Rosa Maria Lastra, The division of responsibilities between the ECB and the NCBs within the ESCB

Caption: Rosa Maria Lastra analyses the division of responsibilities between the European Central Bank and the National Central Banks. Whereas responsibility for monetary policy has been transferred to the supranational level, responsibilities in the field of exchange rate policy, prudential supervision and crisis management remain at the national level.

Source: Jean-Victor Louis & Hajo Bronkhorst. The Euro and European Integration = L'euro et l'intégration européenne. Euro Institute = Institut de l'euro éd. Brussels: P.I.E.-Peter Lang S.A., 1999. 365 p. ISBN 90 5201 912 6 / US 0 8204 4652 1. (coll. Cité européenne - European Policy n° 21). "The Division of Responsibilities between the European Central Bank and the National Central Banks within the European System of Central Banks", auteur:Lastra, Rosa Maria, p. 199-216.

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The Division of Responsibilities between the European Central Bank and the National Central Banks within the European System of Central Banks

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Introduction

The euro was introduced on schedule on January 1, 1999. The European System of Central Banks, which started operations on 1 June 1998, is now in charge of the interest rate policy of the eleven countries that have qualified for monetary union. However, the success of the launch of the euro, with no major payment and settlement problems during the conversion weekend, and the smooth operation of the System so far, should not lead to complacency. Major challenges remain ahead, not only with regard to the need to wait for the introduction of euro notes and coins - to take place at the start of the year 2002 - but also with regard to the responsibilities that have not been clearly transferred from the national to the supranational arena, such as banking supervision and regulation, crisis management and exchange rate policy. The challenge is further compounded by the division between European Union (EU) Member States participating in European Monetary Union (EMU) and EU Member States not participating in EMU on the one hand, and by the division of responsibilities between the European Central Bank (ECB) and the National Central Banks (NCBs) within the scope of responsibilities entrusted to the European System of Central Banks (ESCB), on the other. The latter constitutes the subject of my analysis in this chapter.

The primary community legislation applicable to the ESCB (the ECB and the NCBs) comprises the Maastricht Treaty on European Union (hereinafter the Maastricht Treaty)[2] and the protocol on the Statute of the European System of Central Banks and the European Central Bank (hereinafter ESCB Statute), which is annexed to the Treaty. There are also a range of legal acts available to the European Central Bank (ECB regulations, decisions, recommendations and opinions) and intra-ESCB agreements on internal matters between the ECB and the NCBs, which constitute the secondary community legislation available within the ESCB. The provisions in the Maastricht Treaty that refer to the institutional framework of EMU are articles 105 to 124 (ex-109M). Most of the provisions relating to the working of the ESCB in the Maastricht Treaty are then replicated in the ESCB Statute, with the significant exception of article 111 (ex 109) concerning exchange rate policy (an exception which is further explored below). My analysis will mainly focus on the primary community legislation, *i.e.* on the provisions of the Maastricht Treaty and ESCB Statute provisions pertaining to the division of responsibilities between the European Central Bank and the National Central Banks within the ESCB.

To begin, it is worth recalling that the System (ESCB) as such does not have legal personality[3], and that, therefore, it is not a carrier of rights and obligations. The entities with legal personality are both the ECB (European Central Bank) and the NCBs (National Central Banks). Only the ECB and the NCBs, but not the ESCB, have the powers to sue and to be sued[4]. Indeed, article 35.6 of ESCB Statute allows the ECB to sue a NCB if the latter does not comply with its obligations under such Statute. It is important to bear in mind that the NCBs act in a dual capacity. On the one hand they are operational arms of the ESCB when carrying out operations which form part of the tasks of the ESCB[5]. On the other hand, they are national agencies when performing non-ESCB functions[6]. For these reasons, while the law governing the ECB is solely EC law, the laws governing the status of the NCBs emanate not only from EC sources, but also from their respective national legislations. Furthermore, there are substantial differences between the range of functions and responsibilities assigned to each NCB in the various jurisdictions that comprise the euro zone. For instance, some central banks have exclusive responsibility for banking supervision (*e.g.* in Spain or Italy), while others either share supervisory responsibilities with other bodies (*e.g.* in France) or do not have formal supervisory responsibilities at all (*e.g.* in Germany). It should also be pointed out that those countries that have either have opted out of EMU (*i.e.* the UK, Denmark and Sweden) or that have not qualified for EMU (*i.e.* Greece) are nonetheless participating members in one of the governing bodies of the ESCB, namely in the General Council (according to article 45.1 of the ESCB Statute). However, though they are not members

of the other governing bodies, the Executive Board and the Governing Council, which are entrusted with the execution of the tasks that have been transferred from the national to the supranational arena, particularly with regard to the conduct of monetary policy. Though the Maastricht Treaty and the ESCB Statute talk about the "monetary policy of the Community" in some articles (*e.g.* article 105.2 of the Maastricht Treaty and articles 3.1, 12.1 and 31.2 of the ESCB Statute), in such instances the Community means the Member States that participate in EMU (Member States without a derogation).

The division of responsibilities between the ECB and the NCBs within the ESCB resembles to some extent the structure of the Federal Reserve System in the United States. Indeed, while the ESCB functionally is reminiscent of the [pre-1999] Bundesbank, geographically it resembles the Federal Reserve System. As acknowledged, the Federal Reserve System as such does not have legal personality. The entities with legal personality are the Board of Governors and the Federal Open Market Committee (which are both federal agencies and, as such, public legal persons) on the one hand, and the twelve Federal Reserve Banks on the other. However, as opposed to the NCBs, which are typically public legal persons (publicly managed and, for the most part, publicly owned), the Federal Reserve Banks have private legal personality, with private ownership (100% owned by the member banks in each district) and private management. Nonetheless, the analogy between the Fed and the ESCB is useful to understand the duality of functions of the NCBs. The NCBs act, in solve instances, as a part of the ESCB, and in others on their own, *i.e.*, separately and independently from the ECB. In term of its capital structure, it should be noted that the NCBs are the ECB's sole shareholders.

A general principle applicable to the division of responsibilities between the ECB and the NCBs is article 12.1 paragraph 3 of the ESCB Statute, which reads as follows: "To the extent deemed possible and without prejudice to the provisions of this article, the ECB shall have recourse to the national central banks."

The Functions of the ESCB

The functions of the ESCB are divided into "basic tasks", which are defined in article 105.2 of the Maastricht Treaty and reproduced in article 3.1 of the ESCB Statute, and other functions (non-basic tasks) which are scattered through other provisions. While the language applicable in article 105.2 refers to the "basic tasks to be carried out through the ESCB" (the ESCB to be construed as the compound of its constituent parts, *i.e.*, both the ECB and the NCBs), the language applicable to the other tasks typically mentions the ECB and the NCBs separately (with the one significant exception of article 105.5 of the Maastricht Treaty which refers to the ESCB). The passive tense in the case of the basic tasks: "to be carried out through" contrasts with the tenses used to describe the allocation of the non-basic tasks: "shall have", "may issue" etc.

The basic tasks to be "carried through the ESCB" are four:

1) To define and implement the monetary policy of the Community,

2) To conduct foreign exchange operation consistent with the provisions of article 109,

3) To hold and manage the official foreign reserves of the Member States,

4) To promote the smooth operation of payment systems.

There are other four "non-basic" tasks (*i.e.* not included under the umbrella of "basic tasks"):

1) Issue of banknotes. According to the wording of article 106.1 (ex-105A.1) of the Maastricht Treaty (reproduced in article 16 of the ESCB Statute): "The ECB shall have the exclusive right to authorize the issue of banknotes within the Community. The ECB and the NCBs may issue such notes. The banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender in the Community." article 106.2 (ex-105A.2) further adds: "Member States may issue coins subject to approval by the ECB of the volume of the issue".

2) Prudential supervision to the extent permitted by articles 105.5 and 105.6 of the Maastricht Treaty and articles 25 of the ESCB Statute, which I reproduce in the ensuing lines and further examine below. Article 105.5 of the Maastricht Treaty on states: “The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.” Article 105.6 says that “The Council may, acting unanimously on a proposal from the Commission and after consulting the ECB and after receiving the assent of the European Parliament, confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings”. Article 25 of the ESCB Statute reads as follows:

“(1) The ECB may offer advice and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system. (2) In accordance with any decision of the Council under article 105.6 of this Treaty, the ECB may perform specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.”

3) Advisory functions and collection of statistical information. According to article 105.4 of the Maastricht Treaty, other EU institutions and Member States authorities are to consult with the ECB regarding any Community act or draft legislative provision within its field of competence. In addition, the ECB may *ex officio* submit opinions to EU or national authorities on matters within its field of competence. Article 5 of the ESCB Statute refers to the collection of statistical information by both the ECB and the NCBs.

4) International co-operation and “external operations”. International co-operation is recognised by the Maastricht Treaty (article 111.3 (ex-109.3), 111.4 (ex-109.4) and 111.5 (ex-109.5) and by the ESCB Statute, whose article 6 reads as follows: “In the field of international co-operation involving the tasks entrusted to the ESCB, the ECB shall decide how the ESCB shall be represented. The ECB, and subject to its approval, the national central banks, may participate in international monetary institutions”. According to article 23 of the ESCB Statute the ECB and NCBs may perform the following “external operations”:

- establish relations with central banks and financial institutions in other countries and, where appropriate, international organizations,

- acquire and sell spot and forward all types of foreign exchange assets and precious metals,

- hold and manage the assets referred to in this article,

- conduct all types of banking transactions in relations with third countries and international organizations, including borrowing and lending operations.

Though the Treaty talks about basic and non-basic tasks, I will focus my analysis on the division of responsibilities between the ECB and the NCBs on three issues: monetary policy, banking supervision and foreign exchange policy. These three issues represent the main concerns for central bankers, politicians, and the public at large regarding the safeguard of stable money and sound banking, the twin goals of central banking. With regard to monetary policy, I prefer the use of the words “assignment - or allocation - of responsibilities” rather than “division”, because of the “indivisibility” of monetary policy. With regard to the division of responsibilities in the field of banking supervision, I also consider payment systems oversight and crisis management.

Assignment of Responsibilities in the Field of Monetary Policy

The formulation and implementation of monetary policy is the first and most important basic function to be “carried out through” the ESCB. Responsibility for monetary policy has been clearly transferred from the national arena to the supranational arena. In this sense, it is both accurate and entirely appropriate to talk about a “single monetary policy” (for the countries participating in EMU). Indeed, while the single market has not been fully realised, the idea of a single currency has indeed been fully achieved through the

introduction of the euro on January 1, 1999. The transfer of monetary policy powers from the national to the supranational arena signifies the surrender of one of the classic attributes of sovereignty of the Nation State[7].

With regard to the actual wording of the assignment of responsibilities in the field of monetary policy, René Smits explains in his authoritative work on the European Central Bank the meaning of these words "carried out through the ESCB"[8]:

"For efficient drafting of the legal provisions on monetary policy it was considered best to refer to the System whenever the tasks and activities of its constituent parts are meant. The exception is the enumeration of the operations and activities which the constituent parts of the ESCB can engage in, where both the ECB and the national central banks are mentioned separately (Articles 17-24 ESCB Statute). Where there is a difference in competence between the ECB and the national central banks, they are mentioned separately as well, for instance in the provision on a prudential supervisory task of the ECB itself (article 105.6 of the [Maastricht] Treaty)."

It is important to notice that though monetary policy will be one and indivisible for the countries participating in EMU, there still remains an operational distinction between the ECB and the NCBs in the sense that while the decision-making stage of monetary policy is fully centralised at the ECB, the implementation stage is decentralised. It is the responsibility of the eleven NCBs to conduct the monetary policy operations according to instructions elaborated by the Executive Board[9]. Article 14.3 clearly states that "The NCBs are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB". Accordingly, in the exercise of monetary policy responsibilities the NCBs act in their capacity as a constituent part of the ESCB, and not as national agencies.

As I have indicated above, in its geographic composition, the ESCB resembles the US Federal Reserve System. The analogy with the Fed is also useful to understand the process of centralisation that the Fed has experienced over the years in the field of monetary policy[10], as illustrated by the fact that the discount rate was originally set by each Federal Reserve Bank and eventually became centralised. However, centralisation of one function does not imply centralisation of all functions, as the example of the Federal Reserve Banks within the Federal Reserve System clearly manifests. The Federal Reserve Banks are organically independent[11] from the Board of Governors in Washington D.C. and from the US Government (each has its own Board of Directors, a distinct legal personality and private ownership) while functionally, they some times act in conjunction with the other components of the Federal Reserve System in the implementation of monetary policy, some other times as agents of the US Government (*e.g.*, when they act as fiscal agent or as an agent of the Treasury and the Federal Open Market Committee in the conduct of foreign exchange interventions) and in some other instances as a corporate entity performing corporate functions. The complexity of the tasks assigned to the Federal Reserve Banks is a useful reference to understand the tasks assigned to the NCBs within the ESCB.

Division of Responsibilities in the Field of Banking Supervision

The ESCB Draft Statute included supervision as the fifth basic task of the ESCB[12]. However, the opposition of some countries (notably Germany) to such inclusion meant that the final version of the ESCB Statute and of the Maastricht Treaty only referred to supervision in a limited way, as a non-basic task, according to the language of article 25 of the ESCB Statute and 105.5 of the Maastricht Treaty. However, article 105.6 of the Maastricht Treaty left the door open for a possible expansion of supervisory responsibilities following a relatively simplified procedure (simplified in the sense that it does not require the formal amendment of the Treaty; but not likely to be exercised lightly due to the requirement of unanimity).

The ESCB is entrusted with the "smooth operation of payment systems", according to article 105.2 of the Maastricht Treaty. However, article 22 of the ESCB Statute refers to the constituent parts of the ESCB, *i.e.*, to both the ECB and the NCBs, when it states: "The ECB and national central banks may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Community and with other countries". The ECB and the NCBs are both competent to offer facilities for Community-wide payment systems (typically through TARGET, Trans-European Automated Real-time Gross-settlement Express Transfer[13], but only the ECB - not the NCBs - is given regulatory powers in this area.

Because payment systems are largely conducted - though not necessarily nor exclusively - through the banking system, it is often difficult to dissociate payment system supervision - a basic ESCB task - from banking supervision - a "non-basic ESCB task", which for the most part remains as a national competence, not a community competence. However, the Treaty and the Statute do establish that dissociation and, as anything that is enshrined in a legal text, it has legal consequences. For instance, in the case of an explicit payment system gridlock, the ECB has competence to act as lender of last resort (according to article 105.2 of the Maastricht Treaty).

However, when the crisis does not originate in the payment system, it is not clear from the language of the Statute and the language of the Treaty whether the ECB has competence to act as lender of last resort. According to some commentators a degree of "constructive ambiguity" is desirable in the case of crisis management. And ambiguity is what the EC Law provides. Ambiguity provides scope for different - or even contrasting or possibly conflicting - interpretations. The silence on this point is interpreted by some as a positive sign of the desire of the Treaty negotiators to assign responsibility at the ESCB level with respect to LOLR operations and by some others as a negative signal of those same negotiators on the same point. It will take the first pan-European crisis to bring some light to this ambiguity. A bit of history, as well as an understanding of the complexity of the nature of the LOLR role[14], may help. Germany was reluctant to accept the assignment of a LOLR feature to the ESCB for fear that it may conflict with the sacrosanct goal of price stability. Other countries - based on national practices - favoured the inclusion of a clearly defined LOLR feature. In my opinion, the second indent of 18.1 - regarding credit operations - of the ESCB Statute leaves the door open for a generous interpretation that could allow for such role. In addition, article 105.6 of the Maastricht Treaty is an enabling clause that, if activated, could clearly allocate such a role to the ESCB. However, even if this is never activated, yet, the ESCB could be possibly acting as LOLR before this book goes into print (or soon thereafter).

Furthermore, in the case of a general liquidity dry up, due *e.g.*, to a sudden drop in stock market prices that triggers a market-wide liquidity shortfall, the ECB could act through what it has been called "market operations approach" to lending of last resort[15].

But it is the traditional understanding of LOLR as collateralised emergency credit lines at penalty rates to some specific illiquid but solvent institutions - when the problems do not originate in the payment system - that remains unclear. In principle, the LOLR responsibility is understood to remain at the national level, because it has not been specifically transferred. *I.e.*, the national central banks - in their capacity as national agencies - are ultimately responsible for the decision on whether or not to grant emergency liquidity assistance. However, the wording of the principle of subsidiarity - article 3B of the Maastricht Treaty - leaves the door open for a possible Community competence, which could be exercised either directly by the ECB or by the NCBs in their capacity as operational arms of the ECB. Article 3B states: "In areas which do not fall within its exclusive competence, the Community shall take action in accordance with the principle of subsidiarity, only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason *of the scale or effects of the proposed action, be better achieved by the Community*. Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty" (my italics).

Commentators appear to differ on their understanding of this crucial issue. While it is clear that the injection of liquidity would typically be done through the NCBs, it remains unclear whether national central banks would be considered to be acting as operational arms of the ESCB (according to article 14.3, and 12.1 of the ESCB Statute in combination with a creative and generous interpretation of articles 18 - regarding discount and credit operations - and 20 of the ESCB Statute) or as national agencies (according to article 14.4 of the ESCB Statute). If they were to be acting as national agencies, it is also a matter of some controversy whether the ECB should grant prior authorization or whether it should just be consulted. René Smits states that "the absence of any mentioning of the LOLR function in the ESCB Statute is not surprising, as the LOLR function is normally not spelled out openly in advance in legislation. The "constructive ambiguity" concerning the availability of LOLR support gives the central bank discretion to decide whether or not to support a credit institution". He further adds that "It is clear that LOLR support needs ECB authorization for

the same reason as injection of liquidity for system stability purposes". Karel Lanoo and the other members of the European Shadow Financial Regulatory Committee (ESFRC) argued in their statement of October 1998 that the combination of an ECB in charge of monetary policy and multiple national agencies in charge of banking supervision (including a LOLR feature) is a recipe for disaster, unless steps are taken to ensure a high level of co-operation and information sharing between the various national and supranational authorities. In particular, the ESFRC called for procedures to harmonise LOLR operations at EMU level, including the requirement of prior authorisation from the ECB[16]. Tommaso Padoa-Schioppa in the first public statement by an ECB official on this controversial subject dismissed some of these concerns on three bases: it reflects an outdated notion of LOLR, it underestimates the Eurosystem's capacity to act, and it represents too mechanistic a view of how a crisis is actually managed[17].

Multilateral co-operation amongst the supervisory authorities of the EU Member States is mainly carried out through the Banking Supervision Committee. However, membership of this committee comprises central banks and other supervisory agencies of both EMU and non-EMU participant EU Member States. In this respect, it might be sensible to set up a subcommittee with those NCBs or other supervisory authorities of the Member States participating in EMU. Representatives of these NCBs together with some representatives of the ECB could act as a permanent standing committee to tackle liquidity crises, akin to the Standing Committee formed by members of the Bank of England, HM Treasury and the Financial Services Authority, following the transfer of bank supervisory powers from the Bank of England to the FSA[18]. The only problem with such committee would be that because the United Kingdom is non-participating, and because London is such a key financial centre for the EU, virtually any crises within the EU of any magnitude is likely to impinge on London, and be reflected in London markets, *e.g.*, the London interbank market. Therefore, the United Kingdom supervisory authorities should also be invited to form part of such a coordinating committee if it were to be created.

A most contentious issue - which exceeds the scope of this article - is whether the classic LOLR assistance to troubled institutions, *i.e.*, a "central bank money solution" as opposed to a "taxpayers money" solution or a "private money solution"[19], is solely to illiquid, but solvent institutions. I have argued elsewhere that LOLR operations often provide assistance to insolvent institutions. Hence, the distinction between central bank money solution and taxpayers solution is not always clear[20]. The legal implications of providing central bank money to insolvent institutions are very relevant for the purposes of the discussion of legal or illegal state aid, according to the EC Treaty provisions[21]. In an ideal world, taxpayers' money (a fiscal solution to bail out insolvent institutions) should not be committed in LOLR operations. However, in some cases emergency credit lines are provided - via LOLR - to institutions that are already insolvent. In such cases, the EC rules on state aid become relevant. René Smits argues that "in support operations of central banks, State funds are involved. After all, the central bank's profits are distributed, mainly or wholly to the State. Thus, taxpayers' money is potentially at risk when central bank funds are used to grant credits to a financial institution in difficulties.[22]"

A Draft Commission Communication on Emergency Rescue Aids, released by the Bank Advisory Committee on 8/6/98, would request Member States to notify the Commission of any emergency aid measure to troubled financial institutions, enabling the Commissioner in charge of Competition Policy to accept, on behalf of the Commission, such emergency aid in a very short time. I would suggest, that in the case of Member States participating in EMU, the requirement of prior ECB authorisation also be included. The European Shadow Financial Regulatory Committee, of which I am a member, in its statement of October 1998, called for prior ECB authorisation before a NCB provides emergency liquidity assistance to troubled banking institutions.

Division of Responsibilities in the Field of Foreign Exchange Policy

The conduct of foreign exchange policy involves the determination of the exchange rate and the exchange regime and the management of the official foreign reserves (both gold reserves and foreign currency reserves).

Article 109 of the Maastricht Treaty deals with the division of responsibilities with regard to the

determination of the exchange rate and the exchange regime. Article 109 is a cumbersome provision in legal and economic terms, probably the result of a calculated obfuscation for political purposes. There is a degree of inconsistency, or conflict, between giving the ESCB independence of political control in the conduct of a [price] stability oriented monetary policy on the one hand, and leaving the choice of exchange regime (fixed, floating or managed float) to the political authorities on the other. As René Smits, quoting the German commentator Stadler, emphasises: "The compromise finally arrived at in the monstrous arrangements laid clown in article 109 EC Treaty, with their attributions of competencies and the participation in procedures in the area of external monetary policy, unmistakably expresses the labour pains which accompanied the creation of the provision[23]".

The room for manoeuvre in the field of exchange rate policy - traditionally the domain of the Treasury or Minister of Finance - varies, with some central banks deciding on the exchange rate (*e.g.*, the Swedish Riksbank)[24] and others with freedom only to implement the foreign exchange policy formulated by the government. Article 109 does allow a degree of political meddling with regard to the adoption of a fixed, floating or managed float regime. This may help explain the proposals put forward by the former German Minister of Finance, Oskar Lafontaine, with regard to the adoption of target zones for the euro, the US Dollar and the Yen in order to diminish the volatility of exchange rate movements. Politicians are reluctant to give away their powers over exchange rate policy. As acknowledged, the exchange rate has a dual dimension. On the one hand, it is the external anchor of monetary stability (and in this respect the ESCB has a vested interest in its safeguard) and - on the other - it is an instrument of the general economy policy of a country, closely linked to its trade and employment objectives[25]. For this reason, independent central bankers committed to price stability orientated monetary policy, but deprived of parallel powers in the field of exchange rate policy, are likely to clash with politicians who have other objectives to pursue, besides price stability[26]. It should be noted that in the implementation of exchange rate policies, central banks (including the NCBs participating in EMU) are not independent from the political authorities.

The management and holding of the official foreign reserves of the Member States is one of the basic tasks to be "carried out" through the ESCB. However, only part of the reserves have been transferred to the ECB (according to article 30 of the ESCB Statute), while part of the reserves will be held by the NCBs (according to article 31 of the ESCB Statute). Further complexity is added by the fact that Member States have to comply with their international obligations and hold reserves with such organizations. In particular, EU States are members of the International Monetary Fund, and as part of their membership responsibilities, they hold reserve positions with the IMF. Though article 30.5 of the ESCB Statute states that "The ECB may hold and manage IMF reserve positions and SDRs and provide for the pooling of such assets", it is worth recalling that the IMF according to the articles of Agreement ñ is country-oriented, member-oriented. Therefore only if the EC became a federation - *i.e.*, political union - or if the articles were revised could the IMF "deal" directly with the ECB (the "Community"), in terms of representation (article IV consultations and other obligations of IMF membership) and pooling of reserves.

Conclusion

The purpose of this article was to analyse the division of responsibilities between the National Central Banks and the European Central Bank within the European System of Central Banks. The issue is controversial and the language of the treaties allows for various interpretations. Whatever interpretation will prevail in the end (and one should note that this exercise implies a bit of "futurology") will depend upon the political will of the EMU Member States. As I already pointed out in 1992, the roots of these problems are to be found in the non-exclusive transfer of sovereign powers from the Member States to the EC institutions[27]. Monetary policy responsibilities have been clearly transferred from the national to the supranational arena. However, national competence is - for the time being - the principle prevailing in the exercise of foreign exchange policy, banking supervision and crisis management.

[1]I thank Charles Goodhart for comments. Errors are mine alone

[2] From a legal point of view, the reference to EC and EU Treaty provisions is complex and, at times, confusing. To begin, the Amsterdam Treaty, which amends and renumbers both the [Maastricht] Treaty on European Union (EU Treaty) and the Treaty establishing the European Community (EC Treaty), has not entered into force yet, though it is expected to be ratified by all EU

Member States in the course of 1999. The amendments and the renumbering made by the Treaty of Amsterdam signed on October 2, 1997 will be effective only on its entry into force, as provided for in article 14.2 of that Treaty. Another layer of complexity is added by the fact that references to the Maastricht Treaty provisions concerning the institutional framework of European Monetary Union (*e.g.* , Articles 105 to 109M) are in fact references to provisions in the EC Treaty as modified or introduced by article G of the Maastricht Treaty. (article G of the Maastricht Treaty contains all the "Provisions Amending the Treaty Establishing the European Economic Community with a View to Establishing the European Community"). The President of the Euro Institute, Frans Andriessen, and the President of its Scientific Committee, Prof. Jean-Victor Louis, in their letter of November 10, 1998 inviting me to contribute this article, suggested that any Treaty references be made according to the enumeration enshrined in the consolidated version of the Amsterdam Treaty followed by the original number of the article in brackets. For instance: article 111.3 (ex article 109.3), meaning article 111.3 of the consolidated version of the Treaty establishing the European Community as amended by the Amsterdam Treaty, ex article 109.3 of the Treaty establishing the European Community as amended by the Maastricht Treaty. However, on December 2, 1998, in *Press Release* No. 74/98, the Court of Justice announced its decision to use a uniform system for citing the provisions of the Treaties (see http://europa.eu.int). For this reason and for the purposes of simplicity and clarity bearing in mind that most of the literature on the subject still refers to the Maastricht Treaty- I will be citing Maastricht Treaty provisions throughout my article, unless indicated otherwise.

[3] It is interesting to notice that members of the ECB Executive Board, including its current President, Willem F. Duisenberg often use in their speeches (cf. the ECB web-page site: http://www.ecb.int) the term "Eurosystem". To my knowledge, such term is not legally enshrined in the Treaties. In a speech at the London School of Economics on February 24, 1999, Tommaso Padoa-Schioppa, talking about "EMU and Banking Supervision" defined the Eurosystem as the "euro area central banker". He explained the difference between this "euro area central banker" and what he referred to as "euro area supervisor", *i.e.* the co-operative system of national [bank] supervisors. For the purposes of legal clarity and certainty, I generally use throughout this chapter the terminology enshrined in the Treaty: *i.e.* , ESCB, ECB, and NCBs.

[4] A claim against a NCB is not a claim against the ECB and certainly not against the ESCB. Furthermore, a claim against a NCB is not necessarily a claim against the Member State of that NCB, nor against the European Union as a supranational organization.

[5] See articles 12.1 and 14.3 of the ESCB Statute.

[6] See article 14.4 of the ESCB Statute.

[7] See F.A. Mann, *The Legal Aspect of Money* , 1992, at p.460:
"That the State's sovereignty includes its power to issue and regulate money has traditionally been accepted in international law. The Permanent Court of Justice stated that "it is indeed a generally accepted principle that the State is entitled to regulate its own currency". (*Serbian and Brazilian Loans Cases* , judgement of July 12, 1929, Publications of the Court, Series A, Nos. 20-1 at p.44).

[8] See R. Smits, *The European Central Bank* , Institutional Aspects, Kluwer Law International, The Hague, 1997, at p.193.

[9] See "EMU and the Launch of the Euro", speech given by Tommaso Paddoa Schioppa in Beijing on March 2, 1999, available in the ECB's web-page site: www.ecb.int, at p.4.

[10] Journalists and commentators have often discussed the process of centralisation of power within the Federal Reserve System. However, it should be pointed out that this process of centralisation refers to the monetary policy functions entrusted to the Fed, and not necessarily to other functions. For instance, when the Federal Reserve Banks act in their private or commercial capacity, such as when they enter into depositary agreements with the banks in their respective districts, or when they manage investment accounts for foreign central banks, they act as separate legal persons from the Board of Governors, zealously guarding their independence from the "centre".

[11] The notions of organic and functional independence are further elaborated in my chapter 1 of my book, *Central Banking and Banking Regulation* (1996).

[12] It is for this reason that the language of article 105.5 refers to the ESCB, rather than to its constituent parts, as do other provisions pertaining to other non-basic system tasks.

[13] As Smits (*supra* note 8 at p.301) notes: "In accordance with the decentralization principle, the facilities will be offered by the NCBs, the ECB [...] hooking up with TARGET through the interlinking mechanism."

[14] As I explain in pages 266 and 267 of my book (see *supra* note 11) the nature of the LOLR - provision of liquidity - involves different aspects: (a) monetary policy; (b) banking supervision; (c) a service provided by a central bank in its capacity as bankers' bank.

[15] See "EMU and Banking Supervision", speech given by Tommaso Paddoa-Schioppa at the London School of Economics on February 24, 1999, at p.13 (*supra* note 3). M. Goodfriend and R. King in an article on "Financial Deregulation, Monetary Policy and Central Banking", published in *the Federal Reserve Bank of Richmond Economic Review* in May-June 1988 (Vol. 74, No.3), argue that monetary policy - through open market operations - can effectively limit banking crises without the need to resort, generally, to lending to particular institutions.

[16] The statements of the ESFRC can be accessed through the website of the American Enterprise Institute, http//www.aei.org.

[17] *Supra* note 15, at p.11. This speech by T. Padoa-Schioppa can be accessed through the ECB's web-page site: http://www.ecb.int and through the Financial Markets Group site: http://www.fmg.les.

[18] In the United Kingdom, following the creation of the Financial Services Authority, an example of co-operation between those in charge of monetary policy and those in charge of banking supervision (though the Bank of England retains general responsibility for financial stability, including a lender of last resort function) is provided by the Memorandum of Understanding (MoU) between HM Treasury, the Bank of England and the Financial Services Authority, which was released on October 28, 1997. Paragraph 10 of this MoU foresees the setting up of a "Standing Committee" of representatives of the Treasury, the Bank and the FSA. This Committee will meet on a monthly basis and also at the request of any of the participating institutions in emergency circumstances. Each institution will have nominated representatives which can be contacted, and meet, at short notice. If a financial institution gets into trouble, the first port of call will be the FSA. If either the FSA or the Bank of England spot a problem where a support operation (*i.e.* , LOLR) might be necessary, they will consult each other immediately. If the problem is related to the scope of responsibilities of the FSA, then the FSA will be the lead operation in the support operation, though the funds will still come from the Bank. If the

problem originates in the payment system or other area of responsibility of the Bank of England, then the Bank will be the lead institution in the support operation. In all cases, the FSA and the Bank are supposed to work together very closely and to inform the Treasury, in order to give the Chancellor of the Exchequer the option of refusing the support operation. Indeed, if fiscal resources - *i.e.* , taxpayers' money - are to be committed, then, the Chancellor should have a say in deciding whether or not to provide support to the troubled institutions.

[19] T. Padoa Schioppa (*supra* note 15, at pp. 10-11) discusses these three categories of emergency action: central bank money solution, taxpayers money solution, and private money solution.

[20] As I have already mentioned (*supra* note 19), in the United Kingdom, in the case of a support operation, the FSA and the Bank work closely with the Chancellor of the Exchequer, who has the option of refusing such support operation.

[21] I discuss this issue in an article on "Lender of Last Resort, an International Perspective", forthcoming in the April 1999 issue of the British Institute *International and Comparative Law Quarterly* .

[22] See Smits (*supra* note 8 at pp.270-71). Smits further argues: "In Stage 3 of Economic and Monetary Union, support by the NCBs and the ECB can likewise amount to State aid".

[23] See Smits (*supra* note 8, at p.375, footnote 40).

[24] According to article 4 of the Swedish Central Bank Law of 1991 (SFS 1988:1385), the Riksbank is responsible for Sweden's foreign exchange and credit policies.

[25] As I recall in page 276, footnote 454 of my book, (*supra* note 11), former German Chancellor Helmut Schmidt wrote in his memoirs that "he regarded exchange rate policies... as important part of general foreign and strategic policy."

[26] As S. Fischer indicates in a paper presented at the Bank of England's Tercentenary Celebration on *Modern Central Banking* (1994, at p.4), in today's world, interest rate and exchange rate policies are increasingly interrelated. Fischer also contends - at page 55 of his 1994 paper - that the very effectiveness of central bank independence will depend on the government's choice of exchange regime. Under floating rates, monetary policy affects the exchange rate. Whereas, a system of fixed exchange rates greatly curtails and independent central bank's room for manoeuvre in the conduct of monetary policy.

[27] See R. M. Lastra, "The Independence of the European System of Central Banks", *Harvard International Law Journal* , Vol. 33, No. 2, Spring 1992, at p.516.