The ECB and the Crises of the Eurozone

Reply to the workshop questions by Mathis Heinrich

What has changed since the global financial crisis in 2007/08 and why is this the case?

The European Central Bank (ECB) used to be a porotype of a politically, personally and financially independent institution with a strong ordo-liberal mandate. It duties were primarily focused on monetary stability, while others aspects such as financial issues and economic policies have been excluded. This has incrementally changed with the current crisis of the Eurozone since 2007/2008. In reaction to this crisis, the ECB has not only applied several unconventional measures to stabilize the European economy, but also expanded it competencies into policy fields that go far beyond formal guidelines laid out in the treaties of the European Monetary Union (EMU) (Bieling and Heinrich 2015):

- *First*, the ECB applied a much looser and expansionary monetary policy combined with a stronger consideration of business cycle policies. In reaction to ongoing troubles on European financial system since 2008, it moved towards an active liquidity management of banks and fully protected European credit markets from drying out. By lowering the key interest below 1%, purchasing covered bonds (CBPP I-III), extending long-term refinancing options and providing emergency liquidity assistance, the ECB injected large amounts of additional money into European interbank and private financial markets. In addition, the latest "Expanded Asset Purchase Program" (EAPP) – by which it purchases (at least) €1,1 trillion of asset-backed securities and bonds until September 2016 – also functions to expand the money supply in the Eurozone in order to combat deflationary tendencies and facilitate economic growth.
- *Secondly*, the ECB now seems to have accepted its role as a "lender of last resort" (LLR), not only for European banks (as shown above) but also for sovereign European member states. Since the outbreak of the euro crisis in 2010, it became increasingly active to support and guarantee the liquidity of highly indebted deficit countries via special programs of buying and selling government bonds, such as the "Securities Markets Program" (2010-2012) and the "Outright Monetary Transactions Program" (since 2012). These programs are strongly connected to new mechanisms of financial assistance in the "European Financial Stability Facility" (EFSF) and "European Stability Mechanism" (ESM). Here, the ECB became heavily involved into negotiations and the control of "Structural Adjustments Programs" (SAP) being imposed on indebted member states as a conditionality to receive financial assistance. In fact, as part of the so called "Troika" (European commission, ECB and IMF), the ECB now indirectly intervenes into sensitive domestic realms of social, economic and labor market policies in the Eurozone.
- And *thirdly*, the ECB has been assigned several new tasks to secure the long-term financial stability of the European banking system and the solvency of major European banks – also in order to reduce the costs for public households in the event of new financial cri-

sis emerging in the future. With the gradual introduction of the Banking Union, the central bank now officially took the lead in the common supervision of major European banks, and with the beginning of 2016 will also become responsible for the recapitalization and restructuring of those credit institutions that run into financial trouble. As such, the ECB did not only receive major new competences in order to access information and to get insights into budgets and risk models of European banks (e.g. via stress tests), but it will also be allowed to regulate certain banking activities in order to minimize systemic risks and to insure deposits of customers in times of financial trouble.

So, while an active liquidity management of banks and ongoing interventions into financial markets reflect a substantial adjustment of former monetary policy aims of the central bank, it is especially the new competences in securing financial stability (e.g. in the Banking Union) and the engagement into the enforcement of structural policies (e.g. in the Troika) that now turn the ECB into one of the most powerful institutions in European governance.

In general, the causes for this transformation of European central banking can be seen in the development of recent economic, political and social dynamics in the Eurozone itself. During the last decades, a new formation of European financial-market driven capitalism emerged and with it new dominant social and economic forces became more powerful and structurally relevant for the stability and growth of the European economy, such as institutional investors, mega banks, consulting industries, and monetary market funds. Apparently, this new transnational capitalist formation also has a major impact on the conditions and strategies of European central banking (Dyson, Featherstone, and Michalopoulos 1998). In fact, what we can observe today is that the ECB mainly reacts to recurring crises and political economic challenges of new European dynamics of financial-market driven accumulation in order to stabiles and encourage their functioning in the Eurozone.

First of all, the functioning of this finance-dominated European capitalism implies that the ECB cannot only focus on inflation and price stability anymore, but has to take the development of asset prices and securities on financial markets into account as well. Due to an increasing financialization of social and economic relations, new financial instruments (most prominently CDOs and CDSs) emerged on private money and bond markets (especially on repo markets), which are increasingly used to increase leverage ratios and funding capacities for financial agents (Mügge 2011). As such, these instruments do not only serve as a major source of income for money market funds and financial investors, but also became an important opportunity to produce economic growth via financialized credit-driven accumulation strategies. Hence, with the danger of an increasing devaluation of assets and collaterals underlying those instruments – as it happened during the financial crisis 2008ff – the stability of European money markets and economic growth models has been put at risk (Gabor 2012). The ECB reacted to this threat with an expansionary monetary policy and extensive programs of purchasing bonds and securities on (secondary) financial markets, by which it tries to stop the deflation of assets prices and collaterals underlying new financial instruments in Europe – to the pleasure of (shadow) banks and investors, which are heavily involved into money market activities on European repo markets.

In addition, the expansion of competences of the ECB in the field of financial stability and structural reforms is mainly due to the flawed design of EMU governance not being able to balance disperse dynamics of finance-dominated capitalism in Europe. For decades, (negative) economic integration has been pushed by European elites and experts, while (positive) political integration beyond monetary policy issues remains weak until today (Bieling and Deppe 2003). As a result, deep economic imbalances developed and have not been restricted by any kind of efficient regulation on EU-level yet. European credit relations became increasingly transnationalized, whereas especially big banks from the center serve as the creditor of economic and public authorities in the European periphery (Becker and Jäger 2010).

The systemic risks of this flawed design became exposed with the banking crisis in 2008 for the first time, when banks ran into serious problems to refinance their credit activities. In reaction to these problems, the ECB has been forced to serve as the LLR for European banks in order to secure the functioning of (disperse) European financial system; and with the establishment of the Banking Union it has also been put in the leading position to supervise and restructure risky banking activities in order to guarantee the solvency of Europe`s biggest banks in the future (Le Maux and Scialom 2012). In 2010, the fragmentation of EMU governance became apparent again, when, this time, deficit countries ran into problems to refinance their debts. And once again, due to a lacking alternative, the ECB did not have any other choice than to buy governments bonds on secondary markets and to guarantee an unlimited supply of credits to indebted European member states, if it wanted to prevent the EMU from failure (Schelkle 2012). In the absence of a single crisis management procedure and permanent transfer mechanisms (e.g. euro bonds), the ECB stepped in to close the gap in EMU governance. As such, it orchestrated itself as the major savior of the Eurozone, and even started to act as its government of last resort: today, the central bank is not only involved into negotiations over SAPs, but has actively pushed for the enforcement of further structural reforms in European member states in a time when leading member states and other European political elites were still debating about their responsibilities and the overall meaning of the crisis (Heinrich 2015).

Which have been the actual consequences of this change?

The most obvious change of the described transformation the ECB and its power in European governance is an increasing politicization of its policies. This politicization does not only include a greater visibility of the ECB in the media, but it includes a growing questioning of its crisis management programs (Velthuis 2015). Here, the criticism of the ECB ranges from an ordo-liberal opposition to its new expansionary monetary policies – most prominently from the German Bundesbank – over the rejection of stricter regulations by European banks and investors, and culminates in the resistance of member states (e.g. Greece) and protest alliances (e.g. Blockupy) against the austerity measures and structural reforms enforced by the "Troika" (Risager 2015; Krampf 2014). All of these protests are addressed at the ECB, but actually seem to center around different subjects and policies of its authority. In the press as well as in the academic literature, it is not always clear what different agents and actors actually criticize about the ECB and its transformation: is it the (undemocratic) constitution of the central bank, the orientation of its actual crisis management measures or its alliances with certain economic actors, political agents and experts?

Here, it is helpful to distinguish between different forms of politicization in order to fully understand the consequences that the transformation of the ECB may have. The critical political science literature distinguishes three different modes of politicization, which are seen as different mechanism in relation to the constitution of the polity (institutional setting), the political process (actors and practices of power) and the actual policies being implemented (modes of intervention). In this perspective, politicization either described a reconfiguration of institutions and institutional forms of in- and exclusion (*politization*), shifting stakes and sides of strategic-political practices and power (*politicalization*), and/or a more prominent articulation and increasing legitimation of certain issues of policy making over others *(politicization*) (Jessop 2014). Applying this perspective to the ECB, different modes of politicization can be actually observed in different policy areas of the central bank – i.e. concerning the transformation of monetary policies, financial stability and structural reforms:

- First, in the field of financial stability and banking regulation policies, the ECB is able to significantly extend its authority due to its leading role in emerging new institutions of European governance. These institutions – such as the European Financial Supervision Authorities (ESMA, EPA and EIOPA) and the Mechanisms of the Banking Union – now serve as new reference point for the re-regulation and supervision of European financial markets and banks. After decades of exclusive financial deregulation, a *(re-) politization of finance* is taking place, which actually confronts the financial industry with previously non-existing and unfamiliar waves of financial reforms and regulation. As such, these reforms do not only mark a significant reorientation of policy making in the EU, but provoke a significant amount of resistance from the financial industry and powerful member states. National authorities from European surplus and deeply financialized countries are opposing further steps of supranationalization in this area, because they are either unwilling to co-finance ailing banks in deficits countries and/or fear to lose their authority to privilege their own financial institutions in European competition.
- Secondly, in the field of structural reforms, a clear shift of power from nation states to the European level is taking place, including the ECB. Central bankers seem to use the crisis to expand their control over all kinds of key economic areas of policy making, that actually go far beyond typically spheres of central banking. Especially with the introduction of the European stability mechanism and the "Troika", the ECB now has an important influence on the enforcement all kinds of structural reforms that aim to push the liberalization, privatization and flexibilization of product, service and financial markets, network industries, wage-regimes as well as tax and welfare systems in European member states. Here, a major *politicalization of economic governance* is taking place, which primarily serves to enhance the competitiveness of big and exporting European industrial corporations. This policy is based on well-established alliances among national and transnational European economic, political and intellectual elites. Accordingly, non-elitist and radical protest movements as well as far-left and far-right politicians and govern-

ments seem to be the only forces, that actually question those new powers of a democratically non-legitimised institution in key areas of national sovereignty.

- And finally, in the field of monetary policies, the interventions and programmes of the ECB refer to a new route of loose monetary policies in Europe, which would have been conceived absolutely inappropriate before the crisis – institutionally as well as politically. Here, the ECB finally accept its role as a lender of last resort for European banks in order to defend the functioning of the European Monetary Union by all necessary means. In addition, it gave up parts of its independence from the banking and financial industry, since it started to act as a market maker of last resort as well (Bibow 2013). As such, a *politicization of monetary policy* takes place at the European level that aims to combat deflationary tendencies and to maintain the current monetary order of (private) credit-led accumulation in Europe. It functions to sustain unequal debt relations by preventing a devaluation of debt and/or the default of systemic-relevant burrowers. However, especially those member states that generate big surpluses and do not have a strong tradition in financial accumulation (e.g. Germany) increasingly question this new expansionary route in European central banking, because their growth model are much more based on the necessity to maintain monetary price stability.

In sum, the transformation of the ECB is very much in line with an ongoing trend of technocratization and an expansion of European supranational authorities, thus promotes an increasing politicization of its institutions (in the area of financial stability), policies (in the area of monetary interventions) and politics (in the area of structural reforms). This politicization makes it rather unlikely that a new and strong European consensus in central banking is emerging from the crisis. We clearly see an initial move away from the old so called Brussels-Frankfurt Consensus, which was mainly focused on monetary price stability combined with fiscal policy reluctance and labor market flexibilization (De Grauwe 2006). However, a substantial break with core priorities of EMU governance has not (yet) taken place: the enforcement of neoliberal structural policies and fiscal discipline has been even strengthened with the crisis, while the ECB still sticks to its target of 2% inflation – at least discursively (Gabor 2014). What we can observe instead, seems to be a persistent transformation of ECB policies towards Anglo-American priorities of central banking. This includes a more pragmatic orientation of monetary policies – in particular in times of crisis –, a closer interaction with European banks as well a growing orientation towards issues and concerns on financial markets. As such, a new *Brussels-Frankfurt Consensus Plus* is emerging, which clearly contributes to a stronger re-production of financial-market driven accumulation and neoliberal modes of governance in the EMU – in all their contradictions and weaknesses.

Did other possibilities exist in or for the ECB and why haven't they been realized?

Assuming that there is an initial move towards a more Anglo-American version of the old Brussels-Frankfurt Consensus in European central banking, in principle the ECB could have also stayed with the old consensus or fully apply an Anglo-American version of it. However, holding on to its old priorities in a rigid way would have put the functioning and even the existence of the entire EMU at risk. The ECB was urged to step in as the “firefighter” and to approach the most urgent issues of the crisis, since there was no other institution willing to close the alarming gaps in EMU governance. In contrast, a full Anglo-American approach of central banking would have caused much bigger resistance by structurally dominant surplus countries and the European banking industry: on the one hand, because US standards in banking regulation appear to be much stricter than in the EU; and on the other hand, because permanently loose monetary policies and a closer proximity to financial players would incrementally undermine the independence of the ECB, since its autonomy is based on the compromise that the central bank must concentrate on monetary issues of price stability primarily. This latter point is also the reason why the ECB formally and discursively still holds on to its stability bias in public communications, because it does not want to jeopardize its legitimation bias in European governance (Fontan 2014).

However, structural and functional explanations of the transformation of the ECB can only give a first impression about why other possibilities and alternative developments have been disqualified. What seems to be missing in order to fully understand the driving forces of the particular change in European central banking is an analysis of the actual agency and practice of the ECB. There are strong indications that European central bankers themselves are using the crisis to push for an extension of their competences and an expansion of their authority (Krampf 2014). As such, the transformation of the ECB should not only be regarded as an expression of functional requirements and structural powers, but perceived as a particular strategy set out by the ECB as an autonomous actor in EMU governance.

In this regard, the ECB seems to be a unique actor as it is one of the most independent central banks in the world. However, this autonomy is not only restricted by European governance procedures, discourses and economic structures, but by an interactive embeddedness of the central bank into specific social networks of communication and coordination. European central bankers are rapidly interacting with different private agents and non-state actors in different academic circles, international financial summits (G20), central banking forums (e.g. of the Bank of International Settlements) and European expert committees (e.g. Liikanen group). All of these social coordinative interactions have an important impact on the strategies, priorities and practices of European central banking (Germain 2000). Since these interactions, however, have not been fully examined in the academic literature yet, it is an important task to carry out an agency- and network-based analysis of the transformation of the ECB in future research. This will also help to fully understand the reasons and scenarios of the future development of central banking in Europe.

Which scenarios are possible and shall emerge, and with which consequences for the next 10-15 years, and what are the conditions for the realization of such trends?

Very recent debates about whether the US Federal Reserve may soon turn away from loose monetary policies and return to higher interest rates, already give an indication about key difficulties in central banking that will most likely determine the discussion in the following years. As such, the question how to manage the exit from expansionary monetary policies will play an important role in speculations about the future development and scenarios of European central banking. These debates will circle around the costs and benefits of a continuation of loose monetary policies of the ECB and other world leading central banks.

On the one hand, expansionary monetary policies seem to be a good strategy to gradually devaluate assets and securities which have not been devaluated during the crisis due to huge rescue plans of European governments (Krumbein 2014). This could lead the way to new dynamics of productive and financialized accumulation and growth. On the other hand, however, the concrete way in which the ECB tries to combat deflation – negative interest rates for banks, and extensive purchasing programs of asset-backed securities and bonds – does actually not have a positive effect on productive investments and the real economy yet. Rather, capital is more and more redirected into speculative financial assets, instead of being placed into classical banking deposits or the production process. And the ECB seems to become increasingly aware of the risks that come along with this development, namely yet another overheating of prices on financial markets. In addition, loose monetary policies also increase the risk for competitive currencies devaluations, with all their negative effects on global demand, growth and employment rates. Both issues – currency wars and yet another cycle of financial boom and bust – make it very unlikely that the ECB will continue to inject fresh money into the European markets forever. Hence, in the medium term, a slow withdrawal from crisis pragmatism in monetary policy issues, including a slow return to a moderate enforcement of prices stability, is the most probable scenario from my opinion. But, if this return to higher interest rates and more restrictive market policies will actually work smoothly, is yet another question.

In the matter of financial stability and structural reform policies, however, I actually think that the ECB will continue to increase its power and try to establish itself as one of the most powerful institutions in EMU governance. This is very probable, because in these policy fields the ECB strongly relies on an old and established consensus among European elites in EU politics. This consensus aims to support the development and economic success of transnational European capital via economic liberalization and regulative flexibilization. In this context, the unification of risk models and business cycles as well as the coming restructuring (i.e. monopolization) of European banks as part of the mechanisms of the Banking Union foster the development of more powerful and transnationally integrated European mega banks. Moreover, institutionalized activities of the ECB as LLR will strengthen the position of those banks in global competition, while stronger coordinative interactions with the financial industry also strengthen their impact on European governance. In addition, it is also very likely that the ECB will continue to join forces with the European Commission and the IMF in order to further enforce structural reforms of labor market flexibilization, welfare cuts and privatizations in European member states. Under the guise of the above mentioned European consensus, austerity and fiscal discipline actually aim to enhance the competitiveness of transitional European business and industrial conglomerates – an elite consensus which is as old as the European Union itself and therefore will very likely remain beyond the state of emergency of the current crises in the Eurozone.

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