<sup>417</sup> During the early nineties the literature on inflation targeting (IT) focused on analysing IT regimes in industrialised countries like New Zealand, Canada, the United Kingdom and Sweden (see for instance, on this point, F.S. MISHKIN and A. POSEN, *Inflation Targeting: Lessons from Four Countries*, NBER Working Paper No. w6126, February 1998; F.S. MISHKIN, *From Monetary Targeting to Inflation Targeting: Lessons from Industrialised Countries* World Bank Working Paper Macroeconomic & Growth, Stabilisation, monetary/fiscal policy, No. 2684, 2001). Later, the literature focus changed after the currency crises of the mid and late nineties, when several emerging countries were forced to abandon their fixed exchange rate regimes and some countries like Brazil, Chile, Colombia, Korea, Mexico, Peru, Poland, Czech Republic and Thailand decided to introduce inflation targeting as their new monetary policy framework. Now current studies deal with the question of how possible and recommendable inflation targeting, as monetary policy regime, is for emerging countries (see, on this point, A. FRAGA, I. GOLDFAJN and A. MINELLA, *Inflation Targeting in Emerging Market Economies*, NBER Working Paper No. w10019, October 2003).

inflation is therefore placed at the centre of policy analysis and discussions, both within the central bank and in its presentations to the public.<sup>418</sup>

A third strategy is exchange rate targeting, which was pursued by several European countries prior to Stage Three of EMU in the context of the exchange rate mechanism of the European Monetary System. For small open economies where the production and consumption of internationally traded goods are a large part of the economy, developments in the exchange rate can have a significant impact on the price level through their effect on the price of imports. An exchange rate targeting strategy was not considered appropriate for the euro area, not least as it is a large and relatively closed economy where the impact of exchange rate developments on the price level is more modest.

Thus, having left aside these alternative models, the Governing Council of the ECB agreed on the main elements of its stability-oriented monetary policy strategy in October 1998. In addition to the definition of price stability, the strategy consists of two “pillars”, which organise the information and analysis underlying policy discussions. These two pillars constitute a framework within which the forward-looking assessment of the economic situation can be undertaken, based on as full a set of economic information and analytical tools as possible.

The two pillars of the strategy are tools for conducting the analysis needed to guide monetary policy decisions in order to achieve the primary objective of price stability. They are not distinct targets in and of themselves.

The first pillar of the ECB’s strategy is a prominent role for money. As already noted there is a widespread consensus among economists about the fundamentally monetary origins of inflation over the medium to longer term. One of the most remarkable empirical regularities in macroeconomics is the stable long-run relationship between the price level and money, particularly when the latter is measured using broad monetary aggregates. Monetary developments contain information about future price developments and can therefore help in the overall

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<sup>418</sup> Also in this case, the ECB decided not to pursue such a strategy for a number of reasons. One of these is that, focusing entirely on a forecast inflation figure does not provide an encompassing and reliable framework for identifying the nature of threats to price stability. However, the appropriate monetary policy response will generally depend on the sources of these risks to price stability. As a minimum, it requires a deeper analysis of the underlying economic situation and behaviour than is captured solely in an inflation forecast.

assessment of risks to price stability. Monetary and credit aggregates may also play a role in the transmission mechanism of monetary policy to the price level. For all these reasons, it is important that a central bank monitors monetary and credit developments closely. By assigning money a prominent role within its strategy, the ECB has clearly signalled to the public its intention to undertake such monetary analysis.<sup>419</sup>

In any case the information required to take appropriate monetary policy decisions needs to be comprehensive and broadly based. As a consequence, in parallel with the analysis of monetary growth in relation to the reference value, a wide range of other economic and financial variables is also closely analysed as part of the second pillar of the strategy. These variables are also assessed for the information that they may contain of relevance for monetary policy decisions aimed at price stability.

Analysis under the second pillar focuses on revealing the influence of a variety of factors that normally affect price developments in the shorter term. Such factors are relevant for monetary policy because they may become entrenched and therefore threaten the prospects for price stability in the medium term. In line with standard models of the business cycle, this analysis is often centred on the effects of the interplay between supply and demand and/or cost pressures on pricing behaviour in the goods, services and labour markets.

To take appropriate decision, the Governing Council needs to have a comprehensive understanding of the prevailing economic situation, and be aware of the specific nature and magnitude of economic disturbances that threaten price stability.<sup>420</sup>

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<sup>419</sup> The prominent role of money in the ECB's strategy is signaled by the announcement of a quantitative reference value for the growth of the broad monetary aggregate M3. The focus on M3 is justified by its favourable empirical properties. Most empirical studies for the euro area support the view that there is a stable (long-run) money demand relationship linking M3 to the price level and other macroeconomic variables. M3 has also been shown to exhibit leading indicator properties for future inflation, especially over a medium-term horizon.

It should be noted that the reference value is not a monetary target. The ECB does not attempt to keep M3 growth at the reference value at any particular point in time by manipulating interest rates. However, deviations of M3 growth from the reference value are closely analysed in the context of other economic data in order to extract the information they contain regarding risks to price stability. Any monetary policy response is intended to address the threats to price stability identified by this comprehensive analysis.

<sup>420</sup> For example, the appropriate monetary policy response to the inflationary consequences of a temporary rise in the international price of oil might be different from the appropriate response to higher inflation resulting from the labour cost implications of wage increases not justified by productivity growth. The former results in a transient and short-lived increase in inflation that quickly reverses. As such, if this shock does not lead to higher inflation expectations, it may pose little threat to

It has to be said that, under the second pillar, the ECB regularly reviews developments in overall output, demand and labour market conditions, in a broad range of price and cost indicators, and in fiscal policy, as well as in the balance of payments for the euro area. In particular, developments in the exchange rate are closely assessed for their implications for price stability. As already sketched out, exchange rate movements have a direct effect on price developments through their impact on import prices. Changes in the exchange rate may also alter the price-competitiveness of domestically produced goods on international markets, thereby influencing demand conditions and potentially the outlook for prices. If such exchange rate effects alter the expectations and behaviour of wage and price-setters, the potential for second-round effects stemming from the exchange rate may exist.

To conclude it can be argued that the ECB strategy should be viewed as a framework that not only encompasses all relevant information, but also takes into account various interpretations of this information. Against this background, the two-pillar approach reduces the risks of policy errors caused by relying too much on a single indicator, forecast or model. By taking a diversified approach to the interpretation of economic conditions, the ECB's strategy may be regarded as facilitating the adoption of "a robust monetary policy in an uncertain environment".<sup>421</sup>

Thus, the Governing Council sets the monetary policy instruments of the Eurosystem in order best to serve the achievement of its primary objective. It does so on the basis of the signals regarding the risks to price stability that are provided by both pillars of the strategy. As a result, monetary policy does not react mechanically to developments in any single indicator or forecasts, but rather evaluates, cross-checks and integrates the information from both pillars into an overall assessment of the nature and magnitude of shocks and the resulting economic situation and the prevailing risks to price stability, which incorporates a vital element of policy judgement introduced by the members of the Governing Council themselves.

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price stability over the medium term. In the case of excessive wage increases, the danger exists that a self-sustaining spiral of higher costs, higher prices and higher wage demands may be created. To avoid such a spiral, a strong monetary policy action to reaffirm the central bank's commitment to the maintenance of price stability, thereby helping to stabilise inflation expectations, may be the best response.

<sup>421</sup> ECB, *The Monetary Policy of the ECB*, Frankfurt, 2001, p. 55.

### 3) *The notion of independence and accountability as applied to the ECB in the exercise of its powers.*

Having underlined the importance of a monetary policy directed towards the pursuing of price stability for the euro area, it has to be added that against a broad background of both historical experience and the evolution of the policy debate, central bank independence has in many countries become the preferred means of providing an institutional framework for monetary policy itself.<sup>422</sup> Reflecting this growing consensus, the Maastricht Treaty enshrines the independent status of the European Central Bank and the EU central banks as a bulwark for ensuring that the euro area benefits from price stability, which – as already highlighted – can be seen, quoting a famous expression used by Matthias Herdegen, as a *Grundnorm*<sup>423</sup> within the framework of EMU, as a sort of basic value “that stands above democracy”.<sup>424</sup> This means that in case of confrontations between price stability on the one hand and fundamental rights and the principle of democracy on the other, the latter may take second place. In other words, central bank independence creates means to protect the fundamental right of citizens to price stability, given that inflation means a weakening of this right and an infringement on citizens’ financial position, which the State (or the Union) is under an obligation to protect.<sup>425</sup>

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<sup>422</sup> In Europe, more and more countries belonging to the Organisation for Economic Co-operation and Development (OECD) and countries outside of OECD as well have made their central banks independent. This includes important countries such as France, Italy, Spain, Portugal, Belgium and Greece. The same process has occurred in Latin America, where this movement towards central bank independence involved countries such as Argentina, Venezuela, Chile, Colombia, Ecuador and Mexico. In these countries, the legal reforms were mainly aimed at ending a prolonged period of high inflation rates during which Latin American governments used monetary policy for short-term political purposes, either to finance fiscal deficits or to stimulate economic activity, and to reduce unemployment. On this point it is worth recalling the contribution by F. DE ANDRADE RIBEIRO, *Central Bank: Independence, Governance and Accountability*, IBI – Institute of Brazilian Issues, Washington DC, December 2002.

<sup>423</sup> M.J. HERDEGEN, *Price Stability and Budgetary Restraints in the Economic and Monetary Union: The Law as Guardian of Economic Wisdom*, CML Rev 35, 1998, pp. 9-32. Similarly F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et “Accountability Délibérative”*, in Cahiers de Droit Européen, No. 5-6, 2003, pp. 549-595, who argues that “le SEBC connaît une hiérarchisation des objectifs fondée sur l’axiome selon lequel la stabilité des prix constitue un facteur déterminant de la croissance et de l’emploi” (Emphasis added, p. 554).

<sup>424</sup> P. LEINO, *The European Central Bank and Legitimacy. Is the ECB a Modification of or an Exception to the Principle of Democracy?*, Harvard Jean Monnet Working Paper 1/2001, p. 9.

<sup>425</sup> See on this point H. ARNDT, *Zur Frage der Legitimität der Europäischen Zentralbankautonomie*, in A. MAURER and B. THIELE (eds.), *Legitimationsprobleme und Demokratisierung der Europäischen*

In any case, in order to make the above-mentioned argument more flexible, it has to be acknowledged that the principle of democracy cannot be properly subordinate to the mandate assigned to a central bank to pursue the objective of maintaining price stability, since – here, as in others EU-related fields – it is not a matter of establishing a hierarchy,<sup>426</sup> but it is rather a problem of finding the optimal balance between two different forms of legitimacy in institutional terms.<sup>427</sup>

Having clarified these preliminary issues, it must be conceded that despite the fact that the legal arrangements which have been made in this regard for the ESCB are clearly spelled out in the Maastricht Treaty, clarity does not always prevail concerning the scope of such a strong independence. It is against this background that it is worth clarifying the basic issues of central bank independence as applied to the ECB, both as they are incorporated in the Treaty and as they are interpreted in the academic literature.

As already briefly sketched, over the past decades, two significant changes have taken place in the approach to monetary policy-making, with important consequences for the way the institutional arrangements for the future ESCB were

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*Union*, Schüren Presseverlag, Marburg, 1996, pp. 208-228, as quoted by P. LEINO, *The European Central Bank and Legitimacy. Is the ECB a Modification of or an Exception to the Principle of Democracy?*, *op. cit.*, p. 10.

<sup>426</sup> As rightly observed by P. LINDSETH, *Delegation is Dead, Long Live Delegation: Managing the Democratic Disconnect in the European Market Polity*, in C. JOERGES and R. DEHOUSSE (eds.), *Good Governance in Europe's Integrated Market*, Oxford University Press, Oxford, 2002, p. 140: "(...), it is time to reconceptualise the legal and democratic underpinnings of the Community system – to remove them finally and definitively from the confines of national administrative and constitutional thinking – and to explore alternative means of legitimising the Community's regulatory output in decentralised, non-hierarchical ways that are more congruent with the polyarchical character of the integration project".

<sup>427</sup> Here the reference is to the identification of different forms of legitimacy operating within the EU as a polity, as highlighted by C. LORD and P. MAGNETTE, *E Pluribus Unum? Creative Disagreement about Legitimacy in the EU*, *JCMS*, Vol. 42, No. 1, 2004, pp. 183-202. The basic assumption of the authors – mostly derived by F. SCHARPF, *Notes Toward a Theory of Multilevel Governance in Europe*, Max-Planck Institut für Gesellschaftsforschung Discussion Paper, 5/2000 – is that the Union rests on a plurality of legitimating principles which need to be harmonised for the sake of the integrity of the whole system. According to their conceptualisation, the range of possibilities for a legitimate EU is defined by four vectors: (i) indirect legitimacy; (ii) parliamentary legitimacy; (iii) technocratic legitimacy; (iv) procedural legitimacy. Actually, in the case under examination in the text, two of them are urgently at stake, namely indirect or derivative legitimacy – which depends on the legitimacy of the Union's component states, on its respect for their sovereignty, and on its ability to serve their purposes (while making clear the existing tension between the supranational level and the national one, in a relationship that evoke the principal-agent model) – and technocratic legitimacy, whose example is clearly represented by the ECB which, being an epistemic community composed of unelected officials not supposed to face dominant electoral cycle, "may be more credible even than an independent national central bank where central bankers are either suspected of having political preferences or find that it becomes more difficult to vary interest rates as elections approach" (*Ibidem*, p. 186).

designed. One relates to the adoption of price stability as the primary goal of monetary policy,<sup>428</sup> and the other to the mandate widely given to central banks to pursue this objective independently of political interferences.<sup>429</sup> As a matter of fact, the experience of multiple conflicting goals or short term-oriented political interference in monetary policy led to market volatility and credibility problems and prevented central banks from achieving price stability. This convinced political decision-makers that they should separate the responsibilities of the central bank from those of the government or the private sector by giving the bank full independence in the narrowly defined mandate of price stability.

The first element of this sea-change was probably triggered by the negative experience of the 1970s, when inflation and unemployment rose in parallel, despite the efforts of macroeconomic policy-makers to generate renewed growth in the traditional “Keynesian” manner. This led to growing recognition of the fact that in the long term monetary policy can only systematically control the price level and not real economic variables such as output growth or unemployment. Admittedly, over shorter

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<sup>428</sup> As observed by T. PADOA-SCHIOPPA, *An Institutional Glossary of the Eurosystem*, Article by Tommaso Padoa Schioppa, Member of the Executive Board of the European Central Bank, at the conference on “The Constitution of the Eurosystem: the Views of the EP and the ECB”, 8 March 2000, available at [http://www.ecb.int/key/00/sp000308\\_1.htm](http://www.ecb.int/key/00/sp000308_1.htm), notably at p. 2: “the fact that the maintenance of stable prices has been made the centrepiece of the Eurosystem’s mission derives from the history and experience of Europe’s economies. Throughout the 20<sup>th</sup> century, but especially during the 1970s and 1980s, many European economies suffered from high inflation and its accompanying consequences, i.e. the distortion of price signals in the economy, the erosion of savings and the arbitrary redistribution of wealth. While these experiences have fostered the emergence of a political consensus on the desirability of stable prices and responsible macroeconomic policies, advances in economic research have provided the analytical framework for stability-oriented monetary policies. The recognition that – in the long run – money is neutral, meaning that monetary policy cannot permanently influence growth, investment and employment, provides a cogent argument to steer monetary policy towards the goal of maintaining price stability”.

Moreover, as already underlined in the text, monetary policy has to be by necessity forward looking and medium term-oriented. Overall, economic experience of the past provided several important lessons. First, the narrowly national, inward looking macroeconomic policies and the active use of exchange rates for the purposes of short-term domestic competitiveness led to high inflation, high interest rates and, in fact, to lower competitiveness. These developments convinced political decision-makers of the necessity to aim for stability and low inflation (for a further development of this matter, see S. HÄMÄLÄINEN, *The ECB’s monetary policy – accountability, transparency and communication*, Speech delivered by Ms Sirkka Hämmäläinen, Member of the Executive Board of the European Central Bank, Old Age, New Economy and Central Banking Conference, organised by CEPR/ESI and Suomen Pankki, 14 September 2001, Helsinki, available at <http://www.ecb.int/key/01/sp010914.htm>

<sup>429</sup> In the specific case of the ECB, by shielding the whole decision-making process of the monetary authority from short-term political pressures, the principle of independence aims to enable the ECB effectively to pursue the target of price stability and, without prejudice to that aim, support the economic policies of the Community as required by Article 105.1 EC Treaty. For an overview of the, not entirely conclusive, empirical evidence, see F. AMTENBRINK, *The Democratic Accountability of Central Banks. A Comparative Study of the European Central Bank*, Hart Publishing, Oxford and Portland, Oregon, 1999.

horizons, monetary policy does indeed affect both real and nominal variables. However, it is by now widely accepted among policy-makers and in the academic literature, that deliberate attempts to exploit any short-run trade-offs between output and prices are likely to result in a permanently higher and more variable rate of inflation, with significant adverse consequences for resource allocation, long-run output and productivity growth. Having underlined that, the primary goal of monetary policy should be to achieve and maintain price stability, with any other economic objectives receiving emphasis only to the extent that price stability is not endangered.

The second fundamental change under examination is the widespread tendency to delegate the decision-making power over monetary policy to independent central banks, which are supposed to be granted total freedom to elaborate and conduct their monetary policies, and to choose – without external pressures – the most appropriate instruments to be used. In order to support this tendency, modern economic theory emphasises the inflationary bias in economic policy, which relates in particular to the so-called time-inconsistency issue, i.e. the problem of convincing the public that the monetary authorities will resist the temptation to stimulate output growth in the short run by creating surprise inflation.<sup>430</sup> Against the backdrop of negative past experience, the public is unlikely to have much faith in the authorities' promises to maintain low inflation. Unless a credible form of pre-commitment underpins these promises, the equilibrium inflation rate will be higher than needed, with no better performance in terms of output and possibly even deterioration. As a solution to this problem, it has been suggested that responsibility for monetary policy be separated from political

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<sup>430</sup> As highlighted by F. KYDLAND and E. PRESCOTT, *Rules rather than Discretion. The Inconsistency of Optimal Plans*, in *Journal of Political Economy*, Vol. 85, No. 3, 1997, pp. 473–491, the time-inconsistency problem is closely linked with the discretionary policies of government. At the centre of this stand the problem of a lack of consistency on the part of the policy-makers. In the outset a government may choose to pre-announce its future policies in order to influence the expectations of economic agents. However, at the planned time for the implementation of the policy, after the economic agents have acted in accordance with such expectations, government has to deviate from a pre-set optimal (inflation) policy due to incentives which it did not anticipate at the time of the setting of the policy. Rational forward-looking economic agents assume such a development, by considering the announced policy incredible, and offset the planned policy goals of the government resulting in a higher inflation rate without any of the desired long or short-term benefits. As a result, it would be possible to conclude – together with F. AMTENBRINK, *The Democratic Accountability of Central Banks. A Comparative Study of the European Central Bank. op. cit.*, p. 13 – that “discretionary monetary policy is believed to lack credibility and to result in higher inflation”. On the contrary, “in an environment in which the policy-maker has committed himself to a pre-set policy such temptations do not exist to the same degree, since the costs in terms of loss of credibility which would result from a deviation from the rule are thought to be much higher than is otherwise the case”. On this point see also the economic study by F. LIPPI, *Central Bank Independence and Credibility*, Tinbergen Institute Research Series, 1997.

control and to enshrine this in legislation. According to this view, central banks should be given the freedom to formulate and execute monetary policy in line with their primary objective as determined by the legislator, to whom they are accountable.<sup>431</sup>

Moreover, by shielding monetary policy decisions from political interference, lower inflation can be maintained without having to give up economic growth.<sup>432</sup> Indeed, in that sense, creating an independent central bank appears to be a good thing all round. The reason for this is that monetary policy-making under the influence of politicians tends to focus too much on short-term considerations. This can easily lead to temporary, non-sustainable accelerations in economic activity, at the expense of lasting increases in inflation and also ultimately a curbing of economic output and increases in unemployment. Politicians all over the world, under the considerable influence of economic theories and evidences,<sup>433</sup> have come to realise this and have decided to remove the temptation.

In line with the foregoing analysis, more and more EU central banks have over time been assigned the task of guaranteeing price stability, either explicitly by national law, or more informally as a reflection of an underlying culture of stability. In many cases, these reforms went hand-in-hand with the move towards a greater degree of central bank independence. "These changes in national monetary legislation or at least the practice of central bank independence were beginning to be implemented well before the start of the Maastricht process".<sup>434</sup> They were, however,

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<sup>431</sup> Accountability, in such a context, may involve either a legal obligation for the central bank to give reckoning for the conduct of monetary policy or a commitment to explain its actions, for example, in regular reports and to parliament. This allows central banks to take a medium-term orientation and not to be distracted by short-term political motives, an approach which benefits the credibility, transparency and efficiency of monetary policy. As a matter of fact, no central bank can be totally independent in the sense that it does not have to answer to anyone. Even the most autonomous central bank has to report in some form or another to the legislative branch, which has the ultimate power to change the laws governing the central bank.

<sup>432</sup> See on this point A. CUKIERMAN, *Central Bank Strategy, Credibility, and Independence: Theory and Evidence*, The MIT Press, Cambridge, Massachusetts, London, England, 1992.

<sup>433</sup> For some interesting considerations on the relationship between economics and politics in designing the institutional profile of the ECB and its independence, see P. DE GRAUWE, *Independence & Accountability of Central Banks*, Paper prepared for the Annual World Bank Conference on *Governance, Equity and Global Markets*, Paris, 21-23 June 1999, at p. 4. According to De Grauwe, "the enthusiasm with which central bank independence has been embraced in the European Union is fascinating. It certainly testifies that economic ideas can be very powerful in shaping institutions".

<sup>434</sup> A. LAMFALUSSY, *The European Central Bank: Independent and Accountable*, Keynote speech delivered by Alexander Lamfalussy, President of the European Monetary Institute, at the

further promoted by the recommendations of the Delors Committee with regard to the institutional arrangements for Stage Three of Monetary Union. The Committee's proposals culminated in the inclusion in the Maastricht Treaty and the Statute of the ESCB of the primary objective of price stability, the pursuit of which is delegated to an independent central bank system composed of the ECB and the national central banks of the Member States.

Thus, the conclusion was that central banks should not only have a clear mandate, but should also be detached from daily pressures by separating those who are involved in creating money from those who have motives related to the spending or distribution of money, be they business community or political representatives.<sup>435</sup> In particular, the ECB's task of accomplishing the narrow, commonly agreed objective is based on the understanding that monetary policy supports growth and employment by guaranteeing price stability and that in the medium and long run there is no trade-off between inflation and output.<sup>436</sup>

### ***3.1) The constitutional basis of the independence granted to the ECB in the European legal order***

There is a wide consensus among scholars that, through its inclusion in the Treaty and recently in the draft Treaty establishing a Constitution for Europe (namely in paragraph 3 of Article I-29), the ECB's independence has been given a solid constitutional basis. This can be easily observed by taking into account that the very existence of the ECB and the Eurosystem was the result of a democratic process. The Treaty provisions, and with them, the mandate of the Governing Council of the ECB

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Oesterreichische Nationalbank, Vienna, 13 May 1997, available at <http://www.ecb.int/emi/key/key05.htm>, notably at p. 2.

<sup>435</sup> On the same line of reasoning, it is possible to find an interesting and comprehensive definition of independence given by the Prime Minister Lionel Jospin in May 2000, saying that "independence signifies ignoring pressures, whatever its source. The independence of central banks goes beyond independence from political, executive and legislative power" (...) "it also equates with independence from private or collective economic interest, autonomy versus the short term, frequently imposed by capital markets and, finally, freedom of action vis-à-vis the monetary policy of other central banks" (For the quotation see F. DE ANDRADE RIBEIRO, *Central Bank: Independence, Governance and Accountability*, IBI – Institute of Brazilian Issues, Washington DC, December 2002, p. 6).

<sup>436</sup> For a more detailed analysis of this point, see W. DUISENBERG, *Central Bank Accountability for Monetary Policy*, in *Colloque du Bicentenaire, Indépendance et Responsabilité, Évolution du Métier de Banquier Central*, Paris. Banque de France, 2000, pp. 271 and ff.

to maintain price stability and its high degree of independence, were formulated by the political system itself. In fact, it has to be recalled that the national parliaments of each of the EU Member States approved these provisions and the principles, tasks, objectives and institutional set-up of the Eurosystem.

As a consequence of such an initial set-up, firmly characterised by a political decision, it can be argued that independence from politics should not and does not mean “isolation” from politics.<sup>437</sup> More generally, it is worth highlighting the fact that the introduction of the euro as such and the establishment of the ECB constitute a new, significant step in the process of European integration which has now been under way for more than half a century. This process is based on the political view that an integrated Europe is in the interest of stability, security and prosperity. The European integration process is primarily a political process with, of course, important economic aspects and benefits, which cannot be disregarded.<sup>438</sup>

Having pointed out all that, one can finally move further arguing that the whole process related to the institutional configuration of the Eurosystem has been a matter of finding the best balance between the reasons of political primacy and those of the emerging economic/monetary power, in terms of democratic and political control,<sup>439</sup> on the one hand, and technocratic policy effectiveness, on the other.<sup>440</sup> In

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<sup>437</sup> According to the Opinion of the Advocate General Jacobs, delivered on 3 October 2002, on the OLAF Case (Case C-11/00 – Commission of the European Communities v. European Central Bank), “the principle of independence does not imply a total isolation from, or a complete absence of co-operation with, the institutions and bodies of the Community. The Treaty prohibits only influence which is liable to undermine the ability of the ECB to carry out its tasks effectively with a view to price stability, and which must therefore be regarded as undue”. On the same line of reasoning, J.-V. LOUIS, *A Legal and Institutional Approach for Building a Monetary Union*, CML Rev. 1998, notably at p. 44.

<sup>438</sup> On this point, see C. NOYER, *Politics and central banks*, Speech by Christian Noyer held at the Estonian Central Bank, Tallinn, Estonia on 3 May 1999, available at <http://www.ecb.int/key/sp990503.htm> The author also recalls that at the same time the appointment of the members of the Executive Board of the ECB is another political decision. These members are in fact appointed by the Heads of State or Government on a proposal from the Ecofin Council, following consultation with the European Parliament, for an eight-year term without the possibility of renewal. Moreover, the Governors of the national central banks are similarly appointed by national political decision-makers according to more variable and flexible rules, but always for a minimum of five years. The members of the Governing Council – the NCB Governors as well as the members of the Executive Board – can be removed or discharged only if they no longer fulfill the conditions required for the performance of their duties or if they have been guilty of serious misconduct.

<sup>439</sup> It is interesting to note that during the debate in the European Parliament on *Democratic accountability in stage three of EMU*, the French, Italian and Portuguese versions of the draft report initially used the term *contrôle démocratique*, *controllo democratico* and *controllo democratico*, respectively, while the Spanish version referred instead to *responsabilidad democrática*. Such an element testifies the significance of the issue at stake here in the institutional construction and configuration of the ECB as bearer of monetary sovereignty.

fact, when preparing the Treaty, the Member States sought to provide an optimal framework to allow the Eurosystem to fulfil its mission independently from day-to-day political interferences. In so doing, two basic requirements had to be satisfied: the above-mentioned democratic control and policy effectiveness.<sup>441</sup> In a society based on democratic and market principles, both these requirements are crucial. However, as they are partially conflicting, clear definitions and an appropriate balance in their implementation need to be found.<sup>442</sup>

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On this point see the paper written by L. BINI-SMAGHI and D. GROS, *Is the ECB Sufficiently Accountable and Transparent?*, CEPS, Working Document No. 169, July 2001, where the authors, reflecting on the idea of democratic control, identify three constraints on the exercise of government: (a) *ex ante* control, which defines the rules, standards and principles laid down in advance by a democratically elected body, to be followed by the accountable body in the exercise of its functions; (b) accountability as such, viewed as the act of listening to criticism and responding to questions about the past and future behaviour that may be put forward by a democratically elected body; (c) popular mandate, which refers to the attribution of power through democratic procedures. However, it should be said that the above criteria cannot fully be applied to central banks. The third criterion, in particular, is not relevant in that independent central banks do not receive mandates nor they choose their own policy objectives. "This would imply that the central bank had become a *new separate branch of democratic power*", which is not the case. (*Ibidem*, p. 2. Emphasis added).

<sup>440</sup> For an interesting elaboration on this topic, with specific reference to the notion of accountability and responsibility, cfr. N. JABKO, *Expertise et politique à l'âge de l'euro: la Banque Centrale Européenne sur le terrain de la démocratie*, *Revue Française de Science Politique*, Vol. 51, No. 6, Décembre 2001, pp. 903-931.

<sup>441</sup> It is worth recalling the insightful considerations of P. LEINO (*The European Central Bank and Legitimacy. Is the ECB a Modification of or an Exception to the Principle of Democracy*, Harvard Jean Monnet Working Paper 1/2001) on this point. The author moves further observing that the whole system of monetary decision-making has deliberately been distanced from the conventional politically organised and democratically legitimated system of decision-making in order to make it efficient and immune to political pressure. At the same time, however, it has become difficult to control the accountability of such an independent central bank – "sovereign within the sphere of Community monetary policy" – and secure that it functions in a legitimate manner in the exercise of its "sovereign powers". The problem of finding a workable balance between power and control here arises again. Thus, against the above-described controversial background, the author identifies a crucial question, namely whether it is possible for the ECB to function in an independent and legitimate manner at the same time, fulfilling both the substantive and procedural requirements for legitimacy.

Moreover, in the specific case of the ECB, the main argument that makes everything more difficult to be solved was that, turning over decisions about interest rates, exchange rates, the efficiency of the financial system, and other monetary matters to a staff of unelected officials, might be considered "undemocratic". In fact, assuming that in a democratic society all decisions should be subject to a scrutiny by the elected members of the legislative, the concept of a strong, "sovereign", shielded independent central bank would be, *prima facie*, not acceptable.

<sup>442</sup> As rightly observed by B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien/New York, 2003, p. 88, "the task is to reconcile democratic organisational principles and central bank independence, or its compatibility with the axiom that every exercise of public authority must be democratically legitimised". All this appears to be a real challenge and represents a truly controversial issue in the academic debate. In principle, if the democratic principle can operate at the European level, the Europeanisation of monetary policy cannot constitute *per se* a challenge to it. Nonetheless, the specific institutional framework adopted for this purpose in the Maastricht Treaty still does. The Treaty assigns to the ECB full responsibility for the conduct of the single monetary policy and an extremely high degree of independence from the other Community institutions, as well from the governments of the

In particular, it should be borne in mind that the policy decisions of the Governing Council of the ECB affect the lives and welfare of the almost 300 million people living in the euro area. This is why the transfer of such substantial power into the hands of independent, non-elected central bankers can only be legitimate if effective democratic control and accountability are in place.

As a matter of fact, democracy based on representation assumes a symmetrical relationship between power and accountability – in fact, when public power is implemented someone must be able to be held accountable for it. In principle, such reasoning should be applied also to the ECB as bearer of monetary sovereignty (a new, still controversial form of public power) within the EU. Still, such a “sovereign” power is used by the ECB without or outside the traditional forms of political accountability which otherwise should follow automatically. This can be partially justified by taking into account that the Eurosystem has to be in a position to effectively carry out its tasks, i.e. to actually safeguard the currency and deliver price stability, a prerequisite which may set conditions, and even a limit, to the way in which democratic control is exercised. In particular, the forward-looking character of monetary policy, the long time lags with which monetary policy works, the sensitivity of relevant information and the powerful market reaction to policy announcements, all have to be seriously evaluated in designing the methods of democratic control that are appropriate for the central bank.<sup>443</sup>

Having said that, it should be highlighted that, in recognition of the specific requirements of a successful and efficient policy, the Treaty clearly removes monetary policy-making from the pressures of the day-to-day political debate, and endows the Eurosystem with substantial independence. It is precisely the need to ensure an effective and successful pursuit of its mission that requires, and at the same time

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Member States. In other words, it grants to a group of appointed officials full decision-making powers for a key aspect of macroeconomic policy. It can be concluded – together with C. HADJEMMANUIL, *Democracy, Supranationality and Central Bank Independence*, in J. KLEINEMAN (ed.), *Central Bank Independence. The Economic Foundations, the Constitutional Implications and Democratic Accountability*, Kluwer Law International, The Hague, 2001, p. 134 – that “the establishment by means of constitutional rules of depoliticised, non-majoritarian central banking arrangements, would appear to constitute, at the supranational as much as at the national level, a direct and gross violation of the democratic principle”. That’s why all the described process requires a special justification.

<sup>443</sup> See, in this sense, T. PADOA-SCHIOPPA, *An Institutional Glossary of the Eurosystem*, Article by Tommaso Padoa Schiopa, Member of the Executive Board of the European Central Bank, at the conference on “The Constitution of the Eurosystem: the Views of the EP and the ECB”, 8 March 200, p. 2, available at [http://www.ecb.int/key/00/sp000308\\_1.htm](http://www.ecb.int/key/00/sp000308_1.htm)

justifies, the independence prerogative in the Eurosystem's institutional profile, especially with regard to third parties.

The Treaty (in Article 108) and the Statute of the ESCB (in Article 7) both contain very clear provisions regarding the relationship with third parties, which leave no room whatsoever for misinterpretation. To quote a key sentence, "neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body". Moreover, the aforementioned authorities shall also "undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks". To put it simply "the door to the single monetary policy is locked from both sides and neither the ESCB nor third parties can open the door for political instructions".<sup>444</sup> Even attempts to do so would already be in conflict with the provisions of the Treaty and the Statute of the ESCB.

A part from such guarantees granted to the ECB in terms of independence, it should be borne in mind that a basic condition for central bank independence is the creation of an efficient institutional framework in which decisions on monetary policy and its implementation can be really made without undue interference by the political arena. This involves decisions regarding: (a) *institutional or functional independence*, which means the right to decide on all matters regarding monetary policy and price stability, without being subject to instructions from any other authority;<sup>445</sup> (b)

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<sup>444</sup> A. LAMFALUSSY, *The European Central Bank: Independent and Accountable*, *op. cit.*, p. 2. The author further recalls the fact that some critical observers have argued that the door is not completely shut against political interference, as the Treaty may seem to make an exception to the independence of the ESCB with regard to the exchange rate policy of the euro area. The Ecofin Council may in fact conclude formal exchange rate arrangements with countries outside the EU, or formulate general orientations for exchange rate policy in relation to the currencies of these non-EU countries. This essentially reflects the current situation in most Member States, where the government determines the exchange rate rules (if any) and the central bank is responsible for the execution of this policy. Nevertheless, despite of all these reasonable consideration, Lamfalussy clearly affirms that he has no fear with respect to a potential overburdening of the single monetary policy via the above-described route.

<sup>445</sup> As rightly underlined by the Advocate General Jacobs in his Opinion on the OLAF Case (Case C-11/00), *op. cit.*, para. 152, one of the reasons to justify the institutional independence of the ECB rests on the attribution of legal personality to the ECB, a personality distinct from that of the Community (by virtue of Article 107.2 EC Treaty and Article 9.1 ESCB Statute). As a consequence, the institutions and bodies of the Community – with the notable exception of the ECJ – do not have the power to approve, suspend, annul or defer decisions of the ECB, nor are the institutions entitled to vote during the meetings of the Executive Board and the Governing Council. Moreover, the Treaty has granted the ECB powers to adopt regulations, decisions, recommendations and opinions considered necessary to

*personnel independence*, which covers the selection and appointment of Board members with a high professional expertise and without an obligation to yield to political and other pressures;<sup>446</sup> (c) *instrumental or operational independence*, which means control over the instruments that affect the inflation process, including in particular the prevention of any direct financing of government deficits; and (d) *financial independence*,<sup>447</sup> which requires the central bank to have access to adequate financial resources of its own and full control over its own budget.<sup>448</sup>

In the above-sketched framework, independence manifests itself also in a number of concrete institutional features operating within the Eurosystem.

First, collegiality. As a matter of fact, the Eurosystem's main decision-making bodies (the Governing Council and the Executive Board) are both collegiate, as it is

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carry out certain tasks and to lay down its own rules of procedure for its internal organisation and the terms of employment of its staff.

<sup>446</sup> The rules governing the appointment, security of tenure and external activities of the members of the Executive Board and the Governing Council confer upon the ECB a very high level of personnel independence. Thus, the President and the members of the Executive Board are appointed for a non-renewable period of eight years (Article 112.2 (b) EC Treaty and Article 12.2 ESCB Statute). The Statute also seeks to secure the independence of the Governing Council by providing that the Governors are to be appointed (by the competent national authorities) for a period of no less than five years (Article 14.2 ESCB Statute). Security of tenure is assured since a member of the Executive Board may be compulsory retired (by the Court of Justice on an application by the Governing Council or the Executive Board) only if he/she no longer fulfils the conditions required for the performance of his/her duties or if the person *de qua* has been guilty of serious misconduct (cfr. Article 11.4 ESCB Statute). Equally strict conditions apply where the authorities of a Member State seek to relieve a central bank Governor, and member of the Governing Council, of his/her functions (cfr. Article 14.2, 2<sup>nd</sup> paragraph ESCB Statute). For a comparative analysis of the so-called "organic safeguards of central bank independence" (namely: appointment and suitability; terms of office; tenure and removal; salary; prohibitions applicable to central bank officials while in office; restrictions on central bank officials after they leave office; liaisons and conflicts with other institutions), see R.M. LASTRA, *The Independence of the European System of Central Banks*, Harvard International Law Journal, Vol. 33, No. 2, Spring 1992, pp. 475 – 519.

<sup>447</sup> The ECB has in fact its own budget, which is drawn up by the Executive Board in accordance with principles established by the Governing Council, and its own assets paid up by the national central banks. Moreover, the accounts of the ECB are audited by independent external auditors appointed by the ECB, while – as set forth by Article 248 EC Treaty and Article 27.2 ESCB Statute – the competence of the Court of Auditors is limited to examining the operational efficiency of the management of the ECB

<sup>448</sup> These are the four main elements indicated by the Monetary Committee in its Report of 19 July 1990, as recalled by J.-V. LOUIS, *Monnaie. Union économique et monétaire*, in Rép. Communautaire Dalloz, February 2000, p. 29. For a similar, if not identical classification and further useful references, cfr. F. AMTENBRINK, *The Democratic Accountability of Central Banks. A Comparative Study of the European Central bank*, *op. cit.*, pp. 18 and ff.; see also Chapter Four of the present work, *Some Theoretical Clarifications on the Notions of some Keywords at Stake: modalities of the exercise of the monetary power*, for a detailed analysis of the matter.

An interesting comparative study between the ECB and the Federal Reserve System, with specific regard to the above-mentioned institutional features of central bank independence, is provided by B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, pp. 171-199.

the case with most modern central banks today. Collegiality reinforces independent decision-making process for the simple reason that a group can defend itself better than a single person from various kinds of pressures and influences, be they economic, political or intellectual. As a consequence, the principle under analysis here can be perceived as a means to further shield the decision-making bodies of the ECB in the exercise of their powers.

A second element of characterisation is represented by the majority principle. Only superficial thinking would suggest that unanimity ensures a better recognition of all views. On the contrary, unanimity is conducive to non-decisions or to biased decisions, two evils that an independent central bank must avoid. This is why the Statute of the ESCB lays down that decisions be made by adopting the majority principle. Due to this stipulation the Governing Council cannot be held hostage by a single member who might have misguided motivations.

Third, the one person – one vote rule. This fundamental institutional feature relates to the Eurosystem's independence insofar as it is essential to gear the decisions of the Governing Council towards the fulfilment of the Treaty mandate. The members of the Governing Council of the ECB are represented in a personal capacity, i.e. precisely not as representatives of their home countries and central banks. Since they explicitly do not represent a particular country, it would be illogical to assign weights to their votes. By attending in a personal capacity, the members of the Governing Council do not stand for a particular national interest, but rather for their expertise and experience. Therefore, the Governing Council should not be perceived as a body that balances competing interests. On the contrary, solely on the basis of its accumulated expertise is the Governing Council in a position to act in full independence with the aim to fulfil its mission.

### ***3.2) Democratic accountability as a counterweight to independence. In search of a workable equilibrium.***

Against the above-described scenario, it can be concluded that the notion of independence implies the absence of direct influence of external actors on the policy-making process, i.e. the impossibility to interfere in the policy-making in a way that

would make it deviate from the statutory mission. It is precisely because the Eurosystem has a statutory mission and has been granted such a form of independence to fulfil it that it has to be held accountable, and that it is obliged to *ex post* explain and justify its decisions. As a consequence, accountability can be seen as the reverse side of the coin of central bank independence, even if the latter sets a limit to the role of the institutions to which the central bank is accountable.<sup>449</sup>

In order to well develop the analysis of the notion of accountability within the context of the ECB, it is good to start from the basic constitutional ideas to be applied to the European Union as such, namely that in a democracy citizens delegate power to politicians.<sup>450</sup> The politicians exert this power until they face the electorate again. Thus, the delegation of power to the politicians has two stages. The first one starts when the politicians are vested with power. During this stage they exert this power independently from the electorate. The second stage is the accountability stage, when the electorate evaluates and sanctions the record and the performance of the politicians.

Much of what politicians do is to further delegate power to specialised institutions. This secondary delegation must have the same two stages. In the first

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<sup>449</sup> "If, the European Parliament were to be in a position to exercise a direct influence on the Eurosystem's decisions, this would necessarily imply a shared responsibility and the Eurosystem's obligation to explain and justify its decisions to the European Parliament would appear absurd and devoid of any meaning" (T. PADOA-SCHIOPPA, *An Institutional Glossary of the Eurosystem*, Article by Tommaso Padoa Schiopa, Member of the Executive Board of the European Central Bank, at the conference on "The Constitution of the Eurosystem: the Views of the EP and the ECB", 8 March 200, p. 4, available at [http://www.ecb.int/key/00/sp000308\\_1.htm](http://www.ecb.int/key/00/sp000308_1.htm) )

<sup>450</sup> It is interesting to note that according to some scholars the notion of delegation or the principal-agent model have to be abandoned since they are obsolete and, in particular, inappropriate in justifying the regulatory powers of the Community. As argued by P. LINDSETH, *Delegation is Dead, Long Live Delegation: Managing the Democratic Disconnect in the European Market Polity*, *op. cit.*, p. 140, "one might fairly say that, in trying to understand the Community, the notion of a delegation from the national level should be avoided precisely because it suggests a principal-agent relationship between national parliaments and the producers of regulatory norms that does not exist". Moreover, "even if the norm-producing "agents" in the Community (...) could be said to derive their authority from their purported constitutional "principals" at the national level, the process of regulatory norm-production in the Community operates with so much effective autonomy that it would seem impossible for anyone realistically to assert that the agents work under the control or supervision of a national constitutional principal in any meaningful hierarchical sense". (...) "Rather, in this poliarchival regulatory environment, national parliaments (the locus of democratic legitimacy in classical constitutional theory) are merely one set of actors among many, with certain powers at their disposal but hardly a decisive influence over the regulatory process". This is the result of what the author defines as a "democratic disconnect", influenced by the increasingly attenuated nature of direct national control and oversight over Community norm-production. In a final analysis, thus, also the rejection of the notion of delegation leads to a questioning on the accountability issue, an issue made even weaker in consideration of the role effectively played by the actors supposed to be the addressees of accountability at the national level.

stage, the politicians delegate power to the institution in the form of a contract in which the objectives and the means to achieve the objectives are specified.<sup>451</sup> In the second stage the politicians evaluate the performance of the institution. The first stage can be called the stage in which some form of independence is granted, the second one is the stage in which control is exerted (accountability). These two phases are inextricably linked. The politicians, who are accountable to the electorate, cannot afford to delegate power to an institution (making it independent) except if they can also exert a sort of control over that institution.<sup>452</sup> Applying in such a case the theory of principal vs. agent,<sup>453</sup> it seems evident that “the core sense of accountability is clearly grounded in the general purpose of making agents or subordinates act in accordance with the wishes of their superiors”.<sup>454</sup>

The more the politicians delegate power, the better the control must be organised about how this power is used. If there is little delegation, there is little need for control. Thus, applying these principles to the case of central banks, if the government decides about the interest rate then there is no need for having explicit accountability of the central bank. If, on the contrary, the government delegates a lot

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<sup>451</sup> It has to be borne in mind that the more clearly and precisely this mandate is defined, the easier it will be to monitor the performance of the central bank. Moreover, “the more clearly and narrowly the mandate is defined, the easier it will be in a democracy to justify the delegation of powers to an unelected body, since value judgments and trade-offs concerning several unranked objectives should naturally remain the preserve of democratically elective representatives” (O. ISSING, *The Eurosystem: Transparent and Accountable or “Willem in Euroland”*, Journal of Common Market Studies, Vo. 37, No. 3, September 1999, p. 509).

<sup>452</sup> A partially different reconstruction of this process is provided by A. CUKIERMAN, *Central Bank Strategy, Credibility, and Independence: Theory and Evidence*, op. cit., notably at p. 350. The author argues “the conveyance of authority to the CB by political authorities can be viewed as an act of partial commitment. By delegating some of their authority to a relatively apolitical institution, politicians accept certain restrictions on their future freedom of action. The main motive for such delegation is usually the preservation of price stability” (...) “By delegating some of their authority to the CB, political authorities try to reduce the set of circumstances under which price stability is sacrificed in order to achieve other objectives. The higher the independence of the CB, the stronger will be the commitment”.

<sup>453</sup> Note that according to C. ZILIOLI, *Accountability and Independence: Irreconcilable Values or Complementary Instruments for Democracy? The Specific Case of the European Central Bank*, in *Mélanges en Hommage à Jean-Victor Louis*, Vol. II, Éditions de l’Université de Bruxelles, Brussels 2003, p. 319, it is not possible to identify a principal in the case of the ECB, since there is no proper “delegation” of power, but an irrevocable transfer of power from 12 Member States to the ECB. Moreover, the same principle of independence – with its prohibition to give instructions to the ECB – can not be reconciled with the principal-agent relationship.

<sup>454</sup> A. MULGAN, “Accountability”: *An Ever-Expanding concept?*, in *Public Administration*, 78, 2000, at p. 563. The author further argues “the ever-present threat of being called to account, the potential implicit in accountability, will serve as a sufficient device to secure a satisfactory degree of compliance with political preferences (Ibidem, p. 567).

of power to the central bank, there is a corresponding need to have a high degree of accountability. The reason is that the government maintains its full accountability towards the electorate, and therefore cannot afford to delegate power without maintaining control over the use of this power. As a consequence, independence and accountability are part of the same process of delegation.

Moreover, it has to be said that delegation of power implies the consensus of both parties involved in the process on an agreement in which the objectives to be pursued are specified, together with the method to achieve these objectives. On such a basis, it can be rightly argued – together with Chiara Zilioli – that “accountability is a mechanism through which the performance of government independent bodies and central banks can be checked against pre-set objectives; the difference being that these objectives are not, like in the case of democratically elected representatives, chosen by the candidate and endorsed through the vote by the electorate, but they are pre-defined by the State as a condition for the transfer of power”.<sup>455</sup> As a result, a crucial issue is thus the precision with which the objectives are described. If objectives are left vague, it will be difficult to monitor the behaviour of the central bank. Accountability will be weak. In fact, the more precise the objectives are defined, the easier will be the monitoring and the more legitimate will be the whole process of delegation.

Having established the *ex post* character of the ECB’s accountability,<sup>456</sup> two further questions need to be addressed in order to render this concept meaningful for the present investigation: “accountable for what? Accountable to whom?”<sup>457</sup>

With the aim to find an answer to the first question, it has to be repeated that the Eurosystem should be held accountable simply for the fulfilment of its mandate. In this context, the maintenance of price stability, and hence the formulation and

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<sup>455</sup> C. ZILIOLI, *Accountability and Independence: Irreconcilable Values or Complementary Instruments for Democracy? The Specific Case of the European Central Bank*, in *Mélanges en Hommage à Jean-Victor Louis*, Vol. II, Éditions de l’Université de Bruxelles, Brussels 2003, p. 313.

<sup>456</sup> In the theoretical reconstruction of B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, *op. cit.*, p. 110, the *ex post* accountability comprises different components, namely (i) reporting requirements, (ii) regular statutory hearings of central bank representatives before political bodies, (iii) the power of political bodies to demand appearances, (iv) and inquiries into policy matters. All this applies to the ECB.

<sup>457</sup> These are the fundamental questions examined by C. WYPLOSZ, in his intervention on *Democracy and the Central Banker’s Accountability*, in *Colloque du Bicentenaire, Indépendance et Responsabilité, Évolution du Métier de Banquier Central*, Paris, Banque de France, 2000, pp. 275 and ff.

implementation of the single monetary policy, is at the centre of attention. The Treaty itself provides a yardstick, the maintenance of price stability, against which the Eurosystem's actions should be measured.<sup>458</sup> However, in order to further clarify this mandate, and also to facilitate the external evaluation of the Eurosystem's performance, the ECB has adopted the above-described quantitative definition of price stability. In any case, beyond being accountable with reference to its success in fulfilling its primary objective, the Eurosystem is supposed to be held accountable also in relation to its other tasks. Not least in the dialogue with the European Parliament, it happened that the ECB was called upon to explain its actions and decisions, *inter alia*, relating to payment systems, euro banknote design and production, etc.<sup>459</sup>

Second point to be discussed is: accountable to whom? As the currency is one of the most pervasive components of the social system, and given that price stability is a public good, it should be clear that the Eurosystem is, in the broadest sense, accountable to the European citizens at large.<sup>460</sup> The fact that the European citizens

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<sup>458</sup> As a general rule, central bank performance can be assessed by observing the concrete results of its policies, with a specific look at the inflation statistics. Given the time lag between the setting of monetary policy and its actual effect on price levels, however, observation of the latter enables the observer to assess actions taken about two years earlier. This, of course, is of little interest to market participants and the public at large. Moreover, as pointed out by L. BINI-SMAGHI and D. GROS, *Is the ECB Sufficiently Accountable and Transparent?*, *op. cit.*, p. 4, other further elements complicate the exercise of accountability. It should be recalled, in fact, that inflation is a "monetary phenomenon in the long run, but not at each and every point in time. In the short run inflation is dominated by a number of other variables, such as labour costs, import prices and taxes, which are beyond the control of the central bank and are difficult to forecast". As a result, "the central bank can thus not be held accountable for temporary deviations from price stability, which are not due to its own behaviour". The underlined element has to be taken into account, but it has to be – at the same time – counterbalanced by the consideration that not always market participants know if such deviations are temporary or not, and whether they are due to monetary factors or to some other causes.

<sup>459</sup> In any case, it should be stressed that, despite the general principle highlighted in the text, given the vagueness of the Treaty about the other objectives besides price stability, the ECB has the tendency to interpret this to mean that it has to pursue only price stability. All reference to other objectives has been basically dropped, if and where possible. As a result, the ECB has drastically restricted the domain of responsibilities about which it can be called accountable. If the ECB's interpretation of the Treaty is left unchallenged, the ECB will be able to claim that its only responsibility is inflation, and that it cannot be made responsible for business cycle developments and movements in employment. This strategy, if successful, will make the ECB accountable only for its performance in the area of inflation. The contrast with other central banks is huge. The Fed, for instance, has been made responsible by law for movements in employment. There is no way it could decide on its own that the employment objective is out of its responsibility, the way the ECB has done. As a consequence, the area of responsibilities about which the Fed is accountable is much broader than the ECB's.

<sup>460</sup> According to W. DUISENBERG, *Central Bank Accountability for Monetary Policy*, *op. cit.*, p. 272: "in a democratic society, the public and its elected representatives should have the opportunity to scrutinise the design and implementation of important public policies by independent bodies. In the

place their trust in the Eurosystem to safeguard the currency and to defend their savings makes them the ultimate addressee of the Eurosystem's accountability.<sup>461</sup>

Having in mind what has been just argued, one can apply to this case a famous statement of the German Constitutional Court in its Maastricht judgement, according to which "it is part of the unassailable content of the democratic principle" (...) "that the carrying-out of State functions and the exercise of State powers is derived from the people of the State and the persons doing so are fundamentally answerable to the people".<sup>462</sup> This implies that for any body in order to be in conformity with the principle of democratic organisation, it is necessary to be both legitimated by and fundamentally answerable to the people.

In particular, in the political order of the European Union, the only institution that directly derives its role and legitimacy from the citizens is the European Parliament. Irrespective of the county and constituency where he or she was voted, each member of the European Parliament has been elected to pursue the European public interest, just as parliamentarians of Member States are entrusted with the national interest. The European Parliament is the institution of Europe's democratically elected representatives, which represents the interests of the peoples of Europe. This is why accountability quite appropriately relates, first and foremost, to the European Parliament<sup>463</sup> and the dialogue between the ECB and the European Parliament represents the principal means to exercise accountability.

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context of monetary policy, central bank accountability is therefore an essential element in a democratic society".

<sup>461</sup> "By virtue of the democratic principle, the holding and exercise of political authority – power of people over people – is not justifiable in itself, but authority must be derived from the people, who are the ultimate bearer of this authority. The performance of public tasks, therefore, needs to be legitimised by the people itself" (B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, op. cit., p. 89).

<sup>462</sup> BverfGE 89, 155, translation in CML Rev (1994), 255.

<sup>463</sup> It is though worth specifying that all European institutions are supposed to be accountable for their action, and not only the European Parliament There is an interesting article by V. MEHDE, on the *Responsibility and Accountability in the European Commission*, in CML Rev. 40, 2003, pp. 423-442, where the two above-mentioned concepts of responsibility and accountability are accurately analysed. With specific regard to the position of the European Commission, the author quotes an interesting excerpt taken from the *First Report on Allegations of Fraud, Mismanagement and Nepotism in the European Commission*, written by the Committee of Independent Experts on 15 March 1999, where it is argued that "the responsibility of individual Commissioners, or of the Commission as a body, cannot be a vague idea, a concept which in practice proves unrealistic. It must go hand in hand with an ongoing process designed to increase awareness of that responsibility. Each individual must feel accountable for the measures he or she manages" (...) "The temptation to deprive the concept of

As thoroughly highlighted in the ECB Annual Report, 1999, within the network of the ECB's relations with Community institutions and bodies, the close links with the European Parliament occupy an essential position. In fact, the European Parliament plays a crucial role in holding the ECB accountable for the conduct of monetary policy. The policy decisions of the ECB, aimed at achieving its objective, affect the lives and welfare of millions of EU citizens. In a democratic society, such decisions must be subject to the scrutiny of the citizens or their elected representatives. In this vein, the ECB's relations with the European Parliament should be seen as more than just a statutory requirement. Rather, the appearances of the President and of other members of the Executive Board of the ECB at the European Parliament also help to safeguard the public acceptance of the ECB's independent status. Therefore, it should definitively be in the ECB's enlightened self-interest to nurture such relations.

As already pointed out, ensuring accountability is, by definition, an *ex post* exercise. Indeed, the European Parliament's role *vis-à-vis* the ECB is clearly focused on a retrospective consideration of the ECB's policy actions. The ECB, for its part, undertakes to explain and justify its decisions in detail. Although the ECB may inform the members of the European Parliament of forthcoming initiatives, respect for the ECB's independence implies that it would be unlawful to exert political pressures of any kind.

As a rule, the President of the ECB reports four times a year to the Committee on Economic and Monetary Affairs of the European Parliament on the ECB's monetary policy and related issues. These presentations are followed by an open discussion with the members of the Committee on a variety of issues. Other members of the Executive Board of the ECB may also report to the Committee on Economic and Monetary Affairs and have already done so on specific topics ranging from aspects of the Euro 2002 Information Campaign to the external representation of the Community within the context of EMU. In addition, the ECB presents its Annual Report – which covers the activities of the ESCB and the Eurosystem and the monetary policy of both the previous and the current year – to the European Parliament in line with Article 113.3 of the Treaty. Finally, the European Parliament

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responsibility of all substance is a dangerous one. That concept is the ultimate manifestation of democracy" (Ibidem, p. 429).

must be consulted on the nominations for the positions of President, Vice-President and the other members of the Executive Board of the ECB and conducts hearings to this end.<sup>464</sup>

Beyond that, complying with its reporting requirements, the ECB is also engaged in a dialogue with all the bodies that play a role in the European political process: the Council of Ministers and the European Commission in the first place,<sup>465</sup> but also the Economic and Social Committee.<sup>466</sup> The ECB participates in meetings of

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<sup>464</sup> See *supra* footnote 218.

<sup>465</sup> As a matter of fact, the European Commission plays a pivotal role in the management of Community affairs. Given its core statutory functions, *inter alia* as the initiator of Community policy and as the guardian of the EU Treaties, the European Commission is naturally also involved in the dialogue between the ECB and the Ecofin Council. The Commissioner responsible for Economic and Monetary Affairs attends Ecofin Council meetings. Furthermore, a member of the European Commission is entitled, in accordance with Article 113.1 EC Treaty, to participate in meetings of the Governing Council of the ECB, and this has regularly been the case.

In addition to this policy dialogue at the highest level, the European Commission and the ECB also maintain close working relations, which are reinforced by frequent contacts, both in multilateral settings, such as the Economic and Financial Committee or the Economic Policy Committee, and in bilateral meetings. This contact is particularly important given the central role that the European Commission plays in the process of economic policy-making in the European Community. In particular, the European Commission is entrusted with a number of specific tasks relating to EMU. These include the formulation, each year, of a recommendation for the Broad Economic Policy Guidelines, monitoring and reporting to the Ecofin Council on the budgetary situation in the Member States, and the preparation, at least once every two years, of a convergence report examining the fulfilment of the Maastricht criteria by those Member States which have yet to adopt the euro. Moreover, the European Commission has initiated or is involved in a wide variety of specific activities, which are either related to the introduction of the euro or have implications for the conduct of the ECB's monetary policy. In many cases, such activities can often benefit substantially from or even necessitate the direct involvement of the ECB. In the area of statistics, for example, the European Commission (Eurostat) and the ECB co-operate closely on matters of common interest, such as the development of common statistical standards and reporting. In other areas, too, the ECB is involved in a number of specialised working groups established under the aegis of the European Commission. Such groups deal with topics as varied as financial markets integration, prudential supervision and financial stability, and also issues related to the changeover to the euro banknotes and coins.

Finally, with regard to the process of EU enlargement, the European Commission and the ECB are in close co-operation, with the ECB being consulted on those issues which relate to its competences and expertise.

<sup>466</sup> Despite such a plurality of parties involved in the "accountability's game of the ECB", it has to be borne in mind that there is a significant difference between the situation characterising the Community level and the national level. In fact, monetary policy viewed in the traditional, national sense includes balancing the parliament and the government on the one hand and the central bank on the other. On the contrary, in the European Union the ECB has no equivalent counterpart. The independence of the ECB is further strengthened by the fact that it does not interact with just one, but with several national governments which also means that political pressure remains weaker than in a national environment. On this point see P. LEINO, *The European Central Bank and Legitimacy. Is the ECB a Modification of or an Exception to the Principle of Democracy*, *op. cit.*, notably at p. 7, according to whom the ECB, having to deal with several partners - such as the European Parliament and the Ecofin Council which both represent national interests, and the European Commission, which represents "a vaguely defined Community interest" -, is in a much stronger position, given that all these counterparts cannot properly mobilise an influential political pressure. It is as if the dialogue between the ECB and its interlocutors were fragmented and, as a consequence, becomes less authoritative in terms of accountability.

the Eurogroup, the Ecofin Council. In return, the President of the Ecofin Council and a member of the European Commission have the right to attend the meetings of the ECB Governing Council. The Eurosystem also reaches out to other relevant groups in society, such as the social partners, by joining, for example, the discussions of the Macroeconomic Dialogue. These contacts allow the ECB to explain its decisions, to share its analysis and to receive political feedback and thus be connected to the European political process. At the national level, the national central banks also relate to their national parliaments and entertain links of communication with their governments.<sup>467</sup>

All these kind of connections between the ECB and the institutions and bodies of the Community, which are aimed at an exchange of views and policy dialogue, can be also justified on functional grounds. Indeed, working relations between the ECB and other policy-making bodies within the EU are necessary for the proper fulfilment of the Eurosystem's tasks with a full respect of the democratic principles. This is self-evident for all those tasks in respect of which the Eurosystem shares its competences with Community bodies. In these cases, the Treaty calls for co-operation between the ECB and the institutions or bodies concerned. However, the ECB also has an interest in fruitful dialogue with other policy-makers with regard to the single monetary policy, which is defined and implemented under its exclusive competence. This interest derives from the co-existence of a single and indivisible monetary policy and decentralised economic policy-making. The ECB has the monetary policy instruments required for the maintenance of price stability in the medium term. However, important variables that have an impact on price developments within the euro area economy in the short term are influenced by other economic policy-makers, which operate predominantly at the national level, such as governments or social partners. Regular dialogue between the ECB and other policy-making bodies provides an opportunity to explain the course of monetary policy and to improve external understanding of the ECB's activities. Such exchanges of view are, in fact, of mutual interest, since knowledge of the reasoning behind the ECB's policy decisions can be an essential input into the decisions of other policy-makers. In this respect, the ECB

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<sup>467</sup> In addition to the direct communication with the political decision-making bodies, all the statements and publications of the ECB form a natural additional information channel to the politicians. For instance, the Monthly Bulletin, and its editorial, can be considered very important for the whole euro area. Beyond that, the NCBs produce their own statements and publications for their national audiences that complement the euro area-level information.

can provide a reliable anchor and reference parameter for the decisions of individual actors, with the aim of stabilising inflation expectations.

It can be concluded that the Eurosystem thus fulfils its accountability obligation, *inter alia*, by way of a comprehensive dialogue with political bodies.<sup>468</sup> Since Eurosystem officials take to explaining and justifying decisions *in persona*, the ECB follows a path that differs from other central banks that have chosen to publish the minutes (and in some cases also the voting record) of the meetings of their decision-making bodies.<sup>469</sup> There are a number of good reasons for the Eurosystem's choice. For instance, the extended statements and press conferences given by the ECB President in the immediate aftermath of Governing Council meetings can be considered a more appropriate means to explain and justify the policy decisions. This is because the Eurosystem conveys its message in real-time and is thus in a position to send a timely signal to the markets and the media as well as to the public at large. The *ex post* justification and explanation of decisions as contained in published minutes usually become available after a number of weeks, i.e. at a time when the relevant action in the markets is already matter of the past. As for the publication of the voting record, the Eurosystem is opposed to this proposition, not least in order to shield the members of the Governing Council from undue influence from the Member States. On this point it can be even argued that "a publication of votes harbours the danger of

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<sup>468</sup> According to J.-V. LOUIS, Book Review of Barbara Dutzler, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien, 2003, in CML Rev 41, 2004, p.893, "the ECB has engaged an impressive campaign of communication. It has developed a kind of "monetary dialogue" with the Parliament that is without precedent in the relations of a central bank with a parliament. This evolution should be closely followed because a new form of accountability is growing far beyond what the authors of the Treaty had in mind when providing for reporting obligations of the ECB". On the same line of reasoning, cfr. F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et "Accountability Délibérative"*, in Cahiers de Droit Européen, No. 5-6, 2003, pp. 549-595.

<sup>469</sup> This is particularly evident in the case of collegial decision-making bodies. In the United Kingdom, for instance, where the principle of individual accountability is applied, the necessity to publish the minutes is understandable.

As far as the ECB is concerned, the fact that the minutes are not published gives rise to one of the main criticisms in the context of accountability. In any case, it should be considered that if detailed minutes and voting records were published, the discussions of the collegial Governing Council would certainly become less frank and open-minded. In the view of S. HÄMÄLÄINEN, *The ECB's monetary policy – accountability, transparency and communication*, *op. cit.*, p. 5, "there would be a risk that the necessary euro area-wide thinking of the individual members of the Governing Council would be discouraged if they were subject to pressure from the domestic public". Besides that, there would be a further risk of drawing undue attention to perceived differences between the views of individuals rather than to the actual monetary policy analysis.

encouraging an interpretation of the Governing Council as a collection of national factions”.<sup>470</sup>

It is encouraging to observe a growing recognition and appreciation for the Eurosystem’s distinct method of accountability, which derives not only from the specificity of its institutional profile, but also from the environment in which it is embedded. It should be clear, in fact, that the Eurosystem neither operates in an institutional vacuum, nor is it supposed to do so. Being held accountable should not a burden for the Eurosystem, on the very contrary it should be seen as a safeguard. “It is through discharging its accountability tasks, through exchanges of views and opinions within the European public sphere, including open criticism and controversy, that the Eurosystem can earn its independence every day, and grow in stature”.<sup>471</sup>

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<sup>470</sup> T. PADOA-SCHIOPPA, *An Institutional Glossary of the Eurosystem*, *op. cit.*, p. 6.

<sup>471</sup> *Id.*, *op. cit.*, p.7. Such a target can be achieved by greater transparency. Given its high degree of independence, the ECB should in fact be more transparent than other central banks. On this point, namely the importance of empowering transparency and communication, see A. BLINDER, C. GOODHART, P. HILDEBRAND, D. LIPTON and C. WYPLOSZ, *How do Central Banks Talk?*, ICMB. International Center for Monetary and Banking Studies, Geneva, 2001.

## CHAPTER SIX

### *MONETARY SOVEREIGNTY AND ITS EXTERNAL DIMENSION*

(...) “due to the political obstacles facing participation and representation of the Euro area in international monetary and financial organisations, conferences and caucuses, the international projection of the euro is *Zukunftsmusik*”\*

#### *1) What external voice for the euro?*

In the previous chapters interest focused on the internal *modus operandi* of monetary sovereignty, mainly seen as an attribution of the ECB in the definition and implementation of the single monetary policy of the Community. This chapter moves further taking a look at the external dimension, with the aim to highlight some differences which take place at this level and which may be considered so highly significant to determine a shift in the on-going theoretical investigation on the concept of monetary sovereignty, while leading to surprising conclusions.<sup>472</sup>

To begin with, it is worth clarifying the reason why the external dimension of the EMU and the role of the ECB at the international level deserve specific attention.<sup>473</sup> First of all it has to be recalled that the introduction of the euro was not

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\* J.-V. LOUIS, *The Economic and Monetary Union: Law and Institutions*, CML Rev 41, 2004, p.606.

<sup>472</sup> On the same line of reasoning see. A. MALATESTA, *La Banca Centrale Europea. Gli aspetti istituzionali della banca centrale della Comunità europea*, Giuffrè, Milano, 2003, pp. 217 and ff.. The author, on this point, argues that in the field of external relations in monetary matters one may devise a real shift affecting the main perspective which characterises the conceptualisation of monetary sovereignty of the ECB in terms of absolute dominance and centrality of this subject in the internal sphere. Interestingly enough, as it will be clarified in the following, the subject supposed to have the final say in the external relations on behalf of the Community is the Ecofin Council, while the ECB's role is limited and weak.

<sup>473</sup> This view is shared by S. CAFARO. *Unione Monetaria e coordinamento delle politiche economiche. Il difficile equilibrio tra modelli antagonisti di integrazione europea*, Giuffrè, Milano, 2001, notably pp. 275 and ff., who begins her analysis of the international personality of the Community after the EMU pointing out that “a fronte di una reale sovranità monetaria della Comunità, sia formale che sostanziale - cui corrisponde un elevato grado di istituzionalizzazione - è legittimo domandarsi che riflesso questo potrà avere sul piano delle relazioni internazionali. ovvero sulla capacità della Comunità

only the product of a project due to exert its influence among the participating Member States. The single currency was certainly created with the aim of providing economic benefits for the participant countries while further cementing European economic integration and containing the power of the Bundesbank,<sup>474</sup> nevertheless, there is an additional rationale to be taken into account, namely the empowerment of Europe on the international stage and the raising of its stature in global economic diplomacy. As already outlined at the outset, EMU, after all, was intended to enable the European Union to meet the challenges of globalisation.<sup>475</sup> EMU, and the economic convergence it has inspired, is certainly one of the most important and promising developments in the international monetary system in recent decades. For prospective members, the drive toward EMU has provided strong incentives to strengthen domestic economic policies and to begin addressing deep-rooted structural problems. “For the EU as a whole, EMU will help reinforce monetary stability and cement economic integration. And for the world, EMU holds out the promise of a strong new pillar for the international monetary system”.<sup>476</sup> For all of these reasons, EMU is a momentous and, indeed, historic enterprise, implying – as already seen - a significant transfer of monetary sovereignty from the national to the supranational level. Anyway, what matters stressing here is that such a transfer of sovereign rights was supposed to express itself both in the *forum internum* and in the *forum externum*, meaning that also the right to impose exchange control regimes, uphold restrictions on the movements of capital and current payments and decide upon the mechanism to determine an exchange rate are issues to be taken seriously into account to appreciate the content of monetary sovereignty.

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di concludere accordi monetari, in particolare di cambio, e di rappresentare I Paesi dell'euro nelle istanze internazionali specialmente vocate a gestire questioni monetarie e finanziarie” (Ibidem, p. 275).

<sup>474</sup> See W. SANDHOLTZ, *Choosing Union: Monetary Politics and Maastricht*, in *International Organization* 47, 1993, pp. 1 – 39; A. MORAVCSIK, *The Choice for Europe*, Ithaca, New York, Cornell University Press, 1998; K. DYSON and K. FEATHERSTONE, *The Road to Maastricht: Negotiating Economic and Monetary Union*, Oxford, Oxford University Press, 1999; K. R. McNAMARA, *The Currency of Ideas: Monetary Politics in the European Union*, Ithaca, New York, Cornell University Press, 1998.

<sup>475</sup> F. SNYDER, *Governing Economic Globalization: Global Legal Pluralism and European Union Law*, *op. cit.*; ID., *Globalisation and Europeanisation as Friends and Rivals: European Union Law in Global Economic Networks*, European University Institute Working Paper, Department of Law, 1999, n. 8. See also the Laeken Declaration of 2001 where it is suggested “the EU should shoulder its responsibilities in the governance of globalisation”.

<sup>476</sup> M. CAMDESSUS, *EMU and the euro: Ensuring a Successful launch*, in P. R. MASSON, T. H. KRUEGER and B. G. TURTLEBOOM (eds.), *EMU and the International Monetary System*, International Monetary Fund, Washington D.C., 1997, p. 482.

In fact, these being the issues to be faced in the exercise of monetary sovereignty in *foro externo*, it should be also highlighted that, within the institutional set-up of the EMU, it was hoped that the euro could offer an alternative to the hegemony of the US dollar and transform the international system from a unipolar, American-dominated structure into one in which Europe constituted a power equal to the US. "As the euro is very close to the dollar as to the size of the underlying economy and the volume of trade and finance, many commentators including the IMF, the Commission and the Bank of International Settlement expect a shift in the currencies held and used from the dollar to the euro".<sup>477</sup> Moreover, as a trade invoicing currency, the euro should extend its role beyond direct trade relations. Given the stability oriented policy of the ECB and Member States fiscal policies aimed at sound public finances, the euro is meant to play an important role in financial portfolio's world-wide, and as a major reserve currency.<sup>478</sup> Currency may be, in fact, one instrument of international power.<sup>479</sup>

The question of the international power of Europe is thus an important and hotly debated one. The EU is already one of the two most powerful actors in the world in the realm of trade, and it wields considerable influence in international trade negotiations. In foreign and security policy – still one of the most powerful symbols of sovereignty and statehood -, by contrast, progress towards a unified stance has been very slow up to now. Nevertheless, it should be bear in mind that recently the Draft Treaty establishing a Constitution for Europe – submitted to the European Council in July 2003 (CONV 850/03) –, if and when approved and ratified, might bring about

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<sup>477</sup> N. WEINRICHTER, *The World Monetary System and External Relations of the EMU – Fasten your safety belts!*, available at <http://eiop.or.at/eiop/texte/2000-010.htm>, p. 2. See on this point also S. EVERTS, *Economic and Monetary Union: A Test for US-European Relations*, *The International Spectator*, Vol. XXXIV, No. 4, October-December 1999 and J.-V. LOUIS, *Les relations internationales de l'Union économique et monétaire*, in *Colloque de Bordeaux, Droit international et droit communautaire, perspectives actuelles*, Paris, Pedone, 2000. The author argues that : «le rôle du dollar, en tant que monnaie du commerce international et monnaie des émissions internationales, ne peut que se voir affecter par la survenance de la nouvelle monnaie de l'ensemble européen» (p. 387).

<sup>478</sup> See on this point P. BEKX, *EMU: The International Dimension*, available on internet at [http://www.ecu-activities.be/publication/1999\\_1/bekx.html](http://www.ecu-activities.be/publication/1999_1/bekx.html)

<sup>479</sup> J. KIRSCHNER, *Currency and Coercion: The Political Economy of International Monetary Power*, Princeton, Princeton University Press, 1995; N. WEINRICHTER, *The World Monetary System and External Relations of the EMU – Fasten your safety belts!*, available at <http://eiop.or.at/eiop/texte/2000-010.htm>; G. ALOGOSKOUFIS and R. PORTES, *The Euro, the Dollar, and the International Monetary System*, in P. R. MASSON, T. H. KRUEGER and B. G. TURTELBOOM (eds.), *EMU and the International Monetary System*, International Monetary Fund, Washington D.C., 1997, pp. 58 – 78.

some significant developments in this matter.<sup>480</sup> Still, as a matter of fact, many observers often refer to the EU as an “economic giant but a political dwarf”,<sup>481</sup> meaning that to a certain extent “the hour of Europe” is not yet here, and the road toward becoming a superpower is tremendously difficult.<sup>482</sup>

*Rebus sic stantibus*, several questions related to the present investigation arise: where does monetary integration fit into this picture? Will the euro bring about a new stage in the evolution of the EU towards a more complete international actor with real influence? Will the internally realised monetary power of the ECB be accompanied – sooner or later – by a political influence to be exercised especially in the field of external relations? Is the configuration of “internal” monetary sovereignty meant to be mirrored at the “external” level? And finally: who can be legitimately be viewed as the bearer of monetary sovereignty when external relations are at stake?

To answer these questions it has to be highlighted again, for the sake of clarity, that the nations participating in Economic and Monetary Union in Europe have made the dramatic step of giving up their national currencies and their monetary sovereignty, but they have not proved willing to relinquish their national sovereignty

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<sup>480</sup> In particular, the proposal contained in the Draft Treaty establishing a European Constitution (Article I-27) for the Common Foreign and Security Policy, foreseeing the creation of a Union Minister for Foreign Affairs, has attracted a great deal of attention.

For an elucidating and detailed analysis of the key changes contained in the Draft Constitution, cfr. M. CREMONA, *The Draft Constitutional Treaty: External Relations and External Action*, CML Rev 40, 2003, pp. 1347-1366, who underlines the *ratio* of these changes as an “attempt to create an institutional structure in the hope that unity will emerge and foreign policy weight in the world increase” (Ibidem, p. 1352). For the sake of clarity, some of the above-mentioned changes can be summarised as follows: (i) the bringing of the CFSP and Common Security and Defence Policy under the umbrella of “Union External Action”, alongside the common commercial policy, development policy, and other external policies of Community origin; (ii) the merging of the roles of High Representative for the CFSP and the Commissioner for External Relations into one office, the Minister for Foreign Affairs, who will be both Chair of the Foreign Affairs Council and a Vice-President of the Commission; (iii) the removal of the current CFSP instruments (common strategies, common positions, joints actions) in favour of one single type of instrument, the European decision, which is a binding but non-legislative act (cfr. Article I-32.1 of the Draft Treaty); (iv) some extension of qualified majority voting; (v) the extended provisions on the common security and defence policy, including provisions for enhanced co-operation in various forms.

<sup>481</sup> I. RAMONET, *Un nain diplomatique*, *Manière de voir* (Special Issue on *L'euro sans l'Europe*), No. 61, Janvier – Février 2002, p. 6, who rightly observes that “le vrai test d’une volonté de l’Europe d’exister par elle-même et aux yeux des tiers est sa capacité à parler d’une seule voix dans les grandes affaires du monde. Faute de quoi, elle ne sera qu’une zone d’intégration économique et financière, elle-même simple region de la mondialisation libérale”.

<sup>482</sup> G. MARIN THORNTON, *The Future of European Union External Relations: From a “Pass-the-Buck” Strategy to a Common Voice*, Jean Monnet/Robert Schuman Paper Series, Vol. 1, No. 7, September 2002.

over its external face.<sup>483</sup> Instead, the challenges of international monetary management in fora such as the G7 and the IMF are met with a plurality of voices (instead of a single voice) on the part of European States that retain national policy representation despite their shared currency. It can be argued that as long as no single voice has the political authority to speak on behalf of the euro area, as the US secretary of the Treasury does for the American currency, the pre-eminence of the US in international monetary matters, as in other realms, is likely to remain unchallenged.<sup>484</sup>

Creating a single voice for the euro is a perilous political endeavour, which explains why Member States have so far avoided the issue. Deciding who will speak on behalf of the euro in international monetary fora raises a host of critical questions, which will be taken into account in this chapter. First, is it even necessary to have a single international voice for the euro? If so, why did the Maastricht Treaty not determine precisely how to reconcile the different, and some times contradictory, interests of the Member States into a common position in international monetary negotiations (despite the provision of Article 111)? And in the future, what potential balance between national sovereignty and collective international power could the EU Member States agree on to settle the question of who or what – the European Commission, the Council of Ministers, the European Central Bank – should be representing the interests of the euro zone as a whole? The answers to these questions have implications for the broader political and constitutional trajectory of the EU, shedding light on whether EMU will tip the balance between a federal vision of Europe and a vision of a looser collection of sovereign Member States.

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<sup>483</sup> See on this point the considerations of J.-V. LOUIS, *Les relations extérieures de l'Union économique et monétaire*, Paper presented at the Symposium “*The European Union as an Actor of International Relations*”, organised by the Universities of Macerata and of Camerino (Italy), 5-7 April 2001, where the author recalls “la résistance des Etats à la pleine expression sur le plan externe du transfert de compétences réalisé sur le plan interne. C’est un phénomène qui se manifeste dans d’autres domaines. Ici, la question est plus sensible parce que, comme pour la politique étrangère et de sécurité commune, il s’agit de sujets qui sont considérés comme faisant partie du noyau dur de la souveraineté”. Similarly, B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien/New York, 2003, p. 51, who points at « the reluctance of the Member States to give up their traditional prerogative of exchange rate policy setting ». This situation of reluctance/resistance has led, as it will be specified in the text, to the deep involvement of the Council as the Community policy-making body in this matter.

<sup>484</sup> Cfr. M. WALZER, *The euro: why it's bad for the dollar but good for America*, in *World Policy Journal*, 15, 3, Fall 1998, pp. 1-12; S. EVERTS, *The impact of the euro on transatlantic relations*, London, Centre for European Reform, 1999.

## 2) *A single voice for the euro as an instrument of power for the EU*

And again a preliminary question. Is it possible to have a unified currency with no unified international representation? Or, in other words: is it conceivable to have a fragmentation in monetary sovereignty so to perceive, in *foro interno*, a unified set of powers in the hands of the ECB and, in *foro externo*, a plurality of policy-makers acting on the international stage?

This section analyses what a single voice for the euro implies in terms of international power, and makes comparisons with other areas of common policy-making which have an external dimension, most notably trade.

The central question to start with is: why is a single voice needed? First of all one may argue that a single voice for the euro is needed to defend its value on exchange markets<sup>485</sup> and to influence decisions on a range of broader macroeconomic policy issues, such as international policy co-ordination over fiscal, monetary and exchange rate policy, the construction of a new financial architecture or the management of financial crises. The contexts in which these issues are played out most prominently are the G7 and the IMF.

Speaking with a single voice on these exchange rate and macroeconomic policy issues may be attractive to the EU States for three main reasons. First, a single European monetary voice may be better able to promote the public good of international stability and contain financial crises at the systemic level. Second, in order to fully achieve their own national economic and political goals, EU member countries may require instruments of multilateral co-operation at the international level, tools that may be more effectively wielded by a unified actor. For example, in the event of a financial crisis, the EU will be better able to protect its own investors by participating effectively in the IMF as a stabilisation package is developed; or again, should the EU States decide that it is in their interest to pursue a fixed exchange rate

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<sup>485</sup> On this point it has to be clarified that the issue at stake here is the external aspect of monetary policy, which, as such, mainly concerns the value of the currency in relations to other currencies. This stability of the currency in terms of its external value may have a bearing upon its internal stability. Yet, as stressed by R. SMITS, *The European Central Bank. Institutional Aspects*, Kluwer Law International, The Hague, 1997, p. 367, the two are not the same. In fact, "as guardians of the currency, central banks may, in case of conflicts between the two sides of the coin, give more weight to the internal stability, i.e. the absence of inflation in the national economy. In the European context, this is certainly what is required as the external and internal aspects of monetary policy are geared towards the maintenance of price stability".

agreement with the US, developing such an arrangement will be easier if the euro States can speak with one voice. Finally, the third reason for developing a single external voice for the monetary union lies in the potential for successful international representation to project the image of a unified, strong Europe to key international political and financial actors.

Moreover, important concerns remain about the loss of sovereignty in international economic fora that is an inevitable corollary of the need to merge divergent national policy positions into a coherent unified policy. States lose the freedom and flexibility to set their own policy goals, and in creating a common position may not be able to achieve their own respective priorities. The costs become clearer when one considers the particular settings in which the EU States have historically been represented as national sovereign entities, such as the IMF where the introduction of the euro has created tensions in the continuation of this tradition. Because of these conflicts, monetary union was launched on 1 January 1999 with the question of the EU's external financial representation unresolved. Most notably, the twelve euro zone countries today continue to be represented individually in the IMF while participating in numerous administrative groupings, several of which include non-EU States. In the more informal G7 forum, only three of the twelve euro zone countries (France, Germany and Italy) are members alongside the US, Japan, Canada and the UK.

These unresolved tensions between some sort of resistance of national sovereignty and institutional external representation clearly reflect larger challenges in the EU's political development; and how they are resolved will bear on the future trajectory of the EU in important ways. However, monetary union is not the first policy area in which the EU Member States have been confronted with the issue of acting in concert on the international stage. At the moment similar set of political and institutional challenges persist in the fields of environment, competition, development aid, and foreign and security policies.<sup>486</sup> There is one policy area, however, where

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<sup>486</sup> For the new developments envisaged by the Draft Treaty establishing a Constitution for Europe, see B. DE WITTE, *The Constitutional Law of External Relations*, in I. PERNICE and M. POLARES MADURO (eds.), *A Constitution for the European Union: First Comments on the 2003-Draft of the European Convention*, European Constitutional Law Network-Series, Vol. 4, Nomos Verlagsgesellschaft, Baden-Baden, 2004, pp. 95-106, where the author carefully looks at Part I of the Draft Treaty devoted to the "European Union's external relations", complaining about the dispersion of the different provisions which are not properly organised in a harmonised manner. See also M. CREMONA, *The Draft*

most of these dilemmas have been resolved: international trade. One may thus wonder whether the EU's common commercial policy could provide an institutional template for the euro's external representation.

### 3) *An interesting paradigm: the case of common commercial policy*

Since the inception of the European Community as a customs union with a common external tariffs in 1957, Member States have had to grapple with the question of how to present a common front to the outside world. From unanimity to qualified majority voting, from exclusive Community competence to shared competence between the EU and the Member States, the external trade voice of the Community has been projected through a variety of institutional arrangements, which continue to be the subject of debates even after more than four decades of successful bargaining in international trade negotiations.<sup>487</sup>

As with today's debates over the euro, the founding fathers of the European Community sought to achieve the right balance between national sovereignty and international power when designing the original institutions for representing the Community externally in trade negotiations. Some of the challenges they initially faced in trade policy still exist today in the financial and monetary arena. First and foremost in the need to reconcile into one coherent position the multitude of divergent positions of the Member States. Another related challenge is the desire of national governments to retain some degree of control over the levers of the economy. In the

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*Constitutional Treaty: External Relations and External Action*, CML Rev. 40, 2003, 1347-1366; *Id.*, *The Union as a Global Actor: Roles, Models and Identity*, CML Rev 41, 2004, pp. 553-573.

The basic principles and objectives supporting the new developments related to the EU's external action are aimed at achieving: (i) a more precise delimitation of competences between the EU and the Member States; (ii) the simplification of the Treaties and legislative instruments; (iii) and the efficiency, transparency and democratic accountability of the decision-making process of the different institutions involved. The whole structure provides a legal basis for consistency in external action and between internal and external policy, but – as observed by M. Cremona – “it won't in itself guarantee that consistency”. In practice, this will require a delicate balancing of possibly conflicting objectives and interests. In any case, despite the importance of such innovations, the new developments do not directly affect the area of EMU and its external relations, which keeps on maintain its specificity.

<sup>487</sup> S. MEUNIER and K. NICOLAIDIS, *Who speaks for Europe? The delegation of trade authority in the European Union*, in *Journal of Common Market Studies*, 37: 3, 1999, pp. 477-501, and *Id.*, *Trade competence in the Nice Treaty*, in *ECSA Review*, 14: 2, Spring 2001; K. NICOLAIDIS and S. MEUNIER, *Revisiting trade competence in the European Union: Amsterdam, Nice and beyond*, in M. HOSLI and A. VAN DEEMEN (eds.), *Institutional challenges in the European Union*, London, Routledge, 2002.

trade realm this is evident in, for example, controversies over competition policy. In the monetary realm, fiscal policy becomes a key issue around which questions of sovereignty revolve, remaining within the domestic remit yet impacted upon by EMU.

Despite these similarities between the external role of the EU in trade and in monetary affairs, there are also major differences, which preclude a direct transposition to the monetary arena of the institutional template developed for trade policy. One of these is the time constraint under which the major actors operate. It is quite frequent for trade negotiations to drag on for many years. If the two parties to a trade negotiation cannot come to an agreement, the *status quo* remains. But problems likely to prompt an international financial negotiation carry a quite different sense of urgency. Therefore, financial negotiations demand more timely international co-operation and concerted action, and offer less room for give-and-take and extended negotiating tactics than is found in the trade realm.

Another difference is the number of actors who can have a claim to speak on behalf of the common policy. In the field of trade policy, the longstanding debate on the issue of competence has pitched the Member States (represented by the Council) on the one hand against the Community (represented by the Commission) on the other. The main sources of contention have been the voting rules used to reach an international negotiating mandate and the extent of delegation of authority from the Member States to Commission negotiators.<sup>488</sup> In the monetary and financial area, there is an additional actor with a claim to external representation, namely the European Central Bank. As the ECB is designed to be independent from political bodies at both the EU and the national level, co-ordination with the various actors who have a stake in managing international monetary co-operation becomes even more problematic.<sup>489</sup>

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<sup>488</sup> As far as the involvement of different institutional actors is concerned, note that Article III-217.2 and III-302 of the Draft Treaty establishing a Constitution for Europe are meant to introduce a major change in this area, namely an increased role to be played by the European Parliament. In fact, the CCP is to be implemented by means of European laws or framework laws, which are adopted according to the ordinary legislative procedure (co-decision). Where an agreement is concluded, the European Parliament will for the first time be given the right to be consulted (Art. III-227.7 Draft Treaty). It may be thus argued that the Parliament's consent is required, as the CCP is a field to which the legislative procedure applies. The same logic is applied to the monetary area by virtue of Article 111.1 (conclusion of formal agreements on an exchange-rate system for the euro in relation to non-Community currencies) which grants the same right to be consulted to the European Parliament

<sup>489</sup> Still, as pointed out by W. DUISENBERG, *The role of the ECB at the international level*, Speech by Willem F. Duisenberg at the Annual Meeting of the Institute of International Finance (IIF), Prague, 23

Another difference between the two areas is that, unlike in trade, policy regarding the euro does not include all the EU Member States.<sup>490</sup> Relations between the twelve euro zone States and the three non-participant countries are sensitive in respect of the implications of exclusivity in policy-making beyond the most narrowly defined EMU issues.<sup>491</sup> Britain, in particular, has been wary of allowing a process of policy formulation on topics of fiscal policy and international monetary affairs to deepen among the euro zone States. The degree to which Euroland moves forward as a coherent presence on the international stage could have serious implications for the opt-out States, making agreements on external representation even more difficult.

Finally, a critical difference is that in trade the policy-making competence has been, for the most part, exclusively transferred to the Community level by virtue of the Treaty of Rome. Moreover, both the jurisprudence of the ECJ and the subsequent political tinkering with the competence issue have asserted the principle that external powers are implied by internal powers.<sup>492</sup> In other words, issue areas that have been

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September 2000, available at <http://www.ecb.int/key/00/sp000923.htm>, p. 1, "independence" (...) "does not mean isolation. The Eurosystem, in other words, cannot perform its tasks without establishing appropriate external relations with both market participants and other policy-makers".

<sup>490</sup> To put it with J.A. USHER, *Variable Geometry or Concentric Circles: Patterns for the European Union*. ICLQ 1997, pp. 243-267, the EU is a union of "variable geometry", which means that there is some leeway for differentiation in the Treaties. In particular, EMU is one of the areas in which integration is not uniform, since the euro has not become the single currency of all Member States. For the time being, the UK, Denmark and Sweden have not moved on to Stage Three of EMU, albeit the legal provisions regarding the monetary situation of the three countries are slightly different. Whereas primary Community law ensures that the UK and Denmark are under no obligation to move on to Stage Three of EMU (see Protocol on Certain Provisions Relating to the United Kingdom of Great Britain and Northern Ireland and Protocol on Certain Provisions Relating to Denmark, both attached to the EC Treaty), Sweden only has a derogation under Article 121.1 and 121.3 EC Treaty and is in principle obliged to introduce the euro as soon as it fulfils the convergence criteria. However, following a resolution of the Swedish Parliament of December 1997, Sweden will retain the greatest possible freedom of action regarding future adoption of the euro.

On differentiated integration and EMU see R. SMITS, *The European Central Bank. Institutional Aspects*, *op. cit.*; C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford (namely Chapter 4); J.-V. LOUIS, *Differentiation and EMU*, in B. DE WITTE, D. HANF and E. VOS, *The Many Faces of Differentiation in EU Law*, Antwerp, Oxford, 2001; P. VIGNERON and M.R. MOLLICA, *La différenciation dans l'Union Economique et Monétaire*, Euredia, 2000, pp. 197 and ff.; C. W. HERRMANN, *Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice*, *European Foreign Affairs Review*, Vol. 7, 2002, pp. 1-24.

<sup>491</sup> As pointed out by C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.*, p. 133, for Community law, this situation represents a challenge. It is required to reconcile its claim to uniform, non-discriminatory application throughout the EU with the fact that not all Member States are willing to take part in the single currency. More in particular, "it goes without saying that this challenge is particularly felt in the daily activities of the ECB, which, as a supranational organisation, is responsible for the definition and implementation of the monetary policy of the Community (Article 105.2, second indent, EC), not of a particular group of EU Member States".

<sup>492</sup> This means that exclusive competence will also arise where the conclusion of an agreement is necessary to enable the Union to exercise its internal competence. This is clearly based on Opinion

integrated at the Community level must be defended with a single voice internationally. The common commercial policy is in effect a clear example of this principle at work. Competence in the field of the internal market, including the free movement of goods, is shared, but in order to achieve the internal market objective of removal of internal border controls it is necessary to establish a common commercial policy, and this excludes the maintenance of an autonomous external trade policy by the Member States. In financial and monetary affairs, by contrast, the Treaty of Rome established only that the exchange rate and monetary policies of the Member States should be of common concern, and the Treaty on the European Union provided only a vague direction as to the question of external representation.

Because of the extensive experience accumulated by the EU with respect to international trade representation over the past four decades, the institution for decision-making and negotiating authority in that field seems an obvious place to look for inspiration for the design of the euro's single voice. However, the critical differences between trade policy and financial and monetary affairs mean that the institutional blueprint developed in the field of trade – with its complex design for competence sharing and voting – cannot be simply reproduced for monetary policy. If the EU is to develop a single voice for the single currency, it must strike a new balance between respect for national sovereignty and the need for efficacy and power of the emerging European monetary sovereignty in the international context.

#### ***4) The specificity of EMU: the significance of its external dimension***

As a very first remark, it should be said that for the euro area to become a key player on the international plane requires clarity as regards its relations to other players, be they third countries or international organisations. As a result, “the system of external competences and procedures for their use in the sphere of EMU is thus of paramount importance for the ability of the EU to effectively influence the current

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1/76 as explained by the ECJ in its Opinion 1/94, *Competence of the Community to conclude international agreements concerning services and the protection of intellectual property* (WTO) [1994] ECR, I-5267; 1 CML Rev. 205.

developments of the international financial architecture”.<sup>493</sup> It is also important for the development of the Euro as an international currency and for the further integration of the EU as a polity. However, the Community rules are far from being simple to apply.

EMU implies an economic regime change primarily for the participating countries, the effects to which it gives rise will also have important external implications. Given the economic importance of the euro area – comparable as already stated with those of the USA and Japan -, the introduction of the euro has had significant effects on Member States outside the area as well as on countries outside the European Union.<sup>494</sup>

On the internal side, it is worth taking into account the extent of the powers transferred from the Member States to the Community level,<sup>495</sup> especially in the field of Economic and Monetary Union, with specific regard to the European System of Central Banks. In the field under analysis here, monetary competences were transferred by participating Member States to the Community level at the beginning of the third stage of monetary union on 1 January 1999; in particular – as already outlined -, the new European System of Central Banks has inherited exclusive power to manage central bank money (hence, to conduct monetary policy). In other words, the ESCB (and on its behalf, the ECB) has inherited the power to adopt and issue a

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<sup>493</sup> C. W. HERRMANN, *Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice*, op. cit., p. 1.

<sup>494</sup> As stated by J.-V. LOUIS, *Les relations internationales de l'Union économique et monétaire*, op. cit. : «Les facteurs économique signalés ont évidemment une facette politique. Quel que soit le rythme de l'émergence de l'euro comme monnaie internationale, il apparaît comme un *challenger* du dollar et est ressenti comme tel par les États-Unis. L'événement aura naturellement des répercussions sur les relations commerciales et en matière de sécurité entre ceux-ci et l'Union européenne. Sur le plan interne à l'Union, l'union monétaire appelle des compléments politiques pour renforcer le pôle économique de l'Union européenne et pour faire face aux responsabilités nouvelles de l'ensemble sur le plan mondial » (p. 388).

<sup>495</sup> Case 26/62, *Van Gend en Loos v. Nederlandse Administratie der Belastingen* [1963] ECR 1, 12. See, in particular, the paragraph in which the Court expressly affirms that “the Community constitutes a new legal order of international law for the benefit of which the States have limited their sovereign rights, albeit within limited fields”. As a result of this process, the more sovereign rights have been transferred to the Community level, the less likely it is that the Member States themselves will still appear as autonomous actors in the international arena.

For a close analysis of this aspect, see E. STEIN, *External Relations of the European Community: Structure and Process*, in *Collected Courses of the Academy of European Law*, Volume I, Book I, Kluwer, 1991, 115 – 188). The above-mentioned author distinguishes two different uses of the concept of “transfer of powers”: the first in a horizontal sense and the second in a vertical one, meaning – with the first – the extent, number and significance of the areas of competences that have been transferred in full or in part by the Member States to the supranational institution. In the light of this theoretical approach, it has to be underlined again that EMU is the most important area that realises the effectiveness of the transfer of competences in matters pertaining to economic and monetary policy.

currency – the euro – as a legal tender within the territory under its jurisdiction and regulate the money supply, i.e. the so-called internal monetary sovereignty. Thus, given this devolution of sovereign rights, the legal capacity of the Member States to act on the international arena has been limited accordingly. This is reflected in Article 111 (5) EC Treaty (ex Article 109) that, while providing that Member States may still negotiate in international bodies and conclude international agreements, specifies that this shall be “without prejudice to Community competence and Community agreements regarding economic and monetary union”. As monetary policy has become an exclusive competence exercised solely at the Community level, there is in principle no scope for independent external action by the Member States, whose international legal capacity is thus restricted to those subject’s matters that have not been transferred to the supranational level.<sup>496</sup>

On the external side (which will provide the focus of the following section), the analysis of the issue of the exchange rate regime of the euro *vis-à-vis* third currencies seems extremely interesting, in order to clarify the position of the euro area in the framework of the global monetary system, with a focus on the institutional aspect.

At this point, it seems quite natural to wonder what kind of impact the adoption of the euro as a single currency has had on the world of international and economic co-operation, with all its consequences in the light of the traditional categories of international public law. At first sight it could be answered that there has been a remarkable impact, given the fact that EMU is meant to change the global monetary system, determining an internal division of three main areas (euro, dollar and yen), in reciprocal competition, within the framework of a networked economy. Nevertheless, it has to be also considered that the innovative categories in question are still in a state of flux.<sup>497</sup>

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<sup>496</sup> This is the view of C. ZILIOLI – M. SELMAYR, *The external relations of the Euro area: legal aspects*, (1999) CML Rev., 277. See also S. CAFARO, *Unione monetaria e coordinamento delle politiche economiche. Il difficile equilibrio tra modelli antagonisti di integrazione europea*, p. 328, who argues that one can just identify “una competenza degli Stati Membri a carattere residuale rispetto a quella della Comunità” (emphasis added). As a result the Community competence in external relations is “almost exclusive”.

<sup>497</sup> For this expression, see J.A. CAMILLERI, *Rethinking Sovereignty in a Shrinking, Fragmented World*, in R.B.J. WALKER and S.H. MENDLOVITZ (eds.), *Contending Sovereignities. Redefining Political Community*, Lynne Rienner Publishers, Boulder – London, 1990, notably p. 29. The above-mentioned author incisively states that: “Notwithstanding the steadily upward curve of globalization, the state

Thus, in order to verify this initial statement, interest will focus on the external conduct of the European Community in the sphere of EMU, attempting to shed a light on the different positions of four types of actors actually playing on the stage of the so-called euro area: the Community (and the Council, in particular), the ECB, the Member States and the National Central Banks. Consequently, this chapter will go on dealing with the institutional aspects of central banking in the monetary union and with the changes in the monetary policy function that the passage to Stage Three has determined, with a specific regard to the external dimension of the monetary authority.<sup>498</sup>

### ***5) External competences within the framework of EMU: consequences in the field of sovereignty***

Firstly, it must be highlighted that the external competences in matters pertaining to monetary union do not stand on their own: they are embedded in the general framework of the Community's external powers, as defined by the EC Treaty, the Statute of the European System of Central Banks and of the European Central Bank and the existing *acquis* of Community law on external relations, built through the jurisprudence of the European Court of Justice.<sup>499</sup> Furthermore, the external competences under analysis here are strongly connected with the external aspects of the internal market and of the economic union. That is to say, there are different sources to justify the power of the Community to act *in foro externo*.

A preliminary inquiry on the source and nature of the Community's external competence should be justified on the basis of the consideration that the Community

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remains a critical element in the political equation – but more in the form of a variable than a constant. The equation is complex and in a state of flux”.

<sup>498</sup> For a further study on the institutional and legal aspect of the issue under examination, see R. CHEMAIN, *L'Union Economique et monetaire. Aspects juridiques et institutionnels*, Pedone, Paris, 1996.

<sup>499</sup> P. PESCATORE, *External relations in the Case Law of the Court of Justice of the European Communities*, (1979) CML Rev., 615; TRIDIMAS – EECKOUT, *The External Competence of the Community and the Case Law of the Court of Justice: Principle versus Pragmatism*, Yearbook of European Law, 1994, 143; I. MACLEOD – I.D. HENDRY – S. HYETT, *The External Relations of the European Communities*, Clarendon Press, Oxford, 1996, notably 56 – 74; A. DASHWOOD and C. HILLION, *The General Law of EC External Relations*, Sweet & Maxwell, London, 2000.

itself is built upon the principle of attributed powers and therefore any external Community activity needs a legal basis or a source according to it the precise power in question.<sup>500</sup> Such attribution – according to the jurisprudence of the European Court of Justice -, can in the field of external Community competence be made *expressly* in the Treaty provisions or it can be *implied* from these provisions or from secondary internal legislation adopted pursuant to these provisions.

As far as the express attribution of competences is concerned, it should be recognised that the issue of external competences is dealt with only marginally by the Treaty.<sup>501</sup> There have always been only a few provisions providing explicitly for the competence to negotiate or to conclude public international law agreements (i. e. with a third country or an international organisation) or to participate in international fora. These restricted provisions did not offer sufficient legal ground for the Community's need to act at the international level, the result of the increase of its internal competences following the completion of the common market at the end of the 1960s. Thus, whenever the Community intends to enter into an agreement with a third country or to undertake obligations and assume rights in the context of an international organisation, the question of its power to do so emerges. "In view of the vast areas for which the Community has assumed responsibility, the delimitation of its powers *vis-à-vis* the traditional competences of the Member States became the focal point for judicial decisions".<sup>502</sup> The significance of the latter issue was soon recognised by the ECJ, which, relying on the doctrine of implied powers, developed what is known today as the doctrine of parallelism between internal and external competences, according to which the Community's authority to enter into international commitments

*"may not only arise from an express attribution by the Treaty, but may equally flow implicitly from other provisions of the Treaty and from measures adopted, within the framework of those provisions, by the Community institutions.(...) whenever Community law has created for the institutions of the Community powers within its internal system for the*

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<sup>500</sup> This is clearly expressed in Opinion 2/94, *Accession by the Communities to the Convention for the Protection of Human Rights and Fundamental Freedoms*, [1996] ECR I-1759.

<sup>501</sup> *Contra*, with an express regard to EMU, C. ZILIOLI – M. SELMAYR, *The external relations of the Euro area: legal aspects*, *op. cit.*, 274, who affirm that the EC Treaty, the Statute of ESCB and the *acquis communautaire* "provide clear guidelines to give the euro area a strong, unequivocal voice at the international level".

<sup>502</sup> R. SMITS, *op. cit.*, 369.

*purpose of attaining a specific objective, the Community has authority to enter into the international commitments necessary for the attainment of that objective even in absence of an express provision in that connection*”<sup>503</sup>

It should be noted that the Court not only considered the Community as competent, it also held that its external powers may exclude those of the Member States, i. e. they may be exclusive.<sup>504</sup> Whether this is so, however, must be determined on a case-by-case basis.<sup>505</sup>

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<sup>503</sup> Cfr. Opinion 1/76 [1977] ECR, 741, paragraph 3; and 6/76 *Cornelis Kramer and Others*, [1976] ECR 1279). According to this doctrine (known as doctrine of parallelism), the ECJ has recognised the implied external competences of the Community: with regard to the implementation of the provisions of the Treaty. As a result, the system of internal Community measures may not therefore be separated from that of the external relations, unless two basic requirements are satisfied: (i) the existence of an “inextricable linkage” between the internal measure adopted and the external action to be taken by the Community; (ii) the respect of the criterion of “necessity” with regard to the attainment of the Community’s objectives.

Similarly see Case C-467/98, *Commission v. Denmark*, judgment of 5 November 2002, para.77, where the ECJ confirmed that: “the Community’s competence to conclude international agreements arises not only from an express conferment by the Treaty but may equally flow from other provisions of the Treaty and from measures adopted, within the framework of those provisions, by the Community institutions; that, in particular, each time the Community, with a view to implementing a common policy envisaged by the Treaty, adopts provisions laying down common rules, whatever form these may take, the Member States no longer have the right, acting individually or collectively, to undertake obligations towards non-member countries which affect those rules or distort their scope; and that, as and when such common rules come into being, the Community alone is in a position to assume and carry out contractual obligations towards non-member countries affecting the whole sphere of application of the Community legal system”

For a doctrinal inquiry, see I. MACLEOD, I.D. HENDRY and S. HYETT, *The External Relations of the European Communities*, Oxford University Press, Oxford, 1996; A. DASHWOOD and C. HILLION (eds.), *The General Law of EC External Relations*, Sweet & Maxwell, London 2000; R. HOLDGAARD, *The European Community’s Implied External Competence after the Open Skies Cases*, *European Foreign Affairs Review* 8, 2003, pp. 365-394. For a more EMU-based investigation, R. DEHOUSSE – GEHMAR, *Le traité de Maastricht et les relations extérieures de la Communauté européenne*, (1994) EJIL, 151; BRÜCKNER – LOUIS, *Commentaire Mégret*, Vol. 12, Brussels, 1980.

<sup>504</sup> The Court summarised the notion of “exclusive Community’s competence” in its opinion in the ILO case in the following terms: “*The exclusive or non-exclusive nature of the Community’s competence does not flow solely from the provisions of the Treaty but may also depend on the scope of the measures which have been adopted by the Community institutions for the application of those provisions and which are of such a kind as to deprive the Member States of an area of competence which they were able to exercise previously on a transitional basis*”. Cfr. Opinion 2/91 (*Re ILO Convention 170*) [1993] ECR I – 1061.

As specified by R. HOLDGAARD, *The European Community’s Implied External Competence after the Open Skies Cases*, *European Foreign Affairs Review* 8, 2003, p. 369, there is a general consensus in the literature that two types of exclusivity (*a priori* and ERTA exclusivity) have different rationales. On the one hand, *a priori* exclusive Community competence is necessary because of the nature of the subject matter, regardless of whether the Community has exercised any power in the area in question. If Member States retained competence, this might create distortion within the Common Market also dangerous for the external representation of Community’s interests. On the other hand, the main function of the ERTA exclusivity is to preserve the effectiveness of an existing Community *acquis*, with the view to facilitate a gradual centralisation.

<sup>505</sup> As the Court held in the ERTA Case (Case 22/70) [1971] ECR 263, paragraph 17): “*each time the Community, with a view to implementing a common policy envisaged by the Treaty, adopts provisions*

Consequently, the external competences of the Community may flow from an express provision of the Treaty (such as Article 111 in the case of EMU) or arise implicitly from the Treaty when the Community has exercised its internal powers in the relevant field. When the Community has adopted measures in an area of its competence, the Member States may no longer enter into obligations with third countries that may affect these common rules.<sup>506</sup> The external competence of the Community then arises, not from an express granting of this authority in a specific provision, but from the necessity of protecting the effectiveness of the provision adopted internally. Even in the absence of the adoption of internal rules, the Community may be competent to act externally, should the international act be necessary for the attainment of one of the objectives of the Community.<sup>507</sup> The latter competence is restricted to cases where autonomous action by the Community would not achieve the desired result. On this point it should be also acknowledged that the mere existence of Community legislation in a given area will not necessarily mean that Community competence in that area is exclusive. Even where internal measures have been adopted, there may still be room for the Member States to undertake commitments toward third countries.<sup>508</sup>

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*laying down common rules, whatever form these may take, the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries which affect those rules”.*

<sup>506</sup> This principle, commonly known as the *ERTA principle*, is clearly based on the assumption that the Community's internal legal order would be hopelessly compromised if the Member States were able to undermine Community rules by unilaterally entering into agreements the content of which contradicted the Community rules. The principle that the existence of internal Community legislation has an effect on the external competence of the Member States and, by implication, of the Communities is therefore reasonable, and arguably no more than an application of the principle of the supremacy of Community law over national law.

<sup>507</sup> Opinion 1/76 (*European Laying-up*) [1977] ECR 741, notably paragraph 4. It should be noted that, between the ERTA Case and Opinion 1/76, other decision on the Community's external relations had been made by the Court of Justice, i. e. Opinion 1/75 (*Understanding on a Local Costs Standard*), [1975] ECR 1361, and the judgement in Joined Cases 3, 4 and 6/76 (*Kramer*) [1976] ECR 1279.

<sup>508</sup> See Opinion 1/94 (WTO Agreement), CMLR. 1, 1995, 205, where the Court has affirmed that State external powers may coincide with those of the Community, even in the core area of commercial policy. This decision concerned the conclusion of the WTO Agreement resulting from the Uruguay Round of multilateral trade negotiations.

### 5.1) *The division of external competences in the Economic and Monetary Union*

Given this scenario, it can be legitimately inferred that there is no doubt regarding the international capacity of the Community - either in terms of an exclusive external competence or a shared external competence with the Member States -, in the sense that the Community may be the bearer of rights and duties under public international law. On the contrary, such logic cannot be applied *tout court* to the ECB in consideration of the radically divergent positions of the doctrine that have to be taken into account. The international legal personality of the ECB, in fact, is a hot debated and controversial topic, since the mere interpretation of the Treaty provisions seems to lead different scholars to diverging theoretical reconstructions. According to a pretty consolidated Italian doctrine<sup>509</sup>, Article 107.2 EC Treaty does not confer upon the ECB a legal personality under public international law. The ECB, being the central bank of the Community, cannot and should not be considered as a separate interlocutor with respect to all the other members of the international Community, despite of its recognised independence. Still, there are also different views in the academic debate, which strongly support the idea of a reasonable attribution of international legal personality to the ECB.<sup>510</sup> Namely, in the comparison of Article 107.2 EC Treaty (which simply states that the ECB shall have legal personality, without any further specification) and Article 9.1 ESCB Statute (which deals with the legal personality of the ECB *in the Member States*), it has been argued that the second provision – in parallel to Article 281 and 266 EC Treaty – “can only refer to the ECB’s international legal personality”<sup>511</sup>. This interpretation is supported by Article 105.2, second and third indents EC Treaty, which enables the ECB to conduct foreign exchange operations, and to hold and manage the foreign reserves of the Member States, all tasks which may involve legal contacts with other subjects of international law. Moreover, Article 23 ESCB Statute gives the ECB more specific

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<sup>509</sup> See S. CAFARO, *Unione monetaria e coordinamento delle politiche economiche. Il difficile equilibrio tra modelli antagonisti di integrazione europea*, Giuffrè, *op. cit.*, pp. 320 and ff.; A. MALATESTA, *La Banca Centrale Europea. Gli aspetti istituzionali della banca centrale della Comunità europea*, Giuffrè, Milano, 2003, pp. 224 and ff.; A. TIZZANO, *La personalità internazionale dell’Unione europea*, in ID., *Il Trattato di Amsterdam*, Giuffrè, Milano, 1999, pp. 149 and ff.

<sup>510</sup> See C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.*, notably pp. 179 and ff.; F. DEHOUSSE and E.K. GHEMAR, *Le Traité de Maastricht et les relations extérieures de la Communauté européenne*, Eur. Journal of Intern. Law, No. 5, 1994, pp. 123 and ff.

<sup>511</sup> C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.*, p. 180.

external competences, for example to establish relations with central banks and financial institutions in other countries and with international organisations, and to conduct banking transactions in relation with third countries and international organisations. Finally, as will be specified in the following, Articles 6.1 and 6.2 ESCB Statute explicitly provide for the possibility accorded to the ECB to act at the international level, whenever the tasks entrusted to the ESCB are involved. All these provisions show that the ECB has the competence to act independently at the international level, which may also involve the negotiation and conclusion of public international law agreements.<sup>512</sup> It should be stressed, anyway, that the international legal personality of the ECB is only a derivative one. As a consequence, it is first of all limited to specific fields of tasks, which are entrusted to the ECB by the EC Treaty, which are essentially confined to monetary policy and related matters.<sup>513</sup>

In the light of the above-described framework, having at the same time an international legal personality attributed to the Community, on the one hand, and to the ECB, on the other, it seems clear that the biggest issue at stake is the problem of the division of external competences within the framework of EMU, especially taking into account the “dialogue” between the political and the monetary authorities.<sup>514</sup> Furthermore one should have clear in mind that the exclusive competence in the field

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<sup>512</sup> As recalled by C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.*, p. 181, the international legal personality of the ECB has already been confirmed in two cases: (i) by the Agreement between the ECB and the national central banks of the Member States outside the euro area laying down the operating procedures for an exchange rate mechanism in Stage Three of EMU, dated 11 September 1998 (the “ERM2 Agreement”); (ii) by the conclusion, on 18 September 1998, of a Headquarters Agreement between the ECB and the Government of the Federal Republic of Germany which aims at implementing the Protocol on Privileges and Immunities of the European Communities and thus facilitating the full operation of the ECB at its seat in Frankfurt.

<sup>513</sup> The limited character of the international legal personality of the ECB is strongly highlighted by C.W. HERMANN, *Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice*, *European Foreign Affairs Review*, Vol. 7, 2002, notably at p. 9, where he observes that “it is only the small world of banking operations in which the ECB is recognised as an international legal person with certain powers, stemming from the merely operational tasks it is entrusted with and which, as regards foreign exchange markets, are legally not significantly different from operations of international commercial banks”.

<sup>514</sup> Cfr. C.A.E. GOODHART, *The external dimension of EMU*, in *Recherches Economique de Louvain*, 1993, Vol. 59, 65 – 80. See on this point also S. CAFARO, *I primi accordi della Comunità in materia di politica monetaria e di cambio*, in *Il Diritto dell’Unione Europea*, 2/1999, pp. 243 – 268. Speaking about the peculiarity of the discipline under discussion here, the author observes that: “la politica di cambio è, per così dire, al limite tra le competenze tecnocratiche delle banche centrali e quelle di governo delle istituzioni politiche. Infatti, per quanto costituisca una componente importante della politica monetaria, che è generalmente gestita dalle banche centrali, si riflette inevitabilmente sulla politica estera, campo di azione dei Governi – negli Stati – e principalmente del Consiglio nel sistema disegnato dal Trattato istitutivo dell’Unione europea”. Once again, thus, the issue of the balance of powers between the monetary and the political authority is at stake.

of monetary policy, exercised at Community level in the internal sphere, is – according to the doctrine of parallelism – meant to determine a parallel exclusive competence in external relations.<sup>515</sup> There is, in principle, therefore no scope for any concurrent action of the Member States in this field.<sup>516</sup>

Anyway, in order to properly understand and find a workable solution for the problem of the division of external competences in monetary policy, it would be extremely useful to follow the path traced by Article 111 EC Treaty, which – in particular – may clarify the role played by the ECB and by the Community itself,<sup>517</sup> with specific regard to the conclusion of exchange rate arrangements in respect to third currencies. To this aim it is still worth considering, even if briefly, the historical background against which the division of powers between central banks and States has developed.

To put it clear, it should be recalled the fact that central banks have been only rarely assigned the last word in foreign exchange matters, given the political significance of, and the strategic choices involved in, agreements on exchange rate

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<sup>515</sup> This is the thesis put forward by C. ZILIOLI and M. SELMAYR, *The External Relations of the Euro Area: Legal Aspects*, CML Rev, Vol. 36, 1999, pp. 273-349, who argue that such an exclusive competence does not simply lie with the Community, but is specifically in the hands of the ECB. Their thesis is built upon three strands of argument. Firstly, the authors find the ECB to have international legal personality, albeit relative and limited. Secondly, from the fact that the ECB's competences are laid down completely in primary Community law, the conclusion is drawn that the sovereign powers of the Member States concerning monetary matters have been transferred directly to the ECB. And thirdly, from the independence of the ECB with a view to monetary policy and a double-application of an over-stretched doctrine of implied powers, it is inferred that the ECB is the natural bearer of external competences in the field of monetary policy, since the conduct of external monetary policy is "inseparably linked" to the efficient exercise of domestic monetary policy. *Contra* C.W. HERMANN, *Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice*, European Foreign Affairs Review, Vol. 7, 2002, pp. 1-24.

<sup>516</sup> Anyway, see Article 111.5 which states that: "Without prejudice to Community competence and Community agreements as regards Economic and Monetary Union, Member States may negotiate in international bodies and conclude international agreements".

<sup>517</sup> The interesting perspective offered by this issue stresses the role played by the ECB, even at the international level, as it acts on the basis of a legal personality in its own right, i. e., not as a representative of the Community. As Zilioli and Selmayr note, this is one of the most difficult points to resolve, given the fact that, in this specific dispute of external relations, there is a potential horizontal conflict between the Community and a separate supranational entity with international legal personality under Community law. This innovative kind of conflict is beyond the traditional form of vertical conflict between the Community and the Member States, broadly analysed by Community law (Cfr., Zilioli – Selmayr, *op. cit.*, notably 291).

*Contra*, cfr. TORRENT, R., *Whom is the European Central Bank the Central Bank of? Reaction to Zilioli and Selmayr*, CML Rev., 36, 1999, 1229 – 1241. The author argues that "the ECB is neither a Community of its own, nor a Community within the Community... It is simply the Central Bank of the European Community, no more, no less". Thus there is no possibility for a potential horizontal conflict between the Community and its own Central Bank.

targets. At the same time, it should be emphasised that exchange rate and monetary policies are highly interdependent, for each inevitably influences the aims of the other.<sup>518</sup> Thus, the potential inconsistency between domestic price stability and a fixed exchange rate is self-evident, but less so the extent to which an anchor country should adjust its open market operations or interest rates for the sake of external objectives. Nevertheless, “it does not follow that it is not possible to pursue both policies separately”.<sup>519</sup>

Not surprisingly, the Commission in the negotiation phase spotted a disagreement on the allocation of responsibilities for exchange rate and intervention policy.<sup>520</sup> It subsumed this issue under the heading “double nature of exchange rates”, referring to their narrow monetary and broader economic nature. From this followed that two actors should participate, the monetary authority, being the ECB, and the body responsible for economic policy, namely the Council. Moreover, “there were fears that the effective independence of the ECB might be compromised, if the Treaty placed decisions on exchange rate policy outside the ECB, as exchange rate objectives might conflict with the objective to maintain price stability”.<sup>521</sup>

As a result of the above-described search for an institutional compromise, Article 111 (ex Article 109) - the last provision in Chapter 2 of Title VI (under the heading: “Economic and Monetary Policy”), devoted to monetary policy – is a very complex one. The subject matter regulated in Article 111 may thus be said to have

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<sup>518</sup> See on this point P. KRUGMAN and M. OBSTFELD, *International Economics*, New York, 2000, pp. 329 and ff.

<sup>519</sup> C.W. HERMANN, *Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice*, *op. cit.*, p. 5, who, even if recalls that economic theory suggests that there is a close link between the conduct of internal monetary policy and the exchange rate, still points out that interest rates and money supply are not the only variables influencing exchange rates in an open economy. For instance, long-term expectations of future exchange rates and the overall economic prospects of a currency area, as well as the behaviour of political actors, do influence the exchange rate in a market oriented open economy, where exchange rates are determined by supply and demand. “Experience with the Euro indicates that the exchange rate so far is more influenced by the lack of a coherent European economic policy framework than by monetary policy issues”.

<sup>520</sup> See European Commission, *Economic and Monetary Union; Basic Document of the Commission for the IGC*, Agence Europe Document No. 1650/1651 of 27 September 1990.

<sup>521</sup> B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, *op. cit.*, p. 51. On the possible conflict between the aim of international exchange rate stability and domestic price stability, see C.W. HERMANN, *Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice*, *op. cit.*, notably at p. 7, where the author argues that “it would in theory be possible to partially sacrifice domestic price stability (as read by the ECB) for the sake of exchange rate stability aimed at promoting the growth of world trade”. Such an interpretation is based on a reading of Article I (ii) IMF.

been considered as forming part of the Community's monetary policy. Indeed, Article 111 is, in the first place, devoted to the external aspect of the single monetary policy, i. e. the exchange rate policy in respect of the euro. It also covers other contingent matters. It deals specifically with the negotiation of agreements on monetary and exchange rate matters (see paragraph 3), purports to lay down the international representation of the Community in EMU affairs (paragraph 4), and it confirms the residual competence of the Member States to act on the international scene (paragraph 5). Article 111 regulates, *inter alia*, the exchange rate arrangements, if any, between the single currency and those of third countries. The latter are called "non-Community currencies". In a word, it can be affirmed that the Article under analysis here allocates the institutional competences, governs the procedures and determines the legal effects with a view to the conclusion of formal agreements on exchange-rate system and other agreements concerning monetary and exchange regime matters.

The text of the Article under analysis does not provide a legal basis for exchange rate arrangements between the single currency, on the one hand, and the currencies of the Member States, which do not yet participate in Stage 3 of EMU, on the other.<sup>522</sup>

The key sections, in Article 111 (paragraphs 1 and 2) read:

*By way of derogation from article 300, the Council may, acting by unanimity on a recommendation from the ECB or from the Commission, and after consulting the ECB in an endeavour to reach a consensus consistent with the objective of price stability, (...) conclude formal agreements on an exchange rate system for the ECU in relation to non-Community currencies.*<sup>523</sup>

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<sup>522</sup> In any case, the Member States not participating in Stage Three of the EMU are subject to the obligation stemming from Article 124.2 EC Treaty, which provides for a specific obligation of co-operation, by stating in paragraph 1 – which is to be applied by analogy to the Member States with a derogation – that: "until the beginning of the third stage, each Member States shall treat its exchange rate policy as a matter of common interest. In so doing, Member States shall take account of the experience acquired in co-operation within the framework of the European Monetary System (EMS) and in developing the ECU, and shall respect existing powers in this field". As a result of the application of this provision, it has been insightfully observed that "tali Stati non possono esercitare la loro sovranità in modo da pregiudicare l'attuazione della politica comune decisa dagli Stati parte, in particolare mediante eventuali impegni internazionali assunti ai sensi dell'art. 111" (A. MALATESTA, *La Banca Centrale Europea. Gli aspetti istituzionali della banca centrale della Comunità europea, op. cit.*, p. 233).

<sup>523</sup> The conclusion of formal agreement on exchange rate arrangements between the single currency and the currencies of third countries is subject to a distinct procedure and not to the one normally applicable to treaty-making by the Community. Under Article 300 (ex Article 228), from which Article

*In the absence of an exchange rate system in relation to one or more non-Community currencies (...) the Council, acting by a qualified majority either on a recommendation from the Commission and after consulting the ECB, or on a recommendation from the ECB, may formulate general orientations for exchange rate policy in relation to these currencies. These general orientations shall be without prejudice to the primary objective of the ESCB to maintain price stability.*

The Article makes a clear distinction between two situations:

a formal exchange rate agreement between the euro and one or more third currencies, which is regulated by Article 111 (3) as to procedural aspects;<sup>524</sup>

the situation in which no formal exchange rate arrangement applies, i. e. a situation of floating exchange rates between the euro and third currencies. At present, it will be recalled that Member States currencies float against the major non-Community currencies.

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111 specifically derogates, the procedure is as follows: upon a Commission recommendation, the Council authorise the Commission to open negotiations. The Commission negotiates with third countries on the basis of Council directives and in consultation with a committee of representatives of the Member States. The results of these negotiations are then formally approved by the Council, which concludes the agreement on a proposal from the Commission. The Council has to consult the European Parliament. Exceptions to this consultation requirement are the cases subject to ex Article 113 – on common commercial policy, in which Parliament is not involved, and cases mentioned in the second subparagraph of Article 300 (3) – association agreements and other agreements “establishing a specific institutional framework”, agreements with budgetary consequences for the European Community and agreements entailing an amendment of acts adopted through the co-decision procedure, where the assent of the European Parliament is required.

On the derogation from the discipline set forth by Article 300 see S. CAFARO, *Unione monetaria e coordinamento delle politiche economiche. Il difficile equilibrio tra modelli antagonisti di integrazione europea*, op. cit., p. 279, who rightly speaks about an “affievolimento del ruolo della Commissione”, justified on the basis that there is a concurrent competence of the ECB which plays a role of “negotiator” in this field. The author also mentions a “precisa scelta metodologica” embodied in Article 111 EC Treaty, not to give detailed provisions: “si è preferito, infatti, lasciare la porta aperta a soluzioni diverse da scegliersi in funzione del caso concreto”. On the same line of reasoning, cfr. J. LEBULLENGER, *La projection externe de la zone euro*, Revue Trim. Dir. Eur., No. 4, 1998, notably at p. 465, where the author argues that the provision under examination is definitively characterised by a kind of “flexibilité”.

<sup>524</sup> “The word formal was added to indicate that Bretton Woods-like arrangements are meant; when an exchange rate arrangement of the type meant in Article IV section 4 of the Articles of Agreement of the IMF is concluded, this competence will fall to the Ecofin Council” (SMITS, op. cit., 386). One should remember that the above-quoted Article IV section 4 of the IMF’s Articles of Agreement provides for the institution of a regime of fixed exchange rates, or parities, established for participating currencies in relation to the Special Drawing Right (SDR) or another denominator.

Anyway, on this point there is a remarkable clarity. In fact, the explanation contained in Declaration No. 8 to ex Article 109 that by *formal agreement* it was not intended to create a new form of international agreements in the sense of Community law implies that the Community does not intend to assign these agreements a rank different from the one foreseen in Articles 300, 133 or 11.3 EC Treaty.

In the first situation, the Ecofin Council, as prime carrier of political responsibility in the area of EMU,<sup>525</sup> has been given the competence to conclude formal agreements on an exchange rate system for the euro in relation to non-Community currencies. These agreements are to be concluded after consultation with the ECB, with a view to reaching consensus. This consensus should be consistent with the objective of price stability.<sup>526</sup> It should be highlighted, in particular, that the term *consensus* implies that an agreement of the ECB is required. The term *endeavour*, however, further clarifies that under Article 111.1 EC Treaty there is no legal obligation to come to an amicable solution. Should the opinion of the Council and that of the ECB diverge, the Council has the final say. As a result, the Council can be seen as being the *dominus* “in the driver’s seat”.<sup>527</sup>

Having underlined that, it is worth recalling that the implementation of Article 111 (1), namely the conclusion of formal agreements on an exchange rate system, would be tantamount to a return to a type of Bretton Woods system. There is little

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<sup>525</sup> Note that, according to Declaration No. 4 to the Treaty of Maastricht, all references to the Council have to be read as references to the Ecofin Council.

<sup>526</sup> On this point, see W.H. BUITER, *Alice in Euroland*, CEPR Policy Paper, n. 1, 1999, notably p. 9. The author boldly states that this provision “allows the political leadership of Euroland to create a new Bretton Woods, should they wish to”. Thus it should represent a restriction on the ECB’s operational independence. *Contra* S. CAFARO, *Unione monetaria e coordinamento delle politiche economiche. Il difficile equilibrio tra modelli antagonisti di integrazione europea*, *op. cit.*, p. 323, who observes: “pur avendo il Consiglio l’ultima parola in materia di rappresentanza esterna della zona euro, tuttavia, questo non potrà imporre alla BCE una posizione che ne leda le prerogative, ovvero che costringa l’istituzione monetaria ad assoggettarsi a decisioni contrarie, a suo giudizio, all’obiettivo della stabilità dei prezzi”. Besides, following this statement, it can be recalled that the mandate of the ECB to pursue and maintain price stability has received a solid constitutional basis by the Treaty, thus a predominance of a political decision contrary to the ECB’s mandate would be almost unconceivable in practical terms.

<sup>527</sup> P.J. SLOT, *The Institutional Provisions of the EMU*, in D. CURTIN (ed.), *Institutional Dynamics of European Integration*, Essays in Honour of Schermers, Dordrecht, 1994, at p. 241.

In any case, as pointed out by B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, *op. cit.*, p. 53, there are some limitations to the Council’s dominance, which empower the ECB’s position. First, under Article 230.3 EC Treaty, the ECB may challenge a Council decision in external relations matters for the purpose of “protecting its prerogatives” on the ground of infringement of the Treaty, if the Council in the view of the ECB did not endeavour to reach a consensus consistent with the objective of price stability. However, should the ECJ declare the agreement to be void, this would not alter the binding nature of the agreement in international law; until renegotiations were effected, interventions would have to be carried out by the ECB. Second, any Council decision itself is to be consistent with the objective of price stability, as required by the more general obligation under Article 4.2 EC Treaty. This means that, while it is for the political authorities to make decisions concerning exchange rate policy, the Council’s hands are tied: it can override the ECB only if it is convinced that its exchange rate policy is best-suited to the goal of price stability. Third, from a more practical perspective, it is assumed that, in the absence of a *gouvernement économique*, the consultative role of the ECB is probably a decisive one, similar as under a formal right of assent (cfr. J. LEBULLENGER, *La projection externe de la zone euro*, *op. cit.*, p. 461).

plausibility for such a scenario in the present state of international relations and in light of the highly developed international capital markets. Moreover, the founding fathers of EMU clearly realised the important consequences that such a move would have, also on domestic price stability. As a result, the procedure is a heavy one, requiring unanimity of the Council. Note, however, that the ECB will be consulted, but cannot formally block the decision.

In the second situation, which has been prevalent in international monetary relations since the demise of the Bretton Woods system of fixed exchange rates in the early 1970s, the Ecofin Council can seek to influence the operations of the ECB on the foreign exchange market by formulating general orientations for exchange rate policy in respect of third currencies. The term “general” indicates that such orientations cannot provide for a certain precisely circumscribed conduct to be followed by the ECB. The term is reminiscent of the qualification of the guidelines of the Ecofin Council for the conduct of Member States’ economic policies. Pursuant to Article 99 (2) EC Treaty these are to be “broad”. No specific course of action can be laid down by the Council. It can outline its preferences for exchange rate policy in general terms only. Moreover, the word “orientations” does not connote a certain legal form. The use of a vague term, which does not appear elsewhere in the Treaty, is evidence of the intention of the authors of the Treaty to leave the ECB full freedom of action.<sup>528</sup> This is consistent with the requirement of central bank independence (Article 108 EC Treaty and Article 7 ESCB Statute). The “general orientations may influence the ECB<sup>529</sup>, but they do not amount to an instruction.<sup>530</sup>

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<sup>528</sup> Similarly, B. DUTZLER, *op. cit.*, p. 55, according to whom “the combined effect of the terms *general* and *orientations* indicate that such legal acts are rather directions signs, whereas the timing and volume of the interventions remain in the competence of the ECB”. On this point, see also A. MALATESTA, *op. cit.*, p. 237, who compares the general orientations to acts of soft law, typically used in the field of international monetary co-operation.

<sup>529</sup> To the extent that it is not prohibited under Article 108.

<sup>530</sup> Cfr for the previous analysis R. SMITS, *The European Central Bank. Institutional Aspects*, Kluwer Law International, The Hague, 1997, pp. 398 and ff. The author recalls that the question whether “general orientations” are binding in nature is discussed and answered differently in legal writings. For instance, J.-V. LOUIS, advocates the view that they are not legally binding. He does so with a reference to the ECB’s independence. (See ID., *L’Union économique et monétaire*, in *Commentaire Mégret, Le Droit de la CEE*, 2<sup>nd</sup> edition, Etudes Européennes, Editions de l’Université de Bruxelles, Vol. 6, Brussels, 1995, p. 84).

Thus, in the light of this provision, it is clear that, in the external dimension of EMU, a crucial problem is posed by exchange rate policy, whose guidelines are set by governments.<sup>531</sup>

Notwithstanding, after the first reading, suddenly a problem arises: there is in fact a potential inconsistency, or conflict, between giving the European System of Central Banks independence of political control in general<sup>532</sup> and the prime task of achieving price stability, on the one hand, and leaving the decisions on the choice of external exchange rate regime – i. e. fixed, or float, or managed float – to the political authorities on the other.<sup>533</sup> This situation of potential inconsistency is made even more delicate in consideration of the fact that – according to one of the most common concerns with the formulation of the constitution of the ESCB – nowhere is the definition of price stability strictly specified. Having regard to this *lacuna*, it has been interestingly argued that this might be a deliberate omission by the Central Bankers

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<sup>531</sup> This very point represents a meaningful departure from the situation in Germany (whose central bank has been chosen as a basic, institutional model for the construction of the ECB). Although the federal government reserves the right to choose the appropriate exchange rate regime for the Deutschemark (see Bretton Woods or the ERM), the Bundesbank is in active control of exchange rate policy. This is one of the strengths of the Bundesbank Act, which charges the German central bank with “safeguarding the currency”. If this is interpreted as applying to the external (as well as the internal) value of the currency, the Bundesbank has a direct responsibility for exchange rate policy. On the contrary, the ECB has not such responsibility or powers, and is involved in exchange rate policy purely on a consultative basis. Nonetheless, the Maastricht Treaty does state that any exchange rate decisions or orientations of the European Council must be “without prejudice to the primary objective of the ESCB to maintain price stability”. See S.F. FROWEN – R. PRINGLE, (eds.), *Inside the Bundesbank*, Macmillan Press Ltd, Basingstoke and London, 1998; Deutsche Bundesbank (edited by), *Fifty Years of the Deutsche Mark. Central Bank and the Currency in Germany since 1948*, Oxford University Press, 1999.

<sup>532</sup> It is worth remembering that, in order to guarantee that monetary policy for the euro will in future be depoliticised, Article 108 EC Treaty entrenches constitutionally the far-reaching independence of the ECB, by prohibiting both the Community institutions and bodies and the Member States from giving it instructions. On this point, cfr. C.A.E. GOODHART, *Central Bank Independence*, in LSE Financial Markets Group, Special Paper, n. 57, November 1993; R. SMITS, *op. cit.*, especially chapter 3, II.

<sup>533</sup> By the way of a potential conflict between the political authority at the Community level (the Ecofin Council) and the monetary authority (the ECB), in the field under analysis here, it must be remarked that the provision of Article 111 is obviously a matter of interpretation. Thus it is important to remember that, in accordance with the procedure pursuant to Article 111, the Council is to adopt a special arrangement for the conclusion of an agreement concerning monetary or foreign exchange regime matters. The framework for this arrangement is outlined in Article 111 (3). It is for the Council to conclude these agreements. The ECB is to be involved: consensus between it and the Council is to be achieved, where possible. The Commission is to be fully associated with the negotiations. The European Parliament is to be consulted.

Nevertheless, Article 111 (3), second sentence, specifies that the arrangements to be decided by the Ecofin Council are aimed at ensuring a single position for the Community in the area of monetary or foreign – exchange regime matters. This stipulation narrows down the options for the Council: it can only adopt those arrangements that ensure a single position for the Community, considered as a whole.

involved in the drafting process to avoid the exercise of close public accountability.<sup>534</sup> Apart from these considerations, it is worth underlining that this omission opens the way for differing interpretations of whether some exchange rate orientation would or would not be inconsistent with price stability. Moreover, it may be added that the Council of Ministers needs only to “consult” the ECB, and having done so can decide as the politicians prefer.<sup>535</sup>

However, it would be quite surprising if there was either much conflict between the ESCB and the Council or any attempted reassertion of political supremacy through this route, at least in the foreseeable future. The independent ESCB is bound to challenge any threat to the achievement of the primary objective which it has been allocated, i. e., that of price stability. As such, it is difficult to see the Ecofin Council being prepared to ignore, and override, such objections, unless broader political support for the concept of an independent Central Bank targeted towards the achievement of the main task of price stability has already eroded to such an extent that politicians would also envisage a wholesale revision of the Treaty. However, this is only an unlikely perspective *de iure condendo*.<sup>536</sup>

The conclusions expressed in the previous section seem to be in contrast with the ratio and the concrete *modus operandi* of monetary sovereignty in *foro interno* within EMU, which emphasise the institutional role of the ECB, usually considered the natural bearer of internal competences in the field of monetary policy. In fact, if

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<sup>534</sup> This is the point of view of C.A.E. GOODHART, *The external dimension of EMU, in Recherches Economique de Louvain*, 1993, Vol. 59, p. 66.

<sup>535</sup> Cfr. W.H. BUTER, *op. cit.*, p. 9: “The effective domain of monetary policy is severely circumscribed, and in the limit reduced to nothing, if constraints can be set on the behaviour of the nominal exchange rate” (...) “One can only hope that, in practice, these general orientations will either not be forthcoming or, if they are, that they will be ignored by the ECB as prejudicial to the price stability objective”.

<sup>536</sup> *De iure condito* it is surely noteworthy recalling the reading of Article 12 of the Protocol of the ESCB, according to which the Council can create a new ERM with non-member states by unanimity among the twelve members of the euro-zone (art. 111 (1), ex art. 109 (1) EC), but this is unlikely to happen for the foreseeable future. As said in the text, the Council can also formulate by qualified majority voting among the twelve members of the euro-zone “general orientations for exchange rate policy”, but the Luxembourg European Council of 13 December 1997 decided that such guidelines would be restricted to “exceptional circumstances” like a “clear misalignment” of exchange rates with non-EU currencies and “should always respect the independence of the ESCB and be consistent with the primary objective of the ESCB to maintain price stability”. In any case “guidelines” are not binding and the ECB could choose not to follow them. The same Luxembourg European Council Resolution also stated that “the harmonious economic development of the Community in Stage Three of EMU will call for continuous and fruitful dialogue between the ECB and the Council”. This is a recognition that although monetary policy is in the hands of the ECB, economic policy remains within the Members States of the euro-zone and to a much lesser extent with the Council.

one follows the teaching of the ERTA case, the principle according to which “the system of internal Community measures may therefore not be separated from that of external relations” cannot be ignored.<sup>537</sup> That is to say that, in the framework of the ESCB, the ECB, which is internally exclusively competent to “define and implement the monetary policy of the Community” (Article 105, paragraph 2, EC Treaty), should be able to exercise its external competences by virtue of its separate legal personality and its own decision-making bodies. Consequently, it will be possible to distinguish two types of external competence of the ECB: the first laid down in the above-mentioned Article 105 (2), second indent, EC and Article 23 of the Statute<sup>538</sup> (so-called explicit external competence); and the second related to the parallel internal tasks of the ESCB, so-called implicit external competence.

Anyhow, to have a complete picture of the matter, it should be underlined that the doctrine is again very fragmented on this point. For instance, it has been argued that the powers of the ECB in the *forum internum* do not say anything about the *forum externum* and vice versa. As a consequence, there would be no room to apply the implied powers doctrine to external monetary relations as regards the key elements of monetary sovereignty.

Finally, to complete the analysis of Article 111 EC Treaty, it is worth recalling the so-called “third option” (to be put aside the formal agreements and the general orientations), namely the situation in which the Council abstain from formulating general orientations.<sup>539</sup> In this case, although the Council formally is in the driver’s seat,<sup>540</sup> the ECB has a lot of leeway in practice. In the absence of an exchange rate system or agreements, it may run the current foreign exchange rate policy without

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<sup>537</sup> Case 22/70, *Commission v. Council (ERTA)*, (1971) ECR 263, paragraph 16.

<sup>538</sup> Article 23 of the Statute enumerates the external operations that the ECB may conduct. They include: the establishment of relations with central banks and financial institutions in other countries and, where appropriate, with international organisations; the acquisition and sale of all types of foreign exchange assets and precious metals; the holding and management of such assets; the conduct of all types of banking transactions in relation with third countries and international organisations.

<sup>539</sup> Such a conclusion is justified on the basis of the wording of Article 111.2, where it is specified that the Council *may* formulate general orientation for exchange rate policy in relation to third currencies.

<sup>540</sup> See, for the formal attribution of such competence to the Council, Article 111.3 EC Treaty, where it is set forth that (...) “where arrangements concerning monetary or foreign exchange regime matters need to be negotiated by the Community with one or more States or international organisations, the Council, acting by a qualified majority on a recommendation from the Commission and after consulting the ECB, shall decide the arrangements for the negotiation and for the conclusion of such agreements. *These arrangements shall ensure that the Community expresses a single position*” (Emphasis added).

authorisation.<sup>541</sup> Still, whereas this reduces the danger of potential inconsistencies between external and internal monetary policy choices, successful interventions require international collaboration, which implies a political initiative. As practical experience shows, the strategic exchange rate decisions were in fact taken jointly by the ECB and the finance ministers of the euro area. If this is to be viable beyond a one-off transaction, good working relations are an indispensable requirement.

#### 6) *The ECB's relations with international organisations and fora*

Another crucial aspect of the external dimension of the EMU is represented by the definition of the position of the Community at the international level when "issues of particular relevance to Economic and Monetary Union" are at stake.<sup>542</sup> Such a definition calls for a deeper investigation of the ECB's involvement at the international level, and, more specifically, of its representation in international organisations. Through this kind of investigation, it will be possible to turn to the question posed at the beginning of the chapter, namely the question of which entity is entitled to speak on behalf of the euro when external competences are involved, in

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<sup>541</sup> P.J. SLOT, *The Institutional Provisions of the EMU*, in D. CURTIN and T. HEUKELS (eds.), *Institutional Dynamics of European Integration. Essays in Honour of Henry G. Schermers*, Dordrecht/Boston/London, 1994, p. 241.

<sup>542</sup> According to Article 111.4 EC Treaty, "subject to paragraph 1, the Council shall, on a proposal from the Commission and after consulting the ECB, acting by a qualified majority, decide on the position of the Community at international level as regards issues of particular relevance to economic and monetary union and, acting unanimously, decide its representation in compliance with the allocation of powers laid down in Articles 99 and 105". Such provision sets out the principle that the external representation has to mirror the internal competences of the Community entities, by complying with the allocation of powers laid down in Articles 99 and 105. This is interpreted by the ECB to denote that, for the "exclusive" ESCB competences - such as monetary policy and related central banking tasks, international representation rested solely with the ESCB (see, ECB, *Annual Report*, 1998, p. 80). In this view, the ECB has to be represented in all fora where monetary policy is discussed, if statements on the single monetary policy are to be made at the meetings of international organisations.

In addition, for an interesting definition of the content of the expression "issues of particular relevance to Economic and Monetary Union", see A. MALATESTA, *La Banca Centrale Europea. Gli aspetti istituzionali della banca centrale della Comunità europea*, op. cit., p. 251, who argues that such an expression refers to every kind of Community policy which affects economic policy in a broad sense, like competition policy or the implementation of the internal market. As a result "non può essere limitata alle competenze indicate specificamente nei titoli del Trattato dedicati all'UEM". On the same line of reasoning cfr. S. CAFARO, *La rappresentanza dell'Europa dell'euro nelle organizzazioni monetarie e finanziarie internazionali*, *Il Diritto dell'Unione Europea*, No. 4, 1999, pp. 737-774. Note that the acceptance of such interpretation would contain the voice of the ECB in the field of international representation as it would legitimise the action of different policy-makers in the field of "economic policy in a broad sense".

particular within the framework of international organisations and fora dealing with economic and monetary matters.

To begin with it is worth saying that, generally speaking, central banks have traditionally been involved in international economic, monetary and financial co-operation. This has taken place through their participation in international organisations and fora either of an intergovernmental nature (i.e. the International Monetary Fund and informal fora like the Group of Seven (G7) or based on central bank co-operation (e.g. the Bank for International Settlements – BIS - and the Governors of the Group of Ten). Nevertheless, the establishment of the ECB made it necessary to devise specific arrangements that permit an involvement in international co-operation, both from an institutional and from a policy perspective.

Devising such arrangements has been and still remains a unique task for three main reasons.

First, the existing array of international organisations was designed to promote co-operation among sovereign states that have full competence for the conduct of their economic, monetary and financial policies. The increase in membership of international organisations and fora during the post-war period could easily be accommodated within the prevailing institutional settings. By contrast, the decision by the euro area countries to transfer their monetary sovereignty to the ECB, as a supranational institution, posed some highly novel questions in the present institutional framework for international relations.

Second, individual euro area countries remain responsible for the economic policies other than monetary and exchange rate policies, even though co-ordination mechanisms have been strengthened at the Community level (namely in the areas of fiscal and structural policy). This means that the involvement of the ECB, the European Community and individual EU Member States in the process of international co-operation varies considerably depending on the mandates of the relevant international organisations and fora.

Third, not only the ECB, but also other components of the Eurosystem, namely the NCBs, take part to varying degrees in international organisations and fora depending on the participation in the latter of their respective countries. As a result, achieving a consistent representation of the Eurosystem presented unique challenges.

Theoretically, one could imagine that, in spite of the division of competences as regards the conclusion of agreements, “there would be only one institution or entity charged with speaking on behalf of the euro in international organisations and fora – on a case-by-case basis on behalf of the Community, the ECB, the Member States or even the national central banks”.<sup>543</sup> As a matter of fact, the EC Treaty did despite its practical advantages, not choose this idea of centralised representation; on the contrary, the law on external representation “exactly reflects the substantive competences of the different actors in the external relations of the euro area”.<sup>544</sup> This means that, as a rule, the euro must always be represented in international organisations by an entity that has the external competence to conclude agreements on the subject matter to be discussed in the framework of that organisation.

Having said that, it is worth underlining the fact that the ECB’s involvement in international co-operation is based on very specific rules provided for by the EC Treaty and by the ESCB Statute. These rules are supplemented by the principles included in the Presidency Conclusions adopted by the European Council at its meetings in Luxembourg in December 1997 and in Vienna in December 1998.

The Treaty confers upon the ECB and the Ecofin Council well-defined responsibilities in the fields of international co-operation and representation of the European Community at the international level with regard to issues of relevance to EMU. As already seen, the relevant provisions are laid down in Article 111 of the Treaty. Until now, Article 111 has only been used to conclude agreements between the European Community and certain non-EU countries on monetary and exchange rate matters.<sup>545</sup> The other relevant provisions, including those pertaining to decisions

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<sup>543</sup> C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, *op. cit.*, p. 231. On this point, see also T. PADOA-SCHIOPPA, *The external representation of the euro area*, Introductory statement at the Sub-Committee on Monetary Affairs European Parliament, Brussels, 17 March 1999, available at <http://www.ecb.int/key/st990317.htm>; and W. DUISENBERG, *The Role of the ECB at the international level*, Speech delivered at the Annual Meeting of the Institute of International Finance, Prague, 23 September 2000, available at <http://www.ecb.int/key/00/sp000923.htm> The former President of the ECB rightly observes, on this point, that the euro area as such cannot negotiate and conclude public international law agreement or become a member of international organisations. This also implies that the euro area has thus to be represented externally by Community institutions or bodies which have a legal personality. This means: (i) the Ecofin Council; (ii) the ECB and, in accordance with its decisions, one or more NCBs.

<sup>544</sup> C. ZILIOLI and M. SELMAYR, *op. cit.*, p. 232.

<sup>545</sup> Cfr., for instance, Council Decision 1999/96 EC of 31 December 1998 on the position to be taken by the Community regarding an agreement concerning the monetary relations with the Principality of Monaco [1999] OJ L 30/31; Council Decision 1999/97 EC of 31 December 1998 on the position to be taken by the Community regarding an agreement concerning the monetary relations with the Republic

on the position and the representation of the European Community at the international level, have not been used thus far. Current arrangements for the international representation of the Community are based on the principles adopted by the European Council at its meeting in December 1997 and December 1998. In line with the December 1997 Conclusions of the European Council, the ECB and the Ecofin Council “will fulfil their tasks in representing the Community at the international level in an efficient manner and in compliance with the distribution of powers laid down in the Treaty”.<sup>546</sup>

For its part, the Statute of the ESCB stipulates how the Eurosystem shall be represented at the international level. In this respect, it is for the Governing Council of the ECB – pursuant to Article 6.1 and 12.5 ESCB Statute - to take the relevant decisions.<sup>547</sup> The ECB and, subject to the approval of the Governing Council, the

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of San Marino [1999] OJ L 30/33; Council Decision 1999/98 EC of 31 December 1998 on the position to be taken by the Community regarding an agreement concerning the monetary relations with the Vatican City [1999] OJ L 30/35. See for interesting comments in the doctrine S. CAFARO, *I primi accordi della Comunità in materia di politica monetaria e di cambio*, *Il Diritto Dell’Unione Europea*, 2/1999, pp. 243-268; and C. ZILIOI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, 2001, notably pp. 218 and ff., who refer to these three countries as having a “special status” since they do not have currencies of their own, but have instead entertained for many years special monetary relationship with Italy and France. The reason for having such agreements rests on the consideration that the two above-mentioned countries – with the entry into the third stage of EMU – have lost the competence to renew these monetary agreements without the authorisation by the Community. That’s why the renovation is from that moment a responsibility of the Community which is exclusively competent under Article 111.3 EC Treaty to negotiate and conclude agreements on monetary regime matters.

<sup>546</sup> Presidency Conclusions of the European Council at the meeting in Luxembourg on 12 and 13 December 1997, paragraph 46, where the following adds: “the Commission will be associated with external representation insofar as necessary to enable it to fulfill the role assigned to it by the Treaty”.

<sup>547</sup> According to Article 6 ESCB Statute, “in the field of international co-operation involving the tasks entrusted to the ESCB, the ECB shall decide how the ESCB shall be represented. The ECB and, subject to its approval, the national central banks may participate in international monetary institutions. Article 6.1 and 6.2 shall be without prejudice to Article 111.4 of this Treaty”. It must be stressed, however, that the Statute determines *how* and not *if* the ESCB is to be represented. This cannot be read as a derogation from a hypothetical Council decision not to include the ECB in the representation in areas where it would be competent. Rather, Article 6 is simply the reflection of the right of every Community body to decide in an independent manner on its internal structure. “Whereas the Council is not competent to prescribe the ESCB how the ECB should be represented, it is the Council, and not the ECB, which is competent to decide on the if, as long as this is in accordance with the competences of the ECB as outlined in Article 105” (B. DUTZLER, *op. cit.*, p. 60). As a consequence, Article 6 ESCB Statute cannot be used to widen the external powers of the ECB further to the extent as granted in the Treaty. The principles enshrined therein simply determine that, as soon as Community competences are involved, the Community must be represented by the respective Community body or bodies which is/are competent. Thus, whenever in an international forum issues are discussed which belong to the powers allocated to the ESCB under the Treaty, the Council is bound to reflect this in its formal decision pursuant to Article 111.4 on Community representation, and decide only such principles of representations which take the powers of the ECB under Article 105 EC Treaty into account. For a further analysis of this issue, see J.-V. LOUIS, *Les Relations Internationales de l’Union Economique et Monétaire*, EUI Working Paper, LAW, No. 10/99, notably at p. 14 where the author

NCBs are entitled to participate in international monetary institutions. The ECB, which is represented externally by either the President or his nominee, is in a position to act at the international level, since it has legal personality. The commentary to the Draft Statute expresses that this mode of decision-making is to ensure that “the System speaks with one voice”.<sup>548</sup>

The ECB is involved in international co-operation where the tasks entrusted to the Eurosystem are concerned. Nonetheless, the precise nature of such involvement hinges on the types of tasks concerned and may range from the exclusive representation of policy positions of the European Community to the formulation of the ECB’s own positions alongside those of other policy-makers in the Community.<sup>549</sup> It should be remarked, however, that in case of conflict between an external position of the ESCB and an external political operation, the latter would remain unaffected.

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states: “Le Conseil ne peut s’immiscer dans la conduite des affaires monétaires sous le couvert d’une action externe de la Communauté et la BCE doit s’insérer dans le contexte international en tenant compte des aspects de politique globale de la Communauté”.

<sup>548</sup> Europe, Document No. 1669/1670, 8 December 1990, at p. 21, as quoted by R. SMITS, *The European Central Bank. Institutional Aspects*, op. cit., p. 422.

<sup>549</sup> On this point five interesting cases are reviewed below in order to give a concrete example. First, whenever international co-operation concerns the single monetary policy, the ECB is the sole institution entitled to represent policy positions of the European Community, since the single monetary policy is an exclusive competence of the ECB’s decision-making bodies. Second, with regard to the overall framework pertaining to the exchange rate of the euro, the Treaty provides for a close interaction between the ECB and the Ecofin Council, as laid down in Article 111.1 to 111.3. When applying these provisions, the voting rights of the Member States which have not yet adopted the euro are suspended. Moreover, the Eurogroup regularly reviews exchange rate developments in line with its shared responsibilities for the single currency. It has to be recalled that the responsibilities shared by the ECB and the Eurogroup for issues related to the euro exchange rate concern consultation with third parties – for example at the G7 level – and communication policy. This implies participation in G7 meetings of both the President of the ECB and the President of the Eurogroup when matters related to the exchange rate of the euro are discussed. By contrast, the ECB is solely responsible for decisions on foreign exchange operations. Third, in the area of payment systems the ECB may formulate positions at the international level on issues related to the Eurosystem’s responsibility for promoting the smooth and efficient operation of payment and settlement systems. In formulating such position, the ECB takes into account whether the functioning of payment systems may affect the implementation of the single monetary policy, system stability and the establishment of a level playing-field between participants and cross-border payments both within the EU and with other countries. The euro area NCBs, which participate in international organisations and fora alongside the ECB, may also express views reflecting their own responsibility and experience in managing and overseeing domestic payment and settlement systems. Fourth, the ESCB Statute imposes a general obligation on the ECB, in undertaking the tasks of the Eurosystem, to co-operate in statistical matters with international organisations. This provision, which takes into account the fact that statistical work is carried out within a global context, allows the ECB to formulate positions along with other competent Community bodies. Finally, in the area of prudential supervision and financial stability the ECB may participate in the relevant international meetings and state its position alongside those of the national authorities that have competence in this field. In so doing, the ECB adds a euro area perspective to the discussion. For a more detailed analysis, see ECB, *The ECB’s relations with international organisation and fora*, Monthly Bulletin, January 2001, pp. 57-75.

Given that the ECB has to include the external consistency of Union activities in its considerations, it might well be argued that in case of a conflict, the political action by the Council would prevail.

As far as the policy content of the ECB's international relations is concerned, it should be highlighted that the ECB's involvement in international co-operation consists mainly in the mutual exchange of information and views with other policy-makers within multilateral organisations and fora. In this context, the peer review of the economic developments and policies in major economic areas is particularly important, as it enhances the ECB's ability to analyse the impact of external developments on the economy of the euro area. Given its voluntary and non-binding nature, this form of co-operation activity does not impinge on the ECB's independence.<sup>550</sup>

Exchanges of information and views are complemented by surveillance carried out by independent organisations such as the IMF and the Organisation for Economic Co-operation and Development (OECD). These organisations regularly monitor and assess economic developments in and the policies of their member countries. Whenever the single monetary policy of the euro area is under review, the ECB is the sole counterpart in discussion with these organisations. International surveillance adds to transparency of the ECB as the assessments of the euro area economic policies are made available to the public.

The ECB also participates, within its area of competence, in the efforts of the international community to develop common understandings on a number of best practices and rules designed to improve the efficiency and transparency of policy-making. Best practices, which are to be implemented in each individual country on a voluntary basis, are usually laid down in core principles, standards and codes. The

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<sup>550</sup> The above-mentioned form of co-operation activity can be justified on the basis of one guiding principle of the ECJ, namely the *requirement of unity* in international representation, according to which "the Community institutions and the Member States must take all necessary steps to ensure the best possible co-operation in that regard" (Opinion 2/91, Convention No 170 of the ILO concerning use of chemicals at work, 1993, ECR, I-1061, para.36; Opinion 1/94, WTO [1994] ECR I-5267, para. 108; Case C-25/94, *Commission v. Council, (FAO)* [1996] ECR I-1469, para. 48). As underlined by C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank, op. cit.*, p. 234, footnote 258, "at the time of these opinions and judgments, the ECB did not exist. Therefore, the ECJ did not have to deal with potential conflicts of competence between the Community and a separate actor at Community level. However, as also the ECB has been established under the EC Treaty and thus falls within the framework of Community law, it seems evident that today the ECJ would not hesitate to extend this duty of co-operation also to the relationship between the Community and the ECB".

identification of best practices encourages emulation and transparency among policy-makers, thus making the notion of good public governance a central component of international co-operation.

It should be stressed that the ECB is not involved in *ex ante* international co-ordination of its monetary policy with the policies carried out by non-euro area countries. This could easily become incompatible with its mandate to maintain price stability and its status of independence. Attempts to co-ordinate *ex ante* would not only blur the specific responsibilities of individual policy-makers, but also reduce their accountability. Similar considerations may be also applied to the exchange rate policy co-ordination between large economic areas, making the hypothesis of the set-up of a tripolar monetary system (involving the euro, the dollar and the Japanese yen) unlikely to work.

In line with this view, the European Council pointed out, at its meeting in Luxembourg in December 1997, that the exchange rate of the euro is not a target to be set independently, but the outcome of the economic fundamentals of the euro area relative to those of other economies. Following this line of reasoning, the European Council concluded that the Ecofin Council might formulate “general orientations” for the exchange rate policy of the euro area (according to Article 111.2 EC Treaty) only in exceptional circumstances.

### ***7) The international relations of the ECB in practice***

The European Community’s institutional setting for economic and monetary policies in general, and the provisions governing the institutional relations of the ECB in particular, have, of course, no direct impact on the statutes and/or internal rules governing international organisations and fora. Over the past years some adjustments have been made to the rules and procedures on which international relations are based, since the previous framework was not tailored to the involvement of a monetary union as large as the euro area. Until now such adjustments have largely been based on pragmatism. This is in line with the Conclusions of the European Council in Vienna in December 1998, according to which “a pragmatic approach might be the most successful which could minimise the adaptation of current rules and

practices provided, of course, that such an approach resulted in an outcome which recognised properly the role of the euro”.

As a basic rule, for the ECB to participate in international organisations, the general principle of co-operation among the different actors involved has to be respected. In a context of negotiation and debates, in which multiple parties are allowed to take part on behalf of the euro area, the actors involved are obliged to co-ordinate their positions before such meetings and to agree which of them is entitled to speak and vote, and under which circumstances these rights will pass to the other actor. These agreements should be laid down in inter-institutional or administrative settings. In addition, it may be required by the internal rules of an international organisation that the Community, the ECB and the Member States agree on a declaration of competences which lists the respective fields in which one of them is allowed to speak, to vote or to conclude agreements on behalf of the euro area.<sup>551</sup>

### *7.1) The International Monetary Fund*

The first issue to be addressed concerns the question related to which institutions are included in the right of the ECB to participate in “international *monetary* organisations” under Article 6.2. Zilioli and Selmayr emphasise that an interpretation that includes international organisations dealing also, but not exclusively, with monetary matters is necessary to allow the participation of the ECB whenever matters are discussed which fall in its field of competences.<sup>552</sup> A more restrictive interpretation would create the insurmountable difficulty of identifying “pure monetary organisations”, considering that even the IMF also deals with general matters of economic policy.

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<sup>551</sup> According to C. ZILIOLI and M. SELMAYR, *op. cit.*, p. 235, there is another possible way of co-operation among different actors to act within international organisation and fora, namely the trustee model, where only one type of actor from the euro area (in the case under analysis here) is admitted. This actor will be required to co-ordinate its positions with the other actors beforehand and to act as their trustee whenever their respective competences are at stake. “In the long run, this actor would have to initiate amendments of the internal rules of such organisations to make the participation of the appropriate actors legally possible and thus to permit representation in this organisation to mirror exactly the situation of external competences under Community law”.

<sup>552</sup> C. ZILIOLI and M. SELMAYR, *op. cit.*, p. 232.

In fact, even if the Articles of Agreement of the International Monetary Fund entrust it with several tasks (promoting, *inter alia*, international monetary cooperation, exchange rate stability, facilitating the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objective of economic policy), it would be difficult not to conclude – together with Wim Duisenberg and André Sasz – that “the primary functions of the IMF are clearly monetary”.<sup>553</sup> As a result, the scope of its mandate places the IMF at the very centre of the international monetary and financial system. In addition, in view of the importance of member countries’ economic policies to the stability of the global economic system, surveillance lies at the very heart of the IMF’s activities,<sup>554</sup> with a particular significance in overall external dimension, since all the competences in this field have been granted “en vue du maintien ou du redressement de la position externe des membres du Fonds et à l’occasion de l’octroi d’une assistance financière en vue de restaurer l’équilibre de cette position”.<sup>555</sup>

Given the respective mandates of the IMF and the ECB, it was considered essential for the ECB to be represented at the IMF on those issues which fall within the ECB’s fields of competence. The decision by the IMF Executive Board on 21 December 1998<sup>556</sup> to grant observer status to the ECB provided a pragmatic solution

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<sup>553</sup> W. DUISENBERG and A. SASZ, *The Monetary Character of the IMF*, in J.A. FRENKEL and M. GOLDSTEIN (eds.), *International Financial Policy: Essays in Honour of Jacques J. Polack*, IMF, Washington, 1991, p. 254. On the same line of reasoning see T. PADOA-SCHIOPPA, *The external representation of the euro area*, Introductory statement at the Sub-Committee on Monetary Affairs European Parliament, Brussels, 17 March 1999, available at <http://www.ecb.int/kev/st990317.htm>, notably at p. 3; and J.-V. LOUIS, *Les relations internationales de l’Union économique et monétaire*, EUI Working Paper, Law, No. 10, 1999, p. 1, where the author states “on peut ainsi voir dans le Fonds une institution essentiellement monétaire ou insister sur ses compétences d’examen de l’ensemble des politiques macroéconomiques, souligner son rôle en matière de surveillance ou mettre en lumière davantage ses responsabilités en matière d’assistance financière, valoriser son rôle dans la gestion des crises financières internationales. etc...”.

<sup>554</sup> It should be specified that the notion of surveillance recalls that of monitoring and assessing economic and financial developments and policies of member countries in the context of consultations with member countries under Article IV of the IMF Articles of Agreement. Surveillance also comprises an assessment of the global implications of national policies in an increasingly integrated world economic and financial system (multilateral surveillance).

<sup>555</sup> J.-V. LOUIS, *Les relations internationales de l’Union économique et monétaire*, *op. cit.*, p. 21.

<sup>556</sup> IMF Executive Board’s Decision No. 11875-(99/1) of 21 December 1998, published in IMF, *Selected Decisions and Selected Documents of the International Monetary Fund*, 24th edn, Washington, 1999.

that did not require a change in the IMF's Articles of Agreement, which restrict membership to countries. This arrangement extends a standing invitation to the ECB to participate as an observer in all IMF Executive Board meetings dealing with issues of direct relevance to the ECB. In addition, the ECB Observer may be invited on an *ad hoc* basis to IMF Executive Board meetings dealing with issues recognised by the IMF and the ECB to be of mutual interest. Moreover, the President of the ECB is invited to attend, as an observer, meetings of the International Monetary and Financial Committee. The IMFC meets twice a year in the context of the Spring and Annual Meetings of the IMF to advise and report to the Board of Governors on the supervision of the international monetary and financial system. It also provides policy guidance to the work of the IMF Executive Board.

The standing invitation to the ECB to attend IMF Executive Board meetings as an observer relates to the following agenda items: (a) Article IV consultations on the monetary and exchange rate policies of the euro area; (b) Article IV consultations with individual euro area Member States; (c) the role of the euro in the international monetary system; (d) multilateral surveillance, i.e. biannual discussion of the World Economic Outlook and the International Capital Markets Report and regular discussions on world economic and markets developments.

In all these discussions of the IMF Executive Board, representatives of the euro area member countries respect the allocation of competences provided for by the Treaty. In practical terms this means, first, that insofar as the monetary policy of the euro area is concerned the ECB Observer presents the policy positions of the European Community, and, second, that with regard to exchange rate matters, the Executive Director representing the Eurogroup Presidency and the ECB Observer both present the Community position, reflecting the regular exchange of views which takes place at the euro area level, e.g. at meetings of the Eurogroup.

Since the introduction of the euro, Article IV consultations with euro area member countries have been split into two parts which are distinct in terms of scope and timing. One part of the Article IV process concerns monetary and exchange rate issues of the euro area. The second part deals with individual euro area countries and their economic policies other than monetary and exchange rate policies (e.g. fiscal or structural policies). This two-pronged approach reflects the adaptation of IMF

procedures, which was made necessary by the new division of competences within the euro area.<sup>557</sup>

Given the implications that global economic and financial developments might have for the assessment of risks to price stability in the euro area, the ECB Observer participate in IMF Executive Board meetings which deal with multilateral surveillance. It should be added that in the preparation of the IMF's International Capital Markets Report an IMF team visits the ECB to discuss financial market issues.

Apart from the standing invitation, the ECB Observer may be invited to attend on an *ad hoc* basis for agenda items, which both the ECB and the IMF consider to be of mutual interest for the performance of their respective mandates. It has now become common practice for the ECB Observer to be invited to attend Article IV discussions concerning EU Member States, which have not yet adopted the euro, given that the ECB is involved in monetary policy co-ordination procedures with the NCBs of these Member States. Another example of *ad hoc* participation was the last quinquennial review by the IMF Executive Board of the valuation of the Special Drawing Rights (SDRs), which resulted in a change from a country-based to a currency-based approach in order to take fully into account the introduction of the euro.

The ECB is also involved in certain IMF initiatives to strengthen the international financial architecture whenever these concern the areas of competence of the ECB. This was the case for the Code of Good Practices on Transparency in Monetary and Financial Policies, which contains broad principles for the transparency and accountability of authorities in the field of monetary policy and related central bank tasks, such as payment systems and supervision. The ECB and the national

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<sup>557</sup> As for the first part, namely monetary and exchange rate issues of the euro area, an IMF delegation visits the ECB twice a year to discuss recent developments and relevant policy matters. In this context, the IMF mission also holds discussions on economic developments and policies in the euro area as a whole, which are of relevance for monetary policy and exchange rate developments, with European Community bodies which have a co-ordinating role for these national policies (like in the framework of the Broad Economic Policy Guidelines and the Stability and Growth Pact) such as the European Commission, the Economic and Financial Committee and the Eurogroup. At the Executive Board meeting dealing with the IMF staff report, the ECB Observer presents the position of the Eurosystem, while the representative of the country holding the EU Presidency conveys the position of the Eurogroup. In the second part of the Article IV process, which concerns the economic policies of individual member countries, the IMF continues to visit the individual countries to meet the respective policy-makers at the national level. (For a further analysis of this point see ECB, *The ECB's relations with international organisation and fora*, Monthly Bulletin, January 2001, pp. 61 and ff.)

central banks of the euro area have actively contributed, together with the BIS and a representative group of central banks and experts, to the design of the Code and the preparation of the Supporting Document. Similarly, the ECB is involved in the current process at the IMF of developing guidelines on the management of foreign exchange reserves. These guidelines will also be aimed at reducing the vulnerability of emerging market countries to financial crises.<sup>558</sup>

Finally, it is worth recalling that the ECB has developed working relationships with the IMF in other areas. In particular, the ECB actively participates in the application and development of international statistical standards, such as the IMF's Balance of Payments Manual within the framework of the System of National Accounts 1993.

## 7.2) *The Organisation for Economic Co-operation and Development*

The second case to be taken into account is provided by the OECD, to be qualified as a “non-monetary institution operating in the ESCB’s field of competence”.<sup>559</sup>

The OECD is an intergovernmental organisation, dealing with issues relating to the basic tasks entrusted to the Eurosystem, which provides a forum for its members to consult each other, compare experiences and co-operate in order to achieve the highest possible sustainable growth and to improve economic and social

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<sup>558</sup> In this context, it has been agreed that the IMF will prepare a “Report on the observance of standards and codes” (ROSC) dealing with the ECB’s monetary and payment systems policies in the euro area. Such ROSCs are currently being prepared by the IMF and some member countries as part of broader efforts by the international community to foster the implementation of internationally agreed standards and codes. These reports assess the observance by countries of these standards and codes in order to identify potential weaknesses that may contribute to economic and financial vulnerability. Several countries, and among them some euro area countries, have committed themselves to undergo this exercise in order to lead by example. The ROSC of the ECB will complement reports prepared by individual euro area countries, which do not deal with policies within the ECB’s fields of competence.

<sup>559</sup> See, for the above-mentioned classification, R. SMITS, *The European Central Bank. Institutional Aspects, op. cit.*, p. 426, who insightfully interprets Article 6.2 ESCB Statute (participation of the ECB in international *monetary* institutions), reading the term “monetary” as standing for “relating to ESCB tasks”. According to such a classification, the following bodies may fall under Article 6.2: (i) consultative fora on economic policy co-ordination, such as Working Party 3 of the OECD; (ii) consultative bodies in respect of banking supervision and financial market stability, such as the Basle Committee on Banking Supervision; (iii) regular meetings among bank note printers and central bankers, such as the Bank Note Printers’ Conference, as well as; (iv) fora in respect of payment systems, statistical information in the area of money and banking, etc.

well-being in line with the principles of a market economy. In pursuing these tasks, the OECD covers all areas of public policy, including monetary and other economic policies. Using Protocol No. 1 to the OECD Convention as a legal basis, the OECD Secretary General confirmed in February 1999 that the ECB would be allowed to participate in the work of the relevant committees and working groups of the OECD. As a result, the ECB is a separate member of the European Community delegation in these meetings alongside the European Commission.

As in the case of the IMF, OECD membership is restricted to countries. However, the European Community is permanently represented at and takes part in the work of the OECD in accordance with Article 13 of the OECD Convention and the related Supplementary Protocol No. 1.<sup>560</sup> Accordingly, since 1999 the ECB has participated – as part of the delegation of the European Community alongside the European Commission – in all OECD meetings in which it has an interest. The ECB and the Commission express their own views within their respective fields of competence.

The OECD Committees and Working Parties in which the ECB participates include the following: (a) Economic and Development Review Committee;<sup>561</sup> (b) Economic Policy Committee and its working parties; and (c) Financial Markets Committee.

While the EDRC held informal seminars on EMU in 1999 and 2000, a formal EDRC review of the euro area has been undertaken for the first time in 2001. In line with IMF practice, the review of the euro area mainly focuses on monetary policy and

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<sup>560</sup> The case of the European Communities is explicitly envisaged by Article 13 of the Convention on the OECD, dated 14 December 1960, and, more particularly, by Supplementary Protocol No. 1 to the OECD Convention which reads as follows: “(1). Representation in the Organisation for Economic Co-operation and Development of the European Communities established by the Treaties of Paris and Rome of 18 April 1951, and 25 March 1957, shall be determined in accordance with the institutional provisions of those Treaties. (2). The Commissions of the European Economic Community and of the European Atomic Energy Community as well as the High Authority of the European Coal and Steel Community shall take part in the work of that Organisation”.

As observed by C. ZILIOLI and M. SELMAYR, *op. cit.*, p. 237, the reference to the “institutional provisions of those Treaties” opens the door to an interpretative reference to the internal distribution of competences. It can be concluded, thus, that the OECD Convention is open to enable all potential actors of the euro area to make use of their representational rights inside the OECD.

<sup>561</sup> The Economic and Development Review Committee (EDRC) was established in 1961 with primary responsibility for conducting, on a regular basis, reviews of the economic situation and policies of each OECD member country. Such reviews lead to the publication, under the direct responsibility of the EDRC, of economic surveys that include a number of policy recommendations. Member countries may then take these policy recommendations into account on the basis of the principle of self-assessment.

exchange rate issues and covers macroeconomic (basically fiscal) and structural policies only insofar as they have an impact on the euro area as a whole. As a consequence, the review complements the reviews of individual countries without replacing them.

The Economic Policy Committee (EPC) focuses instead on the global economic situation, with particular emphasis on the implications of developments in three major OECD regions (the United States, the euro area and Japan). By examining a wide range of issues related both to economic outlooks and to policy requirements in the OECD area, the EPC provides OECD members with a comprehensive assessment. The EPC is supported by a number of Working Parties. In particular, Working Party No. 3 (WP3) monitors and assesses major macroeconomic developments (e.g. exchange rate developments, imbalances in the external and/or budget positions, systemic financial risks). Working Party No. 1 focuses on economic issues and policies of a more structural nature (e.g. the links between policies and long-term growth, the criteria for the surveillance of public expenditure, the role of automatic stabilisers). The Short-Term Economic Prospect (STEP) Working Group assists the EPC in formulating economic projections.

Finally, the ECB's involvement in OECD activities also includes participation in the Financial Markets Committee (FMC), which examines structural developments in OECD financial markets.

### *7.3) Informal fora for finance ministers and central bank governors*

- *G7 finance ministers and central bank governors*

Turning to informal fora, it has to be underlined that the G7 Ministers and Governors has become a major component of international co-operation arrangements in the field of monetary and financial policies, providing political guidance not only to the major industrialised countries but also to emerging market and transition economies.<sup>562</sup> Given its role in exchange rate policy co-operation, it is also the forum where the euro area's external representation is most difficult to be arranged.<sup>563</sup>

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<sup>562</sup> More in particular, in the statement of 25 September 1999, G7 finance ministers and central bank governors announced the creation of the Group of 20 (G20). This new informal forum of finance ministers and central bank governors was set up to involve key emerging market countries in the dialogue on international economic and financial policy issues. It aims to facilitate an open exchange of views on those matters and thus promote consensus building on issues discussed by the relevant

Nevertheless, as part of the broader framework of co-operation within the G7, finance ministers and central bank governors have met regularly to discuss key international economic and financial issues. Their meetings are mainly concerned with economic and financial developments and prospects in their respective countries, exchange rate issues and the global economy. In addition, they address issues of common interest related to international monetary and financial policy. These informal exchanges of views may help the participants to achieve a greater understanding of the different issues involved, which may also be of use in the discussion and decision-making process of international organisations such as the IMF, the World Bank or the OECD. As such, it may provide guidance for or give political impetus to the work of these organisations. The main results of the discussions are regularly summarised in joint statements following the meetings.

Up to the launch of Stage Three of EMU, participation in the meetings of G7 finance ministers and central bank governors was restricted to the respective national authorities of the G7 countries.<sup>564</sup> With the transfer of core competences related to monetary and exchange rate policy from the national to the Community level, adequate arrangements needed to be devised to take into account this new allocation of competences within the euro area. As part of this adaptation of existing practices, it was agreed that both the President of the ECB and the President of the Eurogroup should participate in those parts of the meetings that deal with macroeconomic

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decision-making bodies, such as the IMF or the World Bank. The ECB and the EU Presidency are members of the G20. Both participated in the two meetings of G20 ministers and governors, which have taken place thus far, as well as in the preparatory meetings at the deputy level. The participation of both the ECB and the EU Presidency makes it possible to bring a euro area-wide perspective to the issues under consideration. The contributions to the G20 discussion by the ECB and/or the EU Presidency are co-ordinated, to the extent appropriate, in line with the allocation of competences provided for by the Treaty.

The G20 has addressed several issues, ranging from means to reduce the vulnerability of countries to financial crises to the opportunities and challenges posed by globalisation. In respect of the former, the G20 keeps under review the adoption by emerging market economies of exchange rate regimes that are consistent with their specific macroeconomic and financial conditions. Likewise, the importance of prudent liability management is still being considered. In addition, the G20 has started a dialogue with private sector representatives on the adequate involvement of private creditors in crisis prevention and resolution. Finally, the G20 has taken an active stance with regard to the implementation of international standards and codes by committing its members to lead by example in undertaking ROSCs and Financial Sector Assessment Programmes.

<sup>563</sup> According to T. PADOA-SCHIOPPA, *op. cit.*, p. 4, this is due to the fact that “a trade-off has to be found between the need to accommodate the shared responsibilities at Community level between the Ecofin Council and the Eurosystem, on the one hand, and concerns of non-EU members to avoid an over-representation of the euro area”.

<sup>564</sup> Namely United States, Japan, Canada, Germany, France, Italy and the United Kingdom.

surveillance and exchange rate issues. Although the three central bank governors of the euro area G7 countries (France, Germany and Italy) do not participate in this part of the meetings, they do take part when the G7 discusses other issues, i.e. the international financial architecture and debt initiatives in favour of highly indebted poor countries.

As far as the monetary policy of the euro area is concerned, the President of the ECB presents the views of the Eurosystem. The President of the Eurogroup participates in the discussions on other economic developments and policies in the euro area. Given the shared responsibility of the ECB and the Eurogroup for exchange rate matters, the views presented at G7 meetings reflect prior consultations within the euro area.

- *Financial Stability Forum*

Another noteworthy forum is the Financial Stability Forum (FSF), set up in February 1999 by the G7 finance ministers and central bank governors. Its main objectives are to assess vulnerabilities affecting the international financial system and to identify action to promote international financial stability through enhanced information exchange and international co-operation in financial supervision and surveillance. Support for the FSF is provided by a secretariat located at the BIS. A member of the Executive Board of the ECB attended the early FSF meetings as an observer and has attended FSF meetings as a regular member since June 2000 in his capacity as Chairman of the Committee on Payment and Settlement Systems.

The FSF has published concrete recommendations on highly leveraged institutions, on volatile capital flows, and on offshore financial centres and has urged national authorities and international financial institutions to take the necessary steps for their implementation. It has also reviewed developments in the insurance industry relevant to financial stability and is encouraging further work in this area. In the context of the ongoing work to foster the implementation of international standards and codes, the FSF has identified 12 key standards and codes most relevant to sound and well-functioning financial systems. The FSF is currently working on the development of international guidance on deposit insurance schemes and is analysing the implications of electronic finance for supervision, regulation and market functioning.

- *The Bank for International Settlements and central bank fora*

A last word has to be devoted to the Bank for International Settlements, whose major objective is to promote the co-operation of central banks, as laid down in Article 3 of the Statute of the BIS. The ECB takes part in all BIS-based co-operation activities, including associated statistical work. In particular, the President of the ECB participates in the meetings of the Governors of the Group of Ten, which usually take place at the BIS headquarters on a bimonthly basis. This forum discusses key international economic, monetary and financial issues (e.g. economic trends both in industrial countries and in emerging market economies, potential threats to global financial stability and longer-term monetary and financial developments). Meetings are increasingly being opened to the central banks of those emerging market economies, which are of systemic importance.

#### 8) *Concluding remarks*

As highlighted in the present chapter there is a link between the creation of the euro and the potential for the EU to evolve into a unified player in the international political system; however, it is worth saying that the internal political barriers to this evolution have often been underestimated. The experiment represented by the European Monetary Union began without the issue of external representation being settled. That the euro has been created at all is a remarkable economic accomplishment, with strong political and institutional implication; yet important tasks remain.

First of all, the single currency still needs a single voice to establish the role of Europe in the world, to promote the health of the international monetary system and to ensure the long-term success of monetary union.<sup>565</sup> The absence of a unified external

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<sup>565</sup> According to what is written in a document set forth by the European Convention, WG VII on "External Action", CONV 459/02, Brussels, 16 December 2002: "The Union as international player has come a long way and over the years its role has been increasingly recognised on the global stage. At the same time, expectations continue to grow, both within and outside the EU. The challenges of globalisation and increased interdependence of States and of regions require the Union to be a strong and credible player on the international stage, not only in economic but also in political terms. The central question was therefore not whether the Union had a role to play but how it should organise itself in order effectively and coherently to promote fundamental values, defend common interests and contribute to the overall objective of global peace, security, and sustainable development" (p. 11).

front may, in the long run, prevent the euro from becoming a strong currency. Therefore, it has been argued that the EU needs to develop a clear system of political representation in the area of monetary and financial governance, which could be done by strengthening the Eurogroup and appointing a Mr/Ms Euro or a “European External Representative”<sup>566</sup> The Draft Constitution, for instance, opens up interesting perspectives in this direction, mainly related to the presentation and defence of a common position in international fora and to the questions summed up in some proposals made during the Convention work by the reference to a “single chair”.<sup>567</sup>

Moreover, the evolution of the euro’s external face is likely to have several policy implications. An important issue raised by the euro’s external voice is, for instance, how it will deal with EU enlargement. The newly realised enlargement to incorporate ten new countries, with disparate if not contradictory interests, poses a double sense of urgency for devising an adequate system of external representation for the euro. First, the arrangement agreed on for external representation has to function efficiently with a greater number of Member States. Experience in the field of trade policy tends to suggest that institutions designed for a small number of Member States do not work properly when membership greatly expands. Therefore, an informal arrangement designed for twelve members may no longer be adequate when the single voice has to represent twenty-five and more different countries. Second, the current members may have an interest in “locking in” their preferred institutional design before new members join. For instance, the large Member States that are currently in the euro zone may prefer an arrangement that favours them at the expense of smaller States – especially before more small States become members of the EU. Both the “efficiency” and the “lock-in” arguments call for an urgent resolution to the institutional question of the euro’s single voice.

In addition, the increased profile of Europe in the foreign economic policy realm raises once again the question of the so-called “democratic deficit” of policy-

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<sup>566</sup> See on this point K. R. MCNAMARA and S. MEUNIER, *Between national sovereignty and international power: what external voice for the euro?*, in *International Affairs* 78, 4 (2002), 849 – 868. In particular, the authors argue that the Eurogroup’s explicitly political linkages to the national governments and their publics could be a source of both policy effectiveness and legitimacy in the euro’s external voice.

<sup>567</sup> See, on this point, J.-V. LOUIS, *The Economic and Monetary Union: Law and Institutions*, CML Rev 41, 2004, pp. 606 and ff. who argues that “it is only through a single representation that the Euro area will truly appear as a unified economic area”. But he realistically adds that “unfortunately, the request for a single chair very often appears almost as a slogan without a clear content”.

making in the EU. To what degree does the transfer of sovereignty over issues of international monetary co-operation and representation in international organisations require enhanced democratic accountability at the new, EU level of governance? The two arguments most often put forward to justify the apparent absence of democratic input into many EU decisions are: first, that such decisions are more efficient and, second, that technocratic elites understand better than ordinary citizens how to govern. On the face of it, both arguments seem particularly applicable to the case of financial and monetary affairs where, first, speed of reaction and flexibility are of the essence and, second, problems are extremely complex and technical. But one may wonder: what are the limits of this logic? There is also a strong case to be made that, as the EU continues to consolidate policy-making capacity at the centre, it must move beyond the model of insulated decision-making without political representation. The above-mentioned proposal to strengthen the Eurogroup places policy-making squarely in the hands of political representatives who are accountable to their national publics. However, it continues the tradition of elite decision-making without involvement by a direct European-level representative body, the European Parliament. Oversight by the European Parliament is thus critical to sustaining the legitimacy of the Eurogroup; but the Eurogroup must also have a good degree of freedom to pursue its delicate policy-making initiatives which, in certain areas, such as that of exchange rates, will not allow for pre-approval. Ideally, the presence of Mr or Ms Euro will improve the potential for democratic accountability. It might be easier to offer accountability if citizens, and parliamentarians, have one person to praise or blame for the performance of the EU in international monetary affairs.

Finally, despite the absence of political efforts to address upfront the issue of the single voice of the single currency, there seems to be an increased awareness in Europe that the EU has a role to play in the world, and thus that more external co-ordination on the euro is needed. Such co-ordination cannot be discussed, however, independently of the broader question of the institutional future of the European Union highlighted at the 2004 intergovernmental conference. Whether Europe is to become a federal State, as proposed by some German politicians, or a loose collection of Member States, as proposed by some French politicians, will undoubtedly determine whether and how a solution will be found to the practical problem of the external representation of the single currency. It is hard to imagine how the single

currency could acquire a common external voice in the event that the EU turns away from a more federal future.

## CONCLUSIONS

### *1) Towards a critical assessment of the meaning of monetary sovereignty in Europe*

After having investigated the more relevant issues related to the emergence of a new configuration of power in the European Union, it is now time to provide a workable answer to one of the main questions posed at the outset, which can be summarised as follows: who is supposed to be the sovereign, bearer of an ultimate claim to a final authority in monetary matters,<sup>568</sup> and how and through which institutions and procedures democratic control over the newly emergent monetary sovereignty can be exercised within Europe? In other words, the purpose of the present conclusions is that of making a proposal – based on the empirical evidences highlighted in the previous chapters – to identify the institutional *locus/loci* of monetary sovereignty and the sources of its/their legitimacy.

As already outlined in the Introduction, these final considerations are founded upon the application of Karl Popper’s falsifiability method, showing that, having an initial problem (in the present case the definition of the concept of monetary sovereignty as operating within the multilayered context of EMU), one may try to find some workable attempted solutions, consisting of theories, trials, or better, hypotheses or conjectures. As a further step, these “tentative theories” can be eliminated through a critical discussion, including empirical testing, leading to the elaboration of a new, more comprehensive problem.

Assuming that, in a strictly technical sense, the idea of monetary sovereignty embraces “the power to adopt and issue a currency as legal tender within a given

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<sup>568</sup> This preliminary question has been also differently formulated in Chapter One, *Sovereignty in transition*, in the following manner: is it legitimate to argue that this money-based sovereignty is a supreme, autonomous and self-contained power, considering that it expresses itself exclusively in a functionally defined field (that of monetary transactions within and around the euro area), which seems to be significantly detached from the influence of the political sovereignty of the Nation States?

territory and regulate the money supply (*forum internum*), to impose exchange control regimes, uphold restrictions on movements of capital and current payments, and decide upon the mechanisms to determine an exchange rate (*forum externum*)”,<sup>569</sup> it has been initially accepted the hypothesis according to which the European Central Bank became the exclusive bearer of such a power since 1 January 1999 by virtue of the complete denationalisation of monetary policy occurred at that time.<sup>570</sup>

Having that in mind, it should be indeed emphasised that the current definition – adopted as a working tool for heuristic purposes - suggests that there is (or there should be) a close link between the conduct of internal monetary policy (i.e. the regulation of money supply and interest rates as the core variables in monetary policy) and the exchange rate policy. In other words, monetary sovereignty as operating in *foro interno* should go hand in hand with the same degree of power to be exercised in *forum externo*. This approach would contribute to identify a strong, granitic power to be managed by a single authority, which might be – at first glance – the ECB.

Surprisingly, though, the empirical analysis displayed in the previous chapters has showed that it is indeed possible to pursue both policies separately. As rightly observed by Christoph Herrmann, “interest rates and money supply are not the only variables influencing exchange rates in an open economy”.<sup>571</sup> Long-term expectations of future exchange rates and the overall economic prospects of a currency area, as well the behaviour of political actors (in particular taxation policies), do influence the

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<sup>569</sup> See, for this definition, C.W. HERRMANN, *Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice*, in *European Foreign Affairs Review*, No. 7, 2002, p.3. Another similar definition is given by D. CARREAU, *Le système monétaire international privé*, Académie de Droit International, Recueil Des Cours, Vol. 274, 1998, p. 372, who, focusing of national monetary sovereignty, emphasises that “la souveraineté monétaire de l’Etat consiste pour celui-ci à fixer la valeur de sa monnaie, c’est-à-dire à en déterminer le taux (ou le prix) auquel celle-ci s’échange contre d’autres monnaies nationales; à déterminer l’usage qui peut être fait de sa monnaie, c’est-à-dire d’en fixer la convertibilité; à contrôler la masse monétaire nationale par le biais de l’encadrement du crédit à l’économie.

<sup>570</sup> Note again that from 1 January 1999, eleven Member States (all except UK, Denmark, Sweden and Greece) participate in the final stage of EMU by virtue of Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro [1998] OJ L139/1. Greece moved on later to stage three on 1 January 2001 by virtue of Council Decision [2001] OJ L 167/19.

For a strong doctrinal elaboration on the impact of such a transfer of monetary sovereignty to the national to the supranational level in terms of denationalisation and depoliticisation of monetary policies, see, in particular, C. ZILIOLI – M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, notably pp. 13 and ff.

<sup>571</sup> C.W. HERRMANN, *Monetary Sovereignty over the Euro and External Relations of the Euro Area: Competences, Procedures and Practice*, in *European Foreign Affairs Review*, No. 7, 2002, p. 6, who interestingly enough points to the fact that the exchange rate of the euro area so far has been more influenced by the lack of a coherent European economic policy framework than by monetary policy issues.

exchange rate in a market oriented open economy, where exchange rates are determined by supply and demand. As a result, monetary sovereignty “in practice” (both in its internal and external dimension) may be affected by the concurrent action of different institutional and not institutional subjects who have a say in the effective regulation of monetary matters.<sup>572</sup>

## ***2) The actors contending the exclusive attribution of monetary sovereignty upon the ECB***

The most significant and paradigmatic fields in which monetary sovereignty as an exclusive attribution of the ECB is questioned are: (i) the external relations of EMU as disciplined by Article 111 EC Treaty, which highlight a very peculiar tension between the ECB and the Ecofin Council; (ii) the co-ordination of macroeconomic policies (more precisely the interaction between monetary and fiscal policies), which sheds light on the difficult search of an institutional balance between the two legs of EMU; (iii) the non institutionalised area covered by the action of globalised and even more integrated financial markets operating in an open economy.

### ***2.1) The tension between the ECB and the Ecofin Council***

As a very general remark on the first point, one may observe that, crucially enough, the examined law governing the external relations in the EMU confirms the introductory statement according to which, in the post-Maastricht era, a turnover (or “a governance turn”) of the Community legal order has occurred. In fact, having regard to the potential conflict between the Community (the Ecofin Council) and the ECB, one may easily identify two main actors fighting with each other for the attribution of the role of the natural bearer of external competences in the field of monetary policy.

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<sup>572</sup> This argument is interestingly put forward also by M. MORAN, *Politics, Banks and Markets in Euroland*, in K. DYSON (ed.), *The European State and the Euro: Playing the Semi-Sovereignty Game*, Oxford University Press, Oxford, 2001, pp. 124-149, who highlights the challenging interaction of different levels in the case of the regulation of banking and finance in Europe: (i) the European level; (ii) the level of national systems of financial governance, and (iii) that of the evolving global system.

Leaving aside the implied power doctrine, if one looks at the explicit Treaty's provisions – notably Article 111, 59, 60 and 105 EC – it seems that all the fundamental decisions a monetary sovereign can take from the perspective of public international law, and with regard to which it can bind itself *vis-à-vis* other international legal persons are to be taken by the Council as the principal legislative body of the Community. It is for the Council to take highly political decisions to enter into formal exchange rate systems, restrict the flow of capital and payments<sup>573</sup> or enter into other monetary or foreign exchange regime agreements.

To put it in terms of monetary sovereignty: the powers of the ECB in the internal dimension do not say anything about the external dimension (exchange control, restrictions and exchange rate system). They are not mirrored as requested by the implied powers doctrine of the ECJ.

In any case, even if one focuses only on the internal dimension of monetary sovereignty, it would be still possible to appreciate a pretty strong role played by the Council, whose powers *vis-à-vis* the ECB may be constitutionally classified in legislative, juridical and executive.<sup>574</sup>

The legislative powers, for instance, involve the adoption of rules governing the powers of the ECB (Article 107.6 EC Treaty), amendments on certain provisions of the Statute of the ECB (Article 107.5), and adoption of rules permitting the ECB to impose obligations on third parties (Article 20, 2<sup>nd</sup> sentence ESCB Statute). The quasi-judicial function of the Council is the power to decide whether derogation from entry into stage three of a Member State shall be abrogated (Article 122.2 EC Treaty). Finally, the executive powers are the power to appoint the members of the Executive

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<sup>573</sup> See Article 59 EC Treaty which reads as follows: “Where, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the ECB, may take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary”.

<sup>574</sup> For such a classification see B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien, 2003, pp. 142 and ff.

Besides, another important power to be taken into account is the Presidency of the Council's right under Article 113.1 EC Treaty to participate in meetings of the Governing Council. Not only implies the use of the term “participate” a right to speak and join in deliberations, not simply a right to attend silently, but also the legitimate attempt to convince the Governing Council, the limits to these attempts being posed by Article 108 EC Treaty. In addition, the President may also submit a motion for deliberation to the Governing Council of the ECB. Even if he is not entitled to vote and cannot compel the Governing Council to adopt his proposal, the Council, in this way, has influence on the agenda of the ESCB. It must be stressed, though, that the President of the Council in general only once during his six-months period at the helm of the Ecofin Council uses this possibility of participation.

Board of the ECB (Article 112.2 (b) EC Treaty), the conclusion of a formal agreement for an exchange rate system for the euro in relation to non-Community currencies, as well as the formulation of general orientations for exchange rate policy (Article 111.1 and 111.2 EC Treaty).

With this picture in mind, it can be argued that, on a general level, the interaction between these two different actors highlights a very important characteristic of the changing process going on in the EU as such – represented, again, by the unprecedented possibility of a horizontal conflict between the Community and a separate entity with international legal personality under Community law – that is its fluidity. This so-called fluidity, however, is not only a mere consequence of strict legal provisions, but “the result of the increasing complexity of the real world itself”,<sup>575</sup> which is becoming more and more multifaceted. Against this background, one may conclude that the euro area is a kind of “putative polity”,<sup>576</sup> which must be (and has been actually) tested with an approach based on the effectiveness of the conduct put into being by the different institutions involved. In this sense, it is legitimate to affirm that the Treaty and the Statute establish a new and maybe unusual interaction in the internal and external relations of the Eurosystem between the Community, the ECB, but also the Member States<sup>577</sup> and the NCB's, thus involving different types of actors on the same stage, unified by the requested principle of the attainment of the same goal. As a matter of fact, all of them are called on to

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<sup>575</sup> C. ZILIOLI – M. SELMAYR, *op. cit.*, 349.

<sup>576</sup> N. WALKER, *Late Sovereignty in the European Union*, in *Sovereignty in Transition*, Oxford, Hart Publishing, 2003, p. 26.

<sup>577</sup> As far as the interaction between the Community and the Member States is concerned, J.-V. LOUIS, *The Economic and Monetary Union: Law and Institutions*, CML Rev 41, 2004, p. 607, argues that “it should not be acceptable that Euro area Member States continue to express their voice in fields where either they are not competent or they are under commitments to coordinate their policy within the Union”. The author goes even further by observing that “the international scene may not be used as a means of undoing the solidarity achieved within the Union, or of escaping from the discipline imposed by the Union”. As argued elsewhere (cfr. J.-V. LOUIS, *EMU as a Loss of Sovereignty for the Member States in Favour of the EU*, in M. GIOVANOLI (ed.), *International Monetary Law. Issues for the New Millennium*, Oxford University Press, Oxford, 2000, notably at p. 535), this principle has been clearly expressed in Ruling 1/78 of the ECJ, para. 32, where the Court underlined that “to the extent to which jurisdiction and powers have been conferred on the Community under the EAEC Treaty, the Member States, whether acting individually or collectively, are no longer able to impose on the Community obligations which impose conditions on the exercise of prerogatives which thenceforth belong to the Community and which therefore no longer fall within the field of national sovereignty”. A further consequence of such an approach on the international arena is represented by the fact that “it is contrary to EC law to create or maintain a situation in which individual political authorities or national central banks of participating Member States should be able to intervene individually within the IMF framework” (*Ibidem*, p. 535).

demonstrate themselves as an efficient means of co-ordinating the diverging interests related to the single European currency in the vast field of international monetary co-operation.

## *2.2) The picture given by the asymmetrical interaction of monetary and fiscal authorities: towards more intergovernmentalism?*

As observed at the outset (namely in Chapter Two), the economic governance<sup>578</sup> of the European Union, and especially of the euro area, has seen a rapid development since the Maastricht Treaty was signed in 1992 and European Monetary Union started in 1999. Such a factual and institutional development must thus be followed by a new, more flexible theoretical reconstruction.

The Treaty set the institutional framework for policy co-ordination through the triad of an independent European Central Bank, the Excessive Deficit Procedure and multilateral surveillance through the Broad Economic Policy Guidelines. Subsequently, a whole range of complementing processes, methods and strategies have been introduced, starting with the Stability and Growth Pact 1997, the European Employment Strategy (Luxembourg Process) 1997, the Cardiff Process 1998 for product and capital market reform, and the Macroeconomic Dialogue (Cologne Process) 1999. Some of these procedures, notably the SGP and the Macroeconomic Dialogue focus more on stabilisation policies, the policy mix and demand management, others like the Luxembourg and Cardiff Process emphasise structural reforms and the supply side.<sup>579</sup>

Having that in mind, it should be underlined that – with the exception of the ECB – all of the recent institutional innovations have significantly strengthened intergovernmental policy co-ordination; no further policy conferrals to the European level have taken place, while new procedures like the Open Method of Co-ordination

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<sup>578</sup> The term governance is here applied to refer to specific ways of deciding and implementing policies through informal rules and formal institutions and a set of agreed objectives. Different institutional arrangements and policy-orientations define different regimes of governance.

<sup>579</sup> Note that the Lisbon Strategy in 2000 has also institutionalised and developed the Open Method of Co-ordination (OMC), which was further fine-tuned at the European Council in Stockholm (2001), Barcellona (2002) and Brussels (2003).

have been extolled as reorganising the modes of European construction.<sup>580</sup> This may reflect a general trend towards more intergovernmentalism. Yet, the optimality of this development should be questioned.<sup>581</sup> In fact, while economic integration requires institutions endowed with the authority to enact Europe-wide policies, this need may be traded off against costs from imposing identical policies upon heterogeneous groups.

What thus need to be understood is whether the newly developed methods of intergovernmental co-ordination are appropriate for the tasks they are meant to accomplish. While not all European objectives need to be decided or implemented by a central authority, it is also clear that not all forms of intergovernmental policy co-ordination will have the same effectiveness. There is a role for both intergovernmentalism and the Community method.

First of all, policy co-ordination is indeed necessary when there are autonomous and non-unified decision-makers – with possibly incompatible preferences and objectives – and when their action may cause spillovers into each other's jurisdiction. Hence, policy co-ordination is an indispensable feature of intergovernmentalism. Nevertheless, if co-ordination fails to produce a coherent set of actions, delegation of decision-making to a central authority may be required. That is why more integration by conferral was the appropriate response to the case of monetary policy.

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<sup>580</sup> In EU practice, the Open Method of Co-ordination (OMC) may be consistent with this model of intergovernmentalism. This method is available in relation to economic policy (by virtue of Article 99 EC Treaty) and employment policy (Articles 126-130 EC Treaty), and its extension was envisaged by the Lisbon Summit. However, it has not yet been extended to other areas.

By requiring Member States to focus on a common problem and to consider their legal acts in relation to this problem and in a comparative perspective and by exposing their acts to peer review, open co-ordination provides favourable conditions for national legislatures to learn through monitoring. Therefore, open co-ordination offers a constructive approach to dealing with the growing pressure for European solutions under conditions of politically salient diversity.

The usefulness of this method for allowing Member States to compare their efforts and learn from the experience of others is acknowledged by the Commission in its White Paper on *European Governance*, COM (2001) 428 final of 25 July 2001, OJ 2001, C 287/5, available at [http://europa.eu.int/comm/governance/index\\_en.htm](http://europa.eu.int/comm/governance/index_en.htm). However, the emphasis is currently on containing such pluralism. In fact, according to the Commission, the method “must not dilute the achievement of common objectives in the Treaty or the political responsibility of the institutions. It should not be used when legislative action under the Community method is possible” [COM (2001) 429, p. 22]. In referring to the Community method, the Commission has clearly in mind a more centralised approach to integration, which relies on the enactment by the Union institutions of regulations or directives within the meaning of Article 249 EC Treaty.

<sup>581</sup> See S. COLLIGNON, *Is Europe going far enough? Reflections on the Stability and Growth Pact, the Lisbon Strategy, and the EU's Economic Governance*, LSE and CEP, April 2003.

On a more general level, it should be noted that the described configuration of EMU is, anyhow, an inevitable consequence of the unique European blend of federal and intergovernmental structures. As increasingly recognised in the discussions of the Convention, in fact, the governance of the EU cannot be based on standard federal models in which responsibility for a federal fiscal policy would be delegated to a central government (as in the case of monetary policy). It must rest on a “joint government” model in which the Commission, the Council and the Eurogroup play their roles.<sup>582</sup> As a result, what can be concluded from this discussion is that the EU should, as much as possible, save on co-ordination costs while envisaging procedures to make a joint decision possible when needed. To embark on cumbersome routine co-ordination exercises whose influence on actual policy behaviour is minimal makes little sense and can only increase the Member States’ reluctance to effectively regard their policies as a matter of common concern. Rather, the EU should foster multilateral policy transparency and predictability while designing procedures that would allow Member States to undertake joint action when needed.<sup>583</sup>

In any case, leaving aside for a while all these perspectives *de iure condendo*, the fact that, at the moment, there is no European political voice which could act as a counterweight to the centralised monetary component of EMU (condemned to face a plurality of voices, positions and actions) may only lead to the conclusion that the highlighted imbalance represents both the strength and the weakness of the EMU experiment.<sup>584</sup> Strength, as it enabled EMU to take off where no progress would have

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<sup>582</sup> Note that according to the allocation of competences in this matter, the Ecofin Council is responsible both for defining the rules and implementing them, i.e. both for legislation and for policy. Its role for rules-setting is not properly challenger, but still the Eurogroup is increasingly competing with it in the policy sphere. In particular, as policy decisions pertaining to the functioning of the euro area only matter for the members of the Eurogroup, this creates a temptation for the latter to behave as a caucus within the Ecofin and to pre-empt decisions for which it feels legitimated, such as the preparation and the approval of the BEPGs. See for a further elaboration on this point, B. COEURÉ and J. PISANI-FERRY, *Autour de l'euro et au delà: l'UEM et les coopérations renforcées*, Report of a working party, Commissariat général du Plan.

<sup>583</sup> An intriguing proposal made by J. PISANI-FERRY, *A Sustainability Pact for the Eurozone*, Paper presented at the Symposium *Governance and Legitimacy in EMU*, EUI, Florence, 27-28 June 2003 is in the direction of empowering the role of the Eurogroup by giving it the ability to adopt policy guidelines by qualified majority upon Commission proposal, after the latter has determined that the situation requires a common policy response. To remain credible, such guidelines should not be used too frequently, rather they should only be adopted when there is a clear case for joint action. The Council should then refrain from instructing Member States to modify their policy choices in the absence of explicitly defined externalities.

<sup>584</sup> This is the argument put forward by B. DUTZLER, *The European System of Central Banks: An Autonomous Actor? The Quest for an Institutional Balance in EMU*, Springer, Wien, 2003, p. 269.

been possible otherwise. Weakness, as the initial compromise will continue to limit, for the years to come, the possibility to further develop economic co-operation. Moreover, the asymmetrical structure does not strengthen the ECB as a sovereign actor, but rather leads to a loss of credibility. The lack of unity between monetary and economic policy may thus be seen as a serious political deficit.

### *2.3) The role played by financial markets in the elaboration of new forms of “co-operative law”<sup>585</sup>*

As already highlighted in the introductory remarks, the limitations of Nation States’ political and legal frameworks in tackling phenomena arising from globalisation are increasingly evident.<sup>586</sup> Of more consequence, reality is ahead of theory in that the transnational markets seem to sustain and develop themselves without having to refer to their ordering to the constitutional organisation of the Nation State and to judiciary adjudication. The awareness of a commonality of fears, like the uncertainty of risk and the growing complexity of transactions, has led public authorities and private parties to put together mechanisms of trust with a view to creating order and governance among themselves. In this context, the legal significance of relations that, for example, range from relational contracting to complex associations, such as networks, should be established to a high degree. They represent a main source of the regulatory regime that govern global and regional economies.<sup>587</sup>

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<sup>585</sup> To appreciate the meaning of this expression one may refer to what has been stated in the Commission Report on *Enhancing democracy in the European Union*, Working Programme, SEC (2000) 1547, 7 final of 11 October 2000, available at <http://europa.eu.int/comm/governance/work/en.pdf>, according to which “the essence of the European Union is the construction of a Community that is founded on law and that also respects the identity of its Member States. This requires a delicate balance between the institutions that establish this law, characterised by an unique sharing of legislative and executive powers as well as an obligation *towards co-operation*” (Emphasis added). In addition, “as governance is grounded in ideas of interdependence and interaction between various powers at multiple levels, improving governance will help to improve the conditions under which this equilibrium functions and co-operation occurs”.

<sup>586</sup> It should be recalled that Nation States are no longer autonomous in determining political priorities, but need to co-ordinate their policies within international institutions; (ii) national political actors have to strive for recognition not just by their national constituencies; their practices are increasingly exposed to evaluation at the international level; (iii) the Nation States still retain significant resources, which are indispensable for the implementation of internationally agreements upon different policies.

<sup>587</sup> The described process has definitively led to the experience of regionalisation embodied by the experiment of a monetary union in Europe, as an attempt to face the challenge of globalisation, with the

Against this background, one may theorise the existence of forms of “co-operative law” elaborated by public authorities within co-operative regulatory bodies, which provide governance to the international and European financial markets.<sup>588</sup>

An important implication of this sketched state of affairs to be brought to legal theory is that legal pluralism, the qualitative multiplicity of sources and discourses of law, has been used as the concept to be more appropriate to define the process going on within the EU (and one may add also within the EMU). Such pluralism is not rooted in hierarchical assumptions, such as the one between the public and the private sphere. Hierarchies, if at all in existence, get blended in the way that market actors, independently of their original nature (be it public authorities or market participant) functionally distribute tasks in order and governance.<sup>589</sup>

This being so, the contention is that, other than mere public regulation, the concept of legal pluralism is put at stake as the source of market governance. This is because the formal rationality that informs hierarchical power depends on the

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transfer of monetary powers to a higher, supranational level. This is the interesting thesis defended by D. CARREAU, *Le système monétaire international privé*, Académie de Droit International, Recueil Des Cours, Vol. 274, 1998, p. 371, who explicitly links the end of national monetary sovereignty to the forces of financial markets and to the experiments of regionalisations like monetary unions. On this basis, he puts forward the hypothesis according to which “peut-être d’ailleurs est-ce parce que les Etats membres de l’Union européenne ont pris conscience de ce phénomène” – the developments of financial markets and their frontal threat to national sovereignty over money – “qu’ils ont accepté de sacrifier si facilement leur monnaie nationale au profit d’une monnaie unique au titre d’une union économique et monétaire”. Further references to the doctrine are extensively reported in Chapter One. It should be worth here adding to the already sketched list the contribution of E. SCODITTI, *La Costituzione senza popolo. Unione Europea e Nazioni*, Edizioni Dedalo, Bari, 2001, who draws an interesting line between the converging phenomena of economic and political integration as a deeper response to globalisation. He argues, in fact, that “l’opinione che attraverso l’unificazione politica gli Stati europei possano recuperare margini di influenza politica sul ciclo economico è diffusa, e deriva anche dal convincimento che la globalizzazione ha mutato i contenuti della *governance* internazionale: se in passato si trattava di risolvere i problemi conseguenti alla coesistenza tra Stati, oggi diventano materia di *governance* internazionale molte delle questioni che una volta le nazioni gestivano nei propri *interna corporis*, quale espressione della giurisdizione domestica”. On this very last point, it may legitimately argued that the same reasoning can be applied to the case of monetary sovereignty as a matter of interest for the new forms of governance.

<sup>588</sup> A concrete example might be given by the Basel Committee on Banking Supervision, whose aims are of comparing supervisory methods and establishing privileged channels of communication between banking authorities, and also to co-ordinate joint policy on the supervision of international banking. The building principles of such a form of legal integration are related to the rules of conflicts for supervisory competences. As a standard practice, for instance, there are agreements according to which a banking authority should have the responsibility to oversee the activities of the banking groups established in their respective countries with the inclusion of foreign branches: the so-called principle of home-country control. All this represents a form of institutionalisation of multilateral co-operation as an option to a central supranational authority or to mere bilateral assistance.

<sup>589</sup> For a critical assessment see K.-H. LADEUR, *Globalisation and the conversion of democracy to polycentric networks: Can democracy survive the end of the Nation State?*, EU Working Paper in Law, Law03/4, 2003.

possibility of making clear causal connections in order for rules to be produced. In a complex economy this is simply not feasible as markets are numerous and technically manifold, thus revealing themselves to be quite hermetic to external observation from, and consequently regulation, by a central authority (this last element representing a remarkable point of weakness for the ECB and for NCBs as supervisory bodies of financial stability).

As a consequence, given the difficulties in establishing legal centralism for a complex economy, especially out of a Nation State, law-making in transnational markets is assuming very distinct and innovative features, which strongly call for the previously analysed concepts/requirements of independence, accountability, credibility and transparency of the subject supposed to be the main interlocutors of financial markets.<sup>590</sup>

From here, it should be added that all the parties involved in what can be defined as the “semi-sovereignty game”<sup>591</sup> have the common perception that the attainment of a public good is at stake (specifically, in the case of EMU, the maintenance of price stability) in the arrangement of specific institutional relations. Where a central authority is lacking (as in the case of fiscal policy), it should follow that the members of such communities create and then align with a special set of rules, norms and strategies, which ideally conform to the public good or benefits involved in the market-exchanges. As a result, the formation of new, overlapping regulatory organisations seems to be an appropriate means for the market regulators and market participants to select, develop and issue the norms that will regulate their relations.

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<sup>590</sup> As specified in the Commission White Paper on European Governance, in the section on *Enhancing democracy in the European Union*, Working Programme, SEC (2000) 1547, 7 final of 11 October 2000, available at <http://europa.eu.int/comm/governance/work/en.pdf>, the applied idea of good governance “emphasises transparency, accountability and effectiveness as necessary conditions for successful public policy”. All these feature are required to support “the challenge of articulating the action of independent public actors at different geographic levels towards shared objectives”.

<sup>591</sup> K. DYSON (ed.), *The European State and the Euro: Playing the Semi-Sovereignty Game*, Oxford University Press, Oxford, 2001.

### 3) *Back to theory: how to interpret the dynamics occurring in the EMU as a metaphor for the EU in terms of sovereignty*

The descriptive and prescriptive trend of European economic and monetary policies, as outlined above, is towards a “Europe singing like a choir – remembering of course that the choir concept is not meant to replace totally the one voice”.<sup>592</sup> Training several different voices to sing in harmony is at the best of times a most difficult task; one should not thus be surprised if for a long time yet the European choir will often sing out of tune. “Even when successful, one should further not forget that a good choir sometimes sings in unison, other times in several voices and occasionally there is even scope for soloists”.<sup>593</sup>

In order to make sense of such a metaphor, one may go even further by applying the more sophisticated idea of musical counterpoint to the new modes of governance in the EMU. As highlighted in the doctrine, counterpoint is the musical method of harmonising different melodies that are not in a hierarchical relationship *inter se*.<sup>594</sup> It consists of the art of combining in a musical composition two or more melodic lines, each with its own identity. The discovery that different melodies could be heard at the same time in a harmonic manner was one of the greatest developments in musical history and greatly enhanced the pleasure and art of music.

Similarly, in law matters, theorists have to learn how to manage the non-hierarchical relationship between different legal orders and institutions and to discover how to gain from the diversity and choices thereby offered to the interpretation without generating conflicts that ultimately will destroy those legal orders and the values they sustain.

As already seen, there is much to be gained from a pluralist conception of the EU legal order. Nevertheless, to take full advantage of this legal pluralism one needs

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<sup>592</sup> J.H.H. WEILER, *The Evolution of Mechanisms and Institutions for a European Foreign Policy: Reflections on the Interaction of Law and Politics*, EU Working Paper in Law, No. 85/202, 1985, p. 25.

<sup>593</sup> *Ibidem*, p. 25.

<sup>594</sup> See, in the doctrine, A. EVANS and A.D. MC LUCAS, *Musical Counterpoint and Governance Problems in EU Law*, *European Public Law*, Vol. 9, No. 2, 2003, pp. 269-294 and M. POIARES MADURO, *Contrapunctual Law: Europe's Constitutional Pluralism in Action*, in N. WALKER (ed.), *Sovereignty in Transition*, Hart Publishing, Oxford, 2003, pp. 501-537.

to discover forms of reducing and managing the potential conflicts between legal orders and institutions in terms of overlapping competences while promoting communication between them and requiring courts to conceive of their decisions and the conflicts of interests at hand in the light of a broader European legal order – one which arises from the discourse between the EU and national legal orders.<sup>595</sup>

This approach treats European integration as such, but also, and more specifically, European integration around money, as a dynamic process of constitution-making instead of as a mere consequence of the enforcement of international treaties which establish and develop an organisation of international co-operation. In this newly emerging polity, on the one hand, the problem of compatibility between different legal systems or sub-systems is presented as a problem of co-ordination whose only answer can be found in each system adapting its own set of perspectives to the possible contacts and collisions with other systems. On the other hand, the issue of competences allocated among different parties should instead concentrate on “the framing of the institutions that exercise them and on the transparency necessary for political accountability, so that citizens know who exercise which competences on their behalf and with whose consultation and participation”.<sup>596</sup>

But how does sovereignty fit into this picture? Against this theoretical background, one may still legitimately argue that sovereignty is supposed to remain a feature of the system, even though it is now located in a multiplicity of institutional seats: the new emergent transnational private legal regimes or the new supranational organisations with their institutions which have a voice “in the choir”. In any case, it should be observed that all these institutions constrain the autonomy of the Nation States, which, while operating under the rule of law, are caught in a web of obligations they cannot disregard easily.<sup>597</sup> As a result, the game of sovereignty is

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<sup>595</sup> This is again an implication stemming from an application of the multi-level constitutionalism, a perspective that views the Member States’ constitutions and the Treaties constituting the European Union – despite their formal distinction – as “a unity in substance and as a coherent institutional system, within which competence for action, public authority or, as one may also say, the power to exercise sovereign rights is divided among two or more levels” (I. PERNICE, *Multilevel Constitutionalism and the Treaty of Amsterdam: European Constitution-Making Revisited?*, CML Rev 1999, p. 717).

<sup>596</sup> M. POIARES MADURO, *Contrapunctual Law: Europe’s Constitutional Pluralism in Action*, *op. cit.*, p. 537.

<sup>597</sup> On this point, S. SASSEN, *Losing Control? Sovereignty in an Age of Globalisation*, Columbia University Press, New York, 1996, notably at p. 29, refers to “an unbundling of sovereignty”

now mainly Europe-oriented, especially in the field of monetary policy, where one might be tempted to adopt the expression of “Euro-sovereignty” (with its polysemic reference to the single currency).

Having all these considerations in mind, it is now worth trying to close the circle at the theoretical level. As a matter of fact, at the outset of the present work it has been assumed that sovereignty may be seen *in primis* (but admittedly in a very narrow way) as the final capacity to make binding decisions in political and social contexts and to assure the implementation of those decisions. To aid in the application of this definition, it has been distinguished between formal sovereignty - that specifies the sovereign through clearly articulated or implicitly understood rules, laws, norms, and social and cultural conventions - and sovereignty in practice that reflects the reality of decision-making and implementation. When sovereignty in practice closely corresponds to formal sovereignty, one might expect order and legitimacy to prevail. On the contrary, when sovereignty in practice departs significantly from formal sovereignty, one might expect turbulence and change on the horizon.<sup>598</sup>

Without any further elaboration, this working definition already admits readily that sovereignty is not indivisible but can be and regularly is divided up, parcelled out. One institution may be sovereign in one context and a different institution may be sovereign in another, without the need to establish proper formal hierarchies (as already observed in the case of the regulation of monetary and fiscal policies where the ECB and the Member States have a different, concurrent say). Viewing sovereignty in this manner also allows arguing that, over a spatial/temporal horizon, the concentration of sovereignty may change in a very variable manner.

Moving on to a more sophisticated version of this theory, it can be observed that from a jurist’s strictly conceptual perspective, one of the main questions of constitutionalism referring to sovereignty is strongly hierarchies-based; it is namely represented by the problem of how to establish a new legal obligation of the law-maker without violating sound principles already existing in a superior legal order. Therefore, the legalisation of law-making – i.e. the subjection of the law-giver and his

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characterising an “epochal change”, with respect to which “the vocabularies, categories, master images” reveal their inadequateness.

<sup>598</sup> Note that the described bipolar scheme of reconstruction has been specifically applied to the case of the ECB, with the aid of a further classification in terms of internal and external monetary sovereignty. See, in particular Chapter Four and Chapter Six of the present work.

or her action to the rules of the law – seems indeed to presuppose a legal hierarchy: one is led to assume that the law which stipulates the requirements for the enactment of the law must have a higher authority than the enacted law itself. However, this would force the observer to surmise a hierarchy of law-giving authorities, with the truly supreme authority of the ruler who makes the rules about lawmaking at the top, and the derived authority of the lawmaker proper who is bound by the rules of the supreme power below. This hierarchical conception of law forces the analysis to find a source of law which is superior to the sovereign law giver, and even this “super-sovereign” must be ruled by a super-super-sovereign because, according to this hierarchical logic, his or her right to make rules for the sovereign must in turn be based on a superior law.<sup>599</sup> This drives indeed into an infinite regression. Luckily enough, the creative invention of recent constitutionalism has brought about something different and innovative.

The question of ultimate authority (as final capacity to make binding decisions in political and social contexts) is not simply a question of last resort in case of conflicts ever arise among different legal orders. In reality, the issue of ultimate authority (far from being exclusively rooted in Kelsen’s idea of hierarchies and *Grundnorm*) is of importance with regard to other meanings of sovereignty. One could talk of at least two such other meanings of sovereignty (both of which could be included under the label of political sovereignty)<sup>600</sup>: first the autonomy of a political community in determining its policies (self-government), its power to exercise independently the traditional functions of governance; second, the autonomy of a political community in defining participation and representation in that political community: its power to structure autonomously the representation and participation of different members and groups in the framing of its policies. The question of the ultimate authority is mainly presented as a question about legal sovereignty. However, it also has impact on these aspects of political sovereignty. In fact, “the way the question of ultimate authority is addressed in European law impacts on the

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<sup>599</sup> See, for a theoretical investigation of the tackled issue, U.K. PREUSS, *The political meaning of constitutionalism*, in R. BELLAMY (ed.), *Constitutionalism, Democracy and Sovereignty: American and European Perspectives*, Avebury, Aldershot, 1996, pp. 11-27.

<sup>600</sup> The arguments sketched in the text mainly rely on M. POIARES MADURO, *Contrapunctual Law: Europe’s Constitutional Pluralism in Action*, in N. WALKER (ed.), *Sovereignty in Transition*, Hart Publishing, Oxford, 2003, pp. 501-537. For an interesting investigation of the political value of the concept of sovereignty see H. LINDAHL, *Sovereignty and Representation in the European Union*, in N. WALKER (ed.), *Sovereignty in Transition*, Hart Publishing, Oxford, 2003, pp. 87-114.

epistemology of the EU, on its legitimacy, and on the forms of policy-making and representation and participation linked to the notion of political sovereignty”.<sup>601</sup>

Hence, it becomes reasonably clear that the new clothes of sovereignty’s today go hand in hand with the shift to functionally limited polities within a multi-dimensional order. In its traditional statist version, the claim to sovereignty or ultimate authority used to imply both autonomy and territorial exclusivity. In other words the mutual exclusivity of comprehensive territorial jurisdictions in the one-dimensional global map implied a corresponding mutual exclusivity of effective claims to sovereignty.

In the new post-Westphalia order, in contrast, with the emergence of functionally limited polities, which do not claim comprehensive jurisdictions over a particular territory “*it becomes possible to conceive of autonomy without territorial exclusivity* – to imagine ultimate authority, or sovereignty, in non-exclusive terms”.<sup>602</sup> Of more consequence, the development of functionally limited claims is self-reinforcing to the extent that it allows of the possibility of territorial overlap without subsumption. So, for example, “to the extent that the claim to sovereignty of the European Union over a range of competences previously within the exclusive jurisdiction of the fifteen Member States is plausible and effective, this does not seriously question the continuing sovereignty of the fifteen Member States as regards their remaining areas of territorial jurisdiction”.<sup>603</sup> In addition, the case of “Euro-sovereignty” - with specific regard to control over money in Europe - is thus definitively a paradigmatic case in point, as it is possible to identify different actors (ECB, Community, NCBs and Member States) exercising their competences in non-exclusive terms. Even the most powerful of these parties – the European Central Bank as acting within the complex framework of the ESCB – needs to deal with remarkable restrictions to its *prima facie* supposed exclusive and final say over, for instance, the

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<sup>601</sup> Ibidem, p. 502.

<sup>602</sup> N. WALKER, *Late Sovereignty in the European Union*, in N. WALKER (ed.), *Sovereignty in Transition*, Oxford, Hart Publishing, 2003, p. 23.

<sup>603</sup> Ibidem, p. 23.

definition and implementation of monetary policy of the Community, or, even more significantly, over the effective conduct of the external relations of the euro area.<sup>604</sup>

As a final, explanatory remark it should be stressed that, even though the notion of sovereignty and monetary sovereignty seem to have lost part of their “ontological” value (by reference to a single, granitic, untouchable, indivisible subject, bearer of ultimate authority), still the adoption of the concept of monetary sovereignty to shed light on and appreciate the dynamics of power characterising EMU does indeed make sense. At the conceptual level, the case of monetary sovereignty, in fact, mirrors that of sovereignty, which – as already stated - is supposed to remain a key feature of the new system of governance in the EU. It is indeed true that both concepts present different and more sophisticated nuances in their content and their explanatory vocabulary with respect to their conventional meaning. Nevertheless, their core political value remains untouched: the issues at stake here are undoubtedly political as they go above and beyond monetary and currency matters. That is why the concept of monetary sovereignty in the EU has been analysed through the lenses of a multilayered perspective, aimed at going beyond a purely legal approach.<sup>605</sup> A perspective that leaves behind the hierarchical structures of the Nation State and sees sovereignty in its new and fluid form.

#### ***4) An attempt to resolve the challenging issues of democratic legitimacy in the EMU***

The very final issue deserving a word to complete the picture of the here called “Euro-sovereignty” is that of determining how and through which institutions and procedures democratic control over the newly emergent monetary sovereignty can be

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<sup>604</sup> Despite of the wording of Article 105.2, first indent EC Treaty (which might represent a legal/constitutional definition of the core meaning of “formal sovereignty” for the euro area), it can be reasonably concluded that monetary sovereignty in practice emphasises a gap between the formal and the substantial attribution of powers to the ECB. Arguments to support such a conclusion are more extensively offered in the present Chapter, namely in paragraphs 2.1, 2.2 and 2.3.

<sup>605</sup> This is also the view of C. ZILIOLI and M. SELMAYR, *The Law of the European Central Bank*, Hart Publishing, Oxford, 2001, who argue that “Community lawyers” (...) “cannot be satisfied with a unifying (and simplifying) perspective of the European Union, but are obliged to analyse the European Union more in detail” p. 3).

exercised within Europe. In other words it is an inquiry on its democratic legitimacy. The focus is again on both the EU and the EMU, with a specific reference to the ECB.

First of all, it is often said that the functionalist approach followed by the Founding Fathers is no longer able to ensure the legitimacy of the integration process. True, integration can be credit with a number of benefits, but now that it has become clear that decisions taken at the European level influence people's lives in so many ways, it can be assumed that legitimation based on outputs only is not sufficient.<sup>606</sup> As it will be specified in the following, it can still retain a significant importance – especially in the case of EMU –, but it also needs to be enriched by other legitimising principles.

People no longer accept that the quality of decisions is all that matters; they want a say in policy choices that affect their destiny. As a result, calls for an input-based approach have gradually intensified.<sup>607</sup> However, such calls are often inspired by an idealised, Rousseauian vision of parliamentary democracy, in which representatives of the people serve the collective interest of a polity and translate it into legislative decisions. This understanding of democracy is so deeply rooted in Western European political culture that it is exposed by two camps that are at odds with each other: the self professed European Federalism, advocating the upgrading of the powers of the European Parliament, and the *souverainistes*, for whom there can be no real democracy outside national parliaments.<sup>608</sup>

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<sup>606</sup> As rightly observed by C. LORD and P. MAGNETTE, *E Pluribus Unum? Creative Disagreement about Legitimacy in the EU*, JCMS, Vol. 42, No. 1, 2004, p. 183-202, the European Union does not rest on a single principle of legitimacy, but on a “plurality of legitimising principles” or, in other words, “on a plurality of ideas about the rightful exercise of political power”. (Ibidem, p. 199). To specify such insightful idea, they argue that the range of possibilities for a legitimate EU may be defined by four “vectors” - indirect, parliamentary, technocratic and procedural legitimacy – supposed to interact and to be mutually contaminated. Interestingly enough, the author point to the fact that these different vectors of legitimacy seem to be more closely associated with some policy domains than others. Indirect legitimacy is for instance strongest in the CFSP and in co-operation with JHA, while technocratic legitimacy is indeed clearest in those aspects of EMU that are handled by the ECB. For more references on this point, see *supra* footnote 427.

<sup>607</sup> See *supra* footnote 419. In particular, for a theory on the so-called *deliberative democracy*, J. COHEN, *Procedure and Substance in Deliberative Democracy*, in S. BENHABIB (ed.), *Democracy and Difference: Contesting the Boundaries of the Political*, Princeton, Princeton University Press, 1996, pp. 95-123. Cfr. also J. HABERMAS, *Droit et démocratie. Entre faits et normes*, Paris, Gallimard, 1997.

<sup>608</sup> Note that the mere adoption of such perspective is in a way obsolete and inadequate to the present scenario. It opens the door to what has been defined as a “dilemme constitutionnel qui repose sur une conception de la légitimité biaisée, car perçue à travers le seul prisme de la démocratie représentative” (F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la*

As a third, alternative option the existing complex system of governance sketched above has highlighted a new reality in which the involvement of regional, local, national, supranational and also non-governmental actors in the policy-making process has become crucial. Such involvement may also be realised through different – formal and informal - channels. As a matter of fact, it is becoming almost self-evident that the very success of Community decision-making and the acceptability of the rules actually depend on the real involvement of such different actors. If it is accepted that democracy in Europe is based on two twin pillars – (i) the accountability of executives to European and national legislative bodies; and (ii) the effective involvement of citizens in devising and implementing decisions that affect them – it is clear then that the reform of European modes of governance is all about improving democracy in the EU.<sup>609</sup> As a result, rather than sticking with obsolete understanding of democracy, conceptually linked to the Nation State, it should be worth looking for a radically different more process-oriented approach. Admittedly, such an approach departs from classical understanding of European constitutionalism, which focus on the demarcation of the respective powers of the Union and of the Member States and on the balance of power between European institutions. At the same time, its ambition is identical to that of liberal constitutions: to keep power, wherever it lies and whatever its form, under control, and to ensure the fairness of decision-making processes. In any case, the procedural avenue outlined here should not be seen as a substitute to the control exercised by political institutions. On the contrary, the emergence of a public debate on implementing decisions might reinforce the accountability of otherwise obscure bodies, ultimately contributing to the emergence of a transnational public sphere. Governance, particularly in the present-days complex polities, is a multifaceted phenomenon, which cannot be encapsulated into one single model.

Hence, as far as the ECB, in its epistemic and technocratic component, is concerned, one may argue that reliance on the pure expertise model is no longer

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*Banque Centrale Européenne. Dialogue Monétaire et "Accountability Délibérative", in Cahiers de Droit Européen, No. 5-6, 2003, p. 551).*

<sup>609</sup> See again Commission White Paper on European Governance, in the section on *Enhancing democracy in the European Union*, Working Programme, SEC (2000) 1547, 7 final of 11 October 2000, available at <http://europa.eu.int/comm/governance/work/en.pdf>

sufficient in a context in which technocracy has become the focus of much mistrust.<sup>610</sup> Legislative mandates cannot always be sufficiently clear, as it is impossible to consistently set down precise standards and objectives (as in the case of price stability for the ECB).<sup>611</sup> Although more promising, an approach based on Parliamentary control over expert decisions is still far from being sufficient, as the European Parliament cannot claim to represent all the interests, be they national, local or sectorial, that coexist within the EU.<sup>612</sup> As a matter of fact, “the history of the European Parliament has been characterised as a search for reconciliation between international and parliamentary legitimising principles through new forms of deliberation”.<sup>613</sup> Consequently, additional techniques ought to be considered if the legitimacy of the European governance is to be put on firmer ground.<sup>614</sup>

It would thus be interesting to open the doors for new conceptions of democracy that stand outside common perceptions backed by State-centric common places.<sup>615</sup>

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<sup>610</sup> Such a statement is based on the consideration that the democratic challenge has, ever since the adoption of the Maastricht Treaty, involved a mismatch between a general sympathy of citizens towards European ideals concerning the single currency and a nagging mistrust of the institutions. Improved economic circumstances and the visible reality of the Euro have boosted expectations of a near political unity, but still dissatisfaction with the institutions remains, despite the greater powers the European Parliament now has. In particular, people are dissatisfied because they fail to understand the ECB's objectives in practice and are often unable to put names and faces to its tasks. Citizens also strongly feel that the realities on the ground are not adequately taken into account, jeopardising the wealth of cultural, linguistic and regional diversity. That is why there is an emerging call for improving the exercise of European executive responsibilities through a strengthened decentralisation, which, in the case of monetary policy, may be realised by virtue of an empowerment of NCBs and their representatives sitting in the ESCB Committees.

<sup>611</sup> On this point see Chapter Five, *Objectives and Basic Features of the ESCB in Practice*, of the present work.

<sup>612</sup> For a comprehensive analysis of the matter see N. JABKO, *Expertise et politique à l'âge de l'euro: la Banque Centrale Européenne sur le terrain de la démocratie*, *Revue Française de Science Politique*, Vol. 51, No. 6, Décembre 2001, pp. 903-931.

<sup>613</sup> C. LORD and P. MAGNETTE, *E Pluribus Unum? Creative Disagreement about Legitimacy in the EU*, *JCMS*, Vol. 42, No. 1, 2004, p. 192.

<sup>614</sup> For the specific case of the ECB, it is though worth highlighting the importance of the EP's attempts to establish a “monetary dialogue” that invites the ECB to justify technocratically-taken decisions within a framework of parliamentary scrutiny and cross-examination. For an accurate investigation see F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et “Accountability Délibérative”*, in *Cahiers de Droit Européen*, No. 5-6, 2003, pp. 549-595 and also *supra* Chapter Three, *Some Keywords at Stake: Theoretical Clarifications on the Modalities of the Exercise of Monetary Power*.

<sup>615</sup> It should be worth recalling the intriguing proposals made by K.-H. LADEUR, *Globalisation and the conversion of democracy to polycentric networks: Can democracy survive the end of the Nation State?*, *EUI Working Paper in Law*, Law03/4, 2003. The author interestingly observes that “the concept of democracy must be kept open for historically varied forms of life, not least because the concept of

How then would it be possible to apply new conceptions of democracy to the EMU case? A suitable answer to this question may be found, for instance, by adopting a historical perspective aimed at identifying the original sources of democratic legitimacy invoked when EMU architects picked up a political model so heavily dependent on the culture of stability.

The first source is the magnificent past record observed in Germany. For decades Germany was a hallmark for economic policy biased towards price stability, with monetary policy conducted by the Bundesbank immune to political interferences. Seeing Germany as the most outstanding example of macroeconomic success after the Second World War, it is instructive to recall that all Member States accepted to gear their economic policies towards the German paradigm. Indeed, this process of informally geared convergence occurred while the EMS was working on, erasing the differences between Germany and the other Member States.

During the years of the EMS all Member States had formally competences to run their own monetary policies, but in practice this was not the picture going on. Instead, all Member States focused in mimicking the monetary policy implemented by the Bundesbank, giving Germany a *de facto* leadership role. From this viewpoint, one could ask where the genuine democratic essence lies in the model defined by the characteristics of the EMS years. In other words, what was, at that time, the democratic legitimacy of monetary policy strategies defined in Germany and imitated by the remaining national governments in the EU? How could it be reasonably justified that all Member States but Germany were effectively deprived from running their monetary policies autonomously? The main problem here is the divorce between theory and practice – that is, while in theory all Member States had the formal competence to define and implement their monetary policies, in practice such power of decision was almost non-existent.<sup>616</sup>

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subjectivity inevitably changes with time”. Correspondingly, the institutional solutions offered in this respect by the State-centric conceptual framework are entirely inappropriate.

<sup>616</sup> To fully appreciate the meaning of such a divorce in the present context of analysis, it is indeed worth taking into account the offered definition of sovereignty as the final capacity to make binding decisions in political and social contexts and to assure the implementation of those decisions and, in particular, its bipolar face in terms of formal sovereignty and sovereignty in practice that reflects the reality of decision-making and implementation. The case in point here seems to exemplify in a perfect way the consideration according to which “when sovereignty in practice departs significantly from formal sovereignty, one might expect turbulence and change on the horizon”.

The institutional settlement implemented by the Maastricht Treaty changed this framework. With the creation of the ECB, and with the ability each national central banker has to have a voting power equal to all his/her partners within the Governing Council, a fundamental material transformation was processed. Where before national central bankers of all Member States except Germany were deprived from having autonomous voice for purposes of monetary policy discussion, now this no longer happens. Indeed national central bankers of the euro zone Member States have equal voting powers within the Governing Council of the ECB. This amounts to a vigorous changing pattern due to EMU: all the participating Member States that previously were prevented from contributing for at least a co-ordinated monetary policy setting in the EMS, now have a say in shaping the single monetary policy.

The symbolic meaning of this constitutional landmark of EMU is revealing of a crucial aspect for the purposes of the current investigation on democratic legitimacy. As a matter of fact, EMU erased a source of inequality among the participating Member States in what concerns monetary policy. The completion of monetary union in the EU amplifies the prominence of monetary policy, with all the already examined consequences for the general welfare of European citizens. In particular, having a system that gives every participant the same voting power, a more democratic legitimate process of decision-making has been enhanced.

In a nutshell, comparing the pre-EMU and the post-EMU scenario, the observation is outstanding as to whether monetary union increased or decreased democratic legitimacy associated to the overall economic policy-making. Before the inception of EMU, the picture was the factual dominance exerted by one national actor (the German monetary authorities), whereas, after the establishment of EMU, a more balanced institutional system with a plurality of voices was launched.

Finally, having all these kinds of considerations in favour of democratic legitimacy in mind, one might still put forward some further reservations regarding the consequences stemming from the political-economic orthodoxy of price stability. The next issue of concern is in fact how the obligation imposed upon the ECB to be deeply committed to price stability can be seen as democratic legitimate. Here the answer must be encountered in a new concept of democratic legitimacy, namely a re-

discovered, enriched version of output legitimacy,<sup>617</sup> as opposed to a conventional conception of purely procedural legitimacy, but still “contaminated” by other forms of legitimacy (like parliamentary or indirect legitimacy). The fact is that, contrary to traditional observation of yardsticks measuring how democratic a certain policy is, the process of European integration brought to the surface an alternative dimension according to which democratic legitimacy should be assessed. More important than focusing narrowly on how policies are undertaken, if they respect all the procedures established as conventional landmarks for recognising State-centric legitimacy, the process of European integration appeals to a different conceptualisation. Indeed the EU is a polity where uniqueness is the keyword, a polity that calls for a post-national, post-Westphalia, State-centric nature. Thus, being different from the Member States, and not aspiring to be a Nation State, the EU has to rely on a different conceptualisation of democratic legitimacy.

The analysis and the evaluation of this new dimension of legitimacy – especially when applied to the ECB – may thus be articulated on three overlapping points: (i) the original, constituent process of legitimisation going hand in hand with the delegation of authority; (ii) a proper definition of the tasks to be carried out and of the limits of the action to be exercised; (iii) the exercise of a control (either institutionalised or not institutionalised) over the whole decision-making process.<sup>618</sup>

This provided as a fundamental yardstick to be respected, it can still be concluded that, adopting the point of view of the theorists of output legitimacy, the genuine essence of democracy should be observed in the light of the results provided by the different policies. To the extent that such policies are able to give results that improve citizens’ welfare, such policies are successful and entail a powerful source of democratic legitimacy. The main focus on output legitimacy presents a case for

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<sup>617</sup> For the innovative conception of output legitimacy, notably in its application to the specific context of European integration, see F.W. SCHARPF, *European Governance: Common Concerns v. the Challenge of Diversity*, Harvard Jean Monnet Paper, No. 6, 2001; ID., *Governing in Europe: Effective and Democratic?*, Oxford University Press, Oxford, 1999.

<sup>618</sup> The overlapping nature of the above-mentioned points is well described by F. MARTUCCI, *Le Rôle du Parlement Européen dans la Quête de Légitimité Démocratique de la Banque Centrale Européenne. Dialogue Monétaire et “Accountability Délibérative”*, in *Cahiers de Droit Européen*, No. 5-6, 2003, p. 565-566, who underlines that “la banque centrale est créée par des statuts démocratiquement adoptés définissant les objectifs de son action et les pouvoirs dont elle dispose”. Moreover, “les banquiers centraux sont nommés par des autorités démocratiquement désignées; le processus décisionnel de la banque centrale est bien défini; les décisions de la banque centrale doivent être justifiées et soumises au contrôle politique”.

underestimating the means through which results are achieved (which though do not lose their intrinsic weight in the overall picture), and concentrates its attention on the ends themselves. What directly affects citizens' welfare are not procedures used to implement policies; on the contrary, citizens' welfare is affected by the quality of the policies, and this item should be seen as the benchmark against which democracy should be measured. In a word, more important than the clothes that decision-making processes wear is what they provide to the public, the latter being the ultimate arbiter who evaluates, controls and legitimises the action undertaken by the different actors involved in the sovereignty game.

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