# The Independence and Democratic Legitimacy of the European Central Bank in the Public Debt Crisis

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## 1. Introduction

June 2010 witnessed the opening of a new chapter in the history of the European Central Bank (ECB). Without any debate or decision-making process outside the closed doors of the ECB's conference rooms, the Bank decided to extend its activities far beyond the field of traditional monetary policy. With the launch of the Security Markets Programme (SMP), it began to purchase government bonds on a large scale. The programme was temporarily suspended in Spring 2011 but was then revived with another significant bond purchase initiative in August. The ECB does not publish which country's debt it buys. However, it is widely believed that the first purchases were focussed on Greek, Irish, and Portuguese bonds, while the revival of the programme mainly included Italian and Spanish ones (Müller et al. 2011; New York Times 2011; Washington Post 2011). As of late October 2011, the ECB has acquired overall more than €170 billion of sovereign debt (Der Spiegel 2011).

But what gives the ECB the right to intervene in member states' fiscal policies in such a drastic way? And are the Bank's actions reconcilable with democratic principles?[1] This essay will try to answer these questions by carrying out a three-step analysis of the ECB and its policies. The first section will examine the scope of the Bank's independence in general terms. Afterwards, the second section will review different theoretical approaches presented in the relevant literature to justify the Bank's independence in terms of democratic legitimacy. Finally, the third section will relate the findings of the first two parts to the current events and assess the implications of the SMP for the independence and the democratic legitimacy of the Bank.

It will be argued that the ECB enjoys a degree of independence that is quite extraordinary and which has provided the Bank with the powers to expand its competencies in the debt crisis. Prior to the start of the SMP, this independence could be interpreted as compatible with democratic principles on the basis of both Principle-Agent Theory and a constitutionalist approach. However, considering the SMP, Principle-Agent Theory remains the only possible justification in terms of democratic legitimacy, and only as long as the SMP remains a temporary measure that precedes corresponding actions on the side of governments.[2]

## 2. Unprecedented Independence

Where the independence of the ECB is concerned, some political scientists quickly resort to superlatives. Salvatore (2002, 158-159), for instance, calls the ECB "the world's most independent central bank," while Brentford (1998, p. 106) claims that "the European Central Bank has been endowed with greater powers than any other non-majoritarian Community institution to date." Statements of this kind have to be treated with a certain degree of caution. After all, there is no such thing as an official ranking of all non-majoritarian institutions around the world, and the concept of independence remains subject to various definitions and methods of measurement. Nevertheless, the relevant literature widely agrees that the ECB enjoys an extraordinary degree of it, which goes further than the independence of any other institution responsible for monetary policy in a Western democracy.

A statistical foundation for this view is provided by a synthesis of the comparative research done on central bank independence, presented by De Haan (1997, p. 413) and by De Haan and Eijffinger (2000 pp. 396, 404-405). Their work includes a comparison of various numerical indices designed by previous research in order to measure central bank independence. All of these indices assign an independence score to the ECB that comes very close to the respective model's maximum. This exceptional independence of the ECB can be explained by four key factors:

- First, Art. 130 and 282.3 of the Treaty on the Functioning of the European Union (TEC) in combination with Art. 7 of the ECB-Statute[3] explicitly prohibit member states and EU institutions to instruct or influence the ECB in any way.
- Second, according to Art. 283.2 TEC, the six members of the ECB's Executive Board are appointed for one non-renewable term of eight years. In addition, Art. 11.4 ECB-Statute provides that a board member can only be removed from his post by the European Court of Justice on application by the Executive Council or the Governing Council[4], and only if he "no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct." Furthermore, Art. 14.2 ECB-Statute also requires a minimal office term length of five years for national central bank governors and sets similar conditions for their premature removal.
- Third, Buiter (1999), and De Haan and Eijffinger (2000), stress that the ECB gains additional independence through the vagueness of the treaty provisions concerning its goals and procedural requirements. While Art. 127 TEC defines the maintenance of "price stability" as the ECB's primary objective, it leaves it up to the bank to interpret the exact meaning of the term. Neither do the treaties set clear and comprehensive standards regarding the transparency of ECB decision-making and information policy.
- Fourth, as Brentford (1998, p. 109), De Haan (1997, p. 417), Heisenberg and Richmond (2002, pp. 211-212), as well as Verdun (1999, p. 108) point out, the competencies of the ECB are much harder to curtail than the competencies of any comparable institution at the national level. This is due to the fact that the legal provisions constituting the ECB are part of the EU's treaty framework – a framework than can only be changed through a lengthy procedure which requires the approval of all member states. As a result, the threat to change the Bank's legal foundations does not constitute a very credible tool of exerting political pressure on the ECB.

To summarize, the ECB can be described as an institution, the policies of which are not subject to any kind of approval or formal control by another political actor, the executives of which are extremely difficult to remove once they are in office, the goals and procedures of which depend to a significant extent on its own interpretation, and the competencies of which cannot be changed by passing a simple law. At the same time, this institution holds the sole authority to issue banknotes and to determine the interest rate for the whole Eurozone, which, in turn, influences economic growth, employment, inflation, and the foreign exchange rate.

In the face of an independence-power-ratio of this kind, it does not seem appropriate to choose Enderlein and Verdun's (2009, p. 498) approach and reduce the discussion of the ECB's democratic legitimacy to the mere statement that the ECB has a "democratic mandate through democratically mandated procedures and bodies." Rather does it seem that Joseph Stiglitz (1998, p. 216) makes an important point by noting that "Monetary policy is a key determinant of the economy's macroeconomic performance [...]. That this key determinant of what happens to society – this key collective action – should be so removed from control of the democratically elected officials should at least raise questions." Indeed, an institution which possesses the described combination of independence and power appears prima facie somewhat problematic in the context of a political system that bases itself on the principles of representative democracy.

### 3. An Undemocratic Institution?

However, the finding that the independence-power-ratio of the ECB raises questions in terms of democratic legitimacy does not necessarily imply that the institutional setup of the ECB inherently contradicts the established practice of democratic states. On the contrary, Bredt (2011, pp. 45-54) observes that in all EU member states, a personalised, representative understanding of democracy goes alongside with the existence of certain independent institutions, and Moravcsik (2002, pp. 605-606) points out that "the fact that governments delegate to bodies such as constitutional courts, central banks, regulatory agencies, criminal prosecutors, and insulated executive negotiators is a fact of life." Nevertheless, this fact of life still calls for a careful theoretical justification, especially in the case of the ECB, in which independence goes exceptionally far.

**A. Output Legitimacy**

In their defence of ECB independence, Bini-Smaghi and Gros (2001) repeatedly mention the ECB's "performance" and argue in terms of an "optimal" policy. What is underlying this argumentation is the attempt to justify ECB independence by policy-outcomes. Brentfort (1998, p. 110, emphasis in the original) illustrates this argument more clearly by noting that "Ultimately the Bank my lack social legitimacy and may exacerbate the democracy deficit when we consider the input side of democracy [...]. However, on the *output* side of democracy the effectiveness of the Bank in achieving the goals of monetary policy may provide democratic self-determination [...]."

According to the relevant economic literature there is, indeed, a reasonably strong empirical case for a direct connection between central bank independence and price stability in the sense that central bank independence reduces inflation (Alesina and Gatti 1995; De Haan and Eijffinger 2000; Ehrmann and Fratzscher 2011; Fischer 1995). However, Bellamy (2010) illustrates that policy output by itself is not sufficient to justify a policy in democratic terms. Scharpf (1997, p. 19) agrees by stating that "input-oriented authenticity and output-oriented effectiveness are equally essential elements of democratic self determination," and demands that "political choices should be derived, directly or indirectly, from the authentic preferences of citizens."

**B. Principal-Agent Theory**

A more promising approach to reconcile the independence of the ECB with the principles of representative democracy is based on Principle-Agent Theory. An approach of this kind succeeds in combining Enderlein and Verdun's (2009, p. 498) argument of the "democratic mandate" with the output-related argument reviewed above. Principle-Agent Theory starts from the idea that "one actor (the principal) has an incentive to delegate power to another actor (the agent) with the expectation that subsequently the latter will act in a way which is consistent with the initial preferences of the former" (Elgie 2002, p. 187).

In the case of the ECB, this approach could be applied in the following way: The representatives of the people have a strong preference to keep inflation at bay, and they come to the conclusion that this preference can be more efficiently turned into policy-outcomes by a central bank that enjoys a high degree of independence. This conclusion can be based on the technical and complicated nature of the monetary policy domain, which requires a high degree of professionalism and expertise (Blinder 1997, p. 118; Jabko 2003, p. 728), on the sensitivity of the markets and the importance of operational details such as communication strategy (Lamla and Lein 2011; Sturm and De Haan 2011), and on the desire to shield the policy-making process from the seductive power of expansionary monetary policy's short-term benefits which might be outweighed by corresponding risks in the long run.[5] The empirical performance advantage of independent central banks as described above constitutes another important incentive, but is probably to a large extent the result of the other three factors. In any case, the decision by democratic representatives to delegate significant powers to a largely independent central bank in order to both stabilize policy preferences in the face of everyday policy-making and increase the efficiency of their implementation through independent expertise appears to be legitimate in terms of democratic principles.

However, this conclusion only holds as long as Blinder's (1997, p. 123) condition that "delegated authority must be retrievable" is met, and there are two reasons for this. First, there is the possibility that the central bank uses its independence in a way that no longer corresponds to the initial preferences of the principal (Elgie 2002, p. 188). Second, it may be the case that a profound and fundamental change in policy preferences takes place. After all, inflation-averseness is not a law of nature but a political choice that can be called into question as Stiglitz (1998, pp. 210-216) demonstrates. Does this possibility to retrieve authority exist in the case of the ECB? From a legal perspective, the answer to this question has to be a clear yes. Theoretically, the member states are completely free to use the instrument of treaty revision in order to change the competencies of the ECB in any way they can agree on.

Of course, it is likely to be rather difficult to reach a consensus of this kind in practice. Nevertheless, if there were the unanimous impression that the ECB was abusing its independence, or if there were the unanimous wish to fundamentally change the basic direction of monetary policy, it would be possible for the representatives of the people to take action.

Obviously, Principal-Agent Theory involves a trade-off between agency independence and retrievability. The former provides for the effectiveness of power delegation to the agency while the latter ensures its democratic legitimacy. It is, however, hardly possible to prescribe an optimal equilibrium in this trade-off from a theoretical point of view. As long as both agency independence and retrievability factually exist, the balancing act between them has to be left to the discretion of policy-makers. In the case of the ECB, these policy-makers seem to have chosen to provide the agency with a particularly high degree of independence by creating certain hurdles for retrievability. Nonetheless, these hurdles are not insurmountable, and, due to this fact, the ECB cannot be seen as inherently undemocratic.

**C. Constitutionalist Theory**

An alternative theoretical approach suitable to justify ECB independence is constitutional social contract theory as developed by James M. Buchanan. Bredt (2011, pp. 55-63) applies this theory to the case of the ECB. The approach differs from Principal-Agent Theory insofar as the empowerment of the ECB is not interpreted as a delegation process undertaken by political representatives, but as part of a social contract formed on the basis of a *hypothetical consensus* of society as a whole. This societal consensus elevates price stability to the position of a constitutional principle and installs the ECB as the independent guardian institution of this principle. Accordingly, the ECB gains a position similar to a court which safeguards the constitutional principle of the rule of law. Both institutions, although non-majoritarian, enjoy the same degree of democratic legitimacy as elected representatives, since they are part of the societal consensus reflected in the constitutional system.

Brentford's (1998, p. 84) conclusion that "the legal texts underlying the Bank have been elevated to constitutional dignity" and Jabko's (2003, p. 710) statement that ECB independence possesses "quasi-constitutional value" fit well into this constitutionalist perspective. However, the claim that price stability has acquired a position in European society that is comparable to the rule of law appears to be rather bold and could be disputed. Nevertheless, the constitutionalist approach represents a powerful alternative viewpoint on central bank independence and, if accepted, provides the ECB with a far more solid foundation of democratic legitimacy than Principle-Agent Theory does.

**4. Enter Sovereign Bonds**

The launch of the SMP in the context of the debt crisis was an impressive demonstration of the bandwidth of tools in the ECB's possession. Art. 123 TEU prohibits the direct financing of member states' sovereign debt, which is why the Bank had to purchase sovereign bonds on the secondary market by accepting them as a guarantee from banks in return for central bank money. So, basically overnight, the Bank decided to circumvent a treaty provision, extend its activities far beyond the field of traditional monetary policy, and enter an area of politics which hardly anybody had thought it would ever get involved in. Prior to the launch of the SMP, the political science literature had not paid any attention at all to the possibility that the ECB might start a programme of this kind. Not even those most concerned about the Bank's alleged lack of transparency and accountability and its freedom to interpret its own tasks seemed to have considered this possibility. Nevertheless, in spite of the fact that it had not been anticipated by anybody, the purchase of sovereign bonds on the secondary market was an option entailed in the Bank's legal mandate. The ECB is free to supply banks with money in exchange for bonds. Sovereign bonds are no exception from this principle, since Art. 123 TEU explicitly only prohibits their direct purchases. Accordingly, it was the independence given to the ECB by its mandate that allowed for the drastic expansion of its political activity.

**A. Implications for Independence**

However, as far as the consequences of the ECB's actions for the Bank's independence are concerned, the prevalent interpretation, which has also been widely echoed especially in the German media (Aumüller 2011;

Jackisch 2011; Kaiser 2011), claims that “the ECB has become more dependent in political terms” (Belke 2010, p. 5), because “its leadership bowed to a politicization and intervened in the markets to buy the government bonds that no one else wanted” (Featherstone 2011). Apparently, this interpretation understands independence in terms of behavioural dissonance rather than in terms of institutional competencies. It assumes that the ECB would have to be uncooperative in order to preserve its independence, which does not make much sense. Naturally, the idea of central bank independence also has to include the possibility of an independent decision that conforms to policy-makers wishes, or even responds to insistent demands in the face of a serious crisis. As long as the decision-making process has not been subject to coercion, an ECB decision has to be viewed as independent – and those who argue that the ECB has lost independence fail to explain how, in the current situation, politicians have become able to influence the Bank’s decisions coercively by means that had not been available to them before. While it is certainly possible to interpret the ECB’s behaviour in different ways, a rather clear observation can be made that, from a legal point of view, the Bank has not lost any independence at all. Its decision-making procedures and institutional setup have not been changed in the slightest way. Consequently, the Bank is still the master of its own policies just like before the debt crisis, with the only difference being that it has assumed a new set of competencies.

**B. Implications for Democratic Legitimacy**

During the course of a guest lecture at the University of Siena in October 2011, the former president of the European Parliament, Josep Borell, discussed the role of the ECB in the debt crisis. He drew the picture of a central bank that, in the face of government inactivity, took the initiative in order to prevent public debt default and wrote letters to governments demanding constitutional provisions providing for a tighter fiscal policy as a precondition for further support. While he conceded that without the ECB’s intervention it might very well have come to a default, he emphasised that a central bank which prescribes government constitutional changes is quite problematic in regard to democratic principles.

This analysis raises an important point. However, it overlooks that the ECB, after all, seems to have acted according to the Eurozone governments’ preferences. The ECB’s actions were certainly not uncontroversial. Criticism came from various sides, not only from the media, but even from within the Bank itself as the resignations of *Bundesbank* President Axel Weber and ECB Chief Economist Jürgen Stark clearly showed. However, no criticism came from those political decision-makers who were actually in charge of handling the crisis. To the contrary, it is widely believed that the ECB made its decisions in response to governments’ demands, as the above discussion of the Bank’s alleged independence-loss clearly shows. Furthermore, Müller et al. (2011) continue to argue that the bank is not comfortable at all with its new role as governments’ lender of last resort and that the mentioned strong-worded letter to the Italian government was a defensive tool to calm down critics within the ECB rather than a serious attempt to put pressure on Italy. Consequently, the more convincing conclusion seems to be that the Bank has assumed its new competency to buy sovereign bonds without great enthusiasm, but with the approval of the relevant political decision-makers. Accordingly, it could be argued that this increase in competencies simply represents another spontaneous case of power delegation in terms of the Principal-Agent approach and is thus unproblematic as far as the ECB’s democratic legitimacy is concerned. However, an efficiency-related argument in support of this delegation would be needed in order to justify it in this way, since the Principal-Agent model derives its legitimizing basis from gains in terms of efficiency (Alesina and Tabellini 2007, 2008; Elgie 2002; Majone 2001).

Essentially, sovereign bond purchases by the ECB have the same effect as sovereign bond purchases by the more affluent members of the Eurozone, or the issue of Eurobonds. They ease upward pressure on the bonds’ interest rate by spreading the cost of a default across the Eurozone and thereby decreasing the perceived risk. The reason for this is that, ultimately, the Eurozone members have to guarantee the capital of the ECB and will have to pay the price of a possible default out of their budgets if they do not want to resort to the money press and solve the problem through inflation (Belke 2010, pp. 5-6). However, it is not clear in which way the detour over the ECB makes this mechanism more efficient. Belke (2010, pp. 7-9) even argues that the SMP is, on the contrary, rather inefficient in terms of this goal. However, one efficiency-related argument that remains is the time factor. The ECB is clearly able to react faster than member state governments which first have to undergo comparatively lengthy coordination and decision-making procedures. Accordingly, power delegation to the ECB could be justified by the argument that it enables a rapid reaction to market forces and provides the political decision-making process with breathing space. This justification, however, would define ECB bond purchases as a short-term measure and would imply that governments are obliged to take over responsibility for the purchased bonds as well as for any further measures regarding collective guarantees for public debt at the earliest possible time.

From the constitutionalist perspective, however, there simply is no justification for the increase in the ECB's competencies. The participation of the ECB in the struggle against the possible default of a Eurozone member through the purchase of bonds on the secondary market is not part of any legal document on which the institution is based, and neither has this possibility been part of the political discourse that surrounded the formation of the single currency. Although there do not seem to be any legal obstacles that prevent the ECB from acting in the way it does now, Belke (2010, p. 4) claims that the ECB, while not literally violating the treaty, "offended against its spirit as central bank bail-out of government deficits is prohibited." The same argument was made by the president of Germany in a recent speech (Wulff 2011). So it seems that, as long as no changes are made to the ECB's legal basis, the constitutionalist view has to be abandoned, which leaves Principal Agent Theory as the sole justification of the Bank's democratic legitimacy in the face of the current developments.

**5. Conclusion**

It was the purpose of this essay to investigate the basis of the ECB's competency to intervene in the sovereign bond market in the context of the debt crisis and to answer the question of whether this intervention can be justified in terms of democratic principles. It has been shown that the ECB gained the competency to buy sovereign bonds on a large scale through the extremely independent position provided by its mandate. This position has not been changed during the debt crisis. While the ECB is left with considerable freedom to define its own objectives and choose the tools to achieve them, the obstacles for political intervention into the Bank's affairs remain very high. This means that the representatives of the people have delegated a significant share of political power to central bankers.

In general terms, this delegation of power can be justified both by Principal-Agent Theory and a constitutionalist approach. With reference to Principal-Agent Theory it can be argued, that the delegation of power in order to increase the efficient implementation of policy goals is common practice in any democratic system. It can further be argued that the Principal enjoys a considerable degree of discretion regarding the degree of independence granted to the implementing institution as long as there is the real possibility to retrieve the delegated competencies. The constitutionalist approach goes even further and interprets the Bank's independence as part of the basic constitutional consensus of society, which gives the institution as much legitimacy as, for example, a constitutional court.

However, the constitutionalist approach fails when it comes to the legitimation of the sudden and entirely unanticipated acquisition of competencies by the Bank in the context of the public debt crisis. In this case, Principle-Agent Theory stands alone as a justification of the Bank's actions, and is able to provide legitimacy only as long as the time advantage of the ECB's decision-making capability in comparison to member state governments can be established as the rationale underlying the sovereign bond purchases. In summary, it can be said that, while the ECB can be generally seen as democratically legitimate in spite of its independence, this legitimacy rests on far weaker foundations when it comes to the Bank's recent purchases of sovereign bonds. Therefore, it is important that governments resume the direct responsibility for sovereign debt at the earliest possible time and that the crisis-related measures of the ECB do not become common-practice without a formal political mandate preceded by a careful and open deliberation of risks and advantages.

**Notes**

[1] It is clear that the democratic legitimacy of the European Union as a whole is a complicated issue. Various cases have been made both for and against the existence of the famous democratic deficit (cf. for instance Bellamy 2010; Lindseth 1999; Moravcsik 2002). Unfortunately, a comprehensive review of this ongoing debate in order to clear the way for the analysis of a secondary EU institution like the ECB is not possible in the context of this essay. Accordingly, this essay will make an argument based on the assumption that the main decision-making organs of the EU enjoy a satisfactory degree of democratic legitimacy, because in the contrary case, there would not even be the

need to ask for any democratic legitimacy of the ECB.

[2] Naturally, the analysis of an event as current and unprecedented as the crisis that is troubling the EU at the moment has to be based in some parts on sources of a journalistic, rather than a scientific nature, some of which might entail a certain degree of speculation, or subjective viewpoints based on personal impression. However, the only way to avoid this problem would be to conduct direct interviews with the decision-makers involved, which is neither possible in the context of this essay, nor likely to yield any useful results in the present situation, since it is highly doubtful whether those responsible for policy-making would be willing to play with open cards and reveal their true motives and preferences in a situation as tense as the present one.

[3] Attached to the Treaties as Protocol No. 4.

[4] The Governing Council is the ECB's main decision-making body, consisting of the Executive Board and the governors of the Eurozone's national central banks.

[5] Blinder (1997, p. 122) compares this third consideration with Ulysses' request to be tied to the mast while listening to the sirens, whereas Stiglitz (1998, p. 222) uses the metaphor of an alcoholic who "may recognize his weakness and turn over the key for the liquor cabinet to a friend."

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Jakob Hauter received his PhD from University College London's (UCL) School of Slavonic and East European Studies (SSEES) in 2022. Previously, he studied International Relations and Contemporary European Studies in Dresden, Saint Petersburg, Bath, and Siena. He is the author of the monograph *Russia's Overlooked Invasion: The causes of the 2014 outbreak of War in Ukraine's Donbas* and the editor of the collected volume *Civil War? Interstate War? Hybrid War? Dimensions and Interpretations of the Donbas Conflict in 2014–2020.*