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INDEPENDENCE AND ACCOUNTABILITY OF THE EUROPEAN CENTRAL BANK

Master Thesis

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ABBREVIATIONS

BEPGs	Broad Economic Policy Guidelines
CJ	Court of Justice of the European Union
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
ECON	Committee on Economic and Monetary Affairs
EMU	Economic and monetary union
ESCB	European System of Central Banks
EU	European Union
NCB	National central bank
SSM	Single Supervisory Mechanism
Statute	Statute of the European System of Central Banks and of the European Central Bank
TFEU	Treaty on Functioning of the European Union
Treaty	Treaty on European Union
OJ	Official Journal

INTRODUCTION

General presentation of the study. Relevance of the topic.

The European Central Bank (ECB) since its creation in 1998 plays an important role in planning the financial future of the European countries. From the start the aim of the ECB was to keep the inflation rate of Euro zone steady, thus ensuring a stable financial situation in Europe. Today, having the pivotal role in resolving the current sovereign debt crisis in the Euro zone and being granted with new banking supervisory functions¹, the ECB becomes one of the most powerful institutions of the European Union (EU). During the creation of the ECB the primary objective was to make it highly independent based on the previous experiences of some Central Banks (CB), e.g. *Bundesbank*. The aim of an independent ECB was to ensure a low and stable inflation rate without large costs in terms of unemployment and economic growth. However, such independence comes with relevant costs - a consequent lack of democratic legitimacy, stemming from the voters in the Member States of the EU, and therefore affecting the key principle of democracy. The key to legitimacy lies in the accountability of the bank, as in a democracy, government legitimacy derives from the popular perception that the elected body is legally accountable to its people.² But at the moment of the ECB creation independence was seen as the most important success factor, thus neglecting its accountability and transparency characteristics. With time as the ECB gained more power and responsibilities, debates arose³ if the ECB's accountability should be improved as in a democratic society it is only acceptable to delegate power to an independent institution if that institution is democratically legitimate.

Currently there are two principles regulating ECB activities. The first one is the independence of the ECB. Article 130 of the Treaty on Functioning of the European Union (TFEU)⁴ safeguards this independence in a far-reaching manner, i.e. at the institutional, personnel, functional and financial levels. The second one is a principle of accountability. Even though the independence principle is not directly introduced in the TFEU, both the TFEU and the provisions of the Statute of the European System of Central Banks and of the European Central Bank

¹ At the Council of EU meeting on 12 December 2012 the EU finance ministers agreed on the general approach on the legislative package that establishes single supervisory mechanism (SSM) for the oversight of credit institutions. One of the regulations contained in the legislative proposal on the SSM confers supervisory tasks on the ECB. (Proposal for the Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. COM/2012/0511 final - 2012/0242 (CNS)).

² R. Charlton. *Political Realities: Comparative Government*. - London: Longman, 1986. P. 23.

³ See, e.g., J. de Haan and S.C.W. Eijffinger. The democratic accountability of the European Central Bank: A comment on two fairy-tales.//*Journal of Common Market Studies*, 2000, 38(3). P. 393-407; K. Kaltenthaler, J. K. Anderson, and J. W. Miller. Accountability and Independent Central Banks: Europeans and Distrust of the European Central Bank// *Journal of Common Market Studies*, 2010, Vol. 48, Issue 05. P.1261-1281.

⁴ The Treaty on the Functioning of the European Union. OJ C 83, 2010.

(Statute)⁵ incorporate the basic elements of the ECB accountability. Hence, today when the ECB is gaining even more power as an institution and the EU is seeking to be as democratic as possible, the accountability of the ECB is at question and is in the centre of the heated debate in the EU.

We believe that the question has a great importance henceforth. This thesis aims at studying it in order to provide a better understanding of possible solutions and searches for the optimal solution that combines independence with accountability within the ECB.

Issue of the work. Relevance of the work. As previously mentioned, the power of the ECB has increased since its creation, consequently increasing its importance and impact. However, bank regulation procedures stay unchanged, thus making its influential decisions more questionable. Improving the accountability of the ECB could be beneficial in several aspects for the ECB. Firstly, it would improve the democratic legitimacy of the ECB. Secondly, democratic legitimacy, in its turn, would reduce uncertainty in a monetary policy, because the public being able to make more accurate deductions about the monetary authority's objectives would have more clear expectations or lower dissatisfaction of unfavorable answers about the ECB's decisions and announcements, bolster credibility, facilitating the conduct of monetary policy and guarantee the consistency of the overall process of policy making.

When the ECB pushes toward either end of the independence-accountability spectrum, a conflict within the Euro zone erupts. Too much independence results in the lack of democratic legitimacy of the bank; a fully accountable ECB may be constrained in its room for maneuver. To that end, it is important to answer what could be an optimal model capable to reconcile the ECB's independence with accountability, and to evaluate how much the current ECB framework complies the ideal independence-accountability model.

Investigation level of the topic. The novelty of the study. While the ECB principles of accountability and independence have been studied extensively⁶, the research on optimal model capable to reconcile ECB's independence with accountability has been largely ignored. Previous work of scholars is limited to the study of relation between two principles showing the evidence of negative correlation between the principles.⁷ There are only two authors who give some

⁵ Protocol (No 4) on the Statute of the European System of Central Banks and of the ECB. OJ C 83, 2010.

⁶ R. Smits. *The European Central Bank - institutional aspects*. - Hague: Kluwer law International, 1996. P. 151-223; R. Smits. *The European Central Bank in the European Constitutional Order*. - Utrecht: Eleven International Publishing, 2003. P. 12-25; D. Chalmers, C. Hadjiemmanuil, and G. Monti. *European Union Law*. - New York: Cambridge University Press, 2008. P. 540-554; D. Howarth and P. Loedel. *The European Central Bank: the new European Leviathan?* - Basingstoke: Palgrave Macmillan, 2005; P. De Grauwe. *Economics of monetary Union*. 9th edition. - Oxford: Oxford University Press, 2012. P. 151- 173; R. M. Lastra. The Evolution of the European Central Bank, *Legal Studies Research Paper*, 2012, No.99/2012// <http://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/RevistaEstabilidadFinanciera/10/Ma y/Fic/ref0318.pdf>: 2013-03-20.

⁷ C. Briault, A. Haldane, and M. King. Independence and accountability, *Bank of England Working Paper*, 1996, No. 49// <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb960101.pdf>: 2013-04-02; C. Nolan and E. Schaling. Monetary policy uncertainty and central bank accountability, *Bank of England Working*

suggestions on how to reduce negative correlation between two principles by trying to achieve a compromise between them. P. A. B. Sousa⁸ suggests the enlargement of *de facto* or *de jure* accountability of the CB as a trade-off between two principles. However, he does not provide a detailed explanation of the suggested mechanism. C. Lord⁹ suggests the hybrid of agency within a separation of powers as an optimal arrangement for using accountability through reason-giving to reconcile the accountability and independence of the ECB. However, under this model, as the author notes, the ECB would gain independence in relation to all kinds of monetary decisions, what it does not have according TFEU.

Various authors discuss the same topic from different angles, thus emphasizing the importance of the topic. For example, J. de Haan and S.C.W Eijffinger¹⁰ study a democratic accountability of CBs and compare the legal accountability of the ECB with those of some other CBs. K. Kaltenthaler, J. K. Anderson, and J. W. Miller¹¹ explore why Europeans distrust the ECB. However, there is a lack of studies on independence-accountability optimum. Two discussed works provide insufficient analysis of the mechanisms to hold the ECB responsible for monetary policy in suggested optimum. In this master thesis we will try to develop authors' suggestions by providing more detailed mechanisms to hold the ECB accountable.

The purpose of master thesis is to set the optimal model capable to reconcile ECB's independence with accountability while preserving its independence and, based on analysis, determine how close to the independence-accountability optimum is the ECB today. The independence and accountability of ECB can be regarded from two perspectives: as a monetary policy enforcer, and as an entity carrying out banking supervision functions. However, this master thesis focuses on ECB independence and accountability in monetary policy only, hence studying the stated problem in depth and because framework of the ECB in monetary policy particularly has raised the worries of democratic deficit of the bank today, not its new proposed by European Commission framework in carrying out banking supervision function.¹² Indeed, one of the main arguments against the ECB's new banking supervisory function was that the ECB is a totally

Paper, 1996, No. 54//http://papers.ssrn.com/sol3/papers.cfm?abstract_id=74925: 2013-04-04; J. de Haan. The European Central Bank: Independence, accountability and strategy: A review.// *Public Choice*, 1997, No. 93. P. 395-426.

⁸ P. A. B. Sousa. Central Bank Independence and Democratic Accountability: Master thesis. - Portugal, 2002.// <http://www.univ-orleans.fr/deg/GDRecomofi/Activ/doclyon/desousa.pdf>: 2013-03-12.

⁹ C. Lord. The role of the European Parliament in the accountability of the European Central Bank, *EPRG Working paper*, 1999, No. 3.// <http://www2.lse.ac.uk/government/research/resgroups/EPRG/pdf/workingPaper3.pdf>: 2013-04-10.

¹⁰ J. de Haan and S.C.W Eijffinger. The democratic accountability of the European Central Bank: A comment on two fairy-tales.// *Journal of Common Market Studies*, 2000, No. 38(3). P. 393-407.

¹¹ K. Kaltenthaler, J. K. Anderson, and J. W. Miller. Accountability and Independent Central Banks: Europeans and Distrust of the European Central Bank// *Journal of Common Market Studies*, 2010, Vol. 48, Issue 05. P.1261-1281.

¹² J. A. Emmanoulidis Steps but not roadmap towards GEMU – the result of a disappointing summit. P. 2.// http://www.epc.eu/documents/uploads/pub_3197_post-summit_analysis_-_17_december_2012.pdf: 2013-05-02.

independent institution without any democratic legitimization and accountability. Thus, the supervision of the banking sector was for long time realized at national level by national authorities, which are accountable to governments and to national parliaments.

In order to meet the master thesis objective the following *tasks* have been set:

- Study the importance and scope of the ECB independence.
- Disclose the interdependence between the democratic deficit of CB and the lack of accountability.
- Define a model of accountability-independence optimum.
- Evaluate current arrangements of the ECB accountability by comparing them with the independence-accountability optimum.

The object of master thesis is a study of independence and accountability optimum of the ECB in monetary policy.

The subject of master thesis. In order to analyze properly the object of master thesis, we provide a definition of accountability and analyze forms of the ECB independence and accountability.

Methodology of the study. In order to reveal the chosen topic, following investigation methods were used in this work:

- *Historical method*. This is a theoretical qualitative method based on the research of the historical development of the phenomenon and the substantiation behind its underlying aspects. It allows to study historical aspects of the investigated phenomena. This method was used to determine the main factors that were at play historically when the model of the ECB was designed.
- *Analytical-descriptive method*. This method is comprised of two research methods: descriptive, which provides an accurate characteristics of a particular phenomenon; and analytical, which answers questions why, how, when and by whom. This method provides an opportunity for a coherent analysis of reasons and scope of the ECB independence and accountability and helps to find the model of accountability-independence optimum.
- *Linguistic analysis*. This is a theoretical qualitative research method, which refers to analysis of a language sample. It involves the main branches of linguistics: phonology, morphology, syntax, semantics, and pragmatics. In order to understand the legislation and other documents properly, to interpret them correctly and to identify key ideas, this research method was widely used in this thesis.
- *Comparative method*. This is a qualitative sociological research method used to compare some subjects in the thesis. It was used to compare two central banking

models - *Anglo-French Model* and *German Model* and to compare current arrangements of the ECB accountability with independence-accountability optimum. Hence, the analysis of comparative material allowed the thesis to arrive to conclusions on the ECB coincidence with the independence-accountability optimum.

Structure of master thesis. The thesis is organized as follows: an introduction, two investigative chapters, conclusions, a list of references, and thesis summary in English and Lithuanian. The first chapter overviews the history of the ECB creation and reasoning behind the chosen model of the ECB. Further, it discusses the link between primary the ECB objective and independence. Finally, it analyzes the scope of the ECB's independence and a number of possible restrictions on it.

The second chapter studies accountability as a way to prevent democratic deficit of the ECB. Further it defines the model of accountability capable to reconcile the ECB's independence with public control while preserving its independence. Finally, it describes current arrangements of the ECB accountability and shows how far these arrangements contribute to the accountability-independence optimum. The study is finalized by drawing conclusions.

1. THE PRINCIPLE OF EUROPEAN CENTRAL BANK INDEPENDENCE

This chapter overviews the history of the ECB creation and reasoning behind the chosen model of the ECB. Further the link between the primary ECB's objective and independence is discussed. Finally, the scope of the ECB's independence and a number of possible restrictions on it are analyzed.

1.1. The institutional design of the ECB: historical influences

Before discussing the ECB's independence and accountability a brief history of the ECB creation and evolution is overviewed for a deeper understanding of how and why along with its objectives.

The creation of the ECB was a result of the evolutionary stages in economic and monetary integration of Europe. The first integration effort was mentioned in Barre's Report of 1969 with an emphasis on „*greater co-ordination of economic policies and monetary cooperation*”.¹³ The second stage was designed by the Werner Plan of 1970 blueprint. Later, Delors Report of 1989 introduced the project of economic and monetary union (EMU) in three steps with establishment of new institutions such as European System of Central Banks (ESCB). The first stage of the EMU began in 1990. Its goal was to abolish capital controls, improve economic cooperation, free use of European Currency Unit and increase cooperation between CBs. During the second step of EMU, which started in 1994, the predecessor of the ECB - European Monetary Institute (EMI) was established without any responsibility to conduct monetary policy for the EU, but had the objectives to strengthen CB cooperation and monetary policy co-ordination, and to make necessary preparations for the establishment of the ESCB and the ECB. The EMI was liquidated in the 1998 and, thus, the ECB was established. The third step of the EMU started in 1999. Irrevocably fixed exchange rates and the conduct of the single currency-Euro were under the control of the ECB.

Two central banking models were proposed during the design of the ECB in the Treaty of Maastricht: *Anglo-French Model* and *German Model* that have spread in the post-World War II period. These two models have differences from each other both with regard to objectives, which a CB should seek and with regard to institutional structure of the CB.

According to German model, price stability is the primary objective of the CB and other objectives can be pursued as subordinate, inferior to the primary with a condition that their pursuit

¹³ M. Fratianni, J. von Hagen, and C. Waller. *The Maastricht way to EMU*. - Princeton: Princeton University Press, 1992. P. 3.

does not jeopardise price stability. The model differs from Anglo-French model, where CB has a list of concurrent objectives, e.g.: high employment rate, price stability, stable business cycle, etc.

What about the institutional structure of the CB? In Anglo-French model CB is politically dependent, i.e. the monetary policy decisions have to be approved by the government. Thus, in this model the minister of finance controls.¹⁴ In German model, the institutional structure of CB differs: the bank is politically independent, hence, the control over interest rate is free of political authorities. Legislative acts introduce this CB principle and are rigorously protected by CB authorities.

When the Maastricht Treaty was at the top of agenda, it was necessary to make a choice between two models. The key debate around the institutional design and the policy-making powers of the future ECB was over the independence from political impact of CB.¹⁵ It can now be said that German model, with its strong tradition of non-inflationary monetary policy, CB independence, and its federal structure, was chosen as a framework for the ECB, and Anglo-French model was rejected.

Why German model prevailed over the Anglo-French model is an intriguing question. When the Maastricht Treaty was being drafted, the Anglo-Saxon model of central banking was dominant in almost all the EU-member states. Why then was this model rejected and German succeeded? There are two reasons of the victory. One has to do with a huge political leverage of Germany in the process towards the EMU, and the other with broader considerations of economic theory, i.e. the 'monetarist counter - revolution'.

So, Germany's record of successful monetary management and its huge political leverage defined the terms of the debate on the ECB institutional design, making almost impossible the adoption of solutions that would mark a drastic departure from its own domestic practises.¹⁶ Moreover, we should draw attention to the fact that Germany's views were shared by a number of the leading architects of the EMU, primarily within the Delors Committee, that was an unequal committee. The most influential person on the committee, by far, was the *Bundesbank* president Karl-Otto Pöhl.¹⁷ He introduced two important assets to the committee: first, he was a respected president of the most honourable CB in the world; second, he had a *de facto* veto over the EMU project.

¹⁴ P. De Grauwe. *Economics of monetary Union*. 9th edition - Oxford: Oxford University Press, 2012. P. 151.

¹⁵ See P. Brentford. Constitutional Aspects of the Independence of the European Central Bank. // *International and Comparative Law Quarterly*, 1998, 47(1). P. 75-116; A. Verdun. The Institutional Design of EMU: A Democratic Deficit? // *Journal of Public Policy*, 1988, Volume 18. P. 107-132.

¹⁶ D. Chalmers, C. Hadjiemmanuil, and G. Monti. *European Union Law*. - New York: Cambridge University Press, 2008. P. 540.

¹⁷ K. Kaltenthaler. *Policymaking in the European Central Bank – the Masters of Europe's Money*. - United States of America: Rowman & Littlefield Publishers, 2006. P. 22.

Moreover, German authorities faced the risk of having to accept higher inflation when they entered the monetary union. This is why in order to accept the EMU, German monetary authorities insisted on having the ECB that would be even more pragmatic about inflation than they were themselves. In other words, German monetary authorities insisted that having price stability should be a primary objective of the ECB. And the only way to ensure that Germans agree with forming the EMU, in spite of heavy internal resistance from general population and economists, was to transfer the institutional set-up of the *Bundesbank* to the ECB.¹⁸

The second reason why the *Bundesbank* was taken as the primary model for the ECB has to do with the monetarist counter-revolution. After the *Bretton Woods*¹⁹ system had collapsed in 1972, the monetarism revolution - a new and quite different phase of central banking started. Its history begins when the orthodox economic thinkers²⁰ and policy-makers have come to consensus that the achievement of price stability is a primary policy objective for all economies.

Such conclusion was reached, because the money supply was defined as the primary and single element in the economy governance. A stable quantity of currency circulating in an economy was recognised to be very important for economic growth. As a result, the primary objective for CBs should be to combat the inflation. As D. Chalmers, C. Hadjiemmanuil, G. Monti stressed „*inflation corrupts the quality of the currency, both as unit of account and as a store of value, creates distortions in the tax system, leads to a decrease in the demand for money balances*“.²¹ In effect, the higher the level of inflation, the worse its consequences on the function of the real economy.²² An environment of price stability, on the contrary, ensures the minimisation of transaction costs and higher costs through ensuring the provision and confidence of a firm basis upon which private economic entities can operate.

Another important debate was discussing the relationship between the CB and the government. This monetarist view, which is described in the popular Barro-Gordon²³ model, led to an approach about the nature of the relations between the CB and the government.²⁴ Since the

¹⁸ B. Hayo. European Monetary Policy: Institutional design and policy experience.// *Intereconomics*, July/August, 2003. P. 209.

¹⁹ The Bretton Woods system is a system of monetary management, which regulated the commercial and financial relations among the world's major industrial states in the mid-20th century. It was the first example of a monetary order dedicated to control monetary relations among independent states.

²⁰ Orthodox economics is the analysis of economic behavior under existing institutions.

²¹ D. Chalmers, C. Hadjiemmanuil, and G. Monti. *European Union Law*. - New York: Cambridge University Press, 2008. P. 540.

²² See R. J. Barro. Inflation and Economic Growth.// 35 Bank of England Quarterly Bulletin 166, 1995.// <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb950205.pdf>; 2013-01-03.

²³ The Barro-Gordon model shows how the ability of government to manipulate results in inflationary bias. In this model it is supposed that the public will try to keep the unemployment rate below its natural level. This will lead to inflation in wages above their natural level, which thereby results in an overall rate of inflation that is higher than the natural rate of inflation.

²⁴ See R. J. Barro and D. B. Gordon. Rules, Discretion and Reputation in a Model of Monetary Policy.// *Journal of Monetary Economics*, 1983, 12(1). P. 101-121.

pressures to pursue expansionary monetary policies in order to stimulate the economy typically arise from politicians who seek short-term electoral profit, the CB has to be protected from these political pressures by becoming independent. The German *Bundesbank* has long suggested that the bank should act as a state within state - a coalition partner of the government. The *Bundesbank* could act as a check upon the actions of the federal government if the government's spending policies threatened price stability.²⁵ So, in the case monetary performance is measured in terms of lower inflation or price stability, it can be shown to improve when the CB is isolated from the political pressure. The countries where CBs were politically independent seemed to manage their economies better: such countries maintained lower inflation on average without having any costs in terms of higher unemployment or lower economic growth.²⁶

Also, it appeared that an institutional structure that ensures the decision-making independence of central bankers can make a difference, because their incentive structure differs from that of a government's political personnel.²⁷ Government pays little attention on monetary rectitude and is more interested in the discretionary manipulation of the money supply in order to facilitate the financing of governmental expenditure. As D. Chalmers noted „*this objective can be achieved by monetary means as an inflationary monetary expansion boosts the revenue from the issuance of currency while reducing the real value of public debt, which declines when the general level of nominal prices rises*“.²⁸ This can be particularly strong in countries that have very high levels of accumulated public debt and non-effective tax collections systems. Also, political leadership of the country tended to relax the monetary conditions in order to achieve government's general economic objectives, such as resumption of growth and the reduction of unemployment.

It was thought that there is a compromise between inflation and unemployment, synthesised in a so-called 'Phillips curve'²⁹, and where the authorities could select an optimal balance between moderate inflation and low unemployment. Though it should be mentioned that as private economic entities are able to anticipate and counteract the government's strategy, it is accepted today that monetary authorities are unable to systematically lower the unemployment rate below the natural level. They are able to make it lower only temporarily. If the unemployment rate is set below the natural one, this will be done at a price, i.e. the systematic inflation bias will be created. The only path to make unemployment lower permanently is to lower the natural unemployment rate. This can only be achieved by 'structural policies', i.e. by introducing more

²⁵ D. Howarth and P. Loedel. *The European Central Bank: the new European leviathan?* - Basingstoke: Palgrave Macmillan, 2005. P. 119.

²⁶ *Ibid.*

²⁷ D. Chalmers, C. Hadjiemmanuil, and G. Monti. *European Union Law*. - New York: Cambridge University Press, 2008. P. 541.

²⁸ *Ibid.*

²⁹ A. W. H. Phillips. The Relationship between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861- 1957. // *25 Economica*, 1958, No. 283.

flexibility in the labour market and by lowering labour taxes.³⁰ But in contrary, during that time it was also accepted that the CB must be an independent bank with a mandate that requires it to maintain price stability.

An unambiguous legal mandate of this type helps the CB to internalise the value of the price stability and sets a public benchmark against which its performance can be measured.³¹ It is significant for transparency and accountability, i.e. for the right distribution of credit and responsibility for the results of the central banker's policy decisions. In contrary, a CB mandate specifying various objectives provides opportunities for discretionally balances between potentially contradictory policy goals. Even in this case, however, the price stability is taken as priority due to CBs' subjective stimulations. Such self-interest will often tend the CB's governors and members of the board to pursue strict monetary policy, because their personal prestige depends on delivering a stable currency. Thus, „*abandoning monetary decision-making to the professional judgements of independent central bankers and disallowing interventions by the political hierarchy may result in enhanced policy credibility.*”³²

In fact, a negative correlation between legally established CB independence and inflation was established.³³ But, it does not mean that the CB independence causes the price stability. Instead, a particular society may see price stability as a fundamental objective; that explains separately both their actual achievements in pursuing this objective and their solutions to grant independence to their CB. It is, accordingly, possible that the institutional structure of CB is a much weaker determinant of monetary performance than the social context of the monetary decision-making process.³⁴

All in all, the decision to insulate the ECB from political accountability could not be said to be unreasonable in principle. This was obviously recognised by the German Federal Constitution Court in its decision in the *Brunner case*, by which the constitutionality of the Maastricht Treaty was upheld.³⁵ The Constitutional Court in *Brunner case* hold that CB independence jeopardise the field of operation of democratic principle, but this is a justifiable and permissible exception, because „it takes account of the special characteristics (tested and proven – in scientific terms as well – in the German legal system) that an independent CB is a better

³⁰ P. De Grauwe. *Economics of monetary Union*. 9th edition - Oxford: Oxford University Press, 2012. P. 152.

³¹ D. Chalmers, C. Hadjiemmanuil, and G. Monti. *European Union Law*. - New York: Cambridge University Press, 2008. P. 542.

³² *Ibid.*

³³ See A. Alesina and L. Summers. Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence.// 25 *Journal of Money, Credit and Banking*, 1993, No. 151.

³⁴ I. Mas. Central Bank Independence: a Critical View, *World Bank Policy Research Working Paper*, 1994, 1356. P. 62.//

http://www.wds.worldbank.org/servlet/WDSContentServer/IW3P/IB/1994/09/01/000009265_3970716141723/Rendered/PDF/multi_page.pdf: 2013-01-10.

³⁵ Case *Brunner v. European Union Treaty* [1994] 1 CMLR 57, 103-4.

guarantee of the value of the currency, and thus of a generally sound economic basis for the state's budgetary policies and for private planning and transactions in the exercise of the rights of economic freedom, than state bodies, which as regards their opportunities and means for action are essentially dependent on the supply and value of the currency, and rely on the short-term consent of political forces."³⁶ According to this, it means that the situation would not be changed in the case the Federal Republic's monetary competence is transferred to the supranational ECB.

Based on such presumption, the central bankers, who drafted the Delors report (which provided the intellectual framework for the Treaty on European Union (Treaty)³⁷) selected the *Bundesbank* as their model. By declaring price stability as the fundamental objective and political independence as the tool to achieve this objective, the *Bundesbank* appeared as the living realisation of a new monetarist paradigm. In this regard, the ECB was designed with a strong mandate of price stability and high, to the maximum degree workable, independence from Europe's political arenas, both national and supranational.

1.2. Interdependence of price stability and CB's independence

In this chapter we discuss the connection between independence of CB and inflation rates and search for possible explanations of their interdependence in numerous resources. Three different theories are identified and discussed below.

The CB independence and its respective influence on policy credibility have been mentioned by many researchers as a crucial ground for freeing the hand of a CB.³⁸ As A. Cukierman, who was among the first to verify empirically whether the CB independence has any impact on inflation, said „*Institutions such as the legal framework within which policy operates are important determinants of policy outcomes. In particular the independence of central banks from their respective political authorities can influence the degree of policy activism and the distribution of inflation.*”³⁹

A. Posen⁴⁰ stresses that independence and low inflation are both caused by opposition to inflation coming from the financial sector. To support his view, he shows that CB independence is

³⁶ *Ibid.*, para.104.

³⁷ Consolidated Version of the Treaty on European Union. OJ C 83, 2010.

³⁸ See K. Blackburn and M. Christensen. Monetary Policy and Policy Credibility: Theories and Evidence.// *Journal of Economic Literature XXVII*, 1989; J. Woolley. Policy Credibility and European Monetary Institutions. 1992// A. M. Sbragia (ed.), *Europolitics: Institutions and Policymaking in the "New" European Community*. - Washington DC: Brookings Institution. P. 157-90.

³⁹ A. Cukierman. *Central Bank Strategy, Credibility, and Independence: Theory and Evidence*. – Cambridge: MIT Press, 1992. P. 5.

⁴⁰ A. Posen. Why central bank independence does not cause low inflation: There is no institutional fix for politics. 1993. in: O'Brien, Richard (ed.), *Finance and the International Economy: 7: The Amex Bank Review Prize Essays*, Ch. 3. - Oxford: Oxford University Press. P. 41-65.

strongly correlated with its financial opposition measure to inflation, and that independence has no weighty impact on inflation once one accounts for a financial opposition measure to inflation.

So why does CB independence result in lower rates of inflation? Three answers can be found in the literature to this question: public choice arguments, the analysis of N. J. Sargent and N. Wallace⁴¹ and the problem of time inconsistency.⁴²

Public choice theory states that monetary authorities are linked to be influenced by political power in order to act in accordance with the government's preferences. As S. C. W. Eijffinger stressed „*Monetary tightening aggravates the budgetary position of government: the reduction in tax income brought about by a temporary slowdown of economic activity, possibly lower receipts from 'seigniorage', and the short-run increase in the interest burden on public debt all worsen the deficit.*”⁴³ Moreover, the government may seek 'easy money'. For instance, there is evidence that even very independent United States (US) Federal Reserve serves the desires of the president and the Congress. This evidence is based on close inspection of contracts between the bank and politicians and is based on tests whether monetary policy becomes open before elections.⁴⁴ So, obviously that the more independent a CB is, the less it will be influenced by political authority.⁴⁵ It is clear that this statement of J. M. Buchanan and R. M. Wagner is connected primarily to personnel independence.

A second argument explaining why CB independence may tear on inflation was first put forward by N. J. Sargent and N. Wallace⁴⁶ who separated fiscal and monetary authorities. If the size of the government's budget deficit is not influenced by monetary authorities then money supply becomes endogenous. If the public no longer wants or can absorb additional government debt, a result is that monetary authorities will have to finance the deficit by creating money. Thus, the more independent the CB is the less monetary authorities will finance deficits by creating money and the less inflation rate will be.⁴⁷ This argument clearly relates to financial independence.

⁴¹ N. J. Sargent and N. Wallace. Some Unpleasant Monetarist Arithmetic// *Federal Reserve Bank of Minneapolis Quarterly Review*, 1981, No. 5. P. 1-17.

⁴² See F. W. Kydland and E. C. Prescott. Rules rather than discretion: The inconsistency of the optimal plans.// *Journal of Political Economy*, 1977, 85. P. 473–491; R. J. Barro and D. Gordon. Rules, discretion, and reputation in a positive model of monetary policy. // *Journal of Monetary Economics*, 1983, No. 12. P. 101–121.

⁴³ S. C. W. Eijffinger. The new political economy of the central banking. P. 2. // <http://www.ceel.economia.unitn.it/events/monetary/eijffinger.pdf>; 2013-01-22.

⁴⁴ S. C. W. Eijffinger and J. de Haan. The political economy of central-bank independence.// *Princeton Special Papers in International Economics*, 1996, No. 19. P. 4.

⁴⁵ J. M. Buchanan and R. M. Wagner. *Democracy in Deficit: The political Legacy of Lord Keynes*. - New York, 1977. P. 10.

⁴⁶ N. J. Sargent and N. Wallace. Some Unpleasant Monetarist Arithmetic.// *Federal Reserve Bank of Minneapolis Quarterly Review*, 1981, No. 5. P. 1-17.

⁴⁷ S. C. W. Eijffinger and J. de Haan. The political economy of central-bank independence.// *Princeton Special Papers in International Economics*, 1996, No. 19. P. 4.

The most prominent argument for CB independence is based on the *time inconsistency problem*. B. T. McCallum⁴⁸ explaining the central insights of this model noted that it does not matter what stipulates the dynamic inconsistency problem⁴⁹ as in any case the result is – sub-optimal rate of inflation.⁵⁰ For example, the government may request the expectations of the private sector to be influenced by a policy of low inflation. However, after the expectations of low inflation were taken into account by private sector, the government has an incentive to develop surprise inflation in order to exploit short-term output benefits. Understanding that the government may be inconsistent with its policies over time, the private sector will doubt policy notifications of low inflation. As a result, discretionary policy results in inflationary bias.⁵¹ So, it was suggested to appoint CB, because its appointment results in a lower level of inflation.

For instance, it was suggested by K. Rogoff⁵² to delegate monetary policy to a central banker who is more into inflation than the government, in that way he pays more attention on the loss from inflation than the government does. So why would the government be less inflation averse than the central banker? First of all, politicians have shorter visions than CBs do. Politicians are driven to provide short-term easily visible results to electors, while CB is independent and would be more eager to take a better long-term solution. The second difference relates to the subjective importance in the objective function of the CB and that of government officials. Primary goal of CB is inflation. For politicians – it depends on their electoral program and they might have numerous parallel goals.

The so-called *contracting approach* refers to designing monetary institutions through structuring of a contract between the CB (the agent) and the government (the principal). The nature of the contract will have affect on the incentives facing the bank and as a consequence have affect on monetary policy.⁵³ C. E. Walsh⁵⁴ has stated that the government could set the CB's

⁴⁸ B. T. McCallum. Two fallacies concerning central-bank independence.// *American Economic Review, Papers and Proceedings*, 1995, 85. P. 207–211.

⁴⁹ One condition would be the lower unemployment rate as a result from a monetary surprise. Other sources of the time inconsistency problem arise from the public finances. The dynamic monetary policy inconsistency may, firstly, appear because the government may seek to inflate change before and after the public has settled for a nominal interest rate with consideration its expected rate of inflation. Before the public commits itself, the central bank has a motivation to refrain from making inflation. After positions in government bonds have been decided, policymakers have a motivation to create inflation. Another factor of the inconsistency problem also arises in the finances of government and may be taken as the “revenue” or “seigniorage” motive for monetary expansion. The dynamic inconsistency of monetary policy appears here, because of the incentives for the government to inflate change before and after the public has taken the level of real money balances. (S. C. W. Eijffinger. The new political economy of the central banking. P. 2. // <http://www.ceel.economia.unitn.it/events/monetary/eijffinger.pdf>: 2013-01-22.)

⁵⁰ This conclusion generally also exists in models with incomplete information. See A. Cukierman. *Central bank strategy, credibility, and independence*. - Cambridge: MIT Press, 1992.

⁵¹ G. Tridimas. Comparison of Central Bank and Judicial Independence.// *Studies in Public Choice*, 2011, Vol. 23.

⁵² K. Rogoff. The optimal degree of commitment to an intermediate monetary target.// *Quarterly Journal of Economics*, 1985, 110. P. 1169–1190.

⁵³ See T. Persson and G. Tabellini. Designing institutions for monetary stability.// *Carnegie- Rochester Conference Series on Public Policy*, 1993, No. 39.

rewards for achieving planned inflation rates, otherwise CB would be penalized. So C. E. Walsh's solution is formed by a contract between the government (the principal) and the CB (the agent). „The contract is structured such that a linear tax is imposed upon the CB for any inflation in excess of the inflation target, and a linear subsidy is paid to the CB if the outturn is below the inflation target.”⁵⁵ In other cases, the CB has a full discretion in setting a policy. It follows that an inflation contract can be constructed in such a way as to eliminate the inflation bias, but in the same way ensuring that the central banker's stabilization of the real economy is at the optimal level. However, as C. E. Walsh, G. Tabellini and T. Persson show, the inflation rate can be basis for an optimal contract only if monetary authorities share society's preferences between output stabilization and inflation. In other way, a complexity will be needed for the contract. Also, it is argued, that if CB and government make such contract, what is about time constraints? Do they agree that the inflation rate is always below X, or during a course of 1 year, or N years? Because, there are periods when inflation is higher, sometimes it might be better for economics if looking at the results in longer time periods. So, if they agree on a short term solution, it might be not in the best interests of economics. That is why the independence might be needed, because this is like trying to control the CB through the contract.

Hence, we clearly see that independence of a CB is an indispensable element that facilitates the pursuit of price stability. This is why even Article 127 of the TFEU establishes a clear hierarchy of objectives of the ECB that enforces the primacy of price stability and formally sets down the duty of the ECB to assure price stability, the bank might not always be able to do so if it is not independent.

1.3. The scope of the ECB's independence

After discussing the arguments in favour of a strong necessity of CB independence for successful pursuit of the price stability, it is worth to look further at the ECB and its institutional independence.

When the Maastricht Treaty was at the top of the agenda, the structure and operations of the ECB were the subject of many debates. It is worth to mention that there were initial ideas to submit the ECB to policy guidelines of the European Council or to make the Member States the ECB shareholders.⁵⁶ None was introduced in the final version of the Maastricht Treaty. When the drafters of Maastricht Treaty set out the structure and functions of the ECB, they did not even add

⁵⁴ C. E. Walsh. Optimal contracts for central bankers. // *American Economic Review*, 1995, No. 85.

⁵⁵ J. de Haan. The European Central Bank: Independence, accountability and strategy: A review.// *Public Choice*, 1997, 93. P. 404.

⁵⁶ C. Zilioli and M. Selmayr. Recent Developments in the Law of the European Central Bank. P.4.// <http://fds.oup.com/www.oup.co.uk/pdf/0-19-921137-X.pdf>: 2013-01-23.

it to the list of Community institutions together with the European Parliament, European Council, European Commission, Court of Justice of the European Union (CJ) and the Court of Auditors, by so declaring the high level of the ECB independence. This fact had led to the argument that the ECB - unlike any other EU institution - has autonomy from the EU framework.

C. Zilioli and M. Selmayr⁵⁷ argued that the ECB is constituted as an „*independent specialised organisation of the Community law*“, a ‘fourth pillar’ for EMU. In other words, the argument was that the ECB is a new international organisation that is not completely subordinated to the Community. This was the absolutist theory of the ECB autonomy and independence⁵⁸, which, however, did not deny that the primacy of Community law applied to the ECB and its decisions and jurisdiction as such of the CJ.⁵⁹ The stand opposing view was expressed by R. Torrent⁶⁰, who stressed that the ECB is the bank of the Community, and is not an independent legal person only associated with the Community.

Similar legal arguments were put to the ECJ (now CJ) by the ECB. The ECJ has clarified the extent of the independence of the ECB in the *OLAF case*.⁶¹ The ECJ recognises in the *OLAF* judgement „*the distinctive features of its (ECB) status within the Community legal order*“. ⁶² The ECJ considers „*to state at the outset that the draftsmen of the EC Treaty clearly intended to ensure that the ECB should be in a position to carry out independently the tasks conferred upon it by the Treaty*“. ⁶³ To support its view, the ECJ points to two kinds of evidence for this statement: firstly, Article 108 TEC (now Article 130 TFEU)⁶⁴, and secondly, a number of factors which are „*conducive to strengthening the independence thus enshrined in Article 108 TEC*“⁶⁵, such as its own decision-making bodies, the legal personality of the ECB, its own financial resources, privileges and immunities, the fact that only ECJ, on an application of the Governing Council and Executive Board of the ECB, may retire the member of the Executive Board of the ECB. It seems as if the ECJ recognized that Article 130 TFEU expresses a strong independence of the ECB. However, further the ECJ states that the ECB, pursuant to the EC Treaty (now TFEU) „*falls*

⁵⁷ C. Zilioli and M. Selmayr. The European Central Bank: An independent specialized organization of Community law.// *Common Market Law Review*, 2000, No. 37. P. 591.

⁵⁸ R. Goebel. Court of Justice oversight over the European central ban: Delimiting the ECB’s constitutional autonomy and independence in OLAF judgment.// *Fordham International LJ*, 2006, 29. P. 610-624.

⁵⁹ D. Curtin. *Executive Power of the European Union*. - New York: Oxford University Press, 2009. P. 139.

⁶⁰ R. Torrent. Whom is the European Central Bank the Central Bank of? Reaction to Zilioli and Selmayr.// *CML Rev.* 1999, No. 1229. P. 1229-1241.

⁶¹ Case 11/00 *Commission of the European Communities v. European Central Bank* [2003] ECR 00, para. 130-135. This case is referred to as ‘the OLAF (European Anti-Fraud Office) case’. This dispute concerned the fight against fraud and the scope of the OLAF investigative competences to protect the financial interests of the Community.

⁶² *Ibid.*, para. 64.

⁶³ *Ibid.*, para. 133.

⁶⁴ *Ibid.*, para. 132.

⁶⁵ *Ibid.*, para. 133.

*squarely within the Community framework*⁶⁶, thereby confirming the view, that the ECB, despite of its strong independence, is the part of the EU and therefore is based and subject to the primary EU law. The ECJ mentions three links between EU framework and the ECB. First one is the ECB task to contribute to the achievement of the EU objectives as laid down in Article 3 of the Treaty - namely an Economic and Monetary Union and the promotion of economic growth and price stability. Second one is the right (duty) of the European Council to make some decisions related to the ECB financial resources, notably, according to the Article 27.1 of the Statute, to approve the external auditors to examine all books and accounts of the ECB and NCBs and obtain full information about their transactions and, according to Article 28.1 and 30.4 of the the Statute, to set the limits and conditions for an increase of the capital of the ECB and for further calls of foreign reserve assets. The last but not least is the possibility of the European Council to make amendments to the certain provisions of the Statute (Article 129 (4) TFEU). This confirms that there are connections between the ECB and EU in terms of objectives, financial interests and institutionally, but also this is an evidence of the limited notion of the ECB's independence.

Despite the above mentioned CJ statement about the conductive factors strengthening the independence thus enshrined in Article 130 TFEU, the position of CJ is clearly for a limited notion of independence. It declared that the principle of independence covers the functions and powers of the ECB, which are enshrined in the Statute and the TFEU and, therefore, does not apply to other functions of these bodies, namely, the functions performed not in connection with the implementation of exchange control. The ECJ stated that the *„recognition that the ECB has such independence does not have the consequence of separating it entirely from the European Community and exempting it from every rule of Community law”*.⁶⁷

The approach of ECJ was also accepted by the Lisbon Treaty drafters, who confirmed the ECB as being comparable in substance to a „Union institution” in the terms of the significance of the ECB's operational and functional role it played in monetary policy. Thus, the point was put on debates by adding the ECB to the list of EU institutions (Article 13 of the Treaty). However, under the Article 282 (3) of the TFEU and 9.1⁶⁸ of the the Statute, the ECB was granted institutional independence with legal personality. Other institutions and bodies within the structure of the EU (e.g., the European Commission, the European Council) do not have the status of an independent legal entity.⁶⁹

⁶⁶ *Ibid.*, para. 92.

⁶⁷ *Ibid.*, para. 135.

⁶⁸ According to Art. 9 (1) of the Statute, the ECB *„shall enjoy in each of the Member States the most extensive legal capacity accorded to legal persons under its law; it may, in particular, acquire or dispose of movable and immovable property and may be a party to legal proceedings.”*

⁶⁹ The only exception is the European Investment Bank-EIB (Article 308 of the TFEU).

In summary, the independence of the ECB does not involve absolute immunity from EU, but comes from the need to effectively fulfil the mandate it has been granted by the TFEU.

Specifically, there are three distinctive contexts that we determine within which the political, social and international interests must be excluded or greatly reduced in order for the ECB to be considered independent. These three contexts are political independence, personnel independence, and financial independence.

1.3.1. Political independence

When discussing *political independence*, as G. Debelle and S. Fischer⁷⁰ point, it may be useful to emphasize the difference between the *goal independence* and *instrument independence*. Talking about *goal independence*, two related issues should be mentioned: the scope for the CB to exercise its own discretion, and whether the monetary stability is the primary goal of the CB. If the CB has various goals, e.g. achieving low inflation and low unemployment, it has the greatest possible scope for discretion. In such case the CB has great goal independence since it is free to set the final goals of monetary policy. It could, for instance, decide that output stability is more important than price stability, and act accordingly.⁷¹ The CB's discretionary powers may be limited by giving it either general or specific objectives with respect to price stability. It is obvious that the ECB has little goal independence, since the TFEU narrowly defines price stability as the primary objective of the ECB. However, neither the TFEU nor the Statute defines price stability. It is considered that it was not just a mistake by the drafters. The lawmakers refrained from specifying the price stability and left it up to the bank to interpret the exact meaning of the term, thereby, providing the ECB with more independence. The ECB has used this granted independence in October 1998 by announcing itself a quantitative definition of price stability⁷², thus usurping the power to define what the inflation is and what it is not.

Finally, a CB must have effective instruments in order to protect its objective(s). A bank that has *instrument independence* has freedom to choose the means by which it seeks to achieve its goals. It is obvious, that if it is necessary to have government approval for the CB's use of policy

⁷⁰ G. Debelle and S. Fischer. How independent should a central bank be? 1995./edit. by J.C. Fuhrer. *Goals, guidelines and constraints facing monetary policymakers.*// *Federal Reserve Bank of Boston, Conference Series*, No. 38, Boston. P. 195–221

⁷¹ S. C. W. Eijffinger and J. de Haan. The political economy of central-bank independence.// *Princeton Special Papers in International Economics*, 1996, No. 19. P. 38.

⁷² The Governing Council of the ECB defined price stability as „a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%” and added that price stability „was to be maintained over the medium term”. This definition was confirmed in May 2003 following a deep evaluation of the ECB's monetary policy strategy. On that occasion, the Governing Council clarified that „in the pursuit of price stability, it aims to maintain inflation rates below but close to 2% over the medium term”. (H. K. Sheller. *The European Central Bank history, role and functions*. 2nd edition, 2006. P. 80.// <http://www.ecb.int/pub/pdf/other/ecbhistoryrolefunctions2006en.pdf>; 2012-02-02.)

instruments, there is no instrument independence. Moreover, if the CB is obliged to finance budget deficits, there is also no instrument independence. In that sense financial independence and instrument independence are related; only that instrument independence is much broader.

The independence of the ECB covers free option of monetary policy instruments. Traditional instruments are provided in the Articles 18 of the Treaty and Article 19 of the Statute. Also Treaty allows the Governing Council to decide by a majority of two thirds on the use of other methods as it sees fit (Article 20 of the Statute).

Further, it will be more focused on *political independence*, which refers to the formal legal competence of the ECB to choose independently the means by which it seeks to achieve its goals independently and without yielding to the pressures of other political bodies.

The fact that the principle of independence was incorporated into the EC Treaty itself as a constitutional principle grants a high status indeed, giving the ECB greater independence than the other banks of the world have.⁷³ The Article 130 TFEU, which states „*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*”, presents the total independence of the ECB and ESCB in their monetary operations. This formulation is more explicit than existing national CB legislation, though the Bundesbank Act (Article 12) comes close: „*In exercising the powers conferred on it by this Act, it [the Bundesbank] is independent of instructions from the Federal Government.*”⁷⁴

Fundamental assumptions about the independence of the ECB stated in the Article 130 TFEU can be considered in two ways. On the one hand, the ECB and members of the decision-making bodies of the ECB are forbidden to receive instructions and guidance from the EU institutions, national governments - the EU members and any other bodies. On the other hand, EU institutions and governments of the EU member states should not to seek to influence the members of decision-making bodies of the ECB in the performance of their substantive competence of ESCB. The ECJ stated that „*Article 108 (now Article 130 TFEU) seeks, in essence, to shield the ECB from all political pressure in order to enable it effectively to pursue the objectives attributed to its tasks, through the independent exercise of the specific powers conferred on it for that purpose by the EC Treaty and the ESCB statute*”.⁷⁵ In other words, the principle aims to prevent potential political influence from the following sources: EU institutions, EU bodies, any government bodies (which can be legislative, executive, and the judiciary. Moreover, the Article 7 of the Statute covers all three levels of the management hierarchy in the state - national, regional

⁷³ K. McNamara. Rational fictions: Central Bank independence and the social logic of delegation.// *West European Politics*, 2002, 25/1. P. 66.

⁷⁴ D. Gros and N. Thygesen. *European monetary integration: from the European Monetary System to economic and monetary union*. - Harlow: Financial Times, 1998. P. 491.

⁷⁵ Case 11/00. para. 134.

and local) as well as any other organs (although, of course, bodies that are within the jurisdiction of the Union).

However, it should be noted that too strict interpretation of the expression „*to exclude political influence*” would affect the free exchange of opinions between the different structures of the EU. Still, the President of the EU Council and Members of the European Commission as the main EU’s political bodies participating in the meeting of the Governing Council without voting rights (Article 284 (1) of the TFEU), or Members of the European Parliament hearing the report of the President of the ECB (Article 284 (3) of the TFEU), should try to create an atmosphere of an open dialogue and not to cross a thin line that separates the free exchange of opinions and political pressure, prohibited by the TFEU.

A similar situation exists with respect to the CJ, whose jurisdiction extends to the ECB (Article 35 of the Statute), and in relation to the Court of Auditors, which has the right to audit financial statements and the management of the ECB (Article 27 (2) of the Statute). Strict application of the principle of independence, which the CJ has demonstrated in a number of cases connected with the decision-making in the area of common economic policy of the Union⁷⁶, provides hope that CJ will follow the same position in cases related to EU currency regulation authorities conducting single monetary policy, leaving for these bodies the freedom to maneuver.

The reason for fastening the principle of independence in Article 130 of TFEU was to ensure that the ECB is autonomous in its control of monetary policy in order to achieve its primary objective – price stability stated in Article 127 of TFEU. This text on the principle of independence was modelled on the principle of independence of the European Commission and its members. However, it reflects more generally what has been termed a „widespread [...] shift“ to granting CB the operational independence.⁷⁷

Given the clear legal mandate, there is little probability that the ECB’s political independence will be weakened in the areas it has sole responsibility. However, it is strongly argued, particularly by German economists⁷⁸, that during the current economic crisis in the euro area, the political pressure on the ECB is enormous. The current member of the ECB Executive Board, J. Stark, said „*That doesn’t just touch ECB’s independence; it endangers it. <...> Politicians from a number of Member States are strongly prompting the ECB to print money and*

⁷⁶ See cases 15/59, 29/59 *Société Metallurgique de Knutange v. High Authority* [1960] ECR 14; Case 138/79 *SA Roquettes Frères v. Council of the European Communities* [1980] ECR 3333, § 25; Case 167/88 *Association Générale des Producteurs de Blé et Autres Céréales (AGPB) v. Office National Interprofessionnel des Céréales (ONIC)* [1989] ECR 1653 § 29.

⁷⁷ D. Curtin. *Executive Power of the European Union*. - New York: Oxford University Press, 2009. P. 38.

⁷⁸ See B. Young and W. Semmler. The European Sovereign Debt Crisis. Is Germany to Blame?// *German Politics and Society*, 2011, Vol. 29, No. 1. P. 1-24.

greatly expand its government bond purchases in an effort to end the bloc's debt crisis."⁷⁹ There were a number of such attempts. For example, the French President Sarkozy encouraged the ECB to buy up Greek government bonds. Later the ECB made decision to buy Greek government bonds. August of 2011, the ECB went even further and bought up Italian and Spanish bonds.⁸⁰

Such the ECB's decisions raised the issue of political independence to the forefront of debate. The German Chancellor Merkel and the Dutch government argued that it is a direct breach of the ECB's independence; the ECB interventions meant a form of quantitative easing which is in direct violation of the TFEU. But it is argued that it is very difficult to prove that certain ECB's decisions were affected by political authority and were not taken by its own, because opinions can just coincide. If we think that every ECB's decision made after a certain politician expressed interest is the consequence of the political pressure on the ECB, we should assume the ECB always to be political in the sense forwarding the agenda of a particular group of interests at a given time. So, there should be a clear evidence that a particular ECB decision is the result of political pressure; that the ECB would not take such a decision on its own. But an open question rises: is it possible to find such an evidence? In other words, operational independence depends on the political and economic circumstances and the personality of the central bankers. What obvious is that high levels of government debt will likely dominate the ECB's decision-making landscape for some years to come. Moreover, it is considered that German government, which is pragmatic about inflation, and another economists contest the rightness of the ECB's decisions (possibility of inflation raise) rather than the breach of the ECB's independence.

Most significantly, the informal body consisted of the euro finance ministers (Eurogroup)⁸¹, which has been progressively formalized acquiring a permanent secretariat, a fixed-term presidency, and legal status under the Lisbon Treaty⁸², is likely to be the most consistent political danger to the political independence of the ECB. There were attempts to influence the ECB even before its formalizations. Tensions came to head in November 2005 Jean-Claude Juncker, the first permanent president of the Eurogroup, let it be known in the public that Eurogroup members saw the ECB's anticipated increase in interest rates as 'not particularly necessary'.⁸³ Moreover, Lamfalussy states that economists' raised question of weather public criticism will be damaging to the ECB's credibility over the long term, is seen as a signal of the

⁷⁹ F. van Esch and E. de Jong. Culture Matters: French-German Conflicts on European Central Bank Independence.// Tjalling C. Koopmans Research Institute, *Discussion Paper Series No.: 11-23 Culture*, 2011. P. 16.

⁸⁰ *Ibid.*

⁸¹ Eurogroup has political control over the currency and concerned aspects of the EU's monetary union such as the Stability and Growth Pact. It is connected to the Council of the European Union (as only members of Eurogroup can vote on issues relating to the euro in Economic and Financial Affairs Council).

⁸² The Treaty of Lisbon. OJ C 306, 17.12.2007.

⁸³ J. Peterson and M. Shackleton. *The Institutions of the European Union*. 3rd edition. - United Kingdom: Oxford University Press, 2012. P. 215.

increasing disregard to the among Eurogroup members for the ECB's independence.⁸⁴ However, it is argued, that such criticism is the result of the Eurogroup's failure to keep discussions of the euro area and fiscal policy behind closed doors. To avoid criticism there is the need of an open dialogue for achieving price stability and higher sustainable growth, but such 'intensive' dialogue between Eurogroup and the ECB must and cannot be changed into a coordination of monetary policy, otherwise it will damage the independence of the ECB.

There is also a broad criticism that unlike the US Federal Reserve System, the Bank of England and the Bank of Japan, the ECB does not publish the minutes of the meetings of its main policy-making body, nor does it publish details of how the members of the Governing Council voted.⁸⁵ This is compatible with the clear provisions of Article 10.4 of the Statute, which states that „*the proceedings of the meetings shall be confidential*”. However, the issue of transparency and accountability is critical here.

It is argued that publication of minutes would create financial market disturbances⁸⁶ and non-disclosure of voting procedure safeguards the independence of Governing Council members, as will be discussed below talking about personnel independence. However, it is more difficult to find out dangers to the independence of the ECB at whole or nationalistic voting patterns on the part of NCB's.⁸⁷ The publication of how the members of the Governing Council voted could raise the question about the pressure and motives behind the decisions of the individual members of the Governing Council. It would even make possible for the public to see whether any efforts to influence on the voting behaviour had had the intended result. Although such efforts might not be particularly connected with the CBs, which operate in „conventional” nation states, NCB governors in the euro area are related with their home countries. There is therefore a risk that the relative NCB governor may be seen as a „national representative” within the Governing Council and may lead to unjustified efforts to impact them.

Hence, even the ECB's operational independence is safeguarded by both the TFEU and Statute, rather than by secondary legislation, the ECB does not operate in a complete political vacuum. Given examples demonstrate a direct effort to affect the monetary policy decision-making process, which confirms that a renewed politicisation of conduct of monetary policy

⁸⁴ Cit: *Ibid.*

⁸⁵ This has been widely criticized. See Decision 2004/257/EC of the ECB adopting the Rules of Procedure of the European Central Bank (ECB/2004/2), OJ 2004 L80/33, Article 23.1; and Decision 2004/526/EC of the ECB adopting the Rules of Procedure of the General Council of the European Central Bank (ECB/2004/12), OJ 2004 L230/61, Article 10(1).

⁸⁶ However, The US Federal Reserve has adopted a practice which reconciles the necessity for the bank to be independent with the necessity for decision-making openness. The fact that minutes of making decisions are published has never once caused any financial market disturbances. No has the independence of the Federal Reserve been called into question by the markets because of the minutes being published.

⁸⁷ W. H. Buiter. The Young Person's Guide to Neutrality, Price Level Indeterminacy, Interest Rate Pegs, and Fiscal Theories of the Price Level, *NBER Working Papers*, 1998, No. 6396.// <http://ideas.repec.org/t/nbr/nberwo/6396.html>: 2013-12-12.

always stays possible. However, the above discussed possible restrictions on operational independence of the ECB can violate its independence only if the ECB would not take its price stability mandate and its institutional protection of independence seriously and start not only to hear the politicians, but also to listen to them.

1.3.2. Personnel independence

Personnel independence is a second crucial determining factor of CB autonomy. It is understood as a balanced system of rules concerning the governmental representation in the governing body of the CB, appointment procedures, term of office and procedures governing dismissal of the board of the bank.

In order to ensure the personal independence of the members of the ECB, a member of the ECB's Governing Council⁸⁸ may not be arbitrary dismissed at the discretion of the authorities who appointed that member. This means that the Heads of State or government of the Euro zone do not have any possibility to dismiss an Executive Board⁸⁹ member (Article 11.4 of the Statute), and the NCB Governor can be dismissed by Euro zone national government or parliament only if they no longer fulfils the conditions required for the performance of their duties or if they have been guilty of serious misconduct (Article 11.2 of the Statute). Removal of members of the Executive Board from their positions is possible only following the decision of the CJ, if they no longer fulfil the conditions required for the performance of their duties or if they have been guilty of serious misconduct (Article 11.4 of the Statute). In such cases, the Governing Council or the Executive Board may apply to the CJ to have the member of the Executive Board compulsorily retired (Article 11.4 of the Statute).

Moreover, in order to foster the personnel independence, Executive Board members are appointed for a non-renewable, eight years term, during which they are required to perform their duties on a full-time basis, without being permitted to engage in any other occupation (Article 283 (2) of the TFEU and Article 11.1 – 11.2 of the Statute). Long-term performance of their duties will

⁸⁸ The Governing Council consists of the Executive Board plus the governors of the national CBs (Article 283 (1) of the TFEU and Art. 10.1 of the Statute). It is the main body of the ECB and is entitled to take the most strategically significant decisions for the Eurosystem. According to the Article 12 (1) of the Statute, the Governing Council adopts all decisions except for those clearly reserved to the Executive Board. With regard to the objectives and tasks of the Eurosystem, it is entitled to formulate the monetary policy of the euro area. In this context, the Governing Council adopts the major decisions in the field of European monetary policy, which ensure the continued performance of the tasks of the Eurosystem, defines the ECB's operational framework, fixes interest rates at which commercial banks can obtain money from the ECB and adopts the guidelines to be followed by the Eurosystem NCBs for the implementation of monetary policy operations.

⁸⁹ The Executive Board consists of 6 members (1 president, 1 vice-president and 4 other members). The Executive Board is responsible for the implementation of monetary policy set by the Governing Council and oversees day-to-day management. Each member of the Executive Board shall have the right to vote and has one vote. The Executive Board shall act by a simple majority of the votes cast. In the event of a tie, the President shall have the casting vote (Article 11.5 of the Statute).

lead to the fact that they in a figurative sense „survive” those who made the decision to appoint them on a political level. Inability of re-appointment prevents potential attempts to succumb to political pressure in order to keep position for another term. However, it is argued, that inability of re-appointment of Executive Board members not necessarily strengthens independence, because in practice the unity of the Executive Board might be decreased and all Executive Board members might depend even more on political good-will to find good jobs after their term has expired.

Another point of personal independence to be emphasized concerns the fact that the term of employment of all members of the Executive Board shall expire at the same time. Terms and conditions of employment of members of the Executive Board, and in particular their salaries, pensions and other social security benefits, are determined by the other members of the Governing Council (Article 11.3 of the Statute).

The NCB’s Governor’s term is renewable. However, each term must be for a minimum five years so as to limit the possibility of a Governor taking monetary policy positions to support the government, with a view to being reappointed by that same government.

Further point ensuring the ECB’s personnel independence, is that only professionally suitable persons, enjoying the trust of all national governments, can be appointed as members of the ECB’s Executive Board. According to Article 283 (2) of the TFEU and Article 11. 2 of the Statute, this mean that the members of the Executive Board must be appointed *„from among persons of recognized standing and professional experience in monetary or banking matters”* by common agreement of the governments of the Members States at the highest level (Heads of State or of Government), *„on a recommendation from Council and after the consultation with the European Parliament and the Governing Council of the ECB”*. This prevents the appointment of politicians within the system of political patronage and a high degree of professional expertise ensures that persons will interpret their mandate in an independent way.

The internal rules of procedure of the ECB also ensure the personal independence of each Governing Council member as he/she takes monetary policy positions at the monthly meetings. Decisions taken at the Governing Council are depersonalised, which mean that the vote of each member remains confidential (Article 23.4 of the Rules of Procedure of the ECB)⁹⁰. Publishing the argument and vote of each member may threaten the personal independence of the members of the Governing Council, because they may be subject to indirect political pressures from their national governments. According to O. Issing, who was a member of the Executive Board: *„[such a] practice would seriously undermine the functioning of the Governing Council. In the context of the*

⁹⁰ The Rules of Procedure of the European Central Bank (ECB/2009/5) (2009/328/EC), OJ L 100, 18.4.2009.

*Eurosystem, it would subject NCB Governors to national and other pressures and would be detrimental to a frank and constructive exchange“.*⁹¹

Moreover, membership in the Governing Council is personal and inalienable. Nevertheless, there are two exceptions (Article 10 of the Statute). Firstly, in the case of financial matters, a Governor who is unable to participate may appoint an alternate to cast his/her vote (Article 10.3 of the Statute). Secondly, if a member of the Governing Council is prevented from voting for a prolonged period he/she may appoint an alternate as a member of the Governing Council (Article 3.3 of the Rules of Procedure of the ECB in conjunction with Article 10.2 of the Statute).

Despite discussed legal safeguards of personnel independence of the ECB, the personnel independence of the ECB seems not to be very strong, because NCB governors are appointed to national procedures that may have different degrees of political influence in the appointment process. This raises the concern that NCB governors may vote in the Governing Council according to national interests. As J. M. Buchanan and R. M. Wagner have put it: „A monetary decision maker is in a position only one stage removed from that of the directly elected politician. He will normally have been appointed to office by a politician subject to electoral testing, and he may even serve at the pleasure of the latter. It is scarcely to be expected that persons who are chosen as monetary decision makers will be the sort that are likely to take policy stances sharply contrary to those desired by their political associates, especially since these stances would also run counter to strong public opinion and media pressures...‘Easy money’ is also ‘easy’ for the monetary manager“.⁹² In other words, what is optimal *ex post* may not be optimal *ex ante*.

Moreover, the appointment of the Executive Board, and especially the President, can be subject to politicisation, or can become the centre of political discussions, as happened with the appointment of the first President in 1998. Whereas, Germany, Netherlands and other EU member states supported the candidacy of Wim Duisenberg, France supported its own candidate, Jean-Claude Trichet (the governor of the Banque de France). After lengthy discussions a political compromise was found. Duisenberg declared that he would be the President for at least four years, but not full time, after which French candidate would take over. As a result, Trichet was a second President of the ECB. It is considered, that the centre of discussions was not political issue, but rather nationality of the President.

Political controversies originate not only in appointing the President, but also in appointing the members of the Executive Board. In several instances this resulted in juxtaposition of the large

⁹¹ E. Apel. *Central Banking Systems Compared: The ECB, the pre-euro Bundesbank, and the Federal Reserve System*. - London: Routledge, 2003. P. 53-54.

⁹² J. M. Buchanan and R. M. Wagner. Democracy in deficit.// *Banca Nazionale del Lavoro Quarterly Review*, 1995, No. 193. P. 117-118.

Member States, such as France, Italy and Spain. They were regarded that they should have ‘some sort of entitlement to seat’⁹³ and the smaller countries, which even had highly qualified candidates, have never had a national from their country in the Executive Board. It is considered, that the Federal Reserve Bank’s procedure of the members of the Board ensure more personnel independence, because all members are appointed by the President of US and approved by the Senate, nor federal authorities participate in appointment procedure. On the other hand, „*unlike in the United States, the nomination process of ECB Executive Board does not comprise a confirmation procedure; the European Parliament has no power to enforce its decision or legally to prevent a nomination.*”⁹⁴

In terms of personnel independence, the ECB faces concerns, because it is difficult to identify the preferences of possible candidates for positions in the Governing Council and they also may change after they have been appointed. Moreover, the nationality issue will always stay open as every state wants to see its candidate in Executive Board and President position.

1.3.3. Financial independence

The third important aspect determining the level and degree of the ECB’s independence is its *financial independence*. It is obvious that politicians can influence the CB if the government has the ability to finance its consumption either directly or indirectly via CB credits. Direct access to CB credits means that monetary policy is subordinated to fiscal policy. Indirect access may result if the CB finances the government or if it runs the management of government debt. In these cases restrictions may be necessary in order to prevent government intervention in monetary policy.⁹⁵

Already from the start of the second stage of EMU it is no longer allowed that CBs provide credits to their respective governments, although it is allowed that they act as „fiscal agent”.⁹⁶ The ECB is not financially dependent on governments, nor the approval of its budget is required. The ECB’s own budget is supplemented by the income from euro banknotes emission; the difference in interest rates on loans and deposits of the ECB; investments in official foreign exchange reserves of the countries - members of the EU, which the ECB maintains and services. According to Article 27 (1) of the Statute „*accounts of the ECB and the NCBs shall be audited by*

⁹³ L. Quaglia. *Central Banking Governance in the European Union*. - London: Routledge, 2008. P. 114.

⁹⁴ C. R. Plath and T. P. Schioppa. The European Central Bank: independence and accountability.// *Zentrum für Europäische Integrationsforschung*, Berlin, Retrieved November 20, 2008. P. 20.

⁹⁵ S. C. W. Eijffinger. The new political economy of the central banking. P. 22. // <http://www.ceel.economia.unitn.it/events/monetary/eijffinger.pdf>: 2013-01-30.

⁹⁶ J. de Haan. The European Central Bank: Independence, accountability and strategy: A review.// *Public Choice*, 1997, No. 93. P. 399.

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.” Taking into account the financial independence of the ECB, it should be noted that it is not subject to the usual procedure of audition by the Court of Auditors, which can analyze only the „operational efficiency management of the ECB” (Article 287 of the Treaty and Article 27 (2) of the Statute).

Surprisingly less focus has been given to the current financial independence of the ECB, which is equally important. A current debt crisis poses a serious risk for price stability and for the financial independence of the ECB. In fact, the relationship between CB independence on the one hand, and the fiscal policy and budgetary position of a member states on the other, is basically characterised by conflicting tensions. Therefore, there are two serious threats to the financial independence of the ECB from current debt crisis. First, the fiscal imbalances may force the ECB to take measures that can blur the division of responsibilities between national policymakers and the ECB, laying it open to the reflection that it has violated its mandate. Second, Euro zone countries’ large debts may force the ECB to take measures to save Euro zone. In this case, the ECB’s financial independence will be damaged and control over prices in the long term may be lost.⁹⁷

Hence, the ECB is provided with strong financial independent. However, it is very important to find out methods to fight with current Euro zone crisis, in order to save the ECB’s financial independence.

Furthermore, there is one more danger to the ECB independence. Recently the ECB is being granted even more powers. At the Council of EU meeting on 12 December 2012 the EU finance ministers agreed on the general approach on the legislative package that establishes single supervisory mechanism (SSM) for the oversight of credit institutions.⁹⁸ One of the regulations contained in the legislative proposal on the SSM confers supervisory tasks on the ECB. In other words, it provides the ECB with the responsibility to supervise the 6,000 euro zone banks as of January 2014. For long time, the prudential supervision remained in the hands of national authorities, the ECB had only an advisory and coordinating role in the prudential supervision of

⁹⁷ T. J. Jordan. Dangers for monetary policy from unsustainable fiscal policy. Discussion presented at the European Central Bank colloquium ‘Monetary policy in unconventional times’, held in honour of José Manuel González-Páramo. 16 May 2012. P. 4.: http://www.ecb.int/events/pdf/conferences/colloq_papad/JJordan.pdf?e4720d8f1b931edeb7a1e086fb78bb8b: 2013-04-04.

⁹⁸ Proposal for the Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. COM/2012/0511 final - 2012/0242 (CNS).

banks or, in other words, its role was limited to making a *contribution* only.⁹⁹ However, the euro zone crisis has shown that the traditional approach of EU supervisory cooperation is not enough.

It seems like the ECB will become even more independent as it is clear that a prudential supervisor should be independent from the political influence. However, it is argued that the new ECB functions endanger the ECB's independence, because as C. Briault¹⁰⁰ states the wider the role CB plays, the more subject it could become to political influences. And as the ECB policymaker J. Weidmann said „*Central banks protect their independence best by interpreting their task narrowly*”.¹⁰¹ Moreover, it is clear that supervisory agent should have public trust in it. As a result, a high level of accountability is required, because one could argue that internalising conflicting goals within a single institution may occur in a more efficient resolution because of enhanced accountability.¹⁰² It may also allow the CB to respond to unplanned results that monetary policy may have on banks risk-taking incentives.¹⁰³ On the other hand, supervisory failures, which of course are inescapable, might damage the ECB's reputation and credibility in preserving price stability. If a CB has responsibility for bank supervision and a bank failure appears, the public apprehension of its credibility could be negatively affected. How it will be in practise, if it really damage the ECB's independence, we will see in the future when the ECB starts to carry its supervisory responsibilities.

To summarise, the ECB is designed by the TFEU as the bank of the EU, focusing on its primary objective - price stability, whose policies are not subject to any kind of approval by another political actor, which executives are hardly removed once they are in office, its goals and procedures depend to a significant extent on its own interpretation, it has own financial budget, and its competencies cannot be changed by passing a simple law. However, these guarantees of independence established in the TFEU and the Statute do not provide total insulation from political arena. The principle of the ECB independence may be supposed by leaders of the Europe, especially during current Euro zone crisis, only as a legal smokescreen, which must be obeyed, all the while being violated in practice. In other words, there is the difference between the degree of

⁹⁹ Today there is distinction between macro-prudential supervision and micro-prudential supervision. Macro-prudential supervision mainly focuses on the safety of the financial and economic system as a whole, the prevention of systemic risk. While micro-prudential supervision means focuses on the safety and soundness of individual institutions as well as consumer protection.

¹⁰⁰ C. Briault. The Rationale for a Single National Financial Services Regulator, *Financial Services Authority Occasional Paper*, 1999, series 2.// http://papers.ssrn.com/sol3/papers.cfm?abstract_id=428086: 2013-03-29.

¹⁰¹ The Telegraph Financial News.// <http://www.telegraph.co.uk/finance/financialcrisis/9816996/Jens-Weidmann-warns-of-currency-war-risk.html>: 2013-04-04.

¹⁰² L. Garicano. Five lessons from the Spanish cajas debacle for a new euro-wide supervisor.// *Banking Union for Europe Risks and Challenges*, 2012. P. 93.

¹⁰³ See V. Ioannidou, S. Ongena, and J. L. Peydró. Monetary Policy, Risk-Taking and Pricing: Evidence from a Quasi-Natural Experiment, *European Banking Center Discussion Paper*, 2009, No. 2009-04S.// <http://arno.uvt.nl/show.cgi?fid=94997>: 2013-04-04.

independence granted by law and the actual degree of independence achieved. This depends on the political and economic circumstances, and the personality of central bankers. As a result, safeguarding the ECB's independence requires more than a series of legal provisions. There is a high need of a wide degree of acceptance and respect of the principle of independence within the underlying political and economic culture of the society.

2. THE NEW POLITICAL CULTURE IN THE EU: DEMOCRATIC ACCOUNTABILITY OF THE ECB

In the recent years, the democratic deficit of the EU has received great attention. There is a wide discussion that EU institutions should be more democratic, because democracy is a way to create greater legitimacy - the acceptance of authority and of the exercising of power.

As a result, the main argument against the ECB's independence is that, while being free from the direct effect of political control, it lacks democratic legitimacy.¹⁰⁴ However, over the last two decades the debate over monetary policy has resulted in a consensus that in a society where the polity and the economy are based on the two principles – democracy and the market, the CB must be at the same time independent and accountable. As was mentioned in Chapter 1, independence of the bank ensures policy effectiveness, while accountability prevents democratic deficit.

However, the word accountability takes a variety of meanings. In the form of political or democratic accountability, it means that the operation of subordinate administrative authority or agency is controlled by the executive or the parliament. In a legal context, it refers to the exercise of judicial control over CB in a form of: a) review the legality of its acts; b) establishment of failure to act; c) review of final decisions of the bank whereby a sanction is imposed; d) giving preliminary rulings concerning the acts of the CB; e) hearing people who consider themselves to have suffered from a measure infringing on their rights as established by an CB act. In managerial context, it means the operational and accounting control over the agency's internal administration. In the sense of accountability to public or transparency, it requires the public dissemination of information on the decision-making procedures, the actual decisions taken by the agency and the policy outcomes as a necessary condition for informed debate on public policies.¹⁰⁵ Overall, the general definition of accountability, for the purposes of this article, could be understood as a responsibility for one's decisions and a requirement to justify them.

¹⁰⁴ See J. de Haan and S.C.W. Eijffinger. The democratic accountability of the European Central Bank: A comment on two fairy-tales.//*Journal of Common Market Studies*, 2000, 38(3), P. 393-407; K. Kaltenthaler. J. K. Anderson, and J. W. Miller. Accountability and Independent Central Banks: Europeans and Distrust of the European Central Bank// *Journal of Common Market Studies*, 2010, Vol. 48, Issue 05. P.1261-1281; G. Blunden. The Role of the Central Bank, *Working paper of University of Wales*, College of Cardiff, 1990; M. Friedman. Should there be an Independent Monetary Authority? In L. B. Yeager. (ed.) *In search of the Monetary Institution*. - Cambridge: Harvard University Press, 1963; R. M. Lastra. The Institutional Dimension of the Central Bank Independence, *Working Paper*, 1995, No 6.//

<http://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/RevistaEstabilidadFinanciera/10/Ma y/Fic/ref0318.pdf>: 2013-03-21.

¹⁰⁵ D. Chalmers, C. Hadjiemmanuil, and G. Monti. *European Union Law*. - New York: Cambridge University Press, 2008. P. 545-546.

2.1. Accountability as a cornerstone of the ECB's legitimacy

This chapter discusses, that it is possible to prevent democratic deficit by providing the ECB with accountability.

It is good to start from the basic idea that in democracy citizens delegate power to politicians. This delegation of the power to politicians has two stages. In the first the power is granted to politicians. During this stage the politicians exert this power independently from the electorate. The second stage is accountability stage during which the electorate assesses and sanctions the record of politician.

Further politicians delegate power to specialised institutions or, in our case, delegate the responsibility for monetary policy to another agent, a CB. This secondary delegation must contain the same two stages. In the first, the power is delegated to the institution in the form of a contract that specifies the objectives and the means to achieve the objectives. In the second stage the conduct of institutions is evaluated by politicians. The first stage is the stage when independence is granted; the second one is the stage in which the control is exerted (accountability).

Additionally to this political order, the accountability requirement of CBs can also be conceptualised in terms of principal-agent relationship theory.¹⁰⁶ This principal means that people and/or its elected representatives transfer the competency for monetary policy to an independent institution, the CB, and clearly clarify its mandate. An imperative part of this contractual relationship between people and agent are provisions on accountability, i.e. instruments by which people hold the agent responsible for its performance.

In the words of C.B. Briault „*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'*” and it may develop into an autocratic Leviathan.¹⁰⁷ In other words, the delegation of power to non-elected officials (the ECB Governing Council) can only be admitted in a democratic society if the bank is accountable in some manner to democratically elected institutions. It comes that democracy is a persuasive argument for accountability. Hence, accountability is an important precondition for and is at the heart of the democratic legitimacy. In a democracy, all power comes from the people. All decisions, if they bind and affect the Union, have to be legitimised by the people's will, because they are the true interested party in the

¹⁰⁶ J. de Haan. The European Central Bank: Independence, accountability and strategy: A review.// *Public Choice*, 1997, No. 93. P. 405.

¹⁰⁷ C.B. Briault, A. G. Haldane, and M.A. King. Independence and accountability, *49 Bank of England Working Paper*, 1995. P. 18.// <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb960101.pdf>: 2013-03-26.

Eurosystem's ability to „safeguard the currency” and to „defend their savings”.¹⁰⁸ Usually legitimacy is considered to comprise two principal elements: first, public policy decisions are legitimate if they express the will of the people („input legitimacy”) and, second, decisions are legitimate if they meet the justified expectations and needs of the people („output legitimacy”).

The TFEU confers upon the ECB the powers to take decisions that directly affect the lives and well-being of over 300 million people in Europe. While decision-making of the ECB is not totally isolated from the political process, it has been protected from any interference from Union institutions, the Member States governments or any other body. Against this principal, certain questions about the ECB's democratic legitimacy may arise. They can be answered with reference to the following three aspects.

First, the ECB enjoys the „input legitimacy” as an institution established by an international treaty, which all Member States signed and ratified in accordance with their constitutional requirements. It was the sovereign decision taken by the people of Europe (through their elected representatives) to transfer the competency for monetary policy to a newly created European body, and to make it independent from political intervention. Moreover, we can see the ECB's „input legitimacy” in the political process whereby the members of the ECB's decision-making bodies are appointed by national governments.¹⁰⁹

Second, the ECB can get „output legitimacy” if it is carrying out the tasks entrusted to it successfully. Experience of a numerous CBs in the post-war period has shown that CB can earn the highest levels of public support, obtain the confidence of the citizens and enjoy full legitimacy in spite of its intentional distance from the normal political process, if it successfully and consistently provides the „public good” of a stable and trusted currency.¹¹⁰ The success of CB is assessed by seeing if CB actually achieves the objectives that have been set for it and does it efficiently. As it is now almost universally recognized that price stability is key of CB mandate (like the ECB), people should be convinced that inflation is kept low and stable. Targeting inflation and keeping inflation below this target are effective means of achieving it.

Third, the independent CB' legitimacy refers to an exhaustive framework to hold them accountable. Thus it can be the requirement to explain and justify to the people of Europe and their elected representatives how its powers and prerogatives, entrusted to it to pursue its objectives, are used. Of course, since it is impossible to make the ECB directly accountable, the ECB can answer before the European citizens' elected representatives - the European Parliament. Members of the decision-making body can be held accountable for the decisions collectively or

¹⁰⁸ T. Padoa-Schioppa. *The euro and its central bank: getting united after the union*. - Cambridge: The MIT Press, 2004. P. 34.

¹⁰⁹ European Central Bank. *Accountability*.// *Monthly Bulletin*, November 2002. P. 46.// http://www.ecb.int/pub/pdf/other/pp45_57_mb200211en.pdf?1208418e0aa9b1fcb0deeb73e2c12ffd; 2013-02-01.

¹¹⁰ *Ibid.*

individually, but it is considered that collective responsibility is exactly what the ECB should pursue. It would be inconsistent to make all the members of the Governing Council individually accountable to the European Parliament, because the governors of any NCB are not appointed by the EU institutions and bodies. Moreover, a decision-making body composed of several and more members is more resistant to external impacts than a single member since it is less probable that the majority of a member are captured by market participants or be pressured by political bodies.¹¹¹ Anything that made it possible to identify who took which positions on the General Council would make central bankers' domestically pressed and not concentrated on their responsibility for achieving price stability in the euro area as a whole.¹¹² Then, the CB can explain and justify its powers and prerogative through scrutiny of policy decisions and activities by the parliament, through reporting obligations and other means such as organising different open dialogues and meetings with parliament.

Further measures aimed at ensuring that the CB does not abuse its powers include judicial review, i.e. ex post control of the legality of the CB's acts, provisions for the exclusion of members of the CB's decision-making bodies for clearly defined reasons, disclosure of the audited accounts of the CB, and observance of integrity standards for its internal governance and financial management.¹¹³

These different provisions should ensure accountability arise from the same rationale: the ECB, just like any other independent CB, is to subject its actions and decisions to public scrutiny and demonstrate that it „acts within the limits and the powers conferred upon it by the Treaty” (Article 13 (2) of the Treaty). Meanwhile, the ECB is also interested to ensure that its decisions are rightly explained and justified so as to make its policy conduct legitimate and foster public support for its independent status. Omitting the explanation of policy decisions could raise the suspicion of ECB hiding information.

However, it is important to mention that democratic accountability requires an ex post explanation and justification. If any political body could have an ability to directly influence CB's policy-making, they would in fact participate in the decision-making process itself. The result of this would be a shared responsibility of the actual policy performance. This would contradict to independency of CB and also render the meaning of the accountability concept. Therefore, the

¹¹¹ If the board would have a heterogeneous collegiality regulatory capture could be even more complicated. Moreover, decisions may cause complex choices amongst various objectives and values, which all meet with a constant and efficient financial system but which, being competing and incomparable, may be combined in different ways. As a consequence, a body composed of more members may combine all the interests in a better way than when one person takes decisions, which usually mirror the scale of values of one single human being.

¹¹² O. Issing. Open for business.// *Financial Times*, 22 September 1998.

¹¹³ European Central Bank. Accountability.// *Monthly Bulletin*, November 2002. P. 46.//

http://www.ecb.int/pub/pdf/other/pp45_57_mb200211en.pdf?1208418e0aa9b1fcb0deeb73e2c12ffd; 2013-02-01.

ECB's obligation to justify its conduct would be meaningless as the political body itself would have set the actions for which the CB is accountable to it.

Moreover, the history painfully reminds many Europeans, especially Germans, of the dangers to the state when there is too much 'political' influence on monetary policy. Political control of the bank led to the hyper-inflationary period, dissolution of the credibility and legitimacy of the government and constant attacks of extremist movements on the left and right.¹¹⁴

Western science of the banking law even proposed a term „accountability independence” (accountable independence) combining the above two principles. This principle has a great importance. The evidence for this is a huge attention to it not only in the scientific articles and essays, but also in monographs.¹¹⁵ It suggests the possible abolition of the intended objective of the „depoliticizing” the institution. Too much independence results in the creation of a democratically unacceptable „state within the state“, whereas too much accountability endangers the effectiveness of independence; a fully accountable CB may be constrained in its room for manoeuvre. Independence and accountability can be seen as the opposite ends of the continuum or two faces of the same coin. The debate about independence and accountability be like, the philosophical debate about freedom and responsibility: independence without accountability would be like freedom without responsibility.

In the light of what have been said, the accountability of ECB is a necessary element in a democratic EU. Provision of adequate sources of accountability can prevent a possible democratic deficit of the ECB, ensure its democratic legitimacy, and foster public support for its independent status. However, those sources should not restrict the effectiveness of the ECB's independence in achieving its objectives laid out in the instrument under which the bank received its delegated authority. To that end, it is both important and challenging to find the accountability-independence optimum.

2.2.The ECB and the model of accountability-independence optimum

This chapter discusses the model of accountability capable to reconcile the ECB's independence with public control while preserving its independence. Before moving to the evaluation of a current accountability measures at the ECB, we try to define what would be an ideal model providing the ECB an accountability and that would preserve its independence. Further two directions of accountability of the ECB: a model applied in New Zealand, and a list of

¹¹⁴ D. Howarth and P. Loedel. *The European Central Bank: the new European leviathan?* - Basingstoke: Palgrave Macmillan, 2005. P. 54.

¹¹⁵ See, e.g., M. Bovens. *Analysing and Assessing Accountability: A Conceptual Framework.* // *European Law Journal*, 2007, Vol. 13. No. 4. P. 447-468; M. Busuioc. *Accountability, Control and Independence: The Case of European Agencies.* // *European Law Journal*, 2009, Vol. 15. No. 5. P. 599-615.

requirements for the ECB on which the economists seem to agree would provide an accountability are discussed.

Many economists¹¹⁶ recognise that the *agency/supervision model*, which has been applied to New Zealand's CB, is the best model that provides both sufficient level of independence and accountability of CB in the recent history of central banking. It is built on an explicit contract governing the setting of targets and conduct of policy. Under this model, the elected government of the day has to agree with the CB governor on a tight target range for inflation, which the bank should pursue. Moreover, government can reward, sanction and provide salary bonuses or dismiss the board. However, it can only do this for success or failure in the achievement of a pre-announced target, CB stays independent for management of monetary policy to maintain price stability. As a result, even being democratically authorised and controlled, it does have a significant level of independence.

The TFEU is highly criticised that it ignored the significant combination of accountability and independence offered by the model of New Zealand. For example, C. Goodhart¹¹⁷ argues that the ECB lost a great opportunity to gain a high level of accountability that it lacks. C. Lord¹¹⁸ as well stresses that the model of New Zealand with its system of sanctions, awards and bonuses could even be superior to the Treaty to the extent that the ECB would have had greater stimulation to hit its target, and this would have been obvious to price and wage fixers. The power of such a model to deliver the ECB accountability is self-evident. The democratic process would be secure from the monetary policy manipulation, because the European Council's members, who would perhaps be primarily responsible for setting inflation targets, are elected according to different electoral cycles. This means that at no moment members of the European Council would have an unanimous interest in instructing the ECB to relax its inflation target.¹¹⁹

However, it is argued that the model of New Zealand is probably precluded by range of features of the EU's political system. First of all, it is too complicated to apply federal central banking structures, where central appointees and representatives of the regions have voting rights and responsibility for implementation is similarly shared between them. In the case of the ECB, NCBs have a majority of the Governing Council; any member has the right to put an item on the

¹¹⁶ See, e.g., A. Huang, D. Margaritis, and D. Mayes. Monetary policy rules in practice: evidence from New Zealand.// <http://www.ecb.int/events/pdf/conferences/Finland.pdf>: 2013-04-12; I. Hasan and L. J. Mester. Central Bank Institutional Structure and Effective Central Banking: Cross-Country Empirical Evidence, *Research Department Working Paper*, 2008, No. 08-5.

¹¹⁷ House of Lords. Select Committee on the European Union. Is the European Central Bank working?, *Session 2002-03 42nd Report*. P. 33.// <http://www.publications.parliament.uk/pa/ld200203/ldselect/ldselect/170/170.pdf>: 2013-04-12.

¹¹⁸ C. Lord. The role of the European Parliament in the accountability of the European Central Bank, *EPRG Working paper*, 1999, No. 3. P. 10.// <http://www2.lse.ac.uk/government/research/resgroups/EPRG/pdf/workingPaper3.pdf>: 2013-04-10.

¹¹⁹ *Ibid.*

agenda; and policy implementation takes place through all financial centres. The ECB is the most decentralised compared to three main models of federal central banking: the ECB, the *Bundesbank* and the US Federal Reserve.¹²⁰

Moreover, to make the ECB's Executive Board dismissible for non-performance would mean to confer responsibility without power since the Executive Board would be sanctionable for the policies of a Governing Council in which it only has a minority of votes, or for implementation gaps between its own sound policies and the inadequate execution of others; yet making the entire Governing Council open to sanction for non-performance would be to terminate the federal structure of the ECB since NCB governors would then be dismissible from the centre. The only way to avoid this problem is to create a more unitary central banking structure.¹²¹ However, the need to represent each national interest is probably inherent in any effort to establish a CB within a multi-national political system. It is hard to believe that the decisions of the ECB would have enjoyed high levels of acceptance if it had followed the US Federal Reserve or the *Bundesbank*, which exist in single-nation federal systems.

Finally, the model of New Zealand is only able to reconcile independence and accountability in a political system with a high capacity to 'guard the guardians'.¹²² If this condition does not apply, a CB will be exposed to a governing authority with powers to redefine its goals and dismiss its board, without the latter being sanctionable for any abuse of its position. The European Council perhaps is not collectively dismissible, not sufficiently transparent.

So, if there is no possibility to reconcile accountability with independence of the ECB within the model of New Zealand, what are the other solutions?

Various indicators for CB disclosure have been suggested in the literature. But, generally, it is considered by economists that CB in order to be recognised as an accountable is required to: a) pursue 'clear objectives'; b) to demonstrate due and transparent process; c) to explain why its decisions are the best means of achieving its objectives in the circumstances; d) and to suffer punishment in the case of eventual misconduct.¹²³

As was mentioned before in Chapter 1, according to the TFEU, the ECB has a clear responsibility to give priority to the control of inflation. Thus, a clear definition of „price stability” provided by the Governing Council, simplified the monitoring of the ECB performance.

¹²⁰ D. Gros and N. Thygesen. *European Monetary Integration*. 2nd edition. - London: Longmans, 1998.

¹²¹ C. Lord. The role of the European Parliament in the accountability of the European Central Bank, *EPRG Working paper*, 1999, No. 3. P. 10.// <http://www2.lse.ac.uk/government/research/resgroups/EPRG/pdf/workingPaper3.pdf>: 2013-04-10.

¹²² *Ibid.*

¹²³ See, e.g., G. Majone. Regulatory legitimacy.// ed. by G. Majone. *Regulating Europe*. - London: Routledge, 1996; A. Sibert. Accountability of the ECB. Briefing paper for the Committee on Economic and Monetary Affairs (ECON) of the European Parliament for the Quarterly Dialogue with the President of the ECB, September 2009// <http://www.europarl.europa.eu/document/activities/cont/200909/20090924ATT61145/20090924ATT61145EN.pdf>: 2013-03-01.

According to P. A. B. Sousa¹²⁴ another above defined challenges can be achieved without any relevant losses in CB's independence by using *de facto* accountability.

In order to increase *de facto* accountability, which is considered being the easiest way to improve accountability as no changes to the law are required, it is necessary to impose *transparency*. The latter is understood as openness, clarity, honesty and common understanding.¹²⁵ The modus in which transparency is provided depends on the degree the CB decision making process being public. This can be few but decisive acts on the part of the bank: a) minutes of the reasons and the votes of participant members; b) a report on past performance and future plans.¹²⁶

Besides, transparency has several positive effects. First it reduces uncertainty in monetary policy, because the public being able to make more accurate deductions about the monetary authority's objectives will not have wrong expectations or dissatisfaction of unfavourable answers to CB's decisions and announcements. In this context, private expectations and CB reputation become more sensitive to bank action; what generally increases the CB's costs from abandoning a declared policy, decreasing the incentive to try that.¹²⁷ As a result, there would be lower variability of inflation and lower inflationary bias, improving social welfare. Moreover, when monetary policy is well understood and CB is seen as able and willing to achieve its goal, price expectations are better entrenched.¹²⁸ In other words, transparency ensures bank's credibility.¹²⁹

However, taking into account that many economists¹³⁰ recognise that a high level of transparency can be counterproductive as it can imply lower flexibility in the reactions of CB, some measures of secrecy are needed in order to keep the market off balance.¹³¹ For this reason publications of the meetings of the ECB's main policy-making body should not be very detailed and a brief delay (e.g. of a month or two) would be sufficient to ensure transparency, and to avoid unnecessary turbulence in financial markets.

Moreover, publishing the minutes of the reasons and the votes of participant members, in order to balance independence and accountability, it is not necessary to disclose the individual

¹²⁴ P. A. B. Sousa. Central Bank Independence and Democratic Accountability: Master thesis. - Portugal, 2002.//<http://www.univ-orleans.fr/deg/GDRecomofi/Activ/doclyon/desousa.pdf>: 2013-03-12.

¹²⁵ P. Geraats. Why adopt transparency? The publication of central bank forecasts, *CIDEI (University of California – Berkeley) Working Paper*, July 2000, C00-113.

¹²⁶ M. L. Campanella. ECOFIN-11 and the European Central Bank. European Community Studies Association. 1999. P. 8-9.// http://aei.pitt.edu/2236/1/002648_1.pdf: 2013-03-12.

¹²⁷ P. A. B. Sousa. Central Bank Independence and Democratic Accountability: Master thesis. – Portugal, 2002. P. 15.// <http://www.univ-orleans.fr/deg/GDRecomofi/Activ/doclyon/desousa.pdf>: 2013-03-12.

¹²⁸ Accountability and transparency.// <https://www.ecb.int/mopo/strategy/comm/html/accountability.en.html>: 2013-03-30.

¹²⁹ Credibility is based on the expectation that a CB can properly fulfil the functions it is entrusted with.

¹³⁰ See, e.g., J. Faust and L. Svensson. Transparency and credibility: Monetary policy with unobservable goals, *Institute for International Economic Studies (Stockholm University) Discussion Paper*, February 2000; P. A. B. Sousa. Central Bank Independence and Democratic Accountability: Master thesis. - Portugal, 2002. P. 15.// <http://www.univ-orleans.fr/deg/GDRecomofi/Activ/doclyon/desousa.pdf>: 2013-03-12.

¹³¹ D. Howarth, P. Loedel. *The European Central Bank: the new European leviathan?* - Basingstoke: Palgrave Macmillan, 2005. P. 132.

votes, as the publishing the argument and vote of each member may threaten the personal independence of the members of the Governing Council, because they may be subject to indirect political pressures from their national governments.

However, *de facto* accountability is unable on its own to reconcile accountability with independence as the financial markets cannot sanction, if they do not deem the explanations and justifications offered by the ECB to be satisfactory, or even they cannot force the bank to provide explanation. Moreover, they are not sufficient to provide sanctions, if the responsibility is included by the accountability for the ‘diffuse public interest’.¹³² For instance, whenever a shock makes an economy to turn from the pareto optimum of full employment with stable prices, a CB has opportunity to choose from a whole series of time-paths by which it can return to equilibrium. The CB’s choice is a purely subjective one, yet the expectations of the financial markets may differ from those of the public as a whole.¹³³

Finally, public right to recall or revise bank’s mandate cannot be confined to a power of last resort, because the recall must be arbitrary and uninformed. If it is, it must be linked to day-to-day arrangements for judging the quality of policy explanations offered by CB.

The solution of these problems is supplementation of *de facto* accountability with the publicly representative bodies or, in other words, *de jure* accountability.

De jure accountability – should include parliamentary accountability as well as judicial review of the CB’s acts and decisions, and a degree of co-operation with the executive to guarantee the consistency of overall process of policy making.¹³⁴

The European Parliament is recognised as the most appropriate body to pass public judgement on the performance of the ECB and policy justifications without dominating it. Moreover, the ECB needs to be politically responsible to the most transparent institutional process available, given that its primary incentive in co-operating fully with any system of public control lies in the opportunity to explain its policy regimes to the public and the markets.¹³⁵

*„Parliamentary accountability should be exercised through a variety of procedures and mechanisms, including annual reports and appearances in front of Parliament or public officials on a regular basis, and also in the case of an emergency situation.”*¹³⁶ Also it is required that

¹³² B. G. Peters. *The Politics of Bureaucracy*. - New York: Longmans, 1995. P. 10.

¹³³ C. Lord. The role of the European Parliament in the accountability of the European Central Bank, *EPRG Working paper*, 1999, No. 3. P. 7-8.// <http://www2.lse.ac.uk/government/research/resgroups/EPRG/pdf/workingPaper3.pdf>: 2013-04-10.

¹³⁴ A. Sibert. Accountability of the ECB. Briefing paper for the Committee on Economic and Monetary Affairs (ECON) of the European Parliament for the Quarterly Dialogue with the President of the ECB, September 2009. P. 1.

¹³⁵ C. Lord. The role of the European Parliament in the accountability of the European Central Bank, *EPRG Working paper*, 1999, No. 3. P. 15.// <http://www2.lse.ac.uk/government/research/resgroups/EPRG/pdf/workingPaper3.pdf>: 2013-04-10.

¹³⁶ R. M. Lastra and H. Shams. Accountability: *Ex ante* or Scrutiny, *Ex post* or Control and Transparency?, *Working Paper*, May 2000. P. 16.//

sanctions be imposed on the CB by the parliament if it considers that the explanations and justifications offered by the CB are unjustified. However, sanctions cannot involve any intervention in the ECB decision-making itself, because it would be the direct violation of the ECB independence. So, they can only lower the credibility of the ECB. Finally, the ECB's credibility cannot be diminished by the European Parliament unless the last one can convince the markets that their criticisms is based on economic reasoning and that they belong to the ECB's strictly defined mandate, because monetary policy's specific nature means that, in practice, certain qualifications should be discussed. Indeed, the policy tools under the direct control of the CB, e.g. short-term interest rates, liquidity management, have influence on prices via a complex web of economic interactions, in other words known as the transmission mechanism.¹³⁷ Given the time-lags in the transmission process, monetary policy can only affect the price level over the medium term.¹³⁸ The CB, indeed, is unable to offset unanticipated shocks to the price level in the short run. What is more, taking into account the uncertainty of the transmission mechanism and the fact that the nature, duration and size of economic shocks impact the appropriate response of monetary policy, a measurement of performance of the CB always asks for a balanced and differentiated assessment.

However, the ECB has a good position to win back credibility in 'subsequent rounds of the game'. This is significant as the European Parliament would not worry that it is not in the long-term interest of those it represents to sanction the ECB for poor reason-giving.

The ECB, in order to be sufficiently accountable, should also have the regular dialogue with other policy-makers and social partners, because is a good opportunity for the ECB to gain information and insights, explain its monetary policy decisions, and for the partners to understand the ECB's actions better. Such dialogue enhances the flow of information, promotes mutual understanding of each other's policy views. However, in order not to violate ECB independence a communication between ECB and counterparts should be in full respect of the respective responsibilities.

The last, but not the least indicator of CB's accountability is a judicial review of the CB's activities and decisions. Judicial review is significant to prevent and control the exercise of discretionary powers. This is a fundamental element of the rule of law, as it means that the bank

http://webfirstlive.lse.ac.uk/fmg/documents/events/conferences/2000/rules/49_lastra.pdf: 2013-02-01.

¹³⁷ European Central Bank. Recent findings on monetary policy transmission in the euro area// *Monthly Bulletin*, October 2002. P. 43-53.//http://www.ecb.int/pub/pdf/other/pp43_53_mb200210en.pdf: 2013-02-01.

¹³⁸ European Central Bank. Accountability.// *Monthly Bulletin*, November 2002. P. 47.//

http://www.ecb.int/pub/pdf/other/pp45_57_mb200211en.pdf?1208418e0aa9b1fcb0deeb73e2c12ffd: 2013-02-01.

does not have absolute legal independence. The discretion of public officials should never be abandoned but subject to legal control.¹³⁹

Hence, the *optimal model*, which would provide a coherent framework for holding the ECB accountable and at the same time safeguard its independence, should include:

- Open, clear, and timely information to the public on the ECB's strategy, assessments, and policy decisions as well as on its procedures. Publications of the meetings of the ECB's main policy-making body should not be very detailed and a brief delay (e.g. of a month or two) would be sufficient. Publications of the voting procedure of the Governing Council should not disclose the individual votes of its members.
- Close control of the European Parliament with a possibility to impose sanctions if it considers that the explanations and justifications offered by the ECB are unjustified. However, sanctions can only lower the credibility of the ECB, but do not involve any intervention in the ECB decision-making itself.
- Judicial review of the ECB's activities and decisions.
- And the regular dialogue between the ECB and other policy-makers and social partners.

Such model not only reconciles independence with accountability, but also helps the ECB to establish and maintain the required credibility in its fight against the inflation.

2.3. Holding the ECB accountable: how close to the accountability-independence optimum is the ECB?

Although the principle of accountability is not directly introduced in the TFEU¹⁴⁰, both the TFEU and the provisions of Chapter III of the Statute „Organization of the ESCB” (the duty to report) and Chapter VI of the Statute „Financial parameters of the ESCB” (setting out the requirements for accounts and audit) incorporate the basic elements of accountability.

In this chapter we discuss current arrangements of the ECB's accountability and see how much do these arrangements contribute to the accountability-independence optimum outlined at the end of section 3.2. And we finish by evaluating if the ECB could be recognised as an „accountable and independent” CB.

¹³⁹ R. M. Lastra and H. Shams. Accountability: *Ex ante* or Scrutiny, *Ex post* or Control and Transparency? *Working Paper*, May 2000. P. 16.

¹⁴⁰ Amttenbrink reaches the conclusion that the accountability of the ECB is particularly feeble, as there is no clear provision of the yardstick against which the monetary policy of the ECB may be judged. (F. Amttenbrink. *The Democratic Accountability of Central Banks: a Comparative Study of the European Central Bank*. – Oxford: Hart, 1999).

2.3.1. Executive accountability and transparency

This chapter discusses the level of the ECB's executive accountability and transparency, and it is tried to answer the question of whether it reaches accountability-independence optimum from section 3.2.

The ECB has some degree of co-operation with an executive to guarantee a consistent overall policy making and to gain accountability. The ECB and the EU Council have a shared responsibility for the matters of exchange rate and the international representation of the euro area. Also, the ECB co-operates with the EU Council on economic policy at the euro area level.

However, it should also be noted that for very important EMU decisions, such as the accession of EU Member States to the euro area or amendments to Article 10.2 of the Statute, which sets the voting procedure of the Governing Council, the EU Council meets in the composition of the Heads of State or Government¹⁴¹. Current EMU matters, on the contrary, fall within the sphere of the Economic and Financial Affairs Council (ECOFIN). In regard to this, paragraph 44 of the Presidency Conclusions of the Luxembourg European Council of 12 and 13 December 1997 noted clearly that the ECOFIN was „*the centre for the coordination of the Member States' economic policies*” and that it was „*empowered to act in the relevant areas*”. Even, Presidency Conclusions do not have any legal weight; they are nevertheless very important as they set the Union's political goals and are referred to detailed negotiations in the EU's three main law-making institutions. As a result, ECOFIN seems to be the main actor with whom the ECB should build up dialogue, what the ECB and does.

Indeed, under Article 284 (2) of the TFEU, the ECB President shall be invited to participate in meetings of the ECOFIN when the EU Council is discussing matters relating to the objectives and tasks of the ECB. Such topics include the Broad Economic Policy Guidelines, currency issues, reforms in the European financial sector and the external representation of the Union within EMU as well as issues related to foreign exchange policy.¹⁴² However, the structure of the article, precisely the part „*the ECB President shall be invited*”, shows that ECOFIN has the responsibility to invite the ECB President, nor the latter having the responsibility to participate. As a result, it seems like the dialogue is held only when the ECB President wants it to be held as CB

¹⁴¹ Such European Council composition should not be confused with the European Council, which brings together the Heads of State or Government of the EU Member States and the President of the European Commission, provides the EU with the necessary impulse for its development and determines the general political guidelines. The decisions of the Heads of State or Government to select the members of the Executive Board and to set the seat of the ECB are of an intergovernmental nature.

¹⁴² H. K. Scheller. The European Central Bank - History, role and functions. 2nd revised edition, 2006. P. 134.//<http://www.ecb.int/pub/pdf/other/ecbhistoryrolefunctions2006en.pdf>: 2013-02-03.

President has no obligation of participating in the dialogue. In order to reach accountability-independence optimum the ECB should be more convinced to create a constant open dialogue.

One could point to the ECB's participation in ECOFIN deliberations about „complementary legislation” or amendments to relevant provisions of the Statute as the evidence of the ECB co-operation with the ECOFIN. And, also on these occasions, the ECB's participation in the relevant EU Council sub-structures when preparing the ECOFIN session. However, it is argued that such co-operation of the ECB's is unsurprising, because otherwise the ECB could miss the opportunity to intercede its independence, if the latter be in danger because of possible amendments. But, it is agreed that the defence of the ECB's independence is also important because of the reasons discussed in Chapter 1.2.

However, the ECB is not so isolated from executive co-operation. For instance, the ECB communicates with the specific bodies dealing with issues of interest or direct relevance to the ECB, such as the Financial Services Committee or the Committee of Wise Men on the Regulation of European Securities Markets. The ECB is also generally welcome to supervise the preparation of other Union legislations in the areas of particular relevance. Finally, the President of the ECB regularly participates in the informal, biannual meetings of the ECOFIN, which insures an open discussion on topical issues that is free from the usual procedural constraints of formal EU Council sessions.

The European Commission also takes part in the dialogue between the ECB and the ECOFIN. Otherwise, it would be an incomplete co-operation of the ECB with the executive. The Commissioner for Economic and Monetary Affairs participates in the meetings of the ECOFIN and the Eurogroup as well as in the meetings of the ECB's Governing Council. This provides the ECB a high level of accountability, because the President of the EU Council and Members of the European Commission participate in meetings, during which Governing Council also makes its decisions of price stability policy. However, the main EU's political bodies participate in the meeting of the Governing Council without voting rights (Article 284 (1) of the TFEU). Otherwise, the ECB's independence would be directly violated. However, the President of the European Council may invite the Governing Council to discuss and include certain issues in the agenda. This means that along with the Governing Council of the ECB, ECOFIN can affect a range of issues addressed by the ECB.¹⁴³ As a result, certain doubts arise if the actual EU's political bodies' participation in the meeting of the Governing Council does not violate the independence of the ECB as it is quite difficult not to cross the thin line that separates the free exchange of opinions

¹⁴³ This gave the opportunity to some foreign scholars to name the autonomy of the ESCB as „independence under observation”. See: J. Haan, S. Eijffinger, and S. Waller. *The European Central Bank: Credibility, Transparency, and Centralization*. - London, 2005; D. Howarth and P. Loedel. *The European Central Bank*. - New York, 2005; H. Scheller. *The European Central Bank - History, Role and Functions*. - Frankfurt, 2006.

and political pressure prohibited by the TFEU. It is debated that this is one more reason for the publication of the meetings from the Governing Council as this could ensure the transparency in decision-making procedure. It would be easier to identify behavior of political bodies during the meetings, thus seeing their statements and arguments. Moreover, it is obvious that a dialogue behind the closed doors differs from an open discussion. Executive accountability of the ECB can also be observed in the close relationships with the Commission that are reinforced by frequent contacts in multilateral settings, such as the Economic and Financial Committee¹⁴⁴ or the Economic Policy Committee¹⁴⁵, and in bilateral meetings. These contacts are very important given Commission's central role in the process of economic policy-making in the Union. In particular, the Commission has many specific tasks relating to EMU such as: formulating recommendations for the Broad Economic Policy Guidelines (BEPGs); monitoring the budgetary situation in the Member States and reporting on this to the ECOFIN; preparing, at least once every two years, a convergence report examining to what extent those Member States that have yet to adopt the euro have fulfilled the convergence criteria.¹⁴⁶ Thus, the co-operation between the ECB and Commission is crucial as the Commission has an obligation to ensure that the EU's common rules are properly applied, and if necessary, seek their enforcement via the CJ. If such co-operation has been left unmaintained, Commission would have lost the opportunity to understand properly the ECB's decisions.

Another requirement for achieving independence-accountability optimum besides the executive accountability is stated in the Article 284 of the TFEU requiring transparency in the ECB. It requires the ECB to present an annual report on the activities of the ESCB and the monetary policy of both the previous and current year to the elected representatives of the European citizens, i.e. the European Parliament, the European Council, EU Council, and the European Commission; just as the national legislative bodies of the US, Japan and the United Kingdom are the principal addressees of democratic accountability for the CBs of those

¹⁴⁴ The Economic and Financial Committee (EFC) was established under Article 134(1) of the TFEU with the aim to provide the ECOFIN Council with preparatory analyses of, and advice on, a numerous economic and financial matters. The Treaty notes that the Member States, the Commission and the ECB must each select no more than two members to the Committee. However, now that the EU has 27 Member States, the EFC is composed of only one representative per Member State and two representatives each from the Commission and the ECB. The ECB's is involved in the EFC on full respect for its independence and exclusive responsibility for the single monetary policy. It takes part fully in discussions and expresses its opinion on all issues, but it does not vote.

¹⁴⁵ The Economic Policy Committee (EPC) was established in 1974 by a Council Decision 74/112/EEC of 18 February 1974 setting up an Economic Policy Committee (OJ L 63, 5.3.1974, p. 21) and is composed of two representatives and two alternates from each of the Member States, the Commission and the ECB. As the EFC, the EPC prepares the Eurogroup and ECOFIN Council meetings, but it more focuses on structural reforms. Since the ECB stresses the importance of structural reforms in the Member States as the main means of combating unemployment and fully exploiting the growth potential of the euro area, the ECB's involvement in the EPC is the great opportunity to contribute to the Committee's work. As with the EFC, the ECB's participation in the work of the EPC is based on full respect for the Bank's independence.

¹⁴⁶ H. K. Scheller. *The European Central Bank - History, role and functions*. 2nd revised edition, 2006. P. 134.//<http://www.ecb.int/pub/pdf/other/ecbhistoryrolefunctions2006en.pdf>: 2013-02-03.

countries.¹⁴⁷ After the presentation, a resolution - a comprehensive assessment of the activities and policy conduct of the ECB - is adopted by the European Parliament. Also under the Article 140 of the TFEU, the ECB reports to the EU Council about biennial convergence exercise and draws up and public reports of the ESCB activities at least quarterly.¹⁴⁸

However, TFEU and Statute provide no details on the contents of the ECB's reports, the ECB itself decides to what extent to include details on the past performance and projections on the future development of monetary policy. As a result, some doubts arise about report's positive affect on the transparency of the ECB. For this reason some additional requirements on details and structure of reports should be provided. It is considered by economists that ideally the report „would contain a description of recent inflation trends, an explanation of past monetary policy decisions in the light of such trends, and precise quantitative forecasts of inflation based on current policy.”¹⁴⁹ Moreover, the information should be structured in a way that the public can understand it, thereby ensuring that no specific interest group can take advantage of policy decisions what in the same time protects the independence of the institution.

Also, transparency of the ECB is provided by regular press conferences of senior officials of the ECB, which follow the meeting of the Governing Council every two weeks. Another means of ensuring transparency of the ECB is the annual publication of collection of the ECB laws.

Doubts about the ECB's legitimacy increase the need for the ECB to give frequent interviews, press conferences and speeches about goals and instruments and a necessity of a framework for the ECB to be directly revised by the European people. To this end, the President and Vice-President of the ECB organize a press conference without a delay after the first Governing Council meeting of each month. A transcript of the latter is published on the ECB's website where the ECB explains and justifies its decisions to the public. It is produced in a form of Monthly Bulletin¹⁵⁰ and by publishing Working Papers and other publications on its website in all official Union languages. And even still, the ECB lacks the transparency, because, as it was mentioned in Chapter 1.3, the ECB does not publish the meeting minutes of its main policy-making body, no does it publish the details of how the members of the Governing Council voted. Hence, the public stays blind to how the decisions are reached; it seems to the public like if the votes were not even taken.

¹⁴⁷ *Ibid.* P. 131.

¹⁴⁸ The process of reports and hearings has also attracted academicians, interest group and other experts who regularly prepare and submit research reports on matters of related interest in preparation of the quarterly hearings.

¹⁴⁹ See, e.g., G. Tabellini. Inflation Targeting and the Accountability of the European Central Bank. Statement prepared for the public hearing on „Democratic Accountability in the Third phase of EMU”, organized by the European Parliament, Subcommittee on Monetary Affairs, on January 6, 1998. P. 2; M. L. Campanella. ECOFIN-11 and the European Central Bank. European Community Studies Association. 1999. P. 12.// http://aei.pitt.edu/2236/1/002648_1.pdf; 2013-03-12.

¹⁵⁰ The first bulletin was published in January 1999 and since then it is regularly published.

So, despite the arguments expressed in Chapter 1.3.1, in order to reach independence-accountability optimum there is a clear need for the ECB to publish the voting records. According to Article 10.2 of the Statute, „*save as otherwise provided by for in this statute, the Governing Council shall act by a simple majority of the members having voting right, and in the event of a tie, the President shall have the casting vote*”. However, it appears that the Governing Council does not use and has never used that decision rule. Instead decisions are taken by consensus as it has been mentioned many times by the ECB’s Presidents. For example, at the Q & A session of the 10 Jan 2008 press conference, President Trichet commented, „*As you know, we do not vote and have never voted in the past.*”¹⁵¹ The problem with the word “consensus” is that decision can be taken despite a strong disagreement by some members. To call it a “consensus”, even if the minority of the members strongly disagree, is inappropriate. Hence, a CB that takes decisions by consensus seems more likely to be inertial than another that acts by simple majority.

Second, it is necessary to publish the minutes of the ECB meetings for its independence-accountability optimum, because they present an overview of the economic information that was reviewed at the meeting, the views that monetary policy makers have about the current economic issues, and finally, it includes an account of the discussion of the policy choices.

As the ECB does not publish the minutes, it tries to remedy this problem. For instance, Jean-Claude Trichet said „*Amongst the major central banks we are still the only one to hold a press conference immediately after decisions are taken. So, in terms of transparency, we are really bold and innovative.*”¹⁵² However, no conferences, no Monthly Bulletin provides the insight into the economic views of the members of the General Council. The argument for not publishing the minutes is based on the Article 10.4 of its Statute that states that „*the proceedings of the meetings shall be confidential*”. However, later, in the same Article is written that „*the Governing Council may decide to make the outcome of its deliberations public*”.

Hence, the relationship of the ECB with the EU Council and the European Commission¹⁵³ in the economic policies matters is only a non-binding dialogue; they cannot imply coordinating monetary policy ex ante with other policies. But, it is a clear evidence of the ECB’s independence. Though, through the mutual participation in EU Council and ECOFIN meetings, EU institutions responsible for formulating a unified economic policy and EU body responsible for carrying out a

¹⁵¹ Cit: A. Sibert. Accountability of the ECB. Briefing paper for the Committee on Economic and Monetary Affairs (ECON) of the European Parliament for the Quarterly Dialogue with the President of the ECB, September 2009. P. 6.

¹⁵² *Ibid.*

¹⁵³ As the Treaty does not provide for a body that joins the finance ministers of euro area member countries to discuss issues about the euro area and the single currency, the Luxembourg European Council of December 1997 decided to establish the „Eurogroup”, which will composed of the finance ministers of euro area countries and the Commissioner for Economic and Monetary Affairs. Since 2005, it has been chaired by a President, whom the Eurogroup members by a simple majority elect for two years.

single monetary policy of the Union maintain a constant dialogue with each other and, thereby, make the ECB more democratically accountable. Such a dialogue provides an opportunity for the ECB to justify its monetary policy decisions, and for the counterparts to improve their understanding of the ECB's actions. As a result, there is a balance between the ECB's independence and executive accountability. However, the same cannot be said about the transparency of the ECB: it is not transparent enough to reach the independence-accountability optimum.

2.3.2. Parliamentary accountability

Ideal is when the ECB and executive would not only be accountable to one another, but also be politically responsible to somebody that has independence of the complex of intra-executive relations.

It is fully agreed with W. H. Buiter that it is essential that „*the European Parliament act as an effective watchdog over the ECB. The legitimacy of the ECB will depend on the extent to which it is effectively accountable to the European Parliament*”.¹⁵⁴ This is why, in regard to reach independence-accountability optimum, the European Parliament should play a primary role in the control of the ECB.

A dialogue between the ECB and the European Parliament mainly relates to the ECB's mandate and tasks fulfilment. The European Parliament has an important role in holding the ECB accountable for the performance of monetary policy and related tasks, but in line with this, the European Parliament plays a significant role in facilitating dialogue between the ECB and the citizens of the EU Member States; thereby playing a major role in any evaluation of the democratic accountability of the CB itself.

Under Article 284 (3) of the TFEU, the President of the ECB and the other members of the Executive Board may, at the request of the European Parliament or on their own initiative, be heard by the competent committees of the Parliament. According to this provision, the ECB's President appears four times a year before the Committee on Economic and Monetary Affairs (ECON). In line with Parliament's Rules of Procedure, this Committee was designated as a body responsible for communications with the ECB, because European Parliament needed a forum where all financial and monetary questions could be discussed with the necessary expertise. This is very important, because otherwise without a sufficient knowledge of economics and monetary policy, the European Parliament could not be able properly evaluate the ECB's decisions.

¹⁵⁴ W. H. Buiter and N. Panigirtzoglou. Liquidity traps: How to avoid them and how to escape them? *NBER Working Paper*, 1999, 7245. P. 200.

These quarterly testimonies have appeared to be the mainstay of Parliament's action in holding the ECB accountable. During them, the President of the ECB explains policy decisions of the bank and answers questions from the ECON members. Other members of the ECB's Executive Board also appear before the ECON. In recent years, the Vice-President has been welcome to present the ECB's Annual Report to the Committee when preparing the subsequent meeting in the plenary session. Additionally, once a year an Executive Board member responsible for economics and research is invited to express the ECB's opinion on the Commission's annual review of the EU economy and the draft BEPGs. On occasion, other members of the Executive Board are also invited to present the ECB's view on specific topics relating to the ECB's competences and tasks. ECON meetings are normally open to the public and a verbatim report of proceedings is published on the website of the European Parliament shortly after the testimony. Moreover, the ECB's Annual Report has a certain chapter on accountability and the ECB's relationship with the Parliament, which stresses the main issues examined in the course of this regular dialogue.

The Parliament's Rules of Procedure¹⁵⁵ also permit all Members of the European Parliament to submit further questions in written form to the ECB via Committee's Chair. These questions and answers of the ECB are subsequently published in the EU's Official Journal in all official Union languages. Although, neither the TFEU nor the Statute provides obligations in this respect, the ECB has accepted this procedure. However, it has been emphasised by the ECB that this should not lower the importance of regular testimonies where the principal issues of the ECB's policy decisions should be discussed further. So, it seems that the ECB recognises the provision of information to European Parliament to be important and thus seeks to improve its accountability.

However, it also sets some limits. The ECB does not recognise that European Parliament has the privileged access to information on the internal policy-making of the ECB. There was a refusal from the ECB side to disclose any documents to the European Parliament; this makes the documents also unavailable to the public at large.¹⁵⁶ Some members of ECON have, on the other hand, shared opinion that they should have certain rights of confidential disclosure of documents, such as those adopted by the working parties of the CB, if they are to meet what they consider to be appropriate standards of parliamentary review. According to this, the ECB's accountability is limited. It is argued that for a better control and independence-accountability optimum European Parliament should have access to the ECB's documents, but should not make them public.

¹⁵⁵ Rule 40a „Questions for written answer to the European Central Bank”.

¹⁵⁶ Duisenberg appearance before ECON, 22 September 1998.

Moreover, it is agreed with P. Geraats, F. Giavazzi and C. Wyplosz¹⁵⁷ that ECON does not ensure a strong accountability of the ECB. There are several reasons for this. First of all, if the ECON is dissatisfied it cannot do much more than to express its dissatisfaction and make it public. Second, ECON consists of 51 members; this is why it is naturally impossible for such a large group of members, who have different political persuasions and all nationality, to conduct tough hearings. The event is rather unorganised and the discussed issues cover a wide range from pointed questions to general statements, including very parochial ones. Hence, a non-systematic assessment of these testimonies suggests that the ECB is not accountable for its conduct of European monetary policy. As a result, in order to reach independent-accountability optimum, ECON should get more powers to punish the ECB, if the latter does not provide justifiable explanations of its behaviour. But, at the same time, ECON clearly needs to reconstruct its internal structure - the number of members should be reduced by half.

Hence, even European Parliament ensures the accountability of the ECB to the European public at large, making people feel the consequences of any wrong decision or policy coming from the ECB, it does not provide the public with a possibility to act collectively in order to discipline the ECB (the ECB cannot be disciplined by the European Parliament).

2.3.3. Complementary aspects of accountability

To complete the picture of the ECB accountability in a broader sense, additional issues addressed below need to be considered. This would allow us to see the full scope of the ECB's accountability and evaluate if the ECB could be recognised as an „accountable and independent” CB.

2.3.3.1. Judicial control

The last point of the independence-accountability optimum is judicial control. So, in order to be sufficiently accountable and to be recognised as an „independent and accountable” CB, the ECB should be controlled by CJ.

As already mentioned, the ECB has broad powers under the TFEU and the Statute, which contain regulatory powers and the right to impose sanctions and penalties on undertakings if they do not comply with the regulations and decisions of the ECB. Therefore, Article 35.1 of the Statute provides for judicial review of the acts and omissions of the ECB under the conditions laid

¹⁵⁷ P. Geraats, F. Giavazzi, and C. Wyplosz. Transparency and Governance, *CEPR Monitoring the European Central Bank*, 2008, No. 6.

down in Articles 263 to 266 of the TFEU. Hence, the proceedings before the CJ against the ECB's acts that produce legal effects vis-à-vis third parties may be initiated by the European Council, the European Commission or any Member State. The CJ has jurisdiction in such actions „*on grounds of lack of competence, infringement of an essential procedural requirement, infringement of [the] Treaty or of any rule of law relating to its application, or misuse of powers*” (Article 263 (2) of the TFEU). Furthermore, any natural or legal person may, under the same conditions, initiate proceedings against the ECB's decision that is of direct and individual concern to that person (Article 263 (4) TFEU).

According to an Article 265 of the TFEU, the Union institutions or a Member State may also initiate proceedings before the CJ against the ECB for infringing the Treaty by failure to act. In the same vein, any natural and legal person may complain to the CJ that the ECB has failed to address to that person an act required by the Treaty or the Statute.

If the action is well-founded, the act is declared by the CJ to be void or, in the case of an omission, declares that the failure to act was contrary to the Treaty. In those cases, the non-contractual liability of the ECB is regulated by Article 340 of the TFEU, while the NCBs are subject to the rules of the national legislation.

The CJ not only has the power to review the acts and omissions of the ECB, but it also has competence to rule in actions brought by the ECB against a Union institution or a Member State for the aim of protecting its prerogatives or against a Union institution because for infringing the Treaty by failure to act (Articles 263 and 266 respectively). Similarly, the ECB may complain to the CJ that the NCB has failed to fulfil its Treaty and Statute obligations (Article 271(d) of the TFEU).

The CJ is also competent to solve the disputes between the ECB and its staff and also has competence in all cases where jurisdiction has been conferred on the CJ by agreement between the ECB and its contractual partners. Also, as it was discussed in Chapter 1.3.2, under an Article 11 (4) of the Statute CJ can remove the member of the Executive Board, if he/she no longer fulfils the conditions required for the performance of his/her duties or if he/she has been guilty of a serious misconduct.

However, for today there is not a big number of cases involving the ECB. Mostly there are staff cases¹⁵⁸ and, of course, cases against the decisions of the ECB, a number of which raised mostly during current economic crisis. It appeared, that despite the TFEU based power of the CJ to review the acts taken by the ECB, to exercise given competence is quite difficult, because of

¹⁵⁸ See, e.g. Joined Cases T-94/01, T-152/01 and T-286/01 *Hirsch and Others v. European Central Bank* [2003] ECR II-27; Case C-409/02 *P. Jan Pflugradt v. European Central Bank* [2004] ECR I-9873; Case C—301/02 *Tralli v. ECB* [2005] ECR I-4071.

given the inherent complexities of monetary policy.¹⁵⁹ Hence, it is argued, that CJ makes a relatively moderate review of the acts of the ECB.¹⁶⁰ The reasons for this is the ECB's large discretion in the field of monetary policy and the fact that the judges do not have the expertise within monetary policy that is necessary to establish that the bank is guilty of a failure to act or has taken the wrong decision.

Thus, it is questionable whether the judicial control of the ECB is sufficient. It seems that without an appropriate expertise within monetary policy, claims of invalidity based on infringement of a procedural requirement or serious misconduct of a Member of the Executive Board might be the only clear-cut cases where the CJ would have the competence to act.

2.3.3.2. Accounting and auditing

The Eurosystem's financial management is a matter of public concern. Ultimately, the ECB and the NCBs has a public function that covers the taxpayer's money. This is why it is one more reason for the ECB to reach independence-accountability optimum. Therefore, the Treaty includes several provisions which subject the financial management and integrity of the ECB to scrutiny.

The accountability of the ECB expresses in the ECB's obligation to draw up its Annual Accounts. According to Article 26.2 of the Statute, the annual accounts of the ECB shall be drawn up by the Executive Board, in accordance with the principles established by the Governing Council. The latter approves accounts and publishes as part of its Annual Reports. Under Article 27.1 of the Statute, the Annual Accounts of the ECB and the NCBs are verified by the independent external auditors, recommended by the Governing Council and approved by the EU Council. Finally, the consolidated financial statement of the ESCB shall be published weekly (Article 15.2 of the Statute). Equally, the consolidated balance sheet of the ESCB shall be prepared annually by the Executive Committee with the „analytical and operational purposes” (Article 26.3 of the Statute). The consolidated balance sheet should reflect the assets and liabilities of the NCBs in the part that is related to the ESCB.

In addition, to the independent external audit, the ECB's financial management is also examined by the European Court of Auditors. Under an Article 27.2 of the Statute, the Court of Auditors examines the operational efficiency of the management of the ECB and publishes an Annual Report in the Official Journal of the EU.

¹⁵⁹ P. Brentford. Constitutional Aspects of the Independence of the European Central Bank, *47 ICLQ*, 1998. P. 99.

¹⁶⁰ 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* 1/01, 2000. P. 14.

Finally, according to the ruling of the *OLAF* case, the ECB is subject to the set up by the European Community on the basis of Article 325 of the TFEU anti-fraud scheme, which provides the European Anti-Fraud Office (OLAF) - an independent investigation service within the Commission¹⁶¹, with the power to investigate fraud and other action at the ECB in the case of a reasoned suspicion. According to the CJ's ruling, the ECB has adjusted its internal rules and procedures to the legal framework of the CJ in its judgement, and has adopted the requisite measures, which will ensure close coordination with OLAF in combating fraud.¹⁶²

The discussed arrangements of the ECB accountability certainly seem to introduce a sufficient level of accountability to the ECB through reason giving. Communication between the ECB and other policy-making bodies provides an opportunity for explanation of the course of monetary policy and improvement of the outsiders' understanding of the ECB's activities and, of course, increases the transparency and credibility of the ECB as well as avoidance of any misunderstanding which might negatively affect the markets, and invite speculation. In this case, the ECB can provide a trusty reference parameter for the individual actors' decisions in order to stabilise inflation expectations.

By pushing the ECB into a continually renewable set of public statements, the European Parliament reduces the threat of allowing the ECB both goal and operational independence: the bank has less capacity to avoid responsibility by keeping goals vague, or by modifying them as it goes along. Taking into account the importance of market credibility to efficient central banking, the European Parliament's right to invite the Executive Board to an unscheduled presence before the ECON is an essential deterrent against poor performance, because if an Executive Board did not appear before ECON or failed to give a convincing answers under cross examination its reputation would probably be lost.

However, the current level of the ECB accountability does not reach the accountability-independence optimum, because, first of all, when talking about an accountability through reason-giving, the issue of transparency form should be raised in acute form. This causes the self-evident difficulty of how the ECB should need to justify its decision in accordance to terms of fixed criteria; to determine the information and methodology used to take each decision; to stipulate the expected consequences of each action in a form that allows eventual outcomes to be tested against initial expectations; and to record the range of debate, including the reasons for rejecting

¹⁶¹ Commission Decision of 28 April 1999 establishing the European Anti-Fraud Office, OJ L 136, 31.5.1999. P. 20.

¹⁶² Decision of the ECB of 3 June 2004 concerning the terms and conditions for European Anti-Fraud Office investigations of the ECB, 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 ECB (ECB/2004/11), OJ L 230, 30.6.2004. P. 56.

alternative courses, so that there is no subsequent scope to claim that particular problems were not foreseeable at the time.¹⁶³

Moreover, as the TFEU does not provide clear provisions of the ECB's accountability, the accountability is not always understood by the European Parliament and the ECB in the same way. The ECB is almost confident that it should only be held politically responsible in a manner that acknowledges, firstly, its narrow concentration on price stability and, secondly, the important theoretical presumption of independent central banking that there are no long-run trade offs between inflation and the real economy. The European Parliament is also seen by the ECB as just one element in a broad strategy of communication and legitimation with the European people.

The final and the most important reason why the ECB does not reach accountability-independence optimum is that sanctions are not imposed on the ECB by European Parliament if it does not deem the explanations and justifications offered by the ECB to be satisfactory. The dialogue exists only when the ECB willingly and responsibly participate in it.

¹⁶³ C. Lord. The role of the European Parliament in the accountability of the European Central Bank, *EPRG Working paper*, 1999, No. 3. P. 16.// <http://www2.lse.ac.uk/government/research/resgroups/EPRG/pdf/workingPaper3.pdf>: 2013-04-10.

CONCLUSIONS

1. The ECB is entrusted with a high degree of independence to pursue its mandate, because guarantees of its independence are entrenched to a particularly high level; they are constitutionalised through their incorporation in the both Treaty on Functioning of the European Union (TFEU) and the Statute of the European System of Central Banks and of the European Central Bank (Statute); this makes provisions of the ECB's independence to be hardly amended, as the TFEU can only be changed if all Member States of EU agree on and ratify amendments.

2. Both the TFEU and the Statute safeguard independence of the ECB in a far-reaching manner, i.e. at the institutional, political, personnel, and financial levels. This means that the ECB's policies are not a subject to any kind of approval by another political actor; its goals and procedures depend to a significant extent on its own interpretation, its executives are hardly removed once they are in office, and it has own budget.

3. While the legal independence of the ECB appeared to be very strong, the actual degree of the ECB's independence may not always to be such. A number of possible restrictions on independence of the ECB, discussed in this master thesis, have shown that the actual degree of the ECB's independence depends on the political and economic circumstances, and the personality of central bankers. As a result, safeguarding the ECB's independence requires more than a series of legal provisions. There is a high need of a wide degree of acceptance of the principle of independence within the underlying political and economic culture of the society.

4. Accountability is an important precondition and lies at the heart of the democratic legitimacy. Provision of adequate sources of the ECB's accountability can prevent a possible democratic deficit of the bank, ensure its democratic legitimacy, and foster public support for its independent status. However, those sources should be designed carefully, otherwise, the reduction of the ECB's independence could be the result.

5. By defining the most important indicators of CB's accountability from various suggested in the literature and taking into account the identified importance of the ECB's independence, it is concluded that the *optimal model*, which would provide a coherent framework for holding the ECB accountable and at the same time safeguard its independence, should comply with the following accountability requirements:

- Open, clear, and timely information to the public on the ECB's strategy, assessments, and policy decisions as well as on its procedures. Publications of the meetings of the ECB's main policy-making body should not be very detailed and a brief delay (e.g. of a month or two) would be sufficient. Publications of the voting procedure of the Governing Council should not disclose the individual votes of its members.

- Close control of the European Parliament with a possibility to impose sanctions if it considers that the explanations and justifications offered by the ECB are unjustified. However, sanctions can only lower the credibility of the ECB; they should not involve any intervention in the ECB decision-making itself.
 - Judicial review of the ECB's activities and decisions.
 - And the regular dialogue between the ECB and other policy-makers and social partners (European Council, EU Council, European Commission and preparatory Committees).
6. The ECB does not reach the accountability-independence optimum, because the first two requirements from the list above are unfulfilled: neither meeting minutes, nor Governing Council member votes are published; European Parliament lacks the instruments to discipline the ECB, hence the dialogue exists only when the ECB willingly and responsibly participates in it. As a result, the ECB is not sufficiently accountable today and, hence, is not democratically legitimate. This is why the accountability of the ECB should be improved upon.
7. The legal provisions of the ECB's accountability do not provide sufficient transparency of the ECB, because both TFEU and Statute provide no details on the contents of the ECB's reports; the ECB itself decides to what extent to include details on the past performance and projections on the future development of monetary policy. For this reason requirements on details and structure of the ECB's reports should be provided. It is suggested, that the ECB should by its own set such requirements, but with the assent of the European Parliament.
8. One of the main reasons why parliament accountability of the ECB is not sufficient is that unlike independence the TFEU does not provide clear imperatives of the ECB's accountability. As a result, accountability is not always understood by the European Parliament and the ECB in the same way; the ECB on its own decides to what extent it subjects itself to the mechanisms of accountability. In this regard, there is a high need for the revision of the legal basis of the ECB, so as to provide clear imperatives of the ECB's accountability and, as a result, to make it democratically accountable to the citizens of the Union.
9. The TFEU-makers have been fully aware of the potential lack of legitimacy of the ECB. Its democratic deficit has not been created by accident. There is no clear answer what was the reasoning behind the decision to choose such a framework, because a large number of documents preceding the decision remains confidential. However, based on the historical analysis of the ECB creation and importance of its independence, the potential explanation could be the need of the ECB to be reactive to the market shocks without parliamentary intervention to market shocks in order to successfully achieve its primary objective – price stability.

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SUMMARY

INDEPENDENCE AND ACCOUNTABILITY OF THE EUROPEAN CENTRAL BANK

Key words: European Central bank independence, price stability, monetary policy, European Central bank accountability, transparency, democratic legitimacy

Today, when the European Central Bank (ECB) is gaining even more power and responsibilities than at any point in its 14-year history, and the European Union (EU) is seeking to bring the democracy at its highest level, numerous debates were initiated questioning the ECB's accountability. However, if the ECB pushes toward either end of the independence-accountability spectrum, a conflict within the Euro zone would erupt. Too much independence results in the lack of democratic legitimacy of the bank; a fully accountable ECB may be constrained in its room for maneuver. The aim of this master thesis is to identify an optimal model reconciling the ECB's independence with accountability, and to evaluate how much the current ECB framework complies with the optimal independence-accountability model. In order to identify the "golden mean" of two desirable outcomes, we first study the importance of both outcomes concluding that independence of the ECB is an indispensable element in a pursuit of the ECB's primary objective – the price stability; Treaty on Functioning of the European Union safeguards this independence in a far-reaching manner. Accountability, on the other hand, serves as a precondition for democratic legitimacy of ECB. It can be ensured through the requirement for the ECB to explain and justify how its powers and prerogatives, entrusted to it to pursue its objectives, are used.

Secondly, based on our analysis we find that the *optimal model*, which would provide a coherent framework for holding the ECB accountable and at the same time safeguard its independence, should comply with the following accountability requirements:

- Open, clear, and timely information to the public on the ECB's strategy, assessments, and policy decisions as well as on its procedures. Publications of the meetings of the ECB's main policy-making body should not be very detailed and a brief delay (e.g. of a month or two) would be sufficient. Publications of the voting procedure of the Governing Council should not disclose the individual votes of its members.
- Close control of the European Parliament with a possibility to impose sanctions if it considers that the explanations and justifications offered by the ECB are unjustified. However, sanctions can only lower the credibility of the ECB, but do not involve any intervention in the ECB decision-making itself.
- Judicial review of the ECB's activities and decisions.
- And the regular dialogue between the ECB and other policy-makers and social partners (European Council, EU Council, European Commission and preparatory Committees).

By comparing current arrangements of the ECB's accountability with the accountability-independence optimum, we conclude that the ECB does not reach the accountability-independence optimum, because the first two requirements from the list above are unfulfilled: neither meeting minutes, nor Governing Council member votes are published; the European Parliament lacks the instruments to discipline the ECB, hence the dialogue exists only when the ECB willingly and responsibly participates in it. As a result, the ECB is not sufficiently accountable today and, hence, is not democratically legitimate. This is why the accountability of the ECB should be improved upon.

SANTRAUKA

EUROPOS CENTRINIO BANKO NEPRIKLAUSOMUMAS IR ATSKAITOMYBĖ

Pagrindinės sąvokos: Europos centrinio banko nepriklausomumas, kainų stabilumas, pinigų politika, Europos centrinio banko atskaitomybė, skaidrumas, demokratinis teisėtumas

Šiandien, kai Europos centrinis bankas (ECB) įgauna dar daugiau galios ir pareigų nei bet kuriuo metu per savo 14 metų istoriją ir, kai Europos Sąjunga (ES) siekia pakelti demokratiją iki aukščiausio taško, daug diskusijų ir abejonių kyla dėl ECB atskaitomybės. Tačiau, jeigu ECB tempia už vieno ar kito nepriklausomumo-atskaitomybės galo, Euro zonoje gali kilti konfliktas. Jeigu bankas yra per daug nepriklausomas, gali atsirasti banko demokratinio teisėtumo trūkumas. Tuo tarpu visiškas banko atskaitingumas gali suvaržyti ECB veikimo laisvę. Todėl, šio magistro baigiamojo darbo tikslas nustatyti optimalų modelį, kuris suderintų ECB nepriklausomumą su atskaitomybę, ir įvertinti, ar dabartinė ECB struktūra atitinka optimalų nepriklausomumo-atskaitomybės modelį.

Siekiant nustatyti “aukso vidurį“ tarp nepriklausomumo ir atskaitomybės, pirmiausia šiame darbe yra analizuojamas abiejų principų reikšmingumas ECB. Remiantis atlikta analize, nustatoma, kad nepriklausomumas yra būtinas ECB elementas banko pagrindiniam tikslui – kainų stabilumui pasiekti; Sutartis dėl Europos Sąjungos veikimo saugo ECB nepriklausomumą plataus mastu. Tuo tarpu atskaitomybė yra ECB demokratinio teisėtumo prielaida. Jinai gali būti užtikrinta per nustatytą reikalavimą ECB paaiškinti ir pagrįsti kaip jo galios ir privilegijos, patikėti jam pasiekti nustatytus tikslus, yra naudojami.

Antra, remiantis atlikta analize nustatyta, kad optimalus modelis, kuris suteiks ECB pakankamą atskaitomybės lygį ir tuo pačiu metu išsaugos banko nepriklausomumą, turi atitikti šiuos atskaitomybės reikalavimus:

- Pristatyti atvirą, aiškią ir aktualią informaciją visuomenei apie ECB strategiją, vertinimus ir politikos sprendimus bei jų priėmimo procedūras. ECB pagrindinio politikos formavimo organo susitikimų protokolų publikavimas neturėtų būti labai išsamus ir vieno ar dviejų mėnesių leidimas turėtų būti pakankamas. ECB Valdančiosios tarybos balsavimo protokolo publikavimas neturėtų atskleisti individualius tarybos narių balsus.
- Glaudi Europos Parlamento kontrolė su galimybe taikyti sankcijas, jei jis mano, kad ECB pateikti pasiaiškinimai ir pateisinimai yra nepagrįsti. Tačiau sankcijos gali tik sumažinti ECB patikimumą, bet neturėtų apimti jokios intervencijos į ECB sprendimų priimą.
- Teisminė ECB veiklos ir sprendimų priežiūra.

- Reguliarus dialogas tarp ECB ir kitais politikos formuotojais bei socialiniais partneriais (Europos Taryba, ES Taryba, Europos Komisija ir parengiamieji komitetai).

Palyginus dabartinius ECB atskaitomybės reikalavimus su nustatytu nepriklausomumo-ataskaitomybės optimumu, prieita prie išvados, kad ECB nepasiekia nepriklausomumo-ataskaitomybės optimumo, nes pirmieji du reikalavimai iš aukščiau pateikto sąrašo yra nevykdomi: nei susitikimų protokolai yra publikuojami, nei Valdančiosios tarybos narių balsai yra skelbiami; Europos Parlamentui trūksta priemonių drausminti ECB. Dialogas egzistuoja tik tada, kai ECB noriai ir atsakingai jame dalyvauja. Atsižvelgiant į tai, ECB nėra pakankamai atskaitingas šiandien ir tuo pačiu demokratiškai teisėtas. Todėl, ECB atskaitomybė turėtų būti pagerinta.