

THE ISSUE OF THE DEMOCRATIC LEGITIMACY OF THE EUROSISTEM – A SKETCH

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ABSTRACT

I poteri della indipendente Banca Centrale Europea previsti dal Trattato hanno legittimazione costituzionale e democratica sostanziale (I).

Il contributo valuta la possibilità di un'applicazione dello slogan sul "deficit democratico" delle istituzioni e degli organismi della UE agli atti giuridici della BCE, oltre ad analizzare se i regolamenti, le decisioni, le direttive o i pareri della BCE non siano solo misure amministrative o misure tese, in definitiva, a regolamentare la condotta delle persone. In quest'ultimo caso, la domanda è rilevante: tali misure sono coerenti con il requisito della accountability a livello politico (II).

In vista dei meccanismi di controllo politico previsti nel Trattato al riguardo (III), si sostiene che la pratica della trasparenza adottata dalla BCE comporta una responsabilità che genera credibilità e fiducia, diventando così di per sé un elemento di legittimazione democratica. Si sostiene inoltre che la responsabilità potrebbe sostanzialmente compensare l'eliminazione dello scrutinio parlamentare dei provvedimenti giuridici dell'Eurosistema - eliminazione intenzionalmente adottata dal Trattato (IV).

I THE ISSUE OF THE LEGITIMACY OF THE INDEPENDENT CENTRAL BANK

The Maastricht Treaty (1992) contains three fundamental provisions on monetary policy. First, the Treaty explicitly enshrines price stability as a guiding principle of the European Community.¹ Second, it separates monetary policy from other economic policies and establishes the European System of Central Banks (ESCB), to which it entrusts the responsibility for the single monetary policy in the European Community, whereby the primary objective of the ESCB is to maintain price stability.² Third, the ESCB, the European Central Bank (ECB) and the national central banks (NCBs) enjoy independence when exercising the powers and carrying out the tasks and duties conferred upon them by the Treaty.³

Such provisions were subsequently included, without any changes in substance, in the Treaty establishing a Constitution for Europe, which was adopted by European governments on 18 June 2004.

As long as there are Member States that have not yet adopted the euro, it is necessary to make a distinction between the ESCB and the Eurosystem. The term “Eurosystem” denotes the ECB and the NCBs of those Member States that have adopted the euro. The term “euro area” refers to the area comprising those EU Member States that have adopted the euro.⁴

The principle of central bank independence as provided in the Treaties has given rise to the issue of the legitimacy of central bank actions. One particular slogan, the so-called democratic deficit, has become something of a catchphrase in the relevant discussions.⁵ This issue is usually raised more generally with respect to EU institutions and bodies, most notably the Council of Ministers and the European Commission. The case of the Eurosystem has, however, some specific features as far as political legitimacy is concerned which warrant a more nuanced approach.⁶

1 Article 4 (3) of the Treaty establishing the European Community.

2 Article 105 (1) and (2).

3 Article 108. Independence refers to functional, institutional, personal and financial features. These features were first described in the 1998 European Monetary Institute (EMI) Convergence Report, and have subsequently been further specified. See EMI, *Convergence Report. Report Required by Article 109j of the Treaty Establishing the European Community* (1998), p. 11

4 ECB, *The Monetary Policy of the ECB 2004*, p. 9.

5 G. Majone, “Europe’s ‘Democratic Deficit’: The Question of Standards”, *European Law Journal* 4 (1998) pp. 5-28 (15). L. Gormley and J. De Haan, “The Democratic Deficit of the European Central Bank”, *European Law Review* 21 (1996), pp. 95-112. L. Siedentop, *Democracy in Europe* (London: Penguin, 2000), pp. 102-21 (119). R. M. Lastra, *Central Banking and Banking Regulation*, London School of Economics (1996), p. 20. However, see Lord Mackenzie-Stuart, “The Amsterdam Treaty and after. Is There Still a ‘Democratic Deficit?’”, in: G. C. Rodriguez Iglesias et al. (eds), *Mélanges en hommage à Fernand Schöckweiler* (Baden-Baden: Nomos Verlagsgesellschaft, 1999), pp. 389-98.

6 P. Magnette, “Towards ‘Accountable Independence’? Parliamentary Controls of the European Central Bank and the Rise of a New Democratic Model”, *European Law Journal* (2000), pp. 326-40. 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). C. Zilioli, “Accountability and Independence: Irreconcilable Values or Complementary Instruments for Democracy? The Specific Case of the European Central Bank”, in *Mélanges en hommage à Jean-Victor Louis* (Brussels: Editions de l’Université de Bruxelles, 2003), pp. 395-422.

2 THE MODERN THEORETICAL FOUNDATION OF CENTRAL BANK INDEPENDENCE⁷

Painful past experiences with monetary instability and inflation as well as developments in economic and political thinking have prompted a radical change in how inflation and its consequences are generally perceived. Price stability has come to be widely regarded as highly desirable, which in turn made it possible to establish price stability as a guiding principle of the European Community and its Member States.

Economic analysis has shown that inflation is not only an impediment to economic growth, but also unfair, because it ultimately hits those who are entirely dependent on their wages and pensions. The economic literature as well as first-hand negative experiences have supported the perception that inflation is very undesirable, as opposed to monetary stability, as reflected in price stability, which is highly desirable.

Experience has also shown that inflation can only be dealt with by making a long-term effort. Initially, this effort will involve some sacrifices, but will eventually yield good results. Petty politics driven by short-term considerations are unlikely to result in the implementation of far-reaching measures and are thus doomed to failure. Related developments in political thinking have, therefore, led to the broadly accepted view that combating inflation is also a matter of overcoming the shortcomings of the parliamentary system, which in the current era represents democracy in the political field.⁸

At the same time, there is a growing awareness that the design of a proper anti-inflationary policy requires expertise and access to timely and reliable information as well as efficient compilation and evaluation of data. This therefore requires the advice of experts who are capable of addressing the problem objectively, as professionals unaffected by either external pressures or petty political considerations.

3 FORMAL AND SUBSTANTIVE LEGITIMACY OF THE POWERS OF THE INDEPENDENT CENTRAL BANK

As a result of such developments and discussions, a broad consensus was reached that is reflected in the Treaty establishing the European Community.⁹ The Treaty

7 R. Smits, *The European Central Bank: Institutional Aspects* (The Hague/London/Boston: Kluwer Law International, 1997), pp. 152-54. L. Gormley and J. De Haan, op. cit., p. 109. A. S. Blinder, "Is Government Too Political?", *Foreign Affairs*, Vol. 76, No 6 (Nov/Dec 1997), pp. 115-26 (116, 126). N. T. Skaggs, Monetary Policy, in T. Cate, G. Harcourt and D. C. Colander (eds), *An Encyclopedia of Keynesian Economics* (Cheltenham: Edward Elgar, 1997), pp. 436-40. J. Cornwall, "What Remains of Keynes", in T. Cate, G. Harcourt and D. C. Colander (eds), op. cit., pp. 299-308. F. A. Hayek, *Law, Legislation and Liberty. A New Statement of the Liberal Principles of Justice and Political Economy*, Vols I-III, complete edition in a new one-volume paperback (London: Routledge & Kegan Paul, 1982), Vol. I pp. 25, 69, 72, 154, 161-62, Vol. III pp. 58, 95. E.-J. Mestmaecker, *Regelbildung und Rechtsschutz in marktwirtschaftlichen Ordnungen* (Tübingen: Mohr Siebeck, 1985), pp. 30, 33-35, E.-J. Mestmaecker, "On the Legitimacy of European Law", *Rabel's Zeitschrift* (1994), pp. 615-35 (626-29, 629-32).

8 A. N. Tsirintanes, *Modern Times in the Light of Christianity. A Spiritual Approach to Politics* (Athens: Union for Hellenic Civilization (Syzetesis Publishers), 1986), pp. 189-208, 210.

9 Articles 2, 4 (2) and (3), 98 and 105 (1) and (2).

enshrines price stability as a guiding principle of the European Community, and entrusts once and for all the definition and implementation of monetary policy to a supranational body, the ESCB. It endows this body not only with administrative and financial self-sufficiency, but also with functional independence, by insulating the ESCB and its decision-making bodies against any interference from political bodies that could exert political, financial or any other influence. Above all, it insulates the ESCB against political pressure from parliamentary majorities. In so doing, the Treaty effectively elevates the ESCB to the status of a quasi-fourth power independent from the other powers of the state.

The endorsement and enactment of all the aforementioned provisions was thus a political decision made by the competent Community bodies and ratified by the respective national bodies in accordance with their respective constitutional requirements. Such a decision has, therefore, full constitutional legitimacy deriving from the Member States, and this will continue under the Treaty establishing a Constitution for Europe. It is the Member States that confer competences (powers) on the Union and its respective institutions and bodies.¹⁰

However, the decision also has substantive democratic legitimacy, since it is in line with the principle of the separation of powers. Matters relating to distributive justice, that is to say distributional fairness and wealth-sharing, as well as matters defining which national or, by extension, supranational body will exercise a given function or responsibility, must, according to the principle of the separation of powers, be dealt with and decided upon by the legislative branch.¹¹ This indeed is what happened in the case under discussion.¹²

4 THE DEMOCRATIC LEGITIMACY OF THE LEGAL ACTS OF THE INDEPENDENT CENTRAL BANK

Any alleged “democratic deficit” can therefore only refer to the democratic legitimacy of the ECB’s actions regarding monetary policy.

Monetary policy measures are actions taken by the executive branch. They are aimed at defining and implementing on each occasion the binding political platform of price stability which has been constitutionally established as a guiding principle of the European Union by the decision taken by the competent legislative bodies.

Admittedly, legislative and executive functions often intersect in modern democratic states; indeed, they even tend to be confused in the practice of rulemaking by the executive branch.¹³ However, the Maastricht Treaty has removed any confusion between the legislative and the executive functions as far as monetary policy is concerned by elevating the task of defining and implementing

10 J. Straw, *Economist*, 10 July 2004, p. 30.

11 F. A. Hayek, „Die Anschauungen der Mehrheit und die zeitgenössische Demokratie“, *ORDO* XV/XVI (1964/65), pp. 19-41 (24-28).

12 Lord Mackenzie-Stuart, *op. cit.*, pp. 631-32.

13 See F. A. Hayek, *op. cit.*, p. 26; K. Tsatsos, *Politics. A Theory of Political Deontology*, 2nd ed. (Athens: OI Εκδόσεις των Φίλων, 1975), pp. 186-202 (190); L. Siedentop, *op. cit.*, p.117.

monetary policy to a separate, autonomous and independent function which it delegated to the ESCB, governed by the decision-making bodies of the ECB.¹⁴ Therefore, the legal acts of the ECB – whether regulations, decisions, recommendations or opinions¹⁵ – are measures of the executive branch¹⁶ as far as the requirement of separation of powers in its original sense is concerned.¹⁷

In principle, administrative measures are generally not subject to the prior approval of parliament or – much less – the electorate. Nevertheless, public administration in general is currently considered to be indirectly legitimised by being subjected to parliamentary scrutiny and, thus, is ultimately accountable to the people.¹⁸

It is in this context that a key question has been raised, namely whether or not the ECB's acts, which are rules that aim at regulating the conduct of people, should, in one way or another, accommodate the requirement for political accountability or not.

5 MECHANISMS OF POLITICAL CONTROL UNDER THE TREATY

In terms of pure reason, there is in principle a conflict between independence and accountability, whereas practical reason would endeavour to reconcile independence and democratic control by making a synthesis of the two. Such a synthesis would call for a conceptual clarification of the nature of central bank independence.

In the first place, central bank independence is not an end in itself. Under the Treaty, it is only an instrument for attaining and ensuring the goal of monetary stability. The principle of independence requires that the Eurosystem and its members are not subject to any governmental or administrative hierarchy, neither seeking nor receiving any instructions whatsoever regarding the performance of their duties. More importantly, it requires them to be legally independent from both the European Parliament and the national parliaments.

Nevertheless, mechanisms are in place for monitoring and controlling the operation of the Eurosystem as well as the acts of the ECB. Six types of control mechanisms can be identified according to the Treaty and the Statute, and are listed below.

First, the ECB's actions are subject to a substantive restraint, namely the Eurosystem's mandate. The principle of independence is binding insofar as it is used for the purpose of monetary stability. The Treaty states that the primary objective of the ESCB shall be to maintain price stability. Without prejudice to

14 Article 8 of the Statute of the ESCB and the ECB.

15 *Ibid.*, Article 34.

16 K. Ballerstedt, „Über wirtschaftliche Maßnahmegesetze“, in: *Festschrift Walter Schmidt-Rimpler* (Karlsruhe: Verlag C. F. Müller, 1957), pp. 369-402 (377, 380, 390, 399, 402).

17 F. A. Hayek, *op. cit.*, p. 26.

18 A. Bleckmann, „Das europäische Demokratieprinzip“, *Juristenzeitung* (2001), pp. 53-58 (58).

the objective of price stability, the ESCB shall support the general economic policies of the Community.¹⁹

Second, in the exercise of its responsibilities, the Eurosystem is subject to the general restraint of rule of law. The decision-making bodies of the Eurosystem operate on the basis of official rules of procedure, and the acts and omissions of the ECB are open to review or interpretation by the Court of Justice of the European Communities.²⁰

Third, the President, the Vice-President and the other members of the ECB's Executive Board are appointed from a pool of persons of recognised standing and professional experience in monetary or banking matters by the common accord of the governments of the Member States at the level of the Heads of State or Government, on a recommendation from the Council of Ministers after it has consulted the European Parliament and the Governing Council of the ECB.²¹ The latter comprises the members of the Executive Board and the governors of the NCBs, who are appointed in accordance with the provisions of national law, and in any case by a decision of the respective government.

Fourth, the members of the ECB's governing bodies may be removed from office before the end of their term if there are serious grounds for so doing (e.g. serious misconduct).²²

Fifth, the Treaty regulates the relations of the ECB with other Community institutions and bodies, in particular the Council of Ministers, the European Commission and the European Parliament.²³

Sixth, the ECB is required to produce an annual report on the activities of the ESCB and on the monetary policy of both the previous and the current year for the European Parliament, the Council, and the Commission, as well as for the European Council. Moreover, this report is presented by the President of the ECB to the European Parliament and the Council of Ministers, which may hold a general debate on that basis.²⁴

Thus, the European Parliament takes note of the ECB's annual report, and the Council of Ministers may each time hold a general debate on this report. However, neither of these bodies has the power (competence) either to approve or to reject the ECB's report on monetary policy.

Article 113 (3) of the Treaty clearly illustrates the idea of the Eurosystem's independence from the representative bodies. However, it may just as easily be

19 Article 105.

20 Article 35 of the Statute of the ESCB and the ECB.

21 Ibid., Article 11.2.

22 Ibid., Article 11.4, regarding the members of the Executive Board; national provisions regulate, according to Article 14.2 of the Statute, the removal from office of each of the other members of the Governing Council.

23 Article 113.

24 Article 113 (3).

perceived, as some have indeed done, as proof of a “democratic deficit” with regard to the functioning of the Eurosystem.²⁵ This is an important issue which is addressed in detail in Section 6 below.

6 THE ECB'S PRACTICE OF TRANSPARENCY

This paper submits that such reasoning is unfounded for three main reasons. In the first place, the assertion of a democratic deficit is based on sophistry. In view of the shortcomings of the parliamentary system, what the drafters of the Treaty had in mind was to safeguard the central bank's administrative and political independence in defining and implementing monetary policy, mainly as a counterweight to the preponderance of parliamentary power in general. Secondly, this argument conveniently disregards the control mechanisms that are in place as described above. Finally, and more importantly, it also fails to consider the fact that, apart from and beyond any statutory requirements, the independent central bank declares itself legally and politically obligated to explain properly and justify each time its decisions to the citizens of the euro area and their elected representatives, thereby making itself responsible for fulfilling its objectives under the Treaty.²⁶

Moreover, the ECB has since its inception practised a policy of dialogue with the general public, based on the ideals of transparency, accountability and credibility.²⁷

The ECB defines central bank transparency as an environment in which the central bank provides the general public and the markets with all relevant information on its strategy, assessments and policy decisions as well as its procedures, and does so in an open, clear and timely manner. The ECB considers that transparency constitutes a crucial component of its monetary policy framework, thereby emphasising the importance of effective communication and proper interaction with the public.

Transparency entails accountability, which is in turn essential for democracy as far as the latter encapsulates the idea of freedom in public affairs. Accountability is consistently applied by the ECB, and is as a result gradually developing into standard central bank practice. It remains somewhat premature to decide whether such practice and understanding of the concept already qualify for customary law. However, accountability itself is certainly an element of democratic legitimacy. The ECB in this regard legitimises itself as a democratic body by consistently acting like one, which is to say, by offering greater transparency and accountability as a matter of political obligation.

25 L. Siedentop, *op. cit.*, p. 119.

26 ECB, *The Monetary Policy of the ECB 2004*, pp. 66-70.

27 See for example C. Noyer, “Politics and Central Banks”, ECB (speech held in Tallinn, 3 May 1999); W. F. Duisenberg, “The Role of the Central Bank in the United Europe”, ECB (speech held in Warsaw, 4 May 1999), p. 8; O. Issing, “The ECB and Its Watchers”, ECB (speech held in Frankfurt, 17 June 1999), p. 24.

7 CREDIBILITY

All efforts to enhance transparency (and through this, accountability) aim at ensuring that monetary policy is better understood by the public and is as a result more credible and effective.

Modern economic theory confirms that if monetary policy is to be credible, the targets set must be consistently pursued. As Robert Lucas argues in his well-known critique as well as in his paper about rational expectations, monetary policymakers should avoid surprises, and only a credible policy can be considered to be “optimal monetary policy”. Market participants have no confidence in a particular policy when policy measures are inconsistently implemented. Credibility, as modern economic theory teaches us, is built on consistency.²⁸

Advances in information technology corroborate these findings. In the high-tech era, financial markets can support or disapprove of and ultimately counteract monetary policy measures on a daily basis, depending on whether such measures are consistent with the announced targets and the proclaimed principles which their respective rational expectations have been based upon. In this specific sense, it can be said that the financial markets “vote”. Strange though it may sound in today’s increasingly globalised world, this statement recalls the idea of direct and participatory democracy.²⁹ However, this topic lies outside the scope of this paper.

Jürgen Habermas, the noted German social philosopher, has remarked that, apart from any formal concept of legitimacy, the main problem with democracy in the European Union is how to prevent a non-transparent, arbitrary and authoritarian bureaucracy from growing to a menacing size. To prevent this, new life should be breathed into the Treaties through dialogue. This would, according to Habermas, promote understanding and lead to the building of a European collective consciousness.³⁰

In other words, the legal framework alone cannot build trust: instead, a synergy of many other aspects is needed. The European Union and each of its bodies need to connect with the way people think and feel, yearn and aspire.

The building of trust is, after all, primarily a matter of character and moral commitment. The latter is implicitly attributed to the policymaker by the general

28 N. E. Savin and C. H. Whiteman, “Lucas critique”, in *The New Palgrave Dictionary of Money and Finance*, Vol. II (New York: Stockton Press, 1994), pp. 618-23. D. W. Jansen, R. E. Lucas, Jr., in T. Cate, G. Harcourt and D. C. Colander (eds), op. cit., pp. 380-83. R. M. Lastra, op. cit., pp. 14-15. O. Issing, “Monetary Targeting in Germany: The Stability of Monetary Policy and the Monetary System”, *Journal of Monetary Economics*, Vol. 39, No 1 (1997), pp. 67-79. G. Alogoskoufis, “The Bank of Greece and Inflation: Independence and Democratic Accountability”, in D. Demopoulos, P. G. Korliras and P. G. Prodromidis (eds), *Essays in Economic Analysis in Honor of Professor R. D. Theoharis* (Athens: Sideris Publishers, 1998), pp. 200-25 (208-09).

29 L. Siedentop, op. cit., pp. 47-63.

30 J. Habermas, “Remarks on Dieter Grimm’s ‘Does Europe Need a Constitution?’”, *European Law Journal* (1995), pp. 303-07 (304). Habermas further developed and expanded these ideas in his Zeit-Stiftung “Hamburg Lecture” of 26 June 2001; see F.A.Z., 28 June 2001, No 147, p. 45. See also J. Habermas, *Der gespaltene Westen*, Kleine Politische Schriften X (Frankfurt am Main: Suhrkamp, 2004), pp. 68-84 („Ist die Herausbildung einer europäischen Identität nötig, und ist sie möglich?“).

public.³¹ However, this parameter, no matter how cardinal it may be, is also beyond the scope of this paper.

To cut a long story short, these preliminary thoughts can be summed up by rephrasing the well-known distinction between law in action and law in the books. It can be reasonably affirmed that only committed accountability in action can establish credibility and trust and, despite any slogans to the contrary, materially compensate for the planned and justified elimination of formal parliamentary scrutiny of the day-to-day measures of monetary policy.

31 C. Stark, „Menschenbild, Institutionen und Ethos“, *Juristenzeitung* (2000), pp. 927-29 (929). H. Schmidt, *Auf der Suche nach einer öffentlichen Moral*, 2nd edition (Stuttgart: Deutsche Verlags-Anstalt, 1998), pp. 43, 173, 197, 210.