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Policy-Maker of Last Resort? Drivers of Discretion at the European Central Bank

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Abstract

Under what conditions does the ECB become the policy-maker of last resort? This article surveys five incidences in which the ECB created its own rules or exercised discretion beyond the effective control of political principals. ECB rule-making took place where the Bank had an initial legal mandate to be present in the policy space, where it could exploit unique institutional interfaces with the banking community and Economic and Monetary Union system, where it had advantages in expertise and information, and where the Council either fully supported the ECB to design new powers, or was divided on whether to retrench ECB freedom. The article examines discretion in macroeconomic policy instruments, capital requirements for banks, including choices that have industrial policy (targeted sectoral) effects, the design of the digital euro, and ECB efforts to force the migration of UK-based financial services to the EU.

Keywords

bank supervision; ECB; industrial policy; macroeconomic policy; microeconomic management

1. Introduction

Does legislative inaction and undersupply of economic goods in the EU drive the ECB to become the policy-maker of last resort? One of the perennial problems of EU politics is the low level of collective public financing for European policies, even when a crisis threatens the core goals of EU member states (Spielberger, 2023). The undersupply of capital on the one hand and ECB initiatives on the other to steer the money supply to meet public policy goals affect the capacity of member state governments to access capital markets. ECB decisions also affect the capacity of the private sector to finance a wide variety of EU-supported industrial policy programs. To supplement public funds for industrial policy ends, Commission proposals frequently seek to leverage private investment. Given the modest reliance of European companies on the stock market, bond market, and private equity funding compared to the US and UK (Braun et al., 2018; Piroska & Epstein, 2023), this means a high reliance on bank loans that are affected by ECB bank supervision. In addition, the ECB is central to initiatives to boost domestic economic resources by requiring financial services for the European economy to migrate from the UK to the EU, and introduce a crypto-based digital euro. These instances place pressure on or create room for the ECB to take initiatives in affecting the supply of capital under conditions of scarcity. How much of this initiative is independent of EU institutions and member states?

The ECB's competencies are in two complementary areas: macroeconomic management directed at financing for national governments and balances between national central banks, and microeconomic bank supervision affecting credit creation. Prudential supervision is one area where the ECB directly applies EU regulations on the desirability of loans banks make, the capital they need to set aside for risk management, and their ability to securitize these loans by selling them, and the risk they carry, to institutional investors. These decisions weigh heavily on the supply of private capital for special EU headline projects that fall into the category of industrial policy, as well as day-to-day and cyclical macroeconomic smoothing. From recent research, we know that the ECB has the discretion to calibrate lending rules for banks in ways that encourage countercyclical lending without being able to enforce it. We also know that ECB guidelines on capital requirements factor in the political desirability of banks holding corporate bonds devoted to climate control investments. However, we lack a more comprehensive overview of how much ECB autonomy exists, or under what conditions. This article undertakes a review across a series of initiatives to uncover how much initiative the ECB takes, in what areas, and under what conditions.

2. Explaining and Exploring ECB Discretion

As a powerful, authoritative, and politically independent EU institution, the ECB acts within treaty law (Treaty on the Functioning of the European Union), and secondary legislation relating to the Banking Union (Capital Requirements Directive and Regulations and Single Supervisory Mechanism). While interest rates are a key tool for promoting or deterring credit creation and fulfilling its mission to ensure price stability, decisions about capital requirements for bank lending are another important tool over which the ECB has some discretion. These decisions as bank supervisors influence the cost of loans that banks make to businesses and households, allowing them to steer the flow of capital into chosen industries and activities, such as green investment. In addition to discretion based on capital requirements, the ECB has also acted as the architect of a crypto-based digital euro, once EU authorities gave it the green light to proceed. However, its influence proved limited when it championed changes to EU rules on UK–EU financial services and failed in 2024. How independent is the ECB from political authorities, and under what conditions? While the ECB is independent in monetary policy, the Treaty on the Functioning of the European Union also required it to consider general economic policy as set by European institutions, which include the European Commission and the Council of the EU. Given the gradual extension of accountability norms in inter-institutional politics (Akbik, 2022; Högenauer, 2023; Maricut-Akbik, 2020; Markakis & Fromage, 2023), this constellation of EU institutions includes the European Parliament. The puzzle before us is to map and explain when the ECB exercises independence and discretion from political principals, and where the limits of those actions lie.

Starting with a principal-agent approach, this article works from the premise that the ECB expands on its original mandate and competencies over time to the extent that political principals allow it. Superior information, expertise, and institutional capacity vis a vis the Commission, Council, and Parliament (Pollack, 2002), coupled with functional and political demands for increased credit at the macro and micro levels create incentives to expand its footprint on public policy, particularly regarding the unfulfilled supply of finance. Demand and supply lead it to overstep its ex-ante mission and terms of establishment (Calvert et al., 1989). Redirection, starting with ex-post controls that notify political principals of drift and allow them to reassert control (McCubbins & Schwartz, 1984), is weak when principals are divided, or when they condone the acquisition of new powers. While division across political principals can inhibit them from realizing checks and balances against agents, an alternative explanation for ECB empowerment is that political principals remain relaxed about agent activity for the reasons of efficiency, expertise, and policy fulfilment that led them to establish agent powers in the first place. In such a case, both agent and principals evolve their goals in parallel without legalizing the change.

This article views political principals in the Council through an intergovernmentalist lens that treats the degree of conflict, deadlock, or unity as a key factor influencing agent control and powers. While governments may agree on delegation within pre-set limits in line with liberal intergovernmentalist expectations, division over priorities, may inhibit agreement on and recalibration of terms for the agent, including ex-post controls, as advocacy coalitions produce deadlock (Donnelly, 2018; Quaglia, 2023) and national governments permit unintended uses of original powers. The first scenario applies to macroeconomic policy, while the second applies to bank supervision practice to meet new challenges, in this case, the demand to increase the supply of capital, with industrial policy effects.

Political and operational independence of the ECB, therefore, depends on an interpretable legal mandate for the ECB that it can claim (creating room for agency discretion to innovate), legal support from the Court of Justice to exercise such powers when contested, and weak unity of member states in the Council over policy priorities and mandate. The ECB should have more leeway when policy requires technical expertise, certainty about responses, and access to privileged information that political principals lack. Principals may reshape mandates if they use ex-post controls that notify them of drift and unite to reassert control and strict adherence to their original mandate.

Unless ex-ante controls are very strong, these conditions favour considerable ECB discretion. Legal competence is strong and independence high for both macroeconomic policy, which focuses on managing periodic crises and smoothing economic activity over time, and bank supervision, which influences the flow of credit into the economy, sometimes in a targeted fashion. Court support in macroeconomic policy is supplemented by a permissive stance of the political principals to pursue industrial policy, including green bonds, pandemic relief, and the digital euro. Both the Council and Commission compare unfavourably to the stronger policy expertise of the ECB regarding strategy, the use of policy tools related to capital requirements, and the behaviour of banks and the financial markets they rely on. This means that the ECB knows more and can parse out the impact of rule changes better than national representatives in the Council. The same is true for the European Parliament, but to a lesser degree, given its practice of commissioning expert reports on technical matters and strategy.

The ECB's additional role as a single supervisor for the EU's banking system has effectively created incentives and discretion to manage critical components of microeconomic policy in addition to its original macroeconomic roles, with a supportive political structure, giving it further opportunities to manage the economy through its treatment of how banks lend money, including more generous loans to finance EU policy goals (Quaglia & Verdun, 2023a), including energy, health, defence, housing, and semiconductor development. This desire to attract and funnel investment into the European economy comes on top of pre-existing demands for the ECB to manage the EU's financial system, particularly lending by banks so that periodic economic crises can be managed safely and economic activity smoothed over time. This makes the European Commission in particular a willing collaborator of ECB proposals and activity in this field. At times the European Parliament has been a supportive force in giving cover to ECB initiatives that calibrate rules touching the environment (Massoc, 2024).

Finally, individual personnel changes may also be decisive in determining and stabilizing changes in the ECB's role in managing financial markets. Presidents like Jean-Claude Trichet and Mario Draghi had opposed notions of ECB roles and responsibilities regarding macroeconomic management, for example (Pierret & Howarth, 2023), while Christine Lagarde introduced new ideas of microeconomic management and industrial policy that should be examined.

Sorting these factors into drivers of high (H1), low (H2), and medium (H3) deviation from the Maastricht model of the ECB, we can set out the following categories of delegation and discretion:

H1. ECB as trustee (macroeconomic policy):

- Asymmetric information, institutional expertise, and institutional toolkit;
- Legal foundation to act and pathways to mission growth;
- Strong functional demand for ECB-regulated resources (finance);
- Division or support of political principals;
- Personnel changes (assertiveness, goals, and strategy).

H2. ECB as a constrained agent (active accounts):

- Consensus of political principals willing to enforce views;
- Strong ex-ante and ex-post control mechanisms.

H3. ECB as front-line interpreter or architect (capital requirements, green bonds, and digital euro):

- Asymmetric information, institutional expertise, and institutional toolkit;
- Legal foundation to act and pathways to mission growth;
- Strong functional demand for ECB-regulated resources (finance);
- Support of political principals.

The Duisenberg and Trichet presidencies of the ECB fit the low use of discretion and agency drift from the Maastricht model. Policy since 2012 under the Draghi presidency largely follows high discretion but remains anchored in long-term policy objectives derived from the Maastricht Treaty (low inflation). The Lagarde presidency briefly returned to the Maastricht model before market turmoil pushed it back to continuing high discretion. This continued the trend that ensuring financial and economic stability in the absence of further measures by the EU keeps the ECB in the zone of heightened agency and discretion for the foreseeable future.

To test the degree of discretion and initiative in rulemaking and application, Section 3 examines the actions of the ECB, the European Commission, and the Council of the EU in five different areas: (a) The (established) balance of payments system between national central banks to cover trade surpluses and deficits between member states, (b) relaxed capital requirement rules during the Covid-19 crisis, (c) relaxed capital requirements for loans and bonds under the European Green Deal scheme, (d) ECB leadership in designing a digital euro for use on crypto platforms, (e) and ECB advocacy of rules compelling UK-based financial services offered to European companies to be domiciled in the EU. To structure the analysis, the article outlines what each initiative is and what its impact on growth/employment/industrial policy targeted; what the legal frameworks for them are, if any; whether the Commission, Council, and Parliament have positions, what they are, and whether they are aligned or conflictual; how much the ECB has done on its own; and the outcome.

3. Cases

3.1. ECB Missions, Tools, and Discretion on Macroeconomic Policy

As the central bank for the eurozone, the ECB manages the supply of credit to the public and private sectors (interest rates, monetary transactions, and quantitative easing). The Bank considers the impact of its decisions on economic activity (aggregate demand), given the performance of national fiscal policies, which in turn are influenced by the EU's fiscal and structural policy framework: the European Semester, the fiscal compact, and the macroeconomic imbalances procedure. As with any central bank, the ECB will raise or lower interest rates to influence aggregate demand given consumer spending, business investment, government consumption, and the inflation rate. Standard macroeconomic management using interest rates focuses on smoothing economic cycles. Actions to serve as lender of last resort during crises, while standard for central banks, were not foreseen in the ECB's original mandate.

While the Maastricht Treaty's mandate focused on ensuring low inflation, the ECB pivoted in 2012 to focus on preventing deflation and eurozone fragmentation, without the full consent of the Council against the original intent of the Treaty on the Functioning of the European Union's framers, as expressed in the 1995 Stability and Growth Pact. The further absence of EU-level fiscal resources to manage macroeconomic shocks and prevent deflation through public stimulus led the ECB to compensate. The unilateral decision to extend the definition of price stability to cover both upward and downward price shifts put a floor under austerity for hard-hit economies, ensured sovereign access to international bond markets for governments facing investor strikes, and kept the eurozone together. It ultimately accomplished this by claiming the right to finance eurozone member states directly, and expanding its toolkit of liquidity instruments in ways originally unintended (Hodson, 2013). However, member state criticism was too isolated to mount any challenge to the ECB from its political principals. Once inflation returned in 2022, the ECB returned to its original mandate as the framers had intended, without being forced (Tuori, 2024).

Overall, the ECB walked the tightrope between accountability and independence in macroeconomic management and lender of last resort capacity by defending its right to interpret its mission as it sees fit, but also engaging in transparency (of monetary policy goals and decisions), engagement (discussions about priorities and performance with the European Parliament), and advocacy (to EU institutions and the member states), as well as defending its positions at the Court of Justice of the EU if required. The Court proved key to legitimizing the ECB's policy innovations under conditions of economic emergency (Chang, 2019), and fending off demands that it adhere strictly to its original mandate and restrictions.

3.2. Economic and Monetary Union: Balance of Payments System (Target2)

Beyond monetary policy, the ECB is also responsible for managing the balance of payments between national central banks, which ensures that exporting eurozone countries with current account surpluses are paid by net importers with current account deficits, allowing single-market trading to take place smoothly. The stability of the eurosystem requires government access to credit markets at payable interest rates. In the absence of a centralized fiscal capacity, national governments within the eurozone experience a cliff-edge effect if payments required for imports and outward financial transfers are not covered by incoming payments or new borrowing. These effects can be seen in the period of the eurozone crisis between 2011 and 2013 which made it impossible for most southern European countries to access credit at payable interest rates to cover imports. Part of this need for capital was provided by the ECB acting as a lender of last resort to national treasuries in financial distress. However, the ECB was also central in building up a system of day-to-day transfers and balances to make the eurozone work during normal times: the Target2 system.

The Target2 system was devised as a payment system to manage transfers between central banks, and to smooth payments by setting up accounts between them. The Maastricht Treaty explicitly forbade fiscal transfers between member states, which also implied that payment balances would have to be transferred regularly, but did not regulate the technical features of how the ECB would regulate the flow of payments between countries, leaving the issue open to ECB discretion. The ECB filled the gap to manage "temporary" payment imbalances and then made the system permanent, centralized, and a central piece of infrastructure able to smooth the economic flows between countries over time (Murau & Giordano, 2023). The outcome was a smooth, automatized system of payment netting and accounting that keeps the eurosystem running and financially stable. In doing so, the ECB acted to establish normal central bank infrastructure where it had been absent in the Economic and Monetary Union's original design. The alternative would not only have been trade limits on countries with balance of payments deficits (insufficient funds), located primarily in Southern and Eastern Europe but also surplus countries in North and Northwestern Europe that export to those countries. The internal market would have ground to a halt for both sides, in addition to a cliff edge effect in financial flows, cutting national economies off from credit.

These two situations indicate that the ECB can exercise significant discretion in level 2 rules (rules that implement EU legislation) and regulations that can point to a specific EU context or a functional necessity of exercising its responsibilities for managing the single currency and its payment systems. While not intended, the Council has not raised serious objections that would have reversed these decisions. The German central bank remains the sole critic of these innovations, plus assorted economic nationalist experts within the country.

3.3. Covid-19 Credit: Small and Medium-Sized Enterprises, Households, and Asset Bubbles

In 2014, the ECB acquired the additional role of chief supervisor for eurozone banks, within a legal framework designed to constrain risky lending and asset holdings. However, in 2020, the ECB, with the support of the Council and Commission, relaxed capital requirements at the beginning of the Covid-19 pandemic for macroeconomic and targeted industrial policy purposes. Capital requirements can be set to do things that interest rates cannot: encourage, discourage, or steer credit creation that supports policy objectives such as loans to help green the economy, build health care facilities, and fund defence production or digital infrastructure. They can also be used to boost aggregate economic demand through private credit creation where fiscal stimulus is insufficient to compensate for negative external shocks.

Where the ECB deems loans and bonds for specific purposes to be low risk, it encourages banks to steer loans in this direction by making the loans cheaper, allowing banks to set aside less capital to cover default risk. While it could be argued that such determinations amplify risk by allowing banks to make risky loans without holding sufficient reserves, this is largely at the firm level. At the industry level, public-sector decisions to increase demand for the products and services generated by the increased volume of loans are hoped to reduce the overall risk of default. Whether driven directly by government consumption, or by private investment attracted by tax incentives, banks have plausible reasons for portraying loans as low risk in an environment where fiscal policy is creating demand.

Since 2020, both external shocks and endogenous demands (policy priorities of EU institutions and the member states) put the ECB at the centre of decisions over how banks create credit to meet pressing challenges in the absence of cross-border transfers typical of a multilateral fiscal capacity. Legal discretion combined with political backing existed for the ECB to relax regulations on banks so that they would increase the supply of credit in the economy during the Covid-19 pandemic, for example, allowing the ECB capacity to decide independently to grow, based on trust, competence, and expertise (Donnelly, 2023a; Heldt et al., 2024; Quaglia & Verdun, 2023b). This extension from macroeconomic policy to microeconomic decision-making in the context of the ECB's role as a single supervisor of the single market's Banking Union is a fundamental shift in the bank's powers, responsibilities, and discretions in the post-Maastricht era (Tuori, 2023).

The Covid-19 pandemic created a negative economic shock for the entire world, as well as the euro area. As in the previous crisis, the European Commission and the Council agreed on the necessity of relaxing fiscal rules to allow increased government stimulus to support consumption and therefore aggregate demand. In addition, negotiations between those two bodies led to a mandate for the ECB as well to support credit creation, particularly for small and medium-sized enterprises (Quaglia & Verdun, 2023b). While this objective did not constitute a hard legal obligation for national governments providing state aid or for the ECB, it reflected a hope that employment could be stabilized to the greatest extent possible through the extension of loans from banks as well as support payments from government coffers.

The ECB as head of the Single Supervisory Mechanism assumed responsibility for calibrating the rules that banks would have to follow when extending loans under the Capital Requirements Directive and the Capital Requirements Regulation. The political cover had already been extended by the Commission and council for the ECB to make it cheaper and easier to extend loans while expressing a hope that these loans would be directed towards small and medium-sized businesses. In practice however, the ECB preferred that banks extend loans to "safe" borrowers rather than businesses without collateral, and warned that it would return to strict conditions on bank loans once the pandemic had passed. This meant lending to households and businesses purchasing real estate that could be repossessed in case of non-payment while keeping the bank financially solvent. Loans were primarily used to buy bigger and more expensive houses in which people could live more comfortably during lockdowns and work more easily at home (Donnelly, 2023a).

This is a case in which the ECB exercised significant discretion in the formulation of rules around implementation that also touched on the very goals itself, and supported the economy through the housing sector rather than business. For the ECB, the main point of relaxing reserve requirements was to increase the overall supply of credit to the economy and therefore aggregate demand. As long as credit got money into people's hands and was spent, the Bank was content. Meanwhile, its principal mission as bank supervisor could be seen hovering over its emergency actions, requiring banks to choose housing over companies, or reserve more money to cover loan defaults in line with renewed supervisor stringency. Safety, in terms of micro-prudential regulation and financial stability, was chosen over credit expansion, in contrast with the political directives of the Council and Commission. However, the ECB's actions encountered a permissive consensus. National governments used extraordinary fiscal stimulus for businesses instead of pressuring the ECB further.

3.4. Green Transition: Corporate Credit Treated as Less Risk for Political Purposes

Investment in green technologies, businesses, and a greener economy are political imperatives for the EU through the European Green Deal, which sets out several initiatives requiring reductions in carbon emissions to meet commitments made to the UNFCCC, but also investments in these areas. Given the lack of public funds at the EU and national levels, and to attract investment into businesses greening their processes, technologies, and products, banks are to be incentivized to give loans.

The ECB supports these goals with the incentive of relaxed risk weights, which lower capital requirements, at its own discretion. This means that banks are not held to the same level of scrutiny regarding collateral against the loans that they make and that more attention is placed on the contributions toward the Green Deal's climate control goals that the investments make (Gabor & Braun, 2023). This steering of credit through ECB discretion is effectively industrial policy. The European Green Deal was announced by the Commission in 2020 with the support of the Council, and the ECB's new approach to making it easier to make loans for green investment was made in 2021. Within the bank, new members of the ECB's Governing Council, and the presidency itself, made the policy initiative possible by rejecting arguments that bank supervision of credit creation should be as strict as possible to avoid both inflation and irrationally exuberant lending.

By 2021, the green camp of central bankers in favour of extending the ECB's remit had won (Deyris, 2023). Their primary opponents within the ECB remain the monetary conservatives who also opposed the extension of its mission to include financial stability as well as combating inflation. Likewise, its primary opponents outside the Bank were politicians and voters mobilized by political opposition to climate control goals. However, the ECB faced majority support from national governments (Jabko & Kupzok, 2024). The 2024 European Parliament elections, which saw resistance grow to climate control measures, might have not yet affected private credit provision encouraged by the ECB. This points to continued independence and discretion on how it defines and implements its tasks as banking supervisor and institution in charge of financial stability more broadly.

It should be noted however that this shift in the Bank's position towards green investments does not do away with the need for attention to risk management and collateral, just as was the case for loans extended during the Covid-19 pandemic. This means that although the ECB supports industrial policy through microprudential means, it is not a substitute for fiscal measures (Golka et al., 2024; Kedward et al., 2024).

Using capital requirements instead of fiscal policy (through public investments or tax credits) instead of fiscal policy leaves the banking system exposed to the risk and cost of default, with additional financial stability implications. It also creates future challenges for the ECB's role as monetary authority: As (green) business and economic cycles move up and down over time, the functional necessity will grow for the ECB to balance the impact of its capital reserve policy with its responsibilities for macroeconomic management, particularly economic cycle smoothing (Copley, 2024).

3.5. Crypto Rules: The Digital Euro

Another situation where the ECB attempted and exercised some rulemaking independence was in the case of a digital euro: a central bank digital currency that would be held and used on the blockchain alongside private stablecoins and other digital assets. Both the European Commission and major countries within the Council supported the development of a digital euro and encouraged legislation to make this possible. However, they were uncertain about the form it would take and the speed with which it would be ruled out. The ECB ended up taking much of the initiative for much of the public policy-making process, effectively becoming its architect. It engaged with working groups at the global level with the support of the Bank for International Settlements, and it conducted consultations with banks and various other stakeholders within the EU over the desirability and features that a digital euro could take.

The political environment in which the ECB did this was politicized, but also conducive to proceeding with a digital euro to protect and promote economic development. On the one hand, the Commission and the Council were both very concerned with the possibility of being left behind by a digital revolution and wanted a digital euro to be developed quickly and adopted extensively: not just by financial institutions but by consumers. This was essential in their view to protecting digital sovereignty and monetary authority in the eurozone, which meant offering a crypto-based means of payment superior to private alternatives vulnerable to high volatility and collapse (Westermeier, 2024). On the other, the European Parliament was highly divided with centre-right politicians and anti-system parties on the left and right both opposed to the project. In other words, the political room to generate robust legislation was lacking.

However, banking associations hated the prospect of a digital euro and did their best to stop it. Banks were concerned that once a crypto-based euro became available, their customers would prefer direct accounts at the ECB if it were allowed, putting them out of business. In order to meet these concerns, the ECB agreed to limit digital euro holdings to households only, to a maximum of €3,000 digital, and make banks the main place where households could get them. Corporations would be left outside these new arrangements, which would limit demand. The ECB also had to contend with demands from German politicians, parliamentarians, and consultation respondents, that the digital euro would have to be entirely private. In other words, users would have to have the ability to use digital euros offline, without any possibility for public authorities to gain insight into transactions.

In this situation, we see that the ECB considers political demands that are made on it by the Commission and Council and that the ECB is able to use its unique role as manager of the euro to design the scope, pace, and conditions of the rollout. The concessions made to the banking sector restrict the rollout of a digital euro quite significantly, but they do not stop it. Demands for privacy led the ECB to make the euro available for offline use and difficult to trace. The Bank added that these features even supported strategic autonomy by making the currency resilient against cyberattacks. Given the Bank's expertise, legal responsibilities, and ability to negotiate with various stakeholders on the design of a digital currency we can conclude that it has significant discretion in rule setting and can be considered an architect of the digital euro in a way that the Commission and Council themselves cannot.

However, this case also shows that the ECB works within political limits. In 2024 the Bank announced that it had the legal authority to issue a digital euro even in the absence of legislation of the Council and the Parliament in accordance with its normal capacity to issue and manage money for the eurozone. However, the ECB later in 2024 sought political cover for issuing a digital euro with dedicated legislation. While the Commission and Council remained firmly in favour of advancing the project in late 2024, it remained to be seen whether the European Parliament elected in 2024 would be as accommodating towards a digital euro as the Parliament that preceded it. We see therefore that while ECB discretion is extremely strong in this case it also chooses to respect the need for political principals to set the broader terms of its actions. The ECB assumes the role of the architect but does not cross the rubicon to claim the independent authority to issue a digital euro.

This can be seen as a case of the ECB bowing to the wisdom of respecting not only the letter of the law setting out its powers to issue currency but also the practical utility of accepting some of the claims by political principals, particularly the European Parliament. One should not expect the ECB to retreat from its own conclusions regarding how a digital currency should be formed and under what circumstances it should be launched, given how it held to its convictions in the case of monetary policy when the euro was launched. By allowing ordinary legislation to be passed, it is handing over the baton to its political principals, after which it will likely resume its independent path.

3.6. Active Accounts and Brexit-Related Financial Services

A further case in which the ECB was involved in advocating and drafting rules was in the case of financial services offered from the UK into the European market after Brexit. The European Commission, at the urging of the ECB and the European Securities and Markets Authority, proposed that British financial services companies should transfer assets and personnel from London to the EU to support their activities as fully independent entities rather than branch offices of UK-based headquarters. Without this, the EU's economy would be exposed to critical risks it could not control. The EU would also lack domestic financial resources to support innovation and growth. Particular attention was devoted to the desirability of forcing central counterparties to shift assets, personnel, and infrastructure to the EU in order to continue performing their services for the single market. For this purpose, the ECB could count on the Commission to support its argument that financial stability and monetary sovereignty as well as the performance of emergency monetary policy during crises required those assets to be within the EU and controlled by an EU supervisor (Donnelly, 2023b).

The method by which central counterparties were supposed to migrate activities was the ECB's proposal for an active account for all companies using central counterparty transactions. This meant that as companies and financial services firms used exchange rate swaps, interest rate swaps, futures, options, and ordinary financial transactions the assets of the banks taking part as members of the central counterparty would have to be located in the EU. This pushed against the footdragging by those banks and them keeping their assets either in the UK or in the US: taking orders in the single market, but processing them in the UK (Panetta, 2023).

The ECB also had the support of the European Parliament, which commissioned research on whether these initiatives were necessary. It did not succeed, however. If the ECB had been successful, it would have been responsible for proposing detailed regulations on active accounts and applying them after the legislation had been passed, as well as the fees central counterparties charged for their services, the thresholds for margin calls, and reserve requirements for participating banks. The ECB would be able to move rates up or down as it deemed circumstances required.

After a great deal of lobbying by the Bank of England and by the central counterparty banks located in London, as well as the International Swaps and Derivatives Association, the Commission withdrew its political support for the ECB's plan on active accounts before legislation could be passed. The industry's argument against the ECB being responsible for all of this activity was that it would fragment global counterparty markets, as well as national markets inside the EU, and impose high costs and greater fragility on the central counterparties located within the single market (Tamma & Asgari, 2024).

Divisions within the Council, reflecting competition between the member states over business transferred from London also played a role in undermining legislative unity on the need for active accounts. National governments, including France and Germany, remained unwilling to allow the ECB and the European Securities and Markets Authority to be the primary regulators of central counterparties in the single market. This unwillingness meant that financial supervision would be exposed to regulatory arbitrage and potentially race to the bottom competition between national competent authorities that would unleash financial stability crises further down the road. The importance of central counterparties as critical infrastructure in the financial system especially during crises made this possibility extraordinarily dangerous for the ECB and the EU as a whole. In other words, the ECB could only move forward with its rulemaking proposals and powers down the line to the extent that European legislative bodies were willing to allow that to happen.

The central counterparties case underlines that the ECB requires a legal mandate to be a policy-maker and that a legal mandate requires unity in the Council, even for the Commission to proceed with a winning legislative proposal reflecting ECB advice.

4. Discussion and Conclusions

The mini-cases studied here examine the same set of actors and their roles in the development and implementation of key issues in which the ECB plays a central part. They not only provide insight into whether the ECB has evolved beyond the original Maastricht mandate but in what ways and under what conditions (Table 1).

Beyond the ECB's discretion in interest rates and quantitative easing, this article looked at the ECB's role as lead supervisor in the Single Supervisory Mechanism. Overall, the ECB has demonstrated a willingness to set rules that it sees as necessary and consistent with its mandate as both a central bank and a bank supervisor, with both macroeconomic management and microprudential supervision in mind, including connections between the two.

The findings confirm a significant degree of ECB discretion and rule-maker of last resort in cases where existing EU legislation and policy are insufficient to meet overall macroeconomic goals (as the responsible institution

Table 1. ECB initiative, discretion, and impact by policy area.

Topic	ECB role	ECB resource	Council	Court/law/EU policy	Result
Macro and financial stability: OMT and Target2	Innovator: Supporting macro-economic goals	Expertise and infrastructural power	Divided	The law restricts ECB but has the Court's support	Strong and lasting ECB power growth beyond the original mandate
Capital requirement adjustments: Covid-19	Interpreter (front-line application): Supporting macro-economic goals	Expertise and regulatory power	Council supports tools for business loans, does not claw back ECB discretion when credit redirected	Commission does not question ECB tolerance of implementation for other purposes	Strong and temporary action, partly in line with the original mandate
Green capital requirement	Interpreter (front-line application): Supporting industrial policy goals	Expertise and regulatory power	Supports	The Commission and Parliament support industrial policy programs	Strong and lasting action, in line with the new industrial policy mandate
Digital euro	Architect: Building on behalf of lawmakers	Expertise, regulatory power, and interaction with stakeholders	Supports	The Commission supports strongly and Parliament lukewarmly supports	ECB awaiting legislative approval
Active accounts	Advocate: Supporting financial stability and industrial policy goals	Expertise and regulatory power	Divided	The Commission supports, then opposes after-industry lobbying	Failure

for monetary policy). This growth of ECB competence was the result of the Bank writing its own rules, in contradiction to its original mandate, opposed by some Council members but not a majority, and supported by the Court of Justice. The agent was able to claim new powers and rewrite the rules in the face of an emergency touching the EU as a whole. These new powers reflected traditional central bank competencies that could be developed, and a new central bank president willing to make the changes. In the case of macroeconomic policy, covering outright monetary transactions, Draghi's personal decision to claim emergency powers for the bank, and to defend them in the Court of Justice against adversaries, made a subsequent and lasting shift in the bank's role possible The Draghi revolution that transformed the ECB's role in the euro area would have been unthinkable under the Duisenberg or Trichet presidencies, both of which were far more originalist in hewing to the text of Maastricht and the intent of the Treaty's framers. Trichet's demands on euro area member states to solve their own banking problems rather than assuming a lender-of-last-resort role are well documented and stand in stark contrast to the fuller central bank under Draghi. But the precedent also made it possible for President Lagarde to pivot away from a short-lived originalist position in 2020 (not the ECB's job to keep yields small on sovereign debt) to the normal path that Draghi had made possible. Similarly, the ECB's decision to structure TARGET2 operating procedures so that balances between national systems would remain open indefinitely also took advantage of its exclusive competence as payments manager that critics were powerless to change. This leaves the ECB with the initiative and the Council unable to offer an alternative.

The Bank also has significant powers to innovate where political principals support new ECB powers but lack the expertise to shape its recommendations, interact with stakeholders, and design the instruments required to implement the decisions. As architect of the digital euro, a legislative framework was absent but political principals were largely united in supporting the Bank's ability to design the legislation on their behalf. The complicated rules around retail holdings of digital euros, the impact on banks, and the privacy features were issues that the ECB was singularly able to address and shape competently, precisely because of the interface with the private sector and civil society. This independence could have extended to issuing a digital euro without new implementing legislation, but the Bank decided to refrain from taking a step that might incur political backlash at a later date.

Institutional interfaces between the ECB and banks, coupled with pre-existing legal responsibilities for bank supervision, and broad tolerance by political principals also allowed the Bank to expand credit for industrial policy purposes by targeting specific economic sectors (real estate support as a pandemic response and green finance). The interface the Bank has with financial institutions as the lead institution of the Single Supervisory Mechanism gives it the opportunity to steer credit creation to specific sectors of the economy. By not only loosening credit temporarily but indicating to banks that loans backed by collateral would be viewed more positively in the pandemic, it was able to redirect credit from business to housing loans. By treating green loans favourably, incentives arise for banks to invest in physical infrastructure for the energy transition, which also functions as physical collateral.

Finally, where the Council is unwilling to extend additional powers to the ECB, the Bank finds itself constrained. While the ECB has a mandate for financial stability that gives it the right to become involved in strategy over central counterparties operating from outside the EU, it is powerless in the absence of support from the Council and Commission.

Overall, the patterns show that the ECB indeed is a rule-maker of last resort under specific circumstances and that the principal-agent theory gives us indications of what these are. First, the Bank requires either a legal framework providing it with a baseline of competencies (all cases except the digital euro), or united political support for the ECB to create such a law. Second, the ECB has the most discretion, even against the stated goals of the Council and Commission, where it has institutional interfaces that allow it to leverage its advantages in information, expertise, and contact with stakeholders (particularly banks). Third, divisions between political principals place the Bank at an advantage by removing the possibility of restricting the Bank's initiatives. Fourth, the support of the Court for the Bank's ability to modify rules has been key to defending the Bank's rule-making when challenged by plaintiffs. Finally, the ECB president's willingness to innovate is an essential component of decisions to exercise more discretion.

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Conflict of Interests

The author declares no conflict of interests.

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