CHAPTER TEN

THE CHANGING NATURE OF THE CRISIS AND THE REVIVAL OF THE LENDER OF LAST RESORT IN EUROPE

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The decisions taken during the crisis (and the circumstances that caused them) have reopened the debate on the role of central banks, their objectives, and the adequacy of monetary policy strategies.

As is well known, the ECB has been granted exclusive jurisdiction to conduct the monetary policy of the euro area. However, rather than the view of the ECB as being tortured by its own statutes, the European Central Bank has exercised its crucial role as a lender of last resort to support the banking and public sectors, with the ultimate goal of safeguarding the stability of the euro area.

In reviewing these issues in the light of the major changes, which have affected the economic and financial environment, we shall attempt a thorough analysis of the principles guiding European monetary authorities in their response to the financial emergency.

The aim of this chapter is to prove that a similar evolution, not exclusive to national "*central banking*", represents the natural outcome of the instrumental framework with which the ECB has been endowed, in order to carry out its tasks effectively.

Key words: lender of last resort, monetary policy, central banking, debt crisis, bail out

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1. Introductory notes

Since its conception, a characteristic of the Eurozone has been the anomaly of the co-existence of many countries and a single monetary policy. In addition, monetarist orthodoxy, constantly reaffirmed in European treaties, has reinforced the neoliberal postulate "currency without a State and States without a currency" (Padoa Schioppa, 2004, p. 5). The euro suffers from "lame" monetary sovereignty because of the lack of national and European "political" counterweights, and its premises sanction it as a failure in the diachronic sense. At the summit of the incomplete institutional framework of the European "fractal" stands a centralized monetary policy that is committed to an institution, the European Central Bank (ECB), which is independent of political decision-makers and has its sole guiding star in the control of inflation.[2] Creating a "*currency without a state*", however, soon proved to be a utopian operation, and giving birth to a currency without an integrated banking system has not proved a wise choice either (Oddenino, 2015, p. 10).

For all the institutions belonging to the European System of Central Banks (ESCB), this structure has also separated currency management from any constraint related to national policies on public debt (Della Cananea, 2011; Merusi, 2014, p. 2 f.)[3].

The reflections presented here are based on the claim that the structural malfunctioning of the "single currency" is a factor of imbalance (or rebalance, where possible) in relations within the market of the economic and monetary union.

The specification of the functions and role assigned to the ECB in the treaties forms the content of this analysis, which, therefore, involves various issues, and tries to provide an appropriate line of argument focusing on the role of the "*Lender of Last Resort*" (LoLR).

Besides the study of the classical notion of the lender of last resort, this line of study also concerns an examination of the extraordinary macroeconomic credit granted by the ECB in relation to, first of all, the liquidity crisis that has strangled the banking system, and, in rapid sequence, to the sovereign debt crisis in some member states. The virulence of the events in question did in effect require, as shown, the use of an instrument outside the contexts within which it was traditionally conceived and applied.

Here, we fear, there is an insufficiently explored link, which is combined with the need to focus research on the examination of a possible change in the institutional role of the ECB. Indeed, the central bank may be asked in the future to perform a far more extensive and important function than that hitherto covered, thus clearly affecting its own subjective organisation.

2. The link (conflict?) between *lex monetae* and fiscal discipline in the light of the treaties

Governing by rules finds its best embodiment in the "*economic constitution*", namely monetary policy and fiscal policy, and specifically their mutual relationship. The initial weakness in European institutional design raised fears about the integrity of the monetary union, particularly with regard to the choice of separating monetary and economic policies while establishing a single currency. Government of monetary policy was assigned exclusively to the Union, pursuant to art. 3, (1), (C) TFEU; the government of economic policy was mainly attributed to the member states, with rather minimal EU (art. 5 TFEU) competence, which plays only a facilitating role in the coordination of the various national choices (Triulzi 2015, p. 7 ff.; Bucci, 2012; Mostacci, 2013, p. 492 ff.). The aforementioned separation contributes to uncertainty concerning the real effectiveness of economic policy coordination, which is impaired by the weakness of procedures of multilateral surveillance (art. 121 TFEU) on the one hand, and excessive deficit detection (art. 126 TFEU) on the other, and most of all by the penalties provided in the event of default (Peroni, 2011, p. 977; Fabbrini, 2013, p. 102 f.; Cafaro, 2001, p. 29 ff.)[4].

The reason for this distinction stems from the idea that monetary policy, aiming to ensure price stability, should be entrusted to a technical body acting in a position of absolute independence from the political influence of the representative bodies (Predieri, 1996; Morosini, 2014, p. 29 ff.). However, because of their redistributive effects, economic and budget policy choices necessarily require a solid foundation in democratic legitimacy that only national political processes can provide.

In the absence of a political union, the economic governance of the euro area was founded on fiscal rules and the "*no-bailout clause*" among member countries. This constitutes a fragile combination of market forces and rules of conduct, in the mistaken belief that, thanks to "*governing by rules*" Europe might live forever in a postmodern paradise; an era with no war, the "*age of Venus*". Market forces drove economic convergence

among member countries, moving towards the definition and implementation of the necessary structural reforms at national level. The rules of conduct were used to ensure prudent fiscal policies.

As pointed out in 1989 by the Delors Report on Economic and Monetary Union, the financial markets were considered unable to provide the right incentives to conduct prudent fiscal policies by themselves[5].

The decision not to have a "*sovereign called upon to decide on the exception*" did not however disarm the state of exception, and thus did not deprive public power of its necessary weapons.

First and foremost, this is because the exchange rate and interest rate on public debt, which normally react to unsustainable fiscal policies, cannot exercise their moderating action in a monetary union, thus potentially causing a member state's policy makers to achieve a budget deficit higher than what is financially tolerable for that country (Winkler, 2014, p. 3 f.).

In a currency area such as the Eurozone, there is a high risk of moral hazard also on the part of national governments. Basically, it is widely held that market discipline is unable to induce responsible behaviours, despite the no-bailout clause and the prohibition of deficit monetization (arts. 125 and 123 TFEU respectively) enshrined in the treaties. Moreover, unsustainable fiscal policy in a country can produce spillover effects on other partners.

3. The lender of last resort in the banking and sovereign debt crisis

At least until the nineties, the role of lender of last resort was usually understood to fall to the national central banks as the last bulwark against the collapse of the domestic banking system. But in recent years, and specifically after the Mexican crisis, the idea has increasingly taken hold that an LoLR can be a good solution even when extended to bailing out states, especially when applied to an economic and financial area that has proved to be more fragile than expected, such as the economic and monetary union.

Therefore, it is not surprising that this role has expanded to the states, because, as Bagehot argues, it is necessary to lend freely to anyone at risk of a liquidity crisis. Sovereign states are not at all different from other debtors when they lack immediate liquidity to face their debts. Moreover,

their possible liquidity crisis is even more dangerous because, given their size, it will inevitably turn into a systemic crisis that then puts the survival of the monetary union at risk.

For some years, it was expected that national banking systems would harmoniously follow the path laid out by the single currency, breaking that centuries-old bond that united them to the nation states. The crisis has obviously broken the spell, showing first of all how risky it is to create a central bank without providing it with the powers typical of the lender of last resort, secondly, how ephemeral and reversible the integration process is and, finally, how close relations between states and banks are (De Grauwe, 2013, p. 520 ff.; Butther, Rahbari, 2012; Wilsher, 2014, p. 255 f.).

The term “lender of last resort” implies a degree of specificity that goes beyond what the function can legitimately define. In the confused political-institutional framework of the euro, central banks tried to face the crisis promptly and incisively, using a wide range of measures (Russo, 2010, p. 492 ff.; ECB, 2010). The financial emergency required a review of the range of interventions designed to further neutralise the degenerative dynamics of the imbalances that had occurred in the economic systems[6]. As empirical evidence has shown, meeting the sudden increase in demand for liquidity prevented a descent into the messy process of deleveraging, and averted the collapse of illiquid, but solvent, banks and, more generally, strengthened confidence in the economy[7].

The spread of the risk of contagion through the banking system and member states in difficulty explains why, from summer 2007 to summer 2008, containing the crisis was largely entrusted to the monetary policy authorities in the major currency areas (Federal Reserve; European Central Bank, Bank of England) and the supervisory authorities of the national banking systems. The first guaranteed the broad refinancing of distressed banks through loans of last resort (discount windows) and open market operations; the second, in agreement with national governments, proceeded at their discretion to bail out banks on the brink of bankruptcy, with the stated purpose of avoiding systemic crises (Solow, 1982).

More generally speaking, the EU response developed along three lines of action: i) providing financial assistance to countries in crisis (Greece, Ireland, Portugal); ii) strengthening controls on the fiscal policies of member states (Spain and Italy); iii) stabilising the conditions of money and capital markets.

The first two lines of action mainly involved the European Commission and national governments at ECOFIN (Council of Finance Ministers) and the European Council; the third line called into question the powers of the European Central Bank (Tufano, 2012, p. 139).

In such a situation, the demand for the implementation of extraordinary measures rose, in addition to the call for the adoption by monetary authorities of "*quasi-fiscal*" interventions suited to the objective of achieving cohesive order within highly pluralistic contexts.

In particular, to prevent tensions in sovereign bond markets likely to jeopardize the smooth transmission of monetary policy because of their impact on the money market and bank lending, the ECB, while continuing to make use of fixed rate full allotment tenders for the refinancing of banks, also launched a programme of government bond purchasing (Securities Market Programme, "SMP").

Finally, the European Central Bank had to accept and play the role of lender of last resort, at first only *de facto* (through 3-year long-term refinancing operations), and then unofficially (with the announcement of the Outright Monetary Transactions plan). The outcome was a somewhat macroscopic expansion of its role that, going beyond the actions related to price stability, extends to the preservation of the European currency itself (Allemand, Martucci, 2012, p. 21).

4. The "floating" nature of the LoLR in relation to the concrete objectives of the treaty

The novelty consisting in the replacement of national currencies by a single one is incorporated in the constitution of the European Central Bank, implying "*first the uniqueness of the function of currency issue and management, and thus the transfer of a national sovereign function to the Federation*" (Merusi, 1997, p. 7). Hence the key role granted to this institution within the Euro-system, as the latter carries out its functions primarily through the organs of the ECB (Papadia, Santini, 1998, p. 28; Santini, 2001, p. 12 ff.; Pellegrini, 2003, p. 214).

The central bank bases its legitimacy on a carefully defined mandate that is integrated into a democratically established constitutional order by virtue of treaty provisions stating the independence of the issuing institution (Art. 130 TFEU), and that of the rules that identify the

"residual" target of the monetary policy. This attribute proved to be a point of undoubted strength for the overall “system” of crisis management.

Indeed, support for the general policies of the Union is to be pursued only when the goal of price stability is “safeguarded” (Art. 127 TFEU)[8], which is to be considered the true "mantra" of EU monetary policy [9]. Monetary stability stands out as “*an essential figure and a definite limit with respect to the ability of the ECB to profile or independently determine its goals. On the other hand, the primary right is always to set this objective within the overall objectives of the EU*” (Oddenino 2015, p. 7)[10].

Therefore, entrusting the ECB with methods of implementing price stability would represent the way to combine the priority goal with the overall framework of its action.

Indeed, it is not to be excluded *a priori* that, in order to act upon “*an open market economy with free competition*”, as stated in the final part of the previously mentioned para. 1 of art. 127, the drafters of the treaty – based on a criterion that ascribes primary emphasis to “cooperation” among member states – might have meant to confer upon the ECB broad and diverse competencies, which may certainly extend well beyond the mere coordination of monetary policies.

This broader interpretation of article 127 would allow for a reduction of the importance of the primary objective of price stability to the benefit of supporting broader economic policies, and thus the legitimacy of further interventions that can be achieved in various ways and expanded in different directions[11].

Moreover, the disputed initiatives put in place by the ECB - while configuring *prima facie* a further exercise of its power of intervention recognised by the “Treaty on European Union” and the “Statute of the ESCB and of the Central Bank” – weigh on the sphere of competence originally assigned to the authority[12].

As stated, these are unconventional operations, all geared to controlling price stability, which materialised in the refinancing of the banking system and the purchase of debt securities of member states.

As is well known, the transmission mechanism of monetary policy is the process by which the European Central Bank aims to influence prices in the Eurozone, *i.e.* by acting on interest rates of reference. The ECB may intervene if the mechanism is hindered by disruptions in some market

segments, and the signal inherent in the ECB rate is not transmitted evenly across the whole Eurozone. In times of extraordinary financial market stress, the ESCB may resort to any means compatible with the treaty that are vital to achieving the objectives set. Therefore, it may decide to counter these tensions by using non-standard measures, which are part of the instruments for the implementation of monetary policy at its disposal, but which are, by definition, extraordinary and temporary tools.

5. "States of exception" and interventions by the monetary authority as LoLR

So, the role of the ECB in managing the crisis required many interventions, which can be considered as those of a lender of last resort coming into play in order to avoid bankruptcy; in the first place that of banks, and secondly that of states when faced with the risk of a fraying union (De Grauwe, 2011; Scipione, 2012, p. 67)[13].

From this perspective, the ECB's addresses, documents, and procedures were gradually adapted to the growing emergency, with a transition from the range of the traditional instruments of monetary policy to the unprecedented use of non-standard operations impacting on financial markets.

Monetary stability is indeed a primary interest, but it should be balanced against the equally important need not to exonerate those member states that do not respect budgetary discipline from their responsibility. However, it is observed that in the history of central banking this goal has coexisted with others. It coexists with others in the Treaty on European Union as well, so it is not unreasonable for the ECB to purchase debt securities issued by a sovereign state.

Among the reasons for this choice is certainly the explicit will to prevent alterations deemed dangerous to the market economy, such as systemic crises. Therefore, if through a gradual, although not necessarily linear process, the European Central Bank has come to believe that it has a duty to intervene in support of this or that sovereign debt, such a choice should not be labelled as *extra legem* or even *contra legem*[14] (Nielsen, 2012; Merler, Pisani-Ferry, 2012; Krauskopf, Steven, 2009, p. 1144 ff.; Perassi, 2011; Malatesta, 2003; Zilioli, Selmayr, 2007).

In fact – as described in economics literature – purchase interventions on the secondary market can affect the financing conditions of public

budgets, with a risk of interfering in fiscal policy. On the other hand, it is interesting to note that other measures that have directly affected the financing of the banking system have not provoked similar debate, although they have also led to a risk of interference, specifically with the prudential supervision authorities. Whenever the central bank injects liquidity through a transaction by which it purchases a banking or a public title for a specified time, it risks creating distortions in the prices of such assets; hence the need for procedures and safeguards. In the case of a loan to the banking system, it is necessary for the banks involved to be deemed healthy, and for the operations carried out to have adequate collateral. Likewise, in the specific case of both public or private securities purchases, it is crucial to consider the underlying status of the issuer healthy and the debt sustainable.

The core of the reflections so far presented should therefore be addressed to the interpretation of the European Central Bank's role in the context of European *governance.* Its reform resulted in albeit limited waivers of sovereignty by all member states, both in the field of the public budget and in the definition of structural policies.

6. The ECB's unconventional monetary policy and support to general economic policies

In the wake of the peculiar contingency mentioned above, the public debt crisis in Greece, Ireland, Portugal, Spain, and Italy coincides with a profound change in the institutional design of the Eurozone, and goes far beyond the scope of monetary policy alone, where it originated. Thus, a power structure has begun to be established, able to redefine the spheres of influence of monetary authority and national governments in Europe.

In this sense, we can say that the Greek case has clearly shown the disciplinary nature of monetary policy on public debt in the crisis context. This manifestation of the phenomenon quickly leaves room for a comprehensive institutional architecture improving and systematically repeating the set of operational practices put in place by the monetary authority. The new European institutional framework, based on the instruments of the European Stability Mechanism (ESM) and Outright Monetary Transactions (OMT), is the most refined form of the disciplining device through which the ECB and the European Commission can exert their influence on national economic policies in Europe (Winkler, 2014, p. 6 f.).

Like ESM, the OMT is nothing but a refinement of the tools necessary to manage financial instabilities with increasing precision, so as to precisely calibrate the degree of pressure exerted on national economic policy makers, and systematically transfer instability within the disciplinary device of the conditional support provided by the lender of last resort.

Indeed, the OMT instrument is bound, according to the principle of conditionality, to the larger design of monetary policy on public debt (Draghi, 2013a). For the reasons mentioned earlier, it is indisputable that the OMT programme blurs the separation between monetary policy and fiscal policy within the Eurozone: monetary policy is able to ensure stability only if the economic fundamentals and the institutional architecture are consistent with it[15].

Fears about the reversibility of the euro are related primarily to those on the sustainability of public debt and the competitiveness of member countries. Therefore, the activation of OMT by the European Central Bank and their continuation depends on precise commitments in terms of public finance and structural reforms within the framework of assistance programmes. Financing programmes using the common resources of the ESM is an incentive to continue to strengthen union governance, which is essential to permanently reduce the "European" component of spreads.

From this perspective, the OMT are perfecting the ECB's activity in the financial markets between 2010 and 2011 through SMP: the ESCB is committed to ensuring stability in the quotes of government bonds only if the country "hit" by financial instability accepts the lines of economic policy set out by the European authorities.

Let it be clear that the strongest reasons in support of the ECB intervention can be found in its consistency with respect to other and further objectives than the ones of strict monetary policy; *i.e.*, the underlying objectives of the union – economic, social, and territorial cohesion, and solidarity among member states (art. 3 TEU) – as reflected in the provision of support measures in case of crisis (arts 122 and 143 TFEU).

Within the described framework of action, the relationship between economic policy and monetary policy is heavily tilted in favour of the latter, as the subject of the first involves a constant adjustment according to changes in the economic situation. This is not so much due to a formal aspect, considering that the instances for economic growth are also present in the treaties (as seen in relation to art. 127 TFEU), but more to a

substantial and identitarian one. Indeed, the ECB has come to identify itself with a very specific model, and based on this model it has exercised its discretion in identifying the graduation of the objectives it is committed to, considering at length its first and main objective, price stability, as potentially fully encompassing all others (Barbier, 2012, p. 212).

These are the aspects that, more than others, provide useful tools to explain the role played by the ECB in respect of the disruption of basic paradigms that international financial markets nowadays hetero-impose on the different spheres of monetary sovereignty. Given that the monetary policy mandate by state sovereignties fades and eventually disappears, it is clear how this causes a tendency to absolutise the monetary imperatives, until the conclusion that the ground for discussion of monetary policies should always be the market, characterised by established, more than proven, self-regulatory virtues (Oddenino, 2015, p. 11).

Are these considerations enough to ensure that the actions of the ECB are located in the flow of community legitimacy? At least from the point of view of institutional balance, there is no denying that there was a *de facto* change or evolution. The ECB has undeniably qualified as an (on-demand) political decision-maker and not merely a technocratic body, as the treaty describes it (Papadia, 2014, pp. 93 ff.; Tucker, 2014, p. 10).

7. Operational discretion by the ECB and profiles of central banking

In the crisis scenario, some operational forms of the ECB mark the requirement for acknowledging a role that is fully responsive to its *nomen iuris.* From the point of view of theoretical argumentation, it is not of secondary importance to stress how the measures taken by the ECB offer the example of an agent who – being forced by external shocks – engages in a redefinition of its mandate, which leads to deepening the integration process and, consequently, clashes with the attempts by some devices to restrain such an evolution.

It is obvious that the role of the LoLR is definitely more effective when assigned to a supranational body (a characteristic that the FED does not possess), and as such the ECB plays a key role in this field, provided, however, reforms are made to both the structure of the monetary union (with important waivers of sovereignty by states) and the powers conferred upon the issuing central institute.

The internationalisation of financial transactions has blurred the lines of responsibility for a national LoLR. Even more important is the fact that today the actions of a central bank produce effects on foreign financial markets, in addition to potential effects on exchange rates. In situations of distress, such as those imposed by the financial crisis, these actions may result in the further destabilisation of markets. Therefore, LoLRs that are nowadays capable of providing liquidity at the global level are more necessary than ever.

There are four potential roles that a supranational level LoLR may play in a context of illiquidity: (i) to prevent panic, simply by virtue of its existence; (ii) if panic is already present, to lend what is needed to avoid worsening the situation; (iii) to grant loans during a debt crisis, also defining reimbursement priorities, as happens in cases of bankruptcy on a national level; (iv) to grant loans during the collapse of a state's public sector, to support it in the strengthening or regaining of its sovereignty - an unlikely mission for private markets (Sachs, 1999, p. 382).

These components make it increasingly urgent to rethink the international, not only European, financial architecture. A possible solution could be found, as has happened with the national central banks since the end of the nineteenth century, in providing the ECB with the full functions of lender of last resort.

Therefore, there is broad consensus on an interpretation of this role that entrusts the European Central Bank with two specific functions:

(A) "Crisis lender", which the ECB would be able to play because of its power to mobilise still very large resources
(B) "Crisis manager", that is to say a coordinator of relations between creditors and debtors, which does not necessarily require financial resources, but above all the ability to impose concrete commitments on both parties, and to verify compliance.

To date, the use of the instrument seems to meet the expectations. The ECB seems to be the most suitable institution to carry out an analysis of the nature of crises in the Eurozone, which, in the national context, corresponds to the liquidity risk assessment of a bank[16].

In all honesty, this argument has not always been presented as thoroughgoing. In the face of a widespread financial crisis, it is not easy to conceive an automatic market mechanism that would make a lender of last

resort unnecessary. The first required procedure is to try and prevent contagion upstream, by supporting states where outbreaks of illiquidity are kindled. Then, such intervention as is aimed at those states cannot shrink to open market operations; it must be allowed to extend to forms of direct refinancing. This is all the more so as the money market moves away from an abstract, never reached, and unattainable perfection.

One thing is certain: the transformation of the ECB into a lender of last resort for the European Monetary Union, in the full sense that the experience of Western countries and the literature on central banking have credited to it, will require a transformation of the international legal system: from a set of sovereign states governed by the principle of *pacta sunt servanda*, but basically devoid of any legal sanction, into a supranational system governed by rules whose breach entails specific consequences provided by law (Giannini, 2004; Howarth, Loedel, 2003; Haan, 2005; Harold, 2012).

Moreover, the lender of last resort is a borderline instrument, between monetary policy and surveillance; in other words, it is addressed to the system as a whole and granted to the individual units that are part of it. The stability of the banking and financial industry is the original and permanent, though no longer the only, *raison d'être* of central banking.

8. Conclusions

Reporting several points of weakness in the legal framework of the European Monetary Union brings a further implication, this time regarding the opportunities that the financial and economic crisis unfolds (Darvas, Merler, 2013, p. 8). The course of action taken by the European Central Bank – although addressed to the restoration of monetary policy and, therefore, to market stabilisation for sovereign debt – cannot be considered *in lieu* of a real policy of public budget consolidation. For non-standard measures to yield expected results, the action of the ECB must be an integral part in a framework of broader reforms at European Community level[17].

But then, the strong "interventionism" that has characterised the activities of the ECB since the beginning of the crisis is a mere consequence of the political vacuum in the European Union and the Eurozone's institutional and political failures[18].

It is now quite clear that the euro crisis is not due solely to the lack of coordination of economic policies in member states, but is mainly the result of the absence of a decision-making centre where a European unitary fiscal policy can be defined and then applied uniformly in each member state.

To allow the ECB to conduct an independent and effective monetary policy in a timely manner, it is necessary to achieve a euro architecture in which all players know their own part: governments, the central bank, and the European institutions. It goes without saying that greater and clearer assignment of responsibilities to the ECB should match a context of strengthened democratic legitimacy.

Euro economic governance is nowadays characterised, on the one hand, by an excessive focus on balanced budgets, as imposed by “fiscal compact”, and on the other, by the search for an adequate conditionality, which, with varying degrees of intensity, accompanies the financial assistance provided by the Financial Stability Mechanism and the ECB itself.

Shaping a new formula for the government of economy and currency at the European level is the factual premise for developing answers to be consistent with EU policy and interventions in support of the purposes mentioned above - namely, facing speculative turbulence on sovereign debt while pursuing, at the same time, strict fiscal policies.

If any form of monetary union is to exist, it is essential, first and foremost, for it to evolve through a gradual transition into a real political union, and secondly, that there be a central bank capable of intervening during financial crises, either by means of an unlimited liquidity offering to calm down the markets or through the so-called liquidity preference (assuming a debt crisis cannot be resolved with the issuance of more debt).

The structural limit of the institutional design of the Eurozone can be overcome by combining two types of interventions: (i) a centralised fiscal policy[19], so as to re-tally the geographical boundaries of the fiscal and monetary authorities, and (ii) an implicit guarantee of government debt by the ECB, through the activity of a buyer of last resort of government debt securities, with no limitations (Panico, Purificato, 2012, p. 17).

Only the transfer of fiscal policy from individual states to the European Union will probably solve the euro crisis. The prevailing argument is that the action of the ECB in the financial markets, through its large arsenal of monetary instruments, can only limit the negative effects of the crisis. On

the other hand, in the absence of an adequate political response on the future of the euro, it will never be able to permanently solve such a dramatic phenomenon[20].

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Notes

[2] So, the link between state and currency, and likewise between fiscal and monetary policy (which is raised with extreme relevance) has deep roots that refer to the origins of the currency. Scholars had already pointed out the anomaly of the Eurosystem in the weak link between currency and State, to a degree never seen before (Goodhart, 1998, p. 407 ff.). A divorce between monetary and fiscal policy that could have absolutely unexpected implications, he wrote. Normally a currency is associated to a State. Rarely is a single currency associated with many States of significant size and with different fiscal policies, such as in the euro area.

[3] Della Cananea, 2011. The States' legal systems were based on an assumption generally taken for granted in legal treatises: for all States, financial sovereignty equals monetary sovereignty. In a united Europe, both postulates have failed, although to varying degrees. As regards currency, what Hayek considered to be the main route, the establishment and control of competition between national currencies, was not followed. It was decided that public authorities would have exclusive competence, but transferring it up to Union level. The adoption of a single *lex monetae* in Europe set aside the differences between countries.

[4] Notwithstanding these limitations, even before 2008 the Eurozone had gradually qualified as a legally distinct area within the Union, an incubator for those innovations that then became necessary to react to the crisis. (See: Dickmann, 2012; Overbeek, 2012, pp. 30 ff., p 38 ff.; Ruffert, 2011, p. 1777 ff.; Chiti, 2012, p. 783 ff.; Chaltiel, 2012, p. 293 f.; Athanassiou, 2011, p. 558 ff.)

[5] Indeed, it was considered in the 1989 Delors Report that regarding public

finance, "the constraints imposed by market forces might either be too slow and weak or too sudden and disruptive". As highlighted in the report, what is lacking in EU economic policy, unlike monetary policy, is the 'institutional solution': its eminently regulatory character, although involving European institutions in the mechanisms of control and correction, entrusts them with very few powers of government. To paraphrase a renowned scholar (Carreau, 1971, p. 592) it can be assumed that once again the EC Treaty seems to be written for a "happy future", "because the lack of elasticity of such a system that would be necessary to adapt to changed circumstances is clear." (Cafaro, 2001, p. 343).
[6] As explained by De Grauwe, 2012:

> [...] if financial stability is to be maintained, because the sovereign and the banks hold each other in a deadly embrace. When the banking system collapses, this threatens the solvency of the sovereign. When the sovereign defaults on its debt, it pulls the banks into default. This means that the banking sector cannot be stabilized if the sovereign is unstable. A central bank that wishes to stabilize the banking sector is condemned to also stabilize the government bond market. Failure to do so leads to a banking crisis, forcing the central bank to provide huge amounts of liquidity to banks that it refuses to provide to the sovereign.

[7] To safeguard the stability of the system, there are proposals to replace the traditional Lender of Last Resort with a Liquidity Provider of Last Resort; a sort of "government" lender that would be ready to purchase Securities in the markets when the panic materialises rather than inject liquidity into the banks.
8 Consistently with the aim of maintaining price stability and controlling inflation (implemented through monitoring of the monetary base and/or setting short-term interest rates), the European Central Bank, pursuant to art. 127, para. 1 of the TFEU, is competent "to support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union". Namely the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and favoring an efficient allocation of resources and respecting the principles of art. 119, (3), TFEU: "stable prices, sound public finances and monetary conditions and a sustainable balance of payments".
9 It should be borne in mind that Art. 2 of the ECB Statute allows the Central Bank to act in support of the EU general economic policies, only subject to the maintenance of price stability.
10 Although a basic precondition for meeting the general objectives of the Union, the achievement of monetary stability is a device "not unique in its strategic components, and whose definition is left to the responsibility of the organ deputed to its pursuit, and to this end, independent" (Oddenino 2015, p. 7). With reference

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to these profiles, see Bini Smaghi, Gross, 2000; Eijffinger, De Haan, 2000; De Grauwe, 2013a, p. 196.

11 In favour of a more flexible interpretation of the same principle of monetary stability see (De Grauwe, 2006, p. 158 ff.; and Domingo Solans, 1999).

12 See, among others, Capriglione, 1999, p. 761 ff., who, with regard to the "supervisory policy" (p. 764), stresses that the original Community legislation limited ECB intervention to an advisory capacity, while specifying that such activity might “affect the exercise of supervision in the Member States”.

13 In this sense, see De Grauwe, 2011a, p. 2, who believes that “[t]he only institution in the Eurozone that can perform this role is the European Central Bank. Up until recently, the ECB has performed this role either directly by buying government bonds, or indirectly by accepting government bonds as collateral in its liquidity provision to the banking system”.

[14] Pinelli, 2012, 3:

> The ECB is in fact an even unitary institution when considering the control of monetary policy, and is structurally supranational, in whose regard the inter-state coordination cannot serve as a political counterweight. By contrast, the Treaty of Lisbon institutionalised the European Council to the point that it became something more than a simple counterweight to the strengthened network between supranational institutions (Parliament and Commission).

[15] According to the European judges (Court of Justice, Case C-62/14), the line between measures of monetary policy and economic policy cannot be traced clearly, as certainly the former have an impact on economic policy and are part of it. Although elusive, the distinction between the two is of considerable importance as it is relevant to the division of responsibilities (both horizontal between institutions and vertically between States and the European Union) as provided for by the Treaties (para 129).

On this, the Court of Justice had already ruled in the Pringle case (Court of Justice, case C-370/12). On that occasion it had stated that “an economic policy measure cannot be treated as equivalent to a monetary policy measure for the sole reason that it may have a direct effect on the stability of the euro” (para 56) and that “the grant of financial assistance to a Member State however clearly does not fall within monetary policy.” (para 57).

[16] Cf. Praet, 2012, who argues that the ECB has been acting as

> lender of last resort for the sovereigns of the euro system since it started its outright purchases of euro area periphery sovereign debt under the securities market program (SMP) in May 2010. The scale of its interventions as LoLR for sovereigns has grown steadily since then and its range of instruments has expanded. We interpret the longer term

> refinancing operations (LTROs) of December 2011 and February 2012 as being as much about acting, indirectly, as LoLR for the Spanish and Italian sovereigns by facilitating the purchase of their debt by domestic banks in the primary issue market as about dealing with a liquidity crunch for Euro area banks.

Accordingly, see also the arguments put forward by Buiter, Rahbari, 2012, p. 1 ff.; Trichet, 2010.

[17] The incompleteness of European integration has effectively prevented the transmission of monetary policy among the member States, thus endangering the functional independence of the ECB. From this perspective, the European sovereign debt crisis has shown that there is no alternative to the harmonisation of European fiscal policies and the reform of EU policies. On the destabilising capacity due to the absence of a common fiscal policy in a common currency area, see Fatás, Mihov, 2010, p. 287 ff. See also the remarks of Gualandri, 2008, p. 3 ff.; Hellwig, 2011, n. 11, June; as well as the intervention of Draghi, 2008. In economics scholarship it is widely accepted that the fiscal crisis and the banking crisis are closely linked: coordination and rules on budgetary discipline must be added with convincing political support for the European supervision and regulation of banks.

[18] This is quite a substantial difference compared with the American system, where the FED faces the Congress and, if necessary, the Treasury Department as its political counterparts, both of which are able to work at federal level, and are highly expansive when necessary.

[19] For an overall appraisal of the new instruments of European economic governance, see Rossolillo, 2014, p. 325 ff.; S. Rossi, 2014, p. 11 f.; European Council, 2012; Boitani, 2012, p. 99 ff.; Bordignon, 2012, p. 139 ff.; Marzinotto, Sapir, Wolff, 2011; Manasse, 2007.

[20] According to Draghi, 2012, although a full federation between European States is not indispensable, in the long term it will be necessary to proceed gradually and achieve four pillars: financial union, fiscal union, economic union, and political union.