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Guest Editorial

The Political Role of the European Central Bank: Between European Politics and National Constraints*

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Abstract

The euro is symbolic for the European integration process. The last decade, in particular, has seen some existential challenges for the single currency. European policy solutions have been foremost associated with one European institution: the European Central Bank (ECB). This special issue focuses on the ECB's new political role in an ever-changing EMU governance structure, a position between European politics and national constraints. Against this backdrop, this contribution discusses the asymmetric institutional design of the EMU and sets the scene for scholarly debate around the changing political role of the ECB.

Die Politische Rolle der Europäischen Zentralbank zwischen Europäischer Politik und nationalen Beschränkungen

Zusammenfassung

Der Euro ist ein Symbol des Europäischen Integrationsprozesses und stand, insbesondere im Zeitraum der vergangenen zehn Jahre, vor existenziellen Herausforderungen. Demgegenüber war die europäische Krisenpolitik insbesondere assoziiert mit einer herausragenden europäischen Institution: der Europäischen Zentralbank (EZB). In ihrer Position zwischen europäischer Politik und nationalen Beschränkungen fragt diese Sonderausgabe nach der neuen politischen Rolle der EZB in einer sich verändernden Gover-

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nance-Struktur der Europäischen Wirtschafts- und Währungsunion. Vor diesem Hintergrund diskutiert dieser Beitrag deren asymmetrische Struktur und bereitet damit den Hintergrund zur akademischen Reflexion der sich verändernden politischen Rolle der EZB.

Keywords: European Central Bank, European Economic and Monetary Union, European Politics

JEL Classification: E50, N24, Z18

I. Approaching the Political Role of the European Central Bank

For the Member States of the European Union (EU), voluntarily abandoning monetary sovereignty and subsequently transferring monetary policy to the supranational level represents one of the most far-reaching steps in the European integration process. The euro, designed as a common European currency, is symbolic for the success of the European integration process, and the European Central Bank (ECB) is its key facilitator. Since the euro's introduction in 1999, the only supranational central bank in the world has been in charge of conducting monetary policy for the entire European Economic and Monetary Union (EMU). The last decade, in particular, has been fraught with existential challenges. The EMU has faced a series of pressing threats in the context of what is known as the global financial crisis – a situation that soon transformed into a European sovereign debt crisis, calling into question not only the coherence of but also the very existence of the EMU. In this context, European policy solutions have been foremost associated with one European institution: the ECB. This special issue focuses on its new political role in an ever-changing EMU governance structure, a position between European politics and national constraints.

The aim of this special issue is twofold. First, each contribution offers new scholarly and practical insights on a number of aspects assessing the political role of the ECB. Second, this special issue brings together different disciplinary perspectives, delivering insights into more recent debates in political science, economics and legal studies on the contemporary evolution of the EMU.

This introductory contribution starts with a brief discussion of the asymmetric institutional design of the EMU and shows how this special issue addresses a number of directly related debates. Section II. provides the background for assessing the debates surrounding the EMU. Finally, in Section III. we introduce each contribution to this special issue and demonstrate how they inform the contemporary debates around the political role of the ECB between European politics and national constraints.

II. Developments in the European Economic and Monetary Union

During the global financial crisis and subsequent European sovereign debt problems, the ECB became in the eyes of many observers – although most likely somewhat "reluctantly" (*Hodson* 2011; *Dyson* 2013) – one of the most important institutions in securing the coherence of the EMU, willing "to do whatever it takes, to preserve the Euro" (*Draghi* 2012). Subsequent developments in the EMU entailed significant changes to the ECB's political role, its policies, its institutional embeddedness and its policy-making powers. There are many examples, including the ECB's role in the so-called Troika, where it negotiated with the European Commission and the International Monetary Fund the conditions of credit programs for EMU Member States. The ECB also started to use its conventional monetary policy instruments very unconventionally, introducing among other things a negative deposit facility, and conducting its main refinancing operations using a zero interest rate tender with full allotment. The ECB is further engaged in what are termed "unconventional monetary policy instruments", basically using its balance sheet which quadrupled since 1999 to EUR 3.7 trillion to date (as of November 2017, see ECB 2017). This changing context further entailed the institutional delegation of powers to the ECB, including newly created responsibilities in the context of macro prudential supervision. In order to further enhance financial stability, this increase in powers was accompanied by a shift of micro prudential powers from the Member States level to the supranational level in context of the Banking Union with – again – the ECB at its core (e.g. *Gren* et al. 2016).

This massive expansion of ECB powers, however, calls into question democratic principles of the institutionalized consensus between European politics and Member States' constraints. This in turn endangers the ECB and the sustainability of the EMU more generally. Arguably, increasing powers of the ECB should be legitimated and requires enhanced accountability arrangements, since issues of legitimacy and a perceived lack of substantive accountability can increase risks of political backlashes against the ECB's independence (*Torres* 2013). Recent evidence suggests that the crisis already led to declining trust in the ECB among the European citizenry (*Kaltenthaler* et al. 2010; *Roth* et al. 2014). Further, against the backdrop of increasing European-wide Euroscepticism (*Serrechio* et al. 2013), asymmetric political developments endanger the political coherence of the EMU; they entail a clear pattern of increasing shares of populist-right election results, especially in the northern creditor states, and more populist-left election results in the southern debtor states (*Kriesi* 2016). With this politicization comes the risk of deepening the cleft between creditor and debtor states, leading to further challenges. Already some have been brought before the European Court of Justice (ECJ) or the German Federal Constitutional Court (GFCC), with the latter demanding parliamentary oversight for matters that are not part of narrow monetary policy (BVerfG 2014). By and large, the ECB shares this insight, arguing that "it is accountable first and foremost to the European citizens" (ECB 2002: 51) – which again should be directly represented in the European Parliament (EP) (see also *Trichet* 2011).

Processes within the EP in turn reflect these patterns of politicization, as for instance the usage of accountability instruments by Members of the EP (MEP) suggests. We map these developments with regard to the usage of written questions. In order to gain previously undisclosed information and to hold the ECB to account, all MEPs can submit written questions to the ECB to which ECB's President (formally) replies. As we display in Figure 1, the usage of written questions by MEPs has increased significantly over time. A slight increase can first be reported for the seventh parliamentary term and especially subsequent to the euro crisis, with an increase from 16 questions in total during the sixth term to 171 questions in the seventh term. However, an even more significant increase can be reported for the eighth parliamentary term, in which around 290 written questions had been submitted to the ECB by mid-term in January 2017. This is more than the sum total of questions ever received from MEPs by the ECB in previous years. It is important to qualify these developments with reference to the numbers of written questions submitted to other European institutions. Although the Commission received nearly double the number of questions in the seventh parliamentary term compared to the sixth, the written questions to the ECB increased more than tenfold. However, the ECB had received less than 400 written questions in total by early 2016, whereas the Commission had received 53,262 questions in the seventh parliamentary term alone. These differences reflect the restriction on the number of written questions MEPs are permitted to

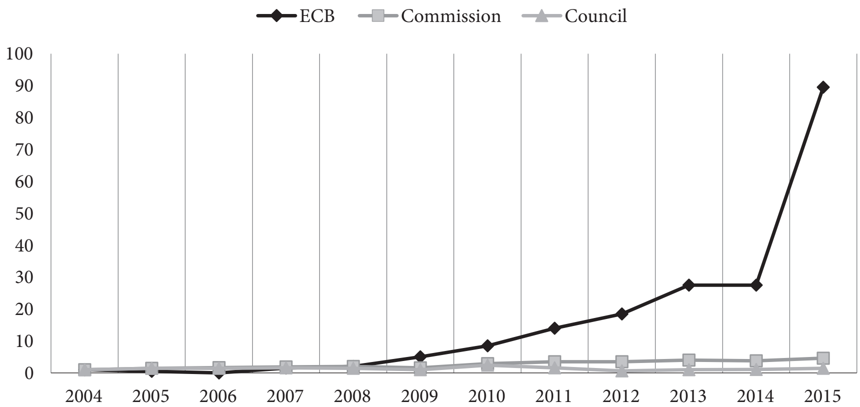

Figure 1: Frequency of Written Questions of MEPs to European institutions (2004 = value 1), Data from the ECB and EP

send to the ECB (six per month) and the fact that the ECB is responsible for a smaller portfolio of topics than the Commission. Even considering these aspects, the difference remains striking.

Considering the background of MEPs who submitted written questions highlights the importance of national patterns. We report that 86 percent of written questions submitted since the establishment of the common currency came from MEPs of just six countries: Greece, Ireland, Italy, Portugal, Spain, and Germany. These patterns of European politics reflect the politicization of European politics in the EMU, and correspond with the asymmetric economic developments of EMU Member States. In particular the period subsequent to the financial crisis posed challenges, especially for European periphery Member States of the European south. Public costs of the banking crisis have enforced the relatively weak fiscal position of several Member States and increased debt levels and public deficits that were already too high. This development is arguably worsened by domestic structural problems of several Member States economies, as reflected in persistent imbalances in EMU Member States' current accounts (*Belke/Dreger* 2013). We illustrate these patterns in Figure 2 by displaying the current account averages and public deficit averages of EMU founding Members (plus Greece) for the period 1999 to 2014.

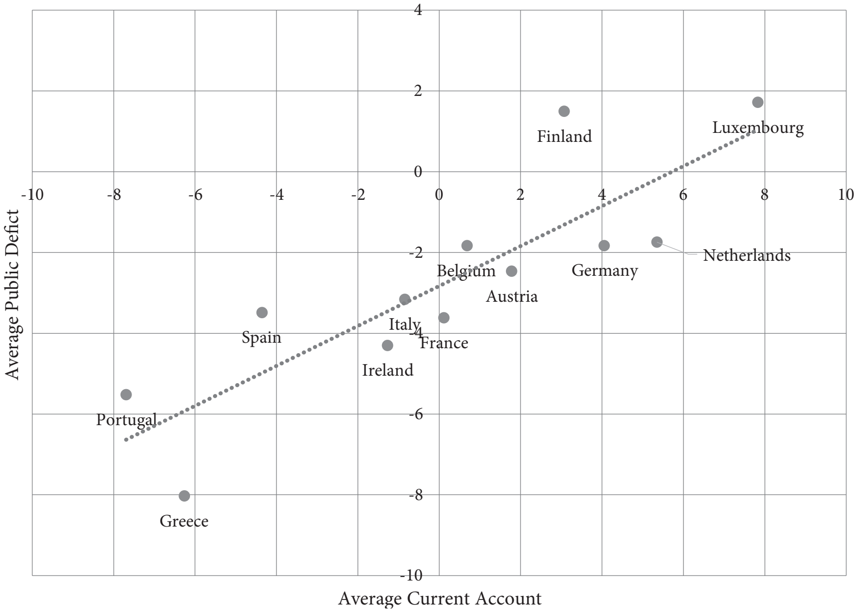

Figure 2: Average current account and average public deficit, 1999–2014, Own Calculation and Presentation, Data from OECD (2016)

The persistence of macroeconomic imbalances in the EMU leads in aggregation to a development in which surplus countries evolve to be the creditors of deficit countries. The creditor countries include, but are not limited to, Finland, Germany, Luxembourg and the Netherlands, while the generally more debtor states comprise in particular Greece, Ireland, Italy, Portugal and Spain. The political impact of this divide includes the deepening of the cleft between the European core and the European periphery, as observed in an often quite moralistic discourse about European macroeconomic developments in the EMU. This discourse frames the divide as a conflict of prudent fiscal "saints" in the core, and irresponsible "sinners" in the periphery (*Dyson* 2014). However, although the developments of current accounts, public deficits and debt ratios map onto this pattern, the explanations of the causes of these asymmetric developments are all but clear-cut.

Countries that enter a monetary union lose the exchange rate as an instrument to accommodate long(er)-term persistent imbalances, while the asymmetric design of the EMU, with the ECB at the supranational level, and fiscal and financial policy at the national level, creates divergent incentives for economic actors. This design forces the ECB to pursue a one-size-fits-all monetary policy for all Member States of the EMU despite their national divergences. This in turn allows for procyclical effects that can generally sustain the maintenance of nationally divergent macroeconomic imbalances. We discuss this argument by considering two prominent variables for monetary policy: the development of the domestic price level and the domestic business cycle (i. e. output gap) (*Taylor* 1993, see also *Enderlein* 2006 for a similar approach).

When a national economy has an output above potential, experiencing a boom in the business cycle, increases in its domestic price level typically follow because of growing demand and higher wages. To control inflation, national central banks typically increase interest rates, inducing higher nominal costs of investment and thus smoothing the business cycle. The opposite would generally be true in case of recessions and deflationary pressures. However, in a monetary union, these effects can be persistent and pro cyclical because the central bank has to conduct its monetary policy based on inflation averages of the entire euro monetary area and cannot sufficiently react to accommodate divergent domestic deviations. Therefore, asymmetric deviations of domestic inflation and output can lead to interest rates that are too low in the economies experiencing an output above potential, and simultaneously too high for economies experiencing a recession. This can have procyclical effects in monetary unions, because domestic inflation creates incentives for economic national actors by affecting the real price of domestic credit, consumption and investment. On the one hand, a high level of domestic inflation decreases the real price for domestic credit and investment, and can provide incentives for domestic actors in sectors that profit from the boom to maintain the imbalance. On the other hand, too high interest rates increase the price for credit and investment in low-inflation countries, negatively affecting economic momentum. Further, especially the actors in the export sectors face incentives to maintain a domestic inflation rate that is lower than the EMU average. Through wage-increase reluctance they can decrease the price of labor to gain competitiveness, which can in turn support growth through the export channel. The expected effects of these relationships are present in the longer-term current account imbalances we discussed previously.

In order to avoid divergent economic effects for EMU Member States' economies in connection with the EMU's asymmetric design, it would be important to align domestic output and inflation. In the following we provide illustrative evidence for the presence of such divergent effects. Figure 3 plots the correlation and average deviation of business cycles (i. e. output gap) for the period 1999–2014 of selected EMU Member States (the eleven founding members plus Greece). Greater distances from 0 on both axes indicate a stronger overall tendency to deviate from the average EMU business cycle. The more important indicator is on the vertical axis: countries with positive values have experienced higher growth momentum (e. g. Ireland) or lower growth momentum (e. g. Germany, Portugal, Italy and Greece). It is important to note that the presented period recaps pre- and post-crisis data, so the impact and respective reversal ef-

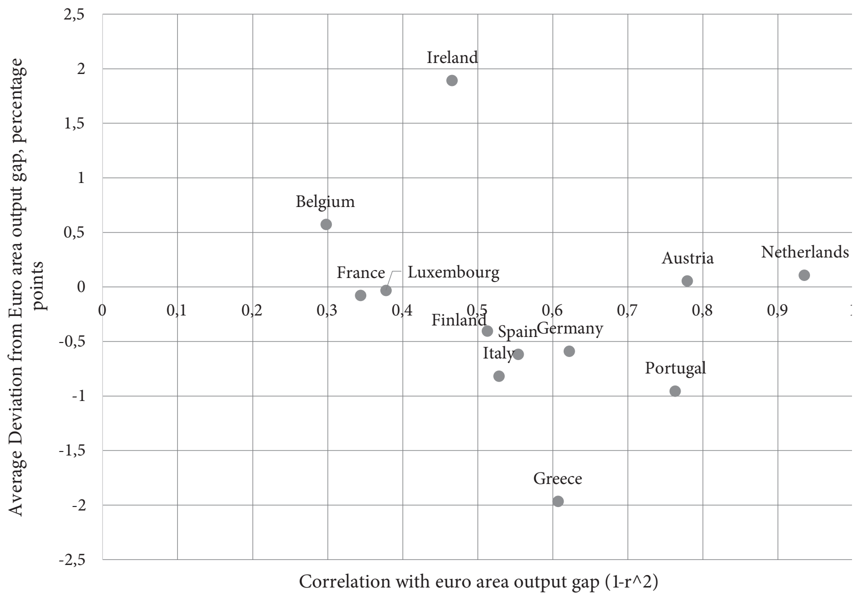

Figure 3: Domestic Output Gap and Euro Area Output Gap, 1999–2014, Calculations Based on Data from OECD (2016)

fects of the crisis are not displayed. However, what is striking is the non-alignment of business cycles within the euro area and the associated difficulties in conducting a single monetary policy.

Similarly, Figure 4 displays the correlation and average deviation of inflation rates for the period 1999–2014 of selected EMU Member States from EMU average (the eleven founding members plus Greece). Again, greater distances from 0 on both axes indicate a stronger overall tendency to deviate from EMU inflation developments. The indicator on the vertical axis shows that inflation deviations remain, on average, within a one percent margin. However, since these deviations are very persistent, especially in the period preceding the financial crisis, they entail a significant accumulation of divergent developments in domestic price levels. In several Member States, these increases have apparently not been accompanied by gains in productivity, causing increases in unit labor costs and losses of competitiveness. This is represented in the previously discussed persistence of current account deficits of several southern EMU Member States and enforced divide of "saints" and "sinners" in public discourse about European macroeconomic developments. It is therefore important to note that several surplus countries contributed to these imbalances and the subsequent tensions of the monetary union by undershooting EMU average inflation. This allowed them to gain competitiveness and accumulate current account surpluses, as in the case of Germany.

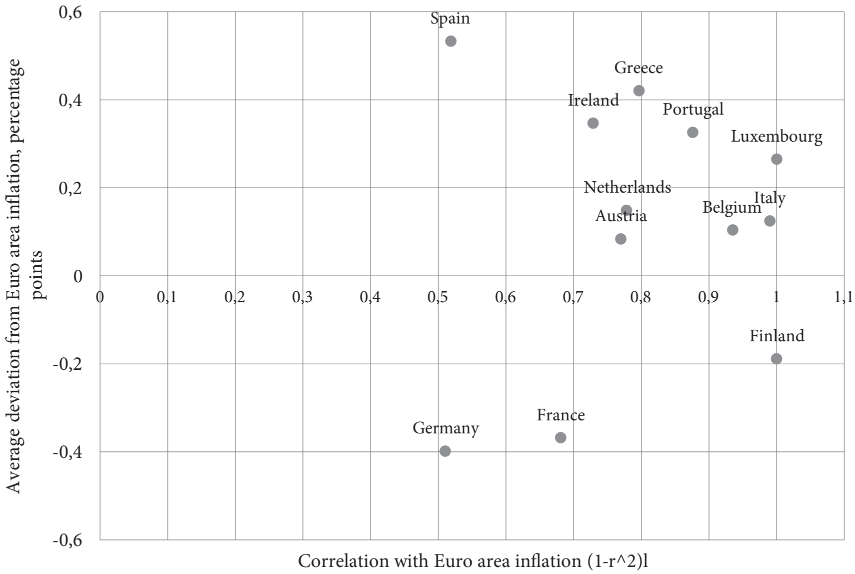

Figure 4: Domestic Inflation and Euro Area Inflation, 1999–2014, Calculations Based on Data from OECD (2016)

The displayed data shows the correlations of domestic output gap deviation and domestic inflation deviation of EMU Member States with EMU averages. This enables the identification and interpretation of divergent patterns that follow from the relationship between the design of the EMU and the development of Member States' economies. When combined with the discussed data on current accounts, two groups of countries emerge. The first comprises the traditional countries of the Deutsche Mark block: Germany, Austria and the Netherlands. These countries share similarities in terms of direction as well as magnitude of the coefficients, both of inflation deviations and correlations of their domestic output gaps with the EMU. Further, all three states share a similar current account position, which characterizes them as surplus or creditor states. The second group comprises the countries Greece, Ireland, Italy, Portugal and Spain. Again, this group of countries share a similar effect direction and size for both correlation coefficients, although the trend to deviate from EMU inflation developments shows less substance for Italy. This might be due to its relatively larger share in the calculation of EMU average, but deserves closer consideration. Again, all Member States in the second group have a similar current account position, classifying them as generally deficit or debtor states. We report that several countries do not fit unambiguously into one of the two groups. Without discussing this phenomenon in further detail here, these countries are Belgium, Finland, France and Luxembourg.

The asymmetric developments in the EMU are, quite paradoxically, closely related to its institutional design failures on the one hand. On the other hand, they create opposing political reform incentives for EMU Member States. Surplus countries of the first group generally lose out when interest rates are low; as creditor states they suffer lower levels of revenues on capital and savings, while tending to profit from EMU coherence and the relatively low foreign exchange rates that follow. Relatively low domestic inflation rates of this group allowed these countries to sustain or regain competitiveness and create economic momentum, often through export-led growth models. Accordingly, they might be incentivized to support constraining fiscal rules within the EMU and measures that underline the narrow mandate of the ECB. This is also true in light of the increasing powers of central banks, such as supervisory powers, that are generally considered to increase inflation (e.g. *Copelovitch/Singer* 2008). In contrast, public finances of the debtor states in the second group tend to benefit from more accommodating ECB monetary policies since this reduces their costs of refinancing, debt service and the overall level of debt in real terms. These countries might therefore push for more supranational monetary discretion and further financial integration. This results in a situation where solvent northern countries are generally incentivized to prefer national adjustment, while southern countries are motivated to prefer mutualized adjustment (see similarly

Schimmelfennig 2015: 181), including the delegation of competences in the context of financial integration to the ECB.

Overall, our brief discussion highlights a need to reflect on three key dimensions of the ECB's political role in the context of contemporary developments of the EMU. Unconventional monetary policy and the transfer of powers to the ECB cast doubt on the transparency and legitimacy of the central bank, which in turn questions the ECB's relationship to other European institutions. Further, asymmetric construction of the EMU in particular highlights the fact that the ECB is, on the one hand, confronted with European-level design failures and subsequent European politics, and, on the other, with asymmetric developments of EMU Member State economies. In our view, this places the ECB between not only European politics but also national constraints. In the following, this special issue picks up some of these debates and offers new scholarly and practical findings across a range of disciplines studying the political roles of the ECB.

III. Summary of the Special Issue on the Political Role of the ECB

Based on this short introduction, *Michele Chang* (2018) continues with her analysis of the ECB's creeping competence during the euro crisis. Her article outlines and offers a neo-functionalist explanation for the most recent policy developments in the EMU. *Chang* illustrates the ECB's increasing powers in activities including redistributive consequences, which she considers problematic against the backdrop of the ECB's legitimacy.

Building on *Chang's* deliberations, *Florin Coman-Kund*, *Anastasia Karatzia* and *Fabian Amtenbrink* (2018) shed light on the transparency aspect of one particular institutional transfer of power to the ECB, the Single Supervisory Mechanism. They find notable changes in the ECB's transparency regime, which they consider, from a legal point of view, preferable and applicable to further policy areas of the ECB, including monetary policy.

The next contribution reflects on the ECB's institutional weaknesses emerging from its position between European politics and national constraints. *Magnus Schoeller* (2018) departs from the prominent announcement of the ECB's outright monetary transactions program in 2012. Based on comprehensive interview material with leading European policy-makers, *Schoeller* tests the leadership by default hypothesis and finds that despite the ECB's emergence as a leader in battling the euro crisis, it has reluctantly acted as a leader by default, rather than as a power maximizer.

Ad van Riet (2018) substantiates this result further. From his practitioner's viewpoint, he diagnoses the ECB as being among the key actors in EMU governance, and elaborates on potential areas of support for the ECB by fiscal policy makers. By calling for a more growth-friendly economic policy mix for the euro area, *van Riet* especially highlights the need to support more far reaching central fiscal capacities in the EMU. He also calls for structural policy coordination in order to prevent asymmetric economic developments of EMU Member States.

Shawn Donnelly (2018) reminds us that the picture is all but politically non-controversial. *Donnelly* replicates different narratives over the nature of the euro crisis, which allows him in turn to juxtapose distinct policy preferences of the ECB and the euro group. His perspective allows us, on the one hand, to highlight the interests of the beneficiaries of austerity measures and therefore to paint the conflict as a picture entailing distributional outcomes. On the other hand, *Donnelly's* approach allows for the linkage of more discursive narratives to the policy preferences of European political actors.

Against this backdrop, *Sebastian Heidebrecht* (2018) engages in linking such divergences to the expertise composition of European macroeconomic policy makers, using the example of European central bankers. By analyzing the causal mechanism between central banker appointments and the expertise composition of central bankers, *Heidebrecht* shows how institutional constraints of European politics has, together with imposed consolidation demands of the beneficiaries of the EMU's ideational consensus, permitted its solid but rather paradoxical reproduction to date.

Leaving the focus within the EMU, *Ansgar Belke* and *Irina Dubova* (2018) conclude this special issue by highlighting the important role of the ECB in an international context outside the EMU. In particular, they engage in a discussion of international spillover effects, reflecting on the role of unconventional monetary policy measures. They question international coordination, in particular with regard to potential exits from unconventional monetary policy. Furthermore, since international spillover effects affect countries closely connected to the EMU, their contribution is of special relevance for EU Member States, which are not members of the EMU to date.

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