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The ECB – Unchecked transgressions and formal extensions

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1. Introduction

The past decade has seen the European Central Bank move from being a powerful technocratic institution within a clearly delimited operational range, to emerge as a powerful political actor, with opinions on and influence over policies that have until now been viewed as the prerogative of democratic politics. This has been achieved through a series of unconventional monetary policies, a massively expanded balance sheet, increased power through its role in new regulatory agencies, and above all, as a member of the troika. Through the troika, the ECB sought to influence the structural reform and bail-out policies of member states, using access to funds as leverage to achieve its desired policy outcomes in non-monetary policy areas, in what has been termed “democratic blackmail” (Sandbu 2015: 101).

The ECB threatened Ireland with bankruptcy if it didn’t structure its bank bailout in a way that made taxpayers foot the bill rather than private creditors. It threatened Greece and Spain along similar lines, requesting for example labour market liberalization in exchange for liquidity support to distressed banking systems. In Italy and Greece, the ECB was also controversially involved in the November 2011 events that resulted in two democratically elected prime ministers being replaced with unelected, Troika-friendly technocrats (Mody 2018: 330). The ECB has moved far beyond the scope of central banking without any formal changes to its intentionally narrow mandate or the already weak mechanisms under which it is held accountable (Braun 2017; Dawson et al 2019).

At its inception, the ECB was given a very narrow mandate of price stability, with a second clause on its independence and a third clause prohibiting policies aimed at financing the budgetary policies of members states. The mandate that was given to the ECB reflected views both of what a central bank should do (managing price stability through managing aggregate demand through short term interests rate) and what would be the greatest threat (the ECB used for member state debt financing). It was not designed to be a lender of last resort, i.e. to be the provider of funds to stabilize markets when everyone else panics. This is a function central banks are expected to play it has gradually achieved taken-for granted status among the ECB's peer since first being formulated in the late 1800s (Bagehot 1873/2008).

After ten years of crisis management, we ask where the ECB stands today. Is monetary policy and central banking an area where the EU is moving forward, muddling through or facing a breakdown? Our short answer is that in terms of *outcomes* the monetary union is moving forward with a strengthened central bank. The ECB has a larger toolkit and has survived legal challenges against its interpretation of its own mandate. However, "muddling through" almost seems too weak a description of the constitutionally messy *process* that led us here, from an initial reluctance by the ECB to act at all, to subsequent radical policy innovation and unchecked transgressions into the realm of democratic politics.

The financial- and euro crises became the ECB's first real test as central bank. Prior to the crisis, the ECB had ten years of what on the surface appeared to be plain sailing. This inspired a slew of self-congratulatory reporting of the central bank's own achievements, primarily low inflation and economic convergence between the Eurozone's members (Tranøy and Schwartz 2019). The crisis would force the ECB, de facto if not officially, to confront the limitations of both its understanding of financial markets and its mandate.

We suggest that the ECB's changed role over the last 10 years can be conceptualized by distinguishing between three different modes of crisis handling: *Denial, Mission Creep* and *Mission Leap*. The ECB was hesitant about acting as lender of last resort. However, this was precisely what Eurozone financial institutions needed when the crisis hit. As the crisis got

worse, the member states themselves needed a sovereign lender of last resort, something the ECB was explicitly designed *not* to be. It's perhaps not that surprising then, that the ECB's initial reaction was denial. Furthermore, it was slower than other central banks to lower interest rates, and in fact raised them in the middle of the crisis. It took half a decade for the ECB to join the other central banks in doing quantitative easing. The severity of the crisis gradually set in motion a series of processes in which the bank started to experiment with granting more long-term loans at favourable rates before diving in and engaging in the outright purchase of financial assets (QE). We label these innovations "mission creep", a term borrowed from security studies and defined by the Oxford dictionary of current English as: *a gradual shift in objectives during the course of a military campaign, often resulting in an unplanned long-term commitment.* These innovations are in some sense merely technical policy innovations falling under the "lender of last resort"-function which most central banks perform. Yet they are also policies that blur the boundaries between monetary policy (which the ECB should be doing), and fiscal and industrial policy (which the ECB should not be doing).

We coin the term "mission leap" for the transgressions that the ECB made into the democratic politics of member states, to denote that the actions the ECB took in negotiations with member states over bail-outs could not be termed "monetary policy" by any stretch of the imagination. The ECB threatening to withhold monetary support unless member states enacted structural reforms.

The rest of the chapter is structured as follows: The three different modes of crisis handling we have identified, Denial, Mission Creep and Mission Leap, organize our narrative in sections 2, 3 and 4. We argue that the ECB has "muddled forward" to a position of considerable strength. In section 5 we analyse the process that yielded such a puzzling range of crisis responses, looking at how both interests and ideas shaped the ECB's response. We also discuss what role the ECB now will take when European markets are less distressed, arguing that a return to the "old normal" is not possible. The extraordinary constitutional protection granted to the ECB was predicated on an old normal, on an understanding of how the economy works and what the appropriate role of a central bank should be, which no longer holds. In short, safeguards erected to defend an old normal will

make it difficult to reform an emergent institutional form in dire need of a democratic rethink.

2. Denial

With the onset of the financial crisis, the ECB would be confronted with the severe limitations of its deliberately narrow mandate and with the inherently difficult territory of being a central bank for multiple countries with different economic needs. The challenges the ECB would face were not immediately obvious at the outset of the crisis. Nor was it clear at the beginning that the currency union itself would come to face an existential threat. The ECB was late in lowering interest rates and raised them again while the continent was still in deep crisis. It delayed in pursuing the kinds of unconventional monetary policies that other central banks were doing, and initially explicitly rejected them (ECB 2009). We term this early crisis response "denial"[1], and show that it fits both the ECB's initial response on interest rates and liquidity measures.

A central bank's primary tool is interest rates. So how did the ECB use its interest rate during the crisis? The ECB's approach diverged from other major central banks. The Federal Reserve started aggressively cutting rates when the markets showed signs of distress in 2007, lowering from 5.25% to 4.25% by the end of 2007, and in 2008 would cut further all the way down to 0.25 %, the level at which the Federal funds rate would remain for almost a decade. The ECB kept their rate at 4 % through the latter half of 2007 and into 2008, even after it had enacted early liquidity measures to combat the crisis. In July 2008, when global markets were highly distressed following the early bank bankruptcies, the ECB *raised* its interest rate to 4.25 %. Only in October 2008, after Lehman's collapse and the ensuing financial calamity, did the ECB start cutting. The rate came down to 1 % by July 2009, but the ECB was hesitant to follow the Fed and other central banks in cutting the rate further. The ECB would keep its rate at a 1 % "floor" for several years, despite steady worsening economic conditions.

[1] A term also used by Mody (2018) and Whelan (2012).

In 2011, while Europe was in deep recession, the ECB decided to swim again the tide and start *raising* interest rates again. On April 7th, the ECB raised rates to 1.25 %, and Jean Claude Trichet defended the decision by citing signs of rising inflation (Stewart 2011). This was true for Germany, which experienced a doubling of demand for German cars and machinery from China between 2009 and 2012, thanks to the Chinese government stimulus. Yet, most of the rest of the euro zone was facing a far greater risk from deflation than inflation. At the press conference, Trichet was pressed by journalists whether he feared that the crisis-ridden periphery countries would suffer from the rate rise. Trichet's answer is worth quoting in full:

> "Price stability is of extreme importance for growth and job creation in the euro area as a whole. Of course, all countries would benefit directly or indirectly from the fact that the euro area as a whole will have more growth and more job creation, in particular, because, with inflation-expectations being well-anchored, we will have a financial environment in which medium and long-term interest rates in the market will be lower than if inflation expectations were higher. This is pure arithmetic. I would also add that high inflation is a particular burden for the most vulnerable and the poorest of our fellow citizens. We call upon all countries, not only the countries you have mentioned, to be ahead of the curve in terms of their public finances, in terms of maintaining their costs at a competitive level; and last but not least in terms of embarking on the appropriate structural reforms. This is very important, particularly the structural reforms" (ECB 2011).

Here Trichet expressed clearly that the ECB remained narrowly focused on price stability, and saw inflation as the greatest threat, even in the midst of a deep recession. Trichet was not alone in his view. The decision to raise rates was unanimous in the ECB's governing council. Mario Draghi, then head of the Italian central bank but soon to succeed Trichet, told the Wall Street Journal that monetary policy "had been expansionary for a long time" (Draghi, quoted in Koeppen and Blackstone 2011). This was a remarkable statement given that the ECB's monetary policy had been far tighter than most other central banks'. A few months later, the ECB raised rates yet again, to 1.5 %, inflicting what the IMF chief economist for Europe termed "a grievous wound" on the European economy (Mody: 2018: 293).

Markets did not react well, and bond market panic spread from periphery countries to Italy and Spain, the eurozone's third and fourth largest economies. The ECB then realized the

error of its ways, and a majority of the governing council voted to abandon Trichet's 1 % floor and lower rates. Ironically, once the ECB finally pursued a low interest rate policy, it went further than many other central banks, and by 2014 was experimenting with negative rates.

From denial to innovation is also the path the ECB took with its liquidity measures. Here the ECB started out conservatively and dragged its feet for half a decade before engaging in unconventional monetary policy. When the global financial crisis began on August 9 2007, the ECB, the Fed and a few other central banks responded with the first of what would become a series of liquidity measures. The ECB inserted a combined €94.8 billion to 49 banks that first day, and on the following day 62 banks took another €61.1 billion. Similar operations continued throughout the fall. These "Fine-Tuning Operations" were aimed at lowering short-term interbank rates and were part of the central bank's regular market operations, although the amounts in question were certainly irregular.

The ECB's initial liquidity measures in 2007 and early 2008 were similar in type and scope to the other central banks'. When these measures quickly proved ineffectual in the face of the largest financial crisis since the 1930s, other central banks, with the Fed leading the way in 2008, engaged in unconventional monetary policies, such as QE. These were aimed at lowering longer-term market rates, in the hope of resuscitating a lifeless economy. Trichet refused to follow, arguing that the ECB was to target short-term rates only (Jones 2010). Other governing council members agreed, seeing QE as inflationary or/and as a mandate-violating bail-out of crisis countries (Evans-Pritchard 2009).

Both in interest rate policy and early liquidity measures, the ECB showed it was in denial about the severity of the financial crisis and the euro zone's desperate need for its central bank to act as lender of last resort. It was therefore a radical change when an ECB governor would tell the world two years later that the ECB would do "whatever it takes".

3. Mission creep

As the crisis grew worse and threatened to break the currency union itself, it became clear the ECB needed to do more. Over the course of just four years, from 2011 to 2015, the ECB would shift from a "no, never"-approach to unconventional monetary policy to leading the pack. The three policies that we label "mission creep" are the long-term refinancing operations beginning in 2011, the Outright Monetary Transaction policy presented in 2012, and the asset purchasing program (QE) that began in 2015. Our use of this label does not signal a normative stance on our part. We label these policies mission creep because they were far outside what the limited mandate of the ECB specifies, and far from the limits ECB officials set for themselves at the beginning of the crisis.

Long Term Refinancing Operations

As the crisis persisted and even worsened the ECB realized it would also have to target longer-term interest rates. To begin with, the ECB started extending 3-month loans to financial institutions against collateral, under a new program called "Long-Term Refinancing operations". LTROs would be the first of the three policy measures the ECB would itself label "non-standard". In 2011 the ECB extended this program in the form of 3-year loans. This effectively gave the banks interest-free loans (the nominal rate was 1 %). While Trichet had early on denied that the ECB would do QE, several observes saw this LTRO innovation as a form of "QE light" (Pisani-Ferry and Wolff 2012). 3-year LTROs certainly stretched the concept of a "crisis liquidity measure". Draghi defended the move, stating that LTROs were "obviously not at all equivalent to the ECB stepping up bond-buying" (Draghi, quoted in Tooze 2018: 421).

The ECB had finally established a lender of last resort system and was doing what any other modern central bank would do in a crisis. Instead of feeling justified, being a lender of last resort "made Frankfurt queasy to the extreme" (Sandbu 2015: 99). At the end of 2011, as the euro crisis was entering what would be its most dramatic year with a real threat of an EMU breakdown, rather than looking for ways to do more, the ECB was looking for exit strategies for its unconventional monetary policy (ibid.). Yet at the same time, it was using the opportunities the crisis created to pursue its preferred policies in non-monetary issue areas. The different "modes" of crisis handling are here at display at the same time, with

both an extremely limited and an extremely expansive view of what central banks could do co-existing in the ECB's operating procedures.

Doing whatever it takes – Outright monetary transactions

Bond market panic spread to larger Eurozone countries in 2012. Spain and Italy faced market interest rates of 6 and 7 %, a rate at which rolling over government debt becomes difficult. The potential for default or a Spanish or Italian "exit" from the euro posed a much larger threat to the EMU writ large than Greece or Portugal ever did. It became clear to the ECB that LTROs would not be enough and they would need to roll out a bigger gun. In a speech given in the summer of 2012, Mario Draghi assured journalists that the ECB would do "whatever it takes" to save the euro, "within their mandate". The markets heard the "whatever it takes"-part as a strong commitment to bail-out Italian and Spanish bonds. Market rates came down considerably in the days and weeks that followed (Randow and Speciale 2018), despite that it would take two months before the ECB formally announced the Outright Monetary Transactions-program to which Draghi was referring. The OMT enabled the ECB to buy almost unlimited amounts of sovereign bonds in the secondary markets, subject to certain conditionalities. The three words spoken by Draghi have been credited with "saving the euro" (Randow and Speciale 2018). The existential crisis of the euro zone was averted, and the OMT program did not need to be used (and has yet to be). The creation of OMT would however reveal cracks in the consensus that had characterized the ECB's policies in the early crisis years. Jens Weidmann, the Bundebank's representative on the ECB's governing board, voted against the OMT program. Chancellor Merkel, however, came out in support, and finance minister Schauble even publicly criticized Weidmann's opposition (Blackstone and Walker 2012).

Quantitative Easing

Quantitative easing is a technical term for the central bank creating money to purchase government and corporate bonds in the secondary market, and in some cases also buying corporate stocks. It is a departure from other liquidity measures in that the central bank is not simply holding these securities as collateral against loans to financial institutions, *but*

actually buying them. The other major central banks, Bank of England, the Federal Reserve and the modern pioneer of this strategy, the Bank of Japan, all began QE programs from 2008 on, in an effort to combat the crisis. The ECB delayed for more than half a decade, realizing eventually that it would need to become "buyer of last resort" in certain bond markets.

When the ECB finally did embark on QE in August 2015, it was designed as open-ended from the very beginning – with a fixed monthly amount for asset purchases (beginning at €60bn/month then increased to €80bn in 2016) but no fixed total amount for the program. Here the ECB seemingly learned from the Fed. The Fed began in 2008 with a fixed total amount, but then had to create a second QE-program when the first program expired, and finally created "QE3" that was designed to be open-ended. When the ECB announced it was winding down its QE program in December 2018, it had purchased assets for €2.6 trillion over less than four years, at a pace of €1.3 million per minute (Carvalho et al 2018). At its peak, the ECB's balance sheet was equivalent to more than a third of Eurozone GDP, making it a much larger QE program than the Fed's (at its peak 25 % of US GDP).

Because QE blurs the boundaries between monetary policy and fiscal and industrial policy, it was a controversial policy also in other countries. Yet, in the ECB's case it became especially controversial as the ECB decided that not all countries were to be included in the program. The program was designed in a way that disqualified Greek bonds. Paul de Grauwe's (2016) argues that the ECB's QE program meant debt relief for all euro members except for the one that needed it the most. The ECB defended its QE-program as simply a program that was designed to improve the "transmission mechanism" for its conventional monetary policy (Andrare et. al. 2016). Argued in these terms, purchasing up to a third of member countries' government debt was not monetary debt financing (and thus a violation of the ECB mandate), but simply a way for the ECB to ensure price stability.

And while the QE program was (and in 2019 is still being) challenged legally on the grounds that it violated the debt financing-prohibition of the ECB, it would not be stopped or actively opposed by the powerful member states once after initiation. QE is now part of

the permanent toolkit of the ECB.[2] As Germany and other parts of the Eurozone slipped back into recession over the summer of 2019, the ECB announced in August it was considered re-upping its QE program in September 2019.

4. Mission leap

Extraordinary liquidity measures that challenged the boundaries between monetary and fiscal policy were being undertaken by many central banks. Yet, the ECB would also expand its power in a sense that was unprecedented. The Troika, an informal but extremely powerful alliance of the IMF, the European Commission and the ECB coordinated the financial assistance given to member states in crisis. Both as a part of, and alongside its role in the Troika, the ECB began actively pressing member states on non-monetary issues.

Creditor countries, or international creditor institutions such as the IMF, usually attach conditionalities to loans, conditions that include politically controversial structural reforms. The novelty of the troika, in this respect, was that this coalition of creditors included a non-creditor and supposedly politically independent central bank. During the crisis, the ECB attempted to influence structural reforms relating to fiscal and labour market policy, to decide the distribution of costs associated with bank bail-outs, and even who should be prime minister in some crisis countries. These are issue that are far beyond the purview of a central bank. While these interventions into the realm of democratic politics was widely criticized, by the governments themselves, by the media, and by economists, these transgressions were left unchecked, and there is little reason to think the ECB will not take the same role in the next crisis, or even possibly seek to influence non-monetary policy in non-crisis periods.

With the bailouts (Ireland, Portugal, Greece and Cyprus), the semi-bailout (Spain) and the almost bailout (Italy), the ECB engaged in direct efforts at political interference, some including threats of withholding monetary support if certain (non-monetary) policies were not enacted. In this section we briefly present some of the most controversial cases. The

[2] https://www.ecb.europa.eu/explainers/show-me/html/app_infographic.en.html.

scope of this chapter means we cannot do justice to the full "litany of sins" committed by the ECB during the crisis, nor the criticism they garnered. They have, however, already been skillfully catalogued by journalists and academics (e.g. Sandbu 2015; Stiglitz 2016; Henning 2017; Mody 2018; Tooze 2018).

In the case of *Ireland*, the ECB pushed for the Irish government to seek a bailout from the EU when the Irish were trying to deal with their crisis alone. Trichet especially was adamant that the Irish should not structure their bailout in a way that would force a haircut on creditors. Ireland, while in a fiscally much stronger position than Greece and Portugal, was in trouble due to the massive banking crisis in the country. The government had issued an ill-advised blanket guarantee of bank liabilities, putting a great deal of pressure on the government's finances. Over the fall of 2011, interest rates on Irish government bonds were rising. In the latter half of 2011, the Irish government was looking to change its laws in order to make the bank guarantee less generous, seeking to "bail-in" senior bond holders and force creditors of Allied Irish Bank and Irish Countrywide to share in some of the losses. The ECB was not pleased. On November 12, Reuters ran a story quoting official sources that Ireland was in talks with the EU over seeking bailout (Strupczewski and Halpin 2012). The Taoiseach and finance minister denied this, at the time and afterwards. Ireland only had a debt level of 25 %/GDP and had a sovereign wealth fund constituting 15 %/GDP and felt confident they could weather the spike in interest rates. Three days later, the finance minister received a letter from Trichet, urging Ireland to seek assistance, and threatening to withdraw the emergency liquidity assistance to the Bank of Ireland, assistance the Irish banks were dependent on, should Ireland not comply. Less than a week later, the governor of the Bank of Ireland announced while on a visit to Frankfurt, that Ireland was in bail out talks.

The ECB denied this story and what Ireland's finance minister claimed the letter contained, and Trichet instead said the Ireland came to apply for assistance voluntarily (Hirst 2014). To the subsequent embarrassment of the ECB Trichet's letter was leaked to a newspaper three years later, supporting the Irish finance minister's version of events. In the letter, Trichet stressed the amount of liquidity the ECB had provided Irish banks over the preceding couple of weeks, and warned that the assessment of the ECB's exposure to Irish

banks "…depends very much on progress in economic policy adjustment, enhancing financial sector capital and bank restructuring" (ECB 2014).

Why the ECB should be so insistent that senior bondholders should be spared any losses is puzzling. Even after Ireland sought assistance, the structuring of the bank guarantee was not part of the Troika's memorandum of understanding (Whelan 2014). The IMF admitted later in its evaluation of its Irish program that it had supported bailing in creditors, but had been overruled by the ECB, and that the IMF considered not sharing losses with creditors was a mistake (IMF 2015). Nor does it seem that Trichet here had the support of the Eurozone's most powerful member. Merkel publicly disagreed with Trichet:

> "The president of the European Central Bank has the view that he wants to do everything to ensure that markets take a calm view of the euro zone. We are also interested in that, but we also have to keep in mind our people, who have a justified desire to see that it's not just taxpayers that are on the hook, but also private investors". (Merkel, quoted in Mody 2018: 279).

The politicians saw the need to share some of the bail-out costs with the financial sector for them to be palatable to their domestic constituents, described by commentators as "applying capitalism to banks" (Sandbu 2015: 98). The ECB was not having it. What the ECB and the Commission told Ireland was that they were worried about contagion to other European bank bonds, although market actors at the time saw little risk in this. Forcing these creditors to take a haircut would likely have caused little contagion to other bond markets (Stiglitz 2016: 157; Sandbu 2015; 104).

In the case of *Greece*, the ECB was also active in setting terms for the financial assistance received from the Troika, terms that included structural reforms to the economy, public sector wages, pensions, privatization, and even regulations of which type of milk could be labelled "fresh" in the Greek dairy market (Stiglitz 2016: 201). When Greek debt was to be restructured in 2012, following Sarkozy and Merkel's monumental Deauville agreement, the ECB also got involved. Trichet was active in the negotiations and advocated for a solution that would not trigger credit default swaps (a form of insurance) on Greek bonds. Structuring the Greek "haircut" in such as way that it didn't trigger CDS' would punish the prudent investors who had taken out insurance on their Greek investment. The only beneficiaries would be the European banks that had sold the credit default swaps and

would thus have to pay out in the event that Greek bonds "defaulted" under the contract terms (Sandbu 2015: 141). While it was no secret that there were disagreements among the member states and among the Troika institutions on the best solutions for Greece, Trichet made his disapproval of the Deauville agreement public, stating that it would be contradictory to ask bond investors to accept haircuts on government bonds for Greece while at the same expecting them to remain confident in the government bonds of other peripheral member states (Henning 2017: 108).

On August 5 2011 Draghi, together with his predecessor Trichet, sent a letter to the *Italian* government under Berlusconi, urging them to undertake certain economic reform measures "as soon as possible" in order to save the Italian economy and the euro. The Italian cabinet called a press conference the same day announcing new measures, and the Italian press described a "secret letter" sent from the ECB (Vaciago 2012). The ECB refused to publish the letter at first but published it after it had been leaked to an Italian newspaper two months later. The letter contained policy recommendations that where far outside the scope of monetary policy, including recommending that the regional administrative level in Italy be removed, in addition to privatization and labour market liberalization (Corriere della Serra 2011). While Italy was not under any formal assistance program with the Troika, the Bank of Italy was heavily dependent on emergency liquidity assistance from the ECB, and the entire Italian banking system would be vulnerable should those taps be turned off.

This would become only the beginning of tensions between Italy and the ECB, with Berlusconi publicly blaming the ECB and Commission for his resignation in November 2011, calling it a "plot" to remove him and insert the technocrat Mario Monti in his place (Mackenzie 2014). Dismissed at the time, Berlusconi would later receive support for his account when former US Treasury Secretary Tim Geithner published his financial crisis-memoir. Geithner wrote that several EU leaders approached Obama, asking him to join a plan to remove Berlusconi, a request Obama turned down (quoted in Evans-Pritchard 2014).

While this is not a full account of all the ECB interactions with member states in this period, they exemplify the ECB's highly political activities. We have called these "unchecked transgressions" as they are not only far outside the formal scope of the ECB's mandate, but also violate the existing norms of how central bankers should and shouldn't engage in political questions that are under the jurisdiction of elected politicians (Pisani-Ferry 2015; Buiter 2015). The ECB had become "Europe's sledgehammer" (Stiglitz 2016: 165), a tool to force member states in line and on board with structural reform.

5. Muddling through to a powerful new normal

This chapter is centered on two ambitions. The first is a stock-taking exercise about gauging output and outcomes, while the second is to analyze the process of how the ECB got to where it is in 2019. Where can we place the EU's monetary policy and by extension the ECB's position on a continuum running from "moving forward" to breakdown. Our answer on this score is unequivocal. The currency union and in particular the ECB could be used to illustrate the old adage that "what doesn't kill you makes you stronger". Faced with the threat of collapse the ECB, if belatedly and sometimes reluctantly, pulled out all the stops, awarding itself new tools and tasks along the way. The ECB is more powerful in 2019 than it was in 2007. It is also difficult to envisage how this new power could be rolled back, as the ECB's already limited system of political accountability have not been expanded. The ECB now has "almost unrestrained" emergency powers and has not been placed under checks and balances to balance this power democratically (t'Klooster 2018). The legal challenge of the ECB's actions was resolved in the European Court of Justice in 2015, with a win for the ECB. Changing the ECB's mandate or accountability structure requires a treaty change and thus unanimity among member states, a high bar to clear even on far less controversial topics.

The gives rise to a deep constitutional irony. The irony is that the legitimacy of this arrangement partly hinged on the narrowness of the ECBs mandate. Giving the bank one task and one tool – controlling inflation through short term interest rates – in principle makes it fairly straight forward to hold the bank accountable. It either delivers low inflation

or it does not. The combination of a vastly enlarged operational range and an unchanged narrow mandate instead forces the ECB to engage in a convoluted form of policy-making that obscures the nature of its activities, thereby rendering political scrutiny more *difficult*. Simultaneously, narrow mandates limit the scope of issues that can be contested about ECB decisions, so that all questions become procedural. (Dawson et. al. 2019).

We have illustrated some of the ECB's key decisions and policy innovations, showing three modes of crisis response; denial, mission creep and mission leap. This curious mix of responses, and the justifications given for them, present a puzzle. One way of establishing analytically distinct (but often empirically overlapping) explanations is to look for ideas, interests and institutional logics (Hall 1997). Our ambition is not to develop hypotheses in order to explain a clearly delimited phenomenon. Instead we will illustrate how interest-driven, institutional and ideational approaches can help us make sense of some the ECBs key actions.

In a technocratic field like central banking, where normative justifications and mandate formulation draws directly on economic theory, a natural starting point for an *ideational approach* is to examine the assumptions underlying the mix of ordoliberal and new macroeconomic theory upon which the banks mandate and modus operandi was founded (Tranøy and Schwartz 2019). That is, rational expectations and the neutrality of money. The problem with starting a sense-making exercise from this world view, is that it has precious little to say about financial crises. To the rational expectations school, a financial crisis is an anomaly, which unless it can be attached to a grave policy mistakes, or an external shock, is impossible to make sense of. It offers no blue print for how to deal with a crisis, apart from a deep skepticism towards the ability of governments and democratic politics to deliver fiscal and monetary discipline (se for instance Kydland and Prescott 1977), which in turn can be seen as an argument for the ECBs resistance to be the lender of last resort for governments.

An *interest driven approach,* of which the Inter Govermentalist perspective in EU-studies is a fine example, places economic interests and power at the centre of analysis. It directs our attention to the relationship between the major powers of the EU and their domestic banks

(se also chapter 20). Simply put, if the existence of big German, British or French banks were threatened by a defaults or restructurings that would confer huge losses on these banks, this perspective would lead us to expect that the ECB would come to their rescue with cheap loans (lender of last resort) and policy stances that protect creditors at the expense of tax-payers when countries are bailed out. To a large degree these expectations are borne out by the data, but the way the ECB dragged its feet before starting to subsidize banks big time via the LTRO programme in December 2011, indicates that even in a deep crisis, material interests are not directly translated into policy by an independent central bank. This points us in the direction of a perspective which gives pride of place to institutional identity.

An identity centered approach directs our attention towards the ECB as a (by comparison to its peers the Bank of England and The Fed for example) new institution trying to arrange its adolescent feet in a complex world prone to throwing unpleasant surprises in its face. We need to ask: What would be appropriate actions for a self-conscious institution seeking to establish its credentials as the purveyor of monetary policy and financial stability for the Eurozone and the EU's internal market for capital? Firstly, this perspective helps us make sense of the bank's initial reluctance to act as a lender of last resort mantle, even though this is considered an obligation for all of its peers. Instead it guarded this unique omission from its mandate for as long as it could.

Secondly, this perspective can help us understand why the ECB took the stance it took in the Irish case. Even in the face of direct calls to the opposite in the shape of the Deauville declaration and Merkel's statement about bailing-in creditors, the bank was willing to lie and manipulate in order to save creditors from taking haircuts. One institutional interpretation is that the ECBs actions during the crisis were guided by a sense of pride in the Eurozone's as an attractive arena for investment and thus responsible for protecting the reputation of the internal market for capital. Haircuts and defaults to any European bonds, even the bonds of countries that had long been in crisis so that markets had priced that risk in, was not acceptable to the ECB under Trichet.

6. Conclusion

The financial and euro crises were crises for which the European Central Bank was unprepared – intellectually as well as in terms of its toolkit. The limited view of central banking that underpinned the creation of the ECB would come to be confronted with the harsh realities of both modern financial markets and the inherent problems of the currency union. The mandate would end up being unchanged formally, but radically altered in practice, and the policy toolkit of the ECB would be massively expanded to include targeted long-term financing, negative interest rates and large-scale asset purchases.

The ECB had multiple and contradictory modes of dealing with the crisis, interpreting its own mandate narrowly and expansively at the same time. On the one hand, it jealously defended its narrow price stability mandate, refusing for two crisis ridden years to take on the lender of last resort function that central banks long have been expected to perform. It was selective in its rescue operations, giving preferential treatment to creditors over taxpayers, and with both its interest rate policy and its liquidity, serving the interests of core member countries over peripheral ones, all the while defending its action with referral back to the sole mandate of price stability. On the other hand, the ECB willingly and aggressively entered unchartered territory for a central bank in seeking to influence fiscal policy and using the threat of withdrawal of lender of last resort-help as leverage.

The ECB short history falls neatly into two time periods. First 10 years of apparent stability bearing out the wisdom of the founding fathers followed by ten chaotic years of crisis and crisis management from which the ECB has emerged stronger, but also more unruly than ever. The current strength and position of the ECB would appear to leave both sides of the central bank independence debate unhappy. If one thinks of the first 10 years as the true normal, where the central bank (on the face of things) could deliver price stability by managing aggregate demand through short term interest rates, one will likely see the expanded lender of last resort functions and QE as threats. Not only to the mandate of price stability, but also an invitation to “politicize” central banking and in so doing threaten its independence over time. The alternative position is to take the policy innovations of the

last 10 years as the new normal, as necessary but also more political, and with more far-ranging distributional consequences than anything the ECB had previously been up to. From this vantage point the impossibility of making a clean cut between technocratic central banking and democratic policy making comes clearly into view. This position makes it difficult to accept the pretense involved in pursuing with the old mandate, and the weak accountability mechanisms which the ECB's operational realities has long since outgrown.

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