The Law and Norms of the European Central Bank as Sovereign Lender of Last Resort: Crystallising Endogenous Authority

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Authority of the European Central Bank (the Bank) over its operational norms in the eyes of market actors – Exogenous and endogenous authority and legitimacy – The reconciliation by the Bank and the Court of Justice of the EU (the Court) of the pre-existing norm and political-economic reality with Article 123 TFEU – Sovereign lender of last resort – Eurozone Crisis – Outright Monetary Transactions (OMT) – Public Sector Purchase Programme (PSPP) – Pandemic Emergency Purchase Programme (PEPP)

Introduction

In a 2015 *EuConst* editorial, the editors captured the post-*Gauweiler* landscape with the observation that 'it seems that so far the [European Central] Bank manages to successfully speak two languages to its different audiences: lawyers and bondholders'.[1] The Bank has likely prevented, at least for now, a sovereign debt crisis resulting from the requirement to place the economies of the Eurozone into a medically induced coma to mitigate the effects of the coronavirus pandemic. The capacity of the Eurozone to withstand this shock to its constitutional framework has been enriched by the fact that the Eurozone enjoys a sovereign lender of last resort if not in original intention, then in accomplished fact. Yet, this significant turn of the screw in the

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[1]ECJ 16 June 2015, Case C-62/14, *Peter Gauweiler and Others* v *Deutscher Bundestag*, ECLI: EU: C:2015:400; 'On Courts of Last Resort and Lenders of Last Resort', 11 *EuConst* (2015) p. 227.

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governance of the Eurozone was achieved absent any meaningful change to the treaties.[2] This simultaneous bilingualism emerged because:

> The Court is satisfied with the current design of the OMT programme, and with the focus of the Bank on the practical limits of the programme, in view of the prohibition of monetary financing. Bondholders, by contrast, are satisfied with the 'whatever it takes' message, combined with the absence of an ex ante quantitative limit to the size of the bond purchases. In fact, the room for manoeuvre which the Court of Justice grants the Bank in Gauweiler will only strengthen the perception of the bondholders that the Bank indeed can and will act as a lender of last resort.[3]

Prior to the judgment, the manner in which the capacity of the Bank to act as sovereign lender of last resort to Eurozone member states was manifested (a press conference and, subsequently, a press release) was legally unsettled and unsettling.[4] But the intervention of the Bank succeeded and the Court itself sent a clear, strong signal to market actors that it would not undermine the sovereign lender of last resort armamentarium appropriated by the Bank to safeguard the euro.[5] Prescient of subsequent empirical testing,[6] the Court did not accept the premise

[2]De Witte notes that there has been one Treaty amendment relevant to Economic and Monetary Union since Lisbon. This was the addition of a third paragraph to Art. 136 TFEU, whereby the Members are authorised to set up a permanent stability mechanism under certain conditions. However, he also points out that the Court pronounced even this Treaty amendment unnecessary in the *Pringle* judgment, where it held that the European Stability Mechanism (the body alluded to in Art. 136(3)) had been lawfully established even before Art. 136(3) entered into force (ECJ 27 November 2012, Case C-370/12, *Thomas Pringle* v *Ireland et al.*, at paras. 184-185): B. De Witte, 'Euro Crisis Responses and the EU Legal Order: Increased Institutional Variation or Constitutional Mutation?', 11 *EuConst* (2015) p. 434.

[3]'On Courts of Last Resort and Lenders of Last Resort', *supra* n. 1, p. 236.

[4]According to former US Treasury Secretary, Timothy Geithener, 'Draghi had not planned to say this, but he was so alarmed by the darkness expressed by hedge funds and bankers at the conference that he ad-libbed an unequivocal commitment to defend Europe': T. Geitherner, *Stress Test: Reflections on Financial Crises*, (Crown/Archetype 2014) p. 7415-7418. For a precis of Geithener's reflections upon the handling of the Eurozone crisis, *see* ⟨www.ft.com/content/5704c0bf-43de-3787-a981-dd1e952f8120⟩, visited 16 February 2021. For the original remarks, *see* ECB (2012), 'Verbatim of the remarks made by Mario Draghi', 26 July 2012, ⟨www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html⟩; ECB (2012), 'Introductory statement to the press conference' (with Q&A), 2 August 2012, ⟨www.ecb.europa.eu/press/pressconf/2012/html/is120802.en.html⟩; ECB (2012), 'Technical features of Outright Monetary Transactions', Press Release, 6 September 2012, ⟨www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html⟩, all visited 16 February 2021.

[5]T. Iversen et al., 'The Eurozone and Political Economic Institutions', 19 *Annual Review of Political Science* (2016) p. 163.

[6]P. De Grauwe et al., 'The EU Debt Crisis: Testing and Revisiting Conventional Legal Doctrine', 51 *International Review of Law and Economics* (2017) p. 29.

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that the spreads in sovereign yields were solely attributable to the economic fundamentals of the member states.[7] Instead, the Court proceeded on the basis of the Bank's diagnosis of a destabilising self-reinforcing disequilibrium.[8] By implication, the Court proved itself attuned to the economic reality that the Bank required authority in the eyes of market actors to quash any doubt and, by extension, any test by the market of its program. Indeed, so successful was the Bank's intervention that the policy of OMT never required formal activation. So clear was the signal of the Court that the *EuConst* editorial went on to predict that the then proposed (third) sovereign bond-buying programme, called the Public Sector Purchase Programme (PSPP), providing for quantitative easing would survive its inevitable legal challenge before the Court, which it did in the 2018 *Weiss* decision.[9]

Together these cleared the way for the announcement of the Bank, on 18 March 2020, of its Pandemic Emergency Purchase Programme (PEPP), in effect a blend of OMT and quantitative easing. It consists of a €750 billion corporate and sovereign bond purchasing programme, and relaxed the self-imposed restrictions on government bonds for the duration of the crisis.[10] Notably, the Bank has suspended its promise to purchase no more than one third of any member's

[7]In the words of the German Federal Constitutional Court: 'According to the European Central Bank, these spreads are partly based on fear – declared to be irrational – of investors of a reversibility of the euro. However, according to the convincing expertise of the Bundesbank, such interest rate spreads *only* [emphasis added] reflect the scepticism of market participants that individual Member States will show sufficient budgetary discipline to stay permanently solvent. Pursuant to the design of the Treaty on the Functioning of the European Union, the existence of such spreads is entirely intended'. These words might imply that: (a) the expertise of the Bank is not convincing; and (b) the analysis of the German central bank was preferred to that of the Bank. Again, the underlying claim has been empirically disproved, *see* De Grauwe et al., *supra* n. 6. German Federal Constitutional Court, BVerfG 2 BvR 2728/13 of 14 January 2014, para. 71.

[8]In the words of the Court, the 'special situation' was as follows: 'According to the ECB, those spreads were not accounted for solely by macroeconomic differences between the States concerned but were caused, in part, by the demand for excessive risk premia for the bonds issued by certain Member States, such premia being intended to guard against the risk of a break-up of the euro area': *Gauweiler*, *supra* n. 1, para. 72.

[9]Case C-493/17, *Weiss and Others*, Judgment of the Court (Grand Chamber) of 11 December 2018, EU:C:2018:1000. *See further* M. Dawson and A. Bobić, 'Quantitative Easing at the Court of Justice – Doing Whatever it Takes to Save the Euro: Weiss and Others', 56 *Common Market Law Review* (2019) p. 1005.

[10]The Bank has also empowered itself to purchase Greek debt which still enjoys so-called 'junk' status despite benchmark ten-year yields falling below 1%, down from nearly 45% during the Eurozone crisis. Decision (EU) 2020/440 of the ECB of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17), OJ L 91, 25.3.2020, p. 1. *See further* ⟨www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html⟩, visited 16 February 2021. On Greek debt, *see* ⟨www.bloomberg.com/news/articles/2020-02-12/greek-bonds-breach-1-milestone-as-rally-confounds-junk-status⟩, visited 16 February 2021.

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available bonds and to purchase the securities in proportion to the member's economy.[11]

On 5 May 2020, the German Federal Constitutional Court delivered judgment in *Weiss* through which it sought to undermine the Bank's ability to operationalise quantitative easing and, by extension, the Pandemic Emergency Purchase Programme.[12] It did so by attacking the European Court of Justice's assessment of the proportionality of the Public Sector Purchase Programme. The approach of the European Court, claimed the German Federal Constitutional Court, 'manifestly fails to give consideration to the importance and scope of the principle of proportionality' and was not 'tenable from a methodological perspective', meaning that the European Court 'manifestly exceeds the mandate conferred upon it' the consequence of which is that 'the CJEU Judgment itself constitutes an ultra vires act and thus has no binding effect [in Germany]'.[13] Although the Bank satisfied the European Court of Justice of the legality of its actions (and should leave judicial disputes to judges), the decision raised the prospect that the Bundesbank might withdraw cooperation from the Pandemic Emergency Purchase Programme or future policy measures.

In effect, the German Federal Constitutional Court has queried the input legitimacy of the Bank's decision-making.[14] Likewise, in their assessment of the unconventional measures required to save the euro, constitutional scholars have, quite properly, focused on the input legitimacy of the political and economic reforms that were the *sine qua non* of financial assistance during the

[11]For legal analysis *see* Goldman and Dawson and Bobić, and for political-economic context *see* Jones: M. Goldman, 'Borrowing Time: The ECB's Pandemic Emergency Purchase Programme', *Verfassungblog*, 27 March 2020, ⟨verfassungsblog.de/borrowing-time/⟩, visited 16 February 2021; M. Dawson and A. Bobic, 'COVID-19 and the European Central Bank', *Hertie School Debate Blog*, 27 March 2020, ⟨www.hertie-school.org/en/debate/detail/content/covid-19-and-the-european-central-bank/?tx⟩, visited 16 February 2021; E. Jones, 'Old Divisions Threaten Europe's Economic Response to the Coronavirus', *Foreign Affairs*, 6 April 2020, ⟨www.foreignaffairs.com/articles/europe/2020-04-06/old-divisions-threaten-europes-economic-response-coronavirus⟩, visited 16 February 2021.

[12]BVerfG, Judgment of the Second Senate of 05 May 2020 - 2 BvR 859/15, paras. 1-237, ⟨www.bverfg.de/e/rs20200505_2bvr085915en.html⟩, visited 16 February 2021.

[13]Weiss, *supra* n. 12, para. 119.

[14]Scharpf distinguishes between the two complementary perspectives of input and output legitimacy by suggesting that the former is characterised by the slogan 'government by the people' and the latter 'government for the people'. Scharpf is sensitive to the role of trust in institutional arrangements: F. Scharpf, *1999: Governing in Europe: Effective and Democratic?* (Oxford University Press 1999). For more recent consideration of input legitimacy, *see* S. Piattoni *The Theory of Multi-level Governance: Conceptual, Empirical, and Normative Challenges* (Oxford University Press 2010), Chapter 10.

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Eurozone crisis.[15] This is important because of the way these reforms were introduced,[16] the input challenge being how to reconcile the power of the Bank with basic principles of democratic accountability.[17]

Yet the treaties served as a vehicle via which a deliberate signal was communicated to market actors. Labelling (now) Article 125 TFEU the 'no-bailout provision' and referring to Article 123 as the 'prohibition of monetary financing' was not 'merely a question of linguistic convenience', it also 'expresses a specific understanding of the provision and serves as a signal to the markets'.[18] And the Bank, supported by the Court, signalled to actors participating in sovereign debt markets that it is now a sovereign lender of last resort.[19] This is a profound constitutional change absent any, or any meaningful, change to the text of those legal provisions that enshrine the grand bargain struck by the member states in the Maastricht Treaty.[20] One view is that the text of the treaty fails to offer an adequate account of the thick network of rules, standards and shared understandings that together manifest the functional constitutional order of the Eurozone and the core changes thereto cannot be understood without reference to norm-governed practices.[21] Unavoidably, capturing the relationship

[15]D. Curtin, '"Accountable Independence" of the European Central Bank: Seeing the Logics of Transparency', 23 *European Law Journal* (2017) p. 28; A. Hinarejos, 'Gauweiler and the Outright Monetary Transactions Programme: The Mandate of the European Central Bank and the Changing Nature of Economic and Monetary Union', 11 *EuConst* (2015) p. 563; T. Beukers, 'The New ECB and Its Relationship with the Eurozone Member States: Between Central Bank Independence and Central Bank Intervention', 50 *Common Market Law Review* (2013) p. 1579; M. Dawson et al., 'Reconciling Independence and Accountability at the European Central Bank: The False Promise of Proceduralism', 23 *European Law Journal* (2019) p. 75.

[16]Although, on the output front, the economic logic and effectiveness of the reforms have been sharply criticised by, amongst others, Stiglitz and Mody who are both economists with significant first-hand policymaking experience of agreeing and implementing structural reforms: J. Stiglitz, *The Euro: How a Common Currency Threatens the Future of Europe* (Norton 2016); A. Mody, *Euro Tragedy* (Oxford University Press, 2018).

[17]*See supra* n. 15 and n. 16.

[18]Editorial, *supra* n. 1, p. 237.

[19]Iversen et al., *supra* n. 5, p. 179; P. De Grauwe, *Economics of Monetary Union* (Oxford University Press 2020), and in particular p. 133-135.

[20]K. Dyson and K. Featherstone, *The Road to Maastricht: Negotiating Economic and Monetary Union* (Repr, Oxford University Press 1999); A. Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Routledge 2005); H. James, *Making the European Monetary Union* (Harvard University Press 2012); K. McNamara, 'Where Do Rules Come From? The Creation of the European Central Bank', in A. Stone Sweet et al. (eds.), *The Institutionalization of Europe* (Oxford University Press 2001).

[21]Renan provides a timely and illuminating review of the literature on the role of structural norms in US constitutional law: D. Renan, 'Presidential Norms and Article II', 131 *Harvard Law Review* (2018) p. 2187; J. White, 'Authority after Emergency Rule', 78 *Modern Law Review* (2015) p. 585; C. Kilpatrick, 'On the Rule of Law and Economic Emergency: The Degradation of Basic Legal Values in Europe's Bailouts', *Oxford Journal of Legal Studies* (2015) p. 325; Dawson et al., *supra* n. 15.

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between the Bank and market actors requires us to embrace what, in the context of US constitutional law, Primus describes as 'small-c' constitutional analysis.[22]

By focusing on output legitimacy, this article complements the work on the relationship between rights, values and legitimacy in the Economic and Monetary Union.[23] It provides a useful set of analytical tools that capture and critique, from a consequentialist perspective, how, and the extent to which, the Bank has emerged as a sovereign lender of last resort.[24] It applies the consequentialist literature developed by Ullman-Margalit and Sunstein on the expressive function of law in revising norms by combining it with the recent pathbreaking work by Krisch and Black on the endogenous appropriation of authority and, by extension, legitimacy of international institutions. Where Kilpatrick focused on the violence visited upon the Rule of Law through the conditionality attached to protection from the market,[25] this study considers the

[22]'Big-C' enquiries tend to focus on the constitutional text and judicial review. In contrast, 'small-c' constitutional analysis embraces 'the web of documents, practices, institutions, norms and traditions' that together structure government. This article will side-step the theoretical debate over the qualifying criteria for, and consequences of, affording 'constitutional' status to certain rules. R. Primus, 'Unbundling Constitutionality', 80 *The University of Chicago Law Review* (2013) p. 1079 at p. 1081-1082. For recent literature reviews, *see also* W.N. Eskridge and J. Ferejohn, *A Republic of Statutes: The New American Constitution* (Yale University Press 2010); D.J. Levinson, 'Parchment and Politics: The Positive Puzzle of Constitutional Commitment', 124 *Harvard Law Review* (2011) p. 657 at p. 700.

[23]Curtin, *supra* n. 15; Kilpatrick, *supra* n. 21; Dawson et al., *supra* n. 15.

[24]To borrow the definition offered by W. Sinnott-Armstrong, Consequentialism 'embodies the basic intuition that what is best or right is whatever makes the world best in the future, because we cannot change the past, so worrying about the past is no more useful than crying over spilled milk': W. Sinnott-Armstrong, 'Consequentialism', in E.N. Zalta (ed.), *The Stanford Encyclopaedia of Philosophy* (Summer 2019 edn.), ⟨plato.stanford.edu/archives/sum2019/entries/consequentialism/ ⟩, visited 16 February 2021. In the broadest sense, *see* J.S. Mill, *On Liberty* (Longman, Roberts & Green 1859). As a first pass at a modern working definition (or slogan), Joshua Green presents utilitarianism (albeit rebranded 'deep pragmatism' to diminish its stigma) as a meta-morality whereby different societies (or groups within a society) agree to mediate disputes over clashing moral intuitions, values, and traditions by each agreeing to pursue the course of action that maximises net happiness impartially: J. Greene, *Moral Tribes* (Penguin Books 2013). On how Consequentialism is bound up with legal theory, *see* C.R. Sunstein, 'If People Would be Outraged by Their Rulings, Should Judges Care?', 60 *Stanford Law Review* (2007) p. 155; C.R. Sunstein, 'There Is Nothing That Interpretation Just Is', 30 *Constitutional Commentary* (2015) p. 193.

[25]Kilpatrick, *supra* n. 21. Cleverly, Kilpatrick offers two normative conceptions of the Rule of Law, one formal and one substantive. The latter builds on the work of Waldron, who is critical of the utilitarian tradition, although both the formal conception of the Rule of Law, borrowed from Lon Fuller, and the more substantive conception find common ground in their fundamental respect for man's inherent dignity. On Waldron's treatment of Kant and Mill *see* J. Waldron, 'Kant's Legal Positivism', 109 *Harvard Law Review* (1996) p. 1535.

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other side of the coin – the analytical and normative implications of the Bank saving market actors from a narrow, originalist interpretation of the treaties.

The argument is as follows. Historically, a state issues debt in a currency controlled by its central bank which it can force to act as lender of last resort at times of crisis thereby creating an 'implicit guarantee' to sovereign debt counterparties that the state will have access to the necessary liquidity to meet its commitments when the bond matures.[26] This is akin to a sticky norm that coordinated the behaviour of counterparties to sovereign debt contracts thereby eliminating the threat of a liquidity crisis capable of pushing a state into a self-reinforcing disequilibrium capable of undermining the economic fundamentals of that state. The Treaty of Maastricht was meant to change that as a constituent member no longer issued debt in a currency under its control. Furthermore, it established a single currency absent a transparent, effective sovereign lender of last resort to the member states of the Eurozone. This was an attempt to revise the pre-existing coordination norm through legal intervention. The lack of credibility surrounding aspects of the legal framework led to a disassociation between the norm embedded within Article 123 and, to an extent, Article 125 TFEU and that guiding market behaviour. In July 2012, the Bank removed any doubt about its operational norms: the Bank will, in effect, play the role of sovereign lender of last resort to the member states subject to conditions.[27] By intervening to exercise interpretive control over its governing norms, the Bank itself played an active role in constructing and maintaining its own authority and legitimacy in the eyes of market actors. This development was subsequently supported by the Court, the sole authoritative interpreter of the treaties, albeit with few if any realistic alternatives available to it. Yet, this approach raises a legitimacy paradox for the Bank.[28]

The balance of this study is structured as follows. The next section traces work in (predominantly) US law and economics literature on decision-making and, in particular, the use of legal intervention to revise norms. This consequentialist literature sensitises us to the pre-existing norm and focuses on monitoring for gaps in compliance with the proposed revised norm. The section after that considers the lender of last resort norm that pre-dated the introduction of the Economic and Monetary Union – the norm targeted for revision by Maastricht.[29] It offers a rational reconstruction of the emergence of the sovereign lender of last resort norm and reviews the then prevailing macroeconomic and political-economic scholarship to gauge the credibility of the Maastricht provisions. The subsequent

[26]De Grauwe, *supra* n. 19, p. 133.

[27]ECB (2012), 'Verbatim of the remarks made by Mario Draghi', *supra* n. 4; Iversen et al., *supra* n. 5; De Grawue, *supra* n. 19.

[28]Editorial, *supra* n. 1; Kilpatrick, *supra* n. 21; Beukers, *supra* n. 15; Curtin, *supra* n. 15; Dawson et al., *supra* n 15.

[29]Consolidated Version of the Treaty on European Union [2008] OJ C115/13.

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section considers the lived experience of those instruments by reference to sovereign bond yields. The article concludes with reflections aimed towards that extant economic shock.

Norm revision through legal intervention

Articles 123 and 125 TFEU contain information introduced to signal change to, inter alia, market actors regarding the future decision-making of the Bank. More particularly, they represent constraints upon the ability of the Bank to provide liquidity to the member states.[30] These constraints, like the euro, were sui generis and represented a departure from the pre-existing norm governing sovereign debt.[31]

In this sense, this study is concerned with the process of changing norms and, by extension, the decisions of actors.[32] Ullman-Margalit draws a helpful distinction between norm change and norm revision.[33] She thinks of norm change as spontaneous natural evolution over time and, occasionally, over communities. Norm revision refers to a situation where a specific existing norm is deliberately targeted for change. That is to say 'where the change is instituted intentionally by some social agency'.[34] In this section, we are concerned with one method of norm revision: through legal intervention.

Posner provides a useful working definition of a 'norm':[35]

[30]On the relationship between the extension of Emergency Liquidity Assistance by national central banks to the credit institutions of Eurozone member states and the sovereign lender of last resort activities of the Bank, *see* ECB (2017) for its current procedures. For a legal analysis *see* A. Steinbach, 'The Lender of Last Resort in the Eurozone', 53 *Common Market Law Review* (2016) p. 361; for an economic analysis *see* K. Whelan 'Banking Union and the ECB as Lender of Last Resort', in F. Allen et al. (eds.), *Filling the Gaps in Governance: The Case of Europe* (EUI 2016), ⟨cadmus.eui.eu/bitstream/handle/1814/41825/Filling_the_gaps_2016.pdf?sequence=3⟩, visited 16 February 2021; ECB, 'Agreement on Emergency Liquidity Assistance', 17 May 2017, ⟨www.ecb.europa.eu/pub/pdf/other/Agreement_on_emergency_liquidity_assistance_20170517.en.pdf?23bb6a68e85e0715839088d0a23011db⟩, visited 16 February 2021.

[31]B. Eichengreen, 'Sui Generis EMU', *National Bureau of Economic Research* (2008) Working Paper No. 13740.

[32]C.R. Sunstein, *How Change Happens* (The MIT Press 2019).

[33]E. Ullmann-Margalit, 'Revision of Norms', 100 *Ethics* (1990) p. 756.

[34]Ullmann-Margalit, *supra* n. 33, p. 756.

[35]There is an extensive literature on 'norms'; this study focuses on the Chicago School lineage and its off-shoots. For reviews of the literatures of the relationship between law and norms, *see* Thaler and Sunstein, *Nudge: Improving Decisions About Health, Wealth and Happiness* (Penguin Books 2009); C. Bicchieri, *Norms in the Wild: How to Diagnose, Measure, and Change Social Norms* (Oxford University Press 2017); R.C. Ellickson, 'The Market for Social Norms', 3 *American Law and Economics Review* (2001) p. 1; R.A. Posner, 'Social Norms and the Law: An Economic Approach', 87 *The American Economic Review* (1997) p. 365; R. Benabou and J. Tirole, 'Laws and Norms', National Bureau of Economic Research (2011)

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> A social norm ('norm' for short) is a rule that is neither promulgated by an official source, such as a court or legislature, not enforced by threat of legal sanctions, yet it is regularly complied with (otherwise it wouldn't be a rule).[36]

Posner goes on to observe that norms constitute a source of law, an alternative to law and, crucially for present purposes, an antagonist to law. Providing a satisfactory account of the emergence of a norm is complicated by the fact that it may not have come into existence at an identifiable point in time; rather it is probably the result of a complex pattern of behaviour involving a substantial array of actors over an extended period of time.[37] Nevertheless, should a complex pattern of behaviour be reducible to a relatively simple, albeit abstract, description of strategic decision-making by market actors and the Bank, then the generation of certain types of norms can be usefully accounted for.[38] To borrow the language of game theory, some norms represent solutions to problems posed by strategic interactions.[39] However, as the challenges faced by actors are not static, neither are the solutions. And so, in the words of Ullmann-Margalit '[n]orms, as social institutions, have careers. They emerge, endure, pass away'.[40]

In an effort to formalise the relationship between law and norms, a wealth of literature on the 'expressive' function of law in revising norms mushroomed in the 1990s in concert with the emergence of the 'New Chicago School' project.[41] Perhaps the most succinct description of the process of revising norms through statements embedded in legal instruments is captured by McAdams's information theory of law: '[. . .] law provides information; information changes beliefs; new

Working Paper No. 17579; E.A. Posner, *Law and Social Norms* (Harvard University Press 2002); D. Acemoglu and M.O. Jackson, 'Social Norms and the Enforcement of Laws', National Bureau of Economic Research (2014) Working Paper No. 20369.

[36]Posner (1997), *supra* n. 34, p. 365.

[37]This article deliberately avoids wading into the contested debate surrounding the extent to which norms are socially 'constructed'. For that, *see* Finnemore and Sikkink for an illuminating intellectual history of the role of norms in international relations. They also explore the relationship between norms and rationality. For present purposes it is sufficient to assume that a norm can exist, it can guide or constrain behaviour, and that legal expressions can affect that norm and vice versa. Likewise, this study will not dwell on the distinction between norms and conventions: M. Finnemore and K. Sikkink, 'International Norm Dynamics and Political Change', 52 *International Organization* (1998) p. 887 at p. 895; L. Lessig, 'The Regulation of Social Meaning', 62 *The University of Chicago Law Review* (1995) p. 943 at p. 949.

[38]E. Ullmann-Margalit, *Emergence of Norms*, 2015 paperback edn. (Oxford University Press 1977).

[39]Ullman-Margalit, *supra* n. 38; R.H. McAdams, *The Expressive Powers of Law: Theories and Limits* (Harvard University Press 2015).

[40]Ullmann-Margalit, *supra* n. 33, p. 756.

[41]C.R. Sunstein, 'On the Expressive Function of Law', 144 *University of Pennsylvania Law Review* (1996) p. 2021; Lessig, *supra* n. 37.

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beliefs change behaviour. Law is informative'.[42] A commonly cited example of this dynamic in action is the dramatic revision of norms surrounding smoking: the enactment of laws criminalising smoking indoors in public spaces implies the default information that smoking in the company of others is obtuse and discourteous.[43] This information, in turn, affects decision-making and behaviour, whether in a prohibited area or not. However, claims to the effect that a legal instrument has affected or shall affect a norm in a particular manner can be empirically difficult to prove (and disprove). Indeed, a criticism of expressivist scholarship is its potential to generate causal assertions that are unfalsifiable. And so for Sunstein the expressive function of law is normative as well as descriptive or positive.[44] Sunstein suggests that legal endeavours aimed at changing behaviour be combined with a consequentialist approach: '[. . .] if legal statements produce bad consequences, they should not be enacted even if they seem reasonable or noble'.[45] In other words, Sunstein suggests that we focus upon the consequences of a legal enactment and limit sterile debate about what so-called 'message' it sends about society's political preferences.

McAdams, like Sunstein, argues that, as states seek to manipulate focal points through legal instruments, they should adopt a consequentialist analysis:[46] attempts to revise norms through legal enactment should focus on the level of 'compliance' with the proposed new norm. Norms that perform a coordinating function, such as the lender of last resort norm, enjoy a propensity to be self-enforcing and enduring, even when considered inefficient by the relevant actors. Such norms are sticky because the 'source of their effectiveness', or the main motivation for complying with them, is their coordinating function; market actors place a higher premium on having a coordination norm than on the efficiency thereof and face difficulties coordinating their behaviour in an effort to revise that norm.[47]

To summarise, some norms, including as we shall see the sovereign lender of last resort norm under consideration, emerge to solve coordination problems; however, by virtue of the systems of expectations that surround them, coordination norms are inherently sticky and difficult to revise. It usually takes a legal event

[42]McAdams, *supra* n. 39, p. 136-168.

[43]Sunstein, *supra* n. 41, p. 2022.

[44]Sunstein, *supra* n. 41.

[45]Sunstein, *supra* n. 41, p. 2025.

[46]Ullman-Margalit's posthumous collection of essays provides sensitive and insightful reflections on norm revision. McAdams incorporates a focus on 'focal points' borrowed from Schelling's seminal work: Ullmann-Margalit, *supra* n. 33; E. Ullmann-Margalit et al., *Normal Rationality: Decisions and Social Order* (Oxford University Press 2017); T.C. Schelling, *The Strategy of Conflict* (Harvard University Press 1980).

[47]Ullmann-Margalit, *supra* n. 33, p. 756.

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to do so. In this instance, the Treaty of Maastricht. Yet, the interpretation of a legal intervention may be inextricably linked with a pre-existing norm. States can misjudge the level of compliance that their legal intervention, and the proposed revised norm embedded therein, will enjoy.

We turn now to elucidate the sovereign norm that pre-dated the introduction of the euro.

The lender of last resort function of central banks to sovereigns

The lender of last resort function of central banks long predates the modern focus on the transmission of monetary policy.[48] In fact, up until the mid-20th century, the key function of central banks was to act as a lender of last resort in times of crisis.[49] Whelan captures the importance of the lender of last resort function in stark terms: '[c]entral Banks were put on this earth to be lenders of last resort'.[50] In 1802 and 1873 respectively, Henry Thornton and Walter Bagehot both recognised this reality.[51] Goodhart summarised Bagehot's classical principles for guiding central bank intervention at times of crisis as follows: (1) lend freely; (2) at a high rate of interest; (3) on good banking securities.[52]

Yet, the lender of last resort function of central banks neither emerged nor operated in an apolitical manner. It developed gradually across the world, leading Calomiris and Haber to argue that the function is a locus of political power and should be viewed as the outcome of a political bargain.[53] By the middle of the 19th century, Britain and France had established operational lenders of last resort whereas the US, Canada and Australia did not do so until 1913, 1929 and 1959 respectively.[54] Even when established, lender of last resort powers and duties

[48]Whelan, *supra* n. 30.

[49]Whelan, *supra* n. 30; C. Goodhart, 'Myths about the Lender of Last Resort', 2 *International Finance* (1999) p. 339; C. Desan, *Making Money: Coin, Currency, and the Coming of Capitalism* (Oxford University Press 2014) p. 400; H.S. Scott, 'The Federal Reserve: The Weakest Lender of Last Resort Among Its Peers', 18 *International Finance* (2015) p. 321. So important is financial stability, Lucas locates the birth of macroeconomics as an intellectual response to the Great Depression. Its purpose was the prevention of another economic disaster: R.E. Lucas, 'Macroeconomic Priorities', 93 *The American Economic Review* (2003) p. 14 at p. 14.

[50]Whelan, *supra* n. 30, p. 11.

[51]H. Thornton, *An Enquiry into the Nature and Effects of the Paper Credit of Great Britain* (Kessinger Publishing 2008); W. Bagehot, *Lombard Street: A Description of the Money Market* (revised edition) (Wiley 1999).

[52]Steinbach, *supra* n. 30; E. Posner, *Last Resort* (Chicago University Press 2018); Goodhart, *supra* n. 49, p. 340.

[53]C. Calomiris and S. Haber, *Fragile by Design: The Political Origins of Banking Crises and Scarce Credit*, (Princeton University Press 2014). *See also* Desan, *supra* n. 49.

[54]C.W. Calomiris et al., 'Political Foundations of the Lender of Last Resort: A Global Historical Narrative', 28 *Journal of Financial Intermediation* (2016) p. 48 at p. 49.

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were, like central banks' independence more generally, far from uniform. The operational independence and flexibility of the central banks in dealing with liquidity shocks in sovereign debt markets differed. Indeed, the heterogeneous legal structures and cultures of the central banks of the member states is a major theme in the authoritative 'micro-history' of the Maastricht negotiations offered by Dyson and Featherstone.

Notwithstanding these important cultural and legal distinctions, it was commonly the case that, prior to the introduction of the euro, each Member issued debt in a currency controlled by its central bank. According to De Grauwe this 'create[d] an implicit guarantee to the bondholders that they will be paid out when the bond matures' because their 'central bank can be forced to provide all necessary liquidity to the sovereign'.[55] The implicit nature of this guarantee, combined with the heterogeneous development of central banking, imposes a methodological constraint on identifying the emergence of the sovereign lender of last resort norm by way of a historico-sociological account. This is because posing seemingly straightforward questions, such as 'How will I identify a norm when I see one?', fail to yield straightforward answers. In fact, in the 1990s the focus on the relationship between law and norms waned, in part, due to the challenge of historically or empirically diagnosing a norm.[56] To make headway, Ullman-Margalit, de-idealising the Carnapian model, offers a framework for the 'rational reconstruction' of the emergence of norms as structural solutions to coordination problems.[57] A structural solution, in the game-theoretical sense, offers 'a description of the essential features of a situation in which *such* an event *could* occur' not simply as a matter of mere logical possibility.[58] Rather, the account of the generation of the norm – in this study the lender of last resort norm – is as a solution to a coordination problem. That is, the norm emerged as a stabilising device from the interdependent expectations of market actors together with those of a central bank.

The emergence of the lender of last resort *norm*

Although this study centres on the sovereign lender of last resort function of the Bank, to elucidate that function we first consider a (stylised) model of banking

[55]De Grauwe, *supra* n. 19, p. 133.

[56]*See* references *supra* n. 35.

[57]Ullman-Margalit gives examples such as Plato's account of the origin of the State in politics, the theories of social contracts offered by Hobbes, Locke, and Rousseau and Rawls's reconstruction of the just society: Ullmann-Margalit, *supra* n. 38, p. 1. R. Carnap, *Logical Foundations of Probability* (Routledge & Kegan Paul 1962). Ullman-Margalit contrasts her approach to Popper's historical accounts of the logic of situations: K. Popper, *The Open Society and Its Enemies* (vol. ii) (Routledge and Kegan Paul 1966).

[58]Ullman-Margalit, *supra* n. 38, p. 1. [Emphasis in the original.]

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before applying the underlying dynamic to sovereign debt markets *mutatis mutandis*.[59] This methodology is utilised for three reasons. First and foremost, to demonstrate that a lender of last resort is a necessary legal condition for sustainable financial systems, akin to the protection of property rights and the enforcement of contracts.[60] Secondly, to show that a state and its banking system are tied at the hip; a banking crisis can contribute to a sovereign debt crisis irrespective of fundamentals and vice versa (i.e. the 'doom loop' or 'deadly embrace').[61] Finally, although we are particularly concerned with rollover sovereign debt crises associated with difficulties in refinancing maturing debt obligations, the choice to provide or withhold liquidity may imply contentious distributional implications. Far from a technical legal concern, the liquidity/solvency categorisation is a crucial site of governance and constitutional debate.[62]

Banks act as intermediaries between depositors and borrowers. In theory, banks secure and invest the shorter-term savings of depositors by matching them with borrowers who generally require longer-term financing in order to invest in projects in advance of revenues ('maturity transformation'). Short-term savers loan their funds to a bank such that those funds are available on demand (i.e. a deposit). Yet that bank may provide a long-term loan to a borrower (e.g. a 30-year mortgage). When the decision of an actor to remove her deposit is correlated with that of many other depositors an otherwise healthy bank may not be able to meet its short-term obligations (i.e. it lacks liquidity). A bank might try and secure a loan from another source which may arrest the dynamic or lead to contagion. In order to meet its short-term needs for cash, a bank may be forced to sell its assets, generally, long-term loan books (such as mortgages) at fire-sale prices. As the bank converts its long-term assets into cash in order to meet its short-term obligations, the discounted price it receives for those assets can diminish its balance sheet such as to convert its illiquidity into insolvency. Depositors withdraw their funds in order to convert them into a safer asset class (i.e. a flight to safety) thereby creating a self-fulfilling liquidity crisis (i.e. a bank run). The crucial point is that this dynamic can commence for a good reason or no good reason (i.e. a 'coordination failure') and, irrespective of the fundamentals of the Bank at the outset, lead to insolvency. Moreover, this coordination problem can be further exacerbated by market sentiments (i.e. 'animal spirits' or 'fear and panic').

[59]The account draws from that offered by Posner. For a more detailed historical perspective, *see* Calomiris et al., *supra* n. 52.

[60]Posner, *supra* n. 54.

[61]E. Farhi and J. Tirole, 'Deadly Embrace: Sovereign and Financial Balance Sheets Doom Loops', 85 *Review of Economic Studies* (2017) p. 1781.

[62]C. Desan, 'The Market as a Matter of Money: Denaturalizing Economic Currency in American Constitutional History', 30 *Law & Social Inquiry* (2005) p. 1.

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Applying this dynamic to rollover debt crises, states enjoy a fiscal authority that chooses how much to consume and borrow through the issuing of sovereign debt.[63] According to De Grauwe, like a bank '[g]overments' liabilities are liquid, while most of their assets are illiquid', such as infrastructure or claims on taxation.[64] Therefore, governments may not be capable of generating cash from asset disposals, taxation or other means quickly enough to payout bondholders at maturity. This gives rise to fear of a rollover crisis where an adverse shift in market expectations, whether for a good reason or not, could restrict a fiscal authority's ability to roll over debt, creating liquidity problems. The fiscal effort to meet those liquidity problems may have significant adverse macroeconomic implications (i.e. an economic contraction) that would feed back into investor's expectations, thereby creating a self-enforcing dynamic that could ultimately lead to sovereign default. Moreover, in a significant recession, a state could find repayment of debt more costly, and default less costly, than otherwise, thereby further exacerbating market expectations of default.

Rollover debt crises are relatively rare and are primarily considered a hazard of fixed exchange rate regimes or of the issuing of debt in a foreign currency (usually the US dollar).[65] The reason that that such crises are rare is attributable to the fact that historically states issue debt in their national currency controlled by their central bank. Therefore, bondholders, like depositors, lend to a state aware that such a dynamic can be arrested by that state's central bank providing the government with the necessary liquidity to rollover the sovereign debt and repay its loans. According to De Grauwe, this creates an 'implicit guarantee for bondholders that they will be paid out when the bond matures'.[66] This not only eliminates the prospect of a liquidity crisis, but in doing so prevents a liquidity crisis pushing a sovereign into self-enforcing disequilibrium thereby deteriorating its economic fundamentals. As we shall see, a member state of the euro area issues debt in a currency it does not control, yet the loss of monetary autonomy was not met with the institutionalisation of a sovereign lender of last resort facility.

Although the foregoing model distinguishes between sovereign and banking lender of last resort activities, domestic financial institutions tend to have significant holdings of the debt of their sovereign. During the Eurozone crisis Ireland's sovereign debt spreads were negligible until investors began to lose confidence in

[63]M. Aguiar et al., 'Coordination and Crisis in Monetary Unions', 130 *The Quarterly Journal of Economics* (2015) p. 1727 at p. 1728.

[64]De Grauwe, *supra* n. 19, p. 133.

[65]For a literature review, *see* J. Bianchi and J. Mondragon, 'Monetary Independence and Rollover Crises', (2018) Federal Reserve Bank of Minneapolis Working Paper 755. For discussion of the relationship between short-term and longer-term debt *see* R. Fernandez and A. Martin, 'The Long and Short of It: Sovereign Debt Crises and Debt Maturity', National Bureau of Economic Research (2014) Working Paper No. 20786.

[66]De Grauwe, *supra* n. 19, p. 133.

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its banking system while Greece's public finances contaminated its banking system.[67] The key point is that, regardless of the source of the initial economic shock, both the banking and sovereign debt spreads moved in lockstep following bad news, creating a 'doom-loop' or 'deadly embrace'.[68]

Central banks are burdened with the responsibility of lender of last resort functions because they enjoy a legal monopoly on printing legal tender.[69] Depending upon the nature and scale of the crisis, it is likely that a central bank is the only institution capable of performing the role of a lender of last resort to a banking system or sovereign. Therefore, the responsibility to act as lender of last resort is intertwined with the legal responsibility of a central bank regarding money creation. In the words of the current President of the European Central Bank:

> As the sole issuer of euro-denominated central bank money, the Eurosystem will always be able to generate additional liquidity as needed [. . .] [s]o by definition, it will neither go bankrupt nor run out of money.[70]

The lender of last resort activity of central banks creates a free-rider problem whereby imprudent risks are undertaken on the belief that a bailout, under the guise of liquidity, will follow ('moral hazard'). Furthermore, taxpayers may be saddled with costs that are not repaid in full (including any costs associated with the provision thereof). Views remain divided on the gravity of moral hazard. The Bagehot principles require central banks to lend at a penalty rate to avoid perverse incentives. Yet, there is no empirical evidence that the introduction of lender of last resort policies in Britain and France in the 1800s created moral hazard.[71]

Despite the antiquity of the Bagehot principles for guiding central bank intervention at times of crisis, there remains no consensus regarding the difference between what constitutes a 'liquidity' versus 'insolvency' issue during a banking

[67]Farhi and Tirole, *supra* n. 61, p. 1781.

[68]Sovereign rollover crises differ from banking crises as no liquidation follows default. In 2001, the International Monetary Fund warned of the serious risks associated with (mis)management of a liquidity crisis in the Eurozone. See A. Belaisch et al., 'Euro-Area Banking At The Crossroads', IMF Working Paper WP/01/28 (2001) in particular p. 55, 63-64, ⟨www.imf.org/en/Publications/WP/Issues/2016/12/30/Euro-Area-Banking-At-the-Crossroads-4013⟩, visited 16 February 2021.

[69]In tracing the development of 18th-century monetary architecture in England, Desan also notes that the LOLR function of the Bank of England was empowered by the fact that the future revenues of the nation comprised the resource dedicated to pay off its bank notes. By contrast, private banks were dependent upon the perception of future profits: Desan, *supra* n. 49, p. 400.

[70]'ECB can't go bankrupt even if it suffers losses', *Reuters*, 19 November 2020, ⟨www.reuters.com/article/ecb-policy-bonds/ecb-cant-go-bankrupt-even-it-suffers-losses-idINKBN27Z12U⟩, visited 16 February 2021.

[71]V. Bignon et al., 'Bagehot for Beginners: The Making of Lender-of Last-Resort Operations in the Mid-Nineteenth Century', 61(2) *Economic History Review* (2012) p. 580.

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crisis or sovereign debt crisis. Speaking to the banking context, Campbell and Lastra are correct to emphasise that the concepts are 'fluid and dynamic'.[72] Goodhart, however, simply considers it a myth to assume that a central bank (or indeed anyone) can tell the difference between the two at the capricious time that the valuation takes place and assistance is required.[73] Stiglitz points out that when market actors refuse to lend, they have made a judgement that they will not be repaid and so, unavoidably, central banks pit their judgement against that of the market.[74] The problems associated with volatile asset valuation extend *mutatis mutandis* to a state in the throes of a sovereign debt crisis.[75]

To summarise, although there were important legal differences between the central banks, prior to the introduction of the euro, all member states provided an implicit guarantee that their central bank was capable of acting as a lender of last resort in respect of their sovereign bonds.[76] This study considers that expectation to have been a coordinating norm, or something akin thereto, that existed prior to the introduction of the euro, that served to eliminate a coordination problem: the threat of a sovereign debt liquidity crisis capable of pushing a state towards a bad equilibrium. This study does not delineate the precise scope of the norm and, in fact, acknowledges that the nature of the self-enforcing dynamic brings with it inherent diagnostic challenges regarding the liquidity/solvency distinction that represents a critical site of constitutional governance.

The proposed revision of the sovereign lender of last resort norm

There exists a wealth of academic literature examining from where the ideas that ultimately found expression in the minimalist architecture of the Economic and Monetary Union originally came.[77] Lastra is undoubtedly correct when she says that the project went well beyond normative economic and monetary institution building.[78] The mandate of the Bank, along with the powers that it may employ towards that end, are (now) enshrined in both the TFEU and the Protocol on the Statute of the European System of Central Banks and of the European Central Bank ('ESCB Statute'). The Bank is expressly mandated to act 'within the limits of

[72] A. Campbell and R.M. Lastra, 'Revisiting the Lender of Last Resort', 24 *Banking & Finance Law Review* (2009) p. 453.

[73] Goodhart, *supra* n. 49.

[74] Stiglitz, *supra* n. 16, p. 398, fn. 26.

[75] De Grauwe, *supra* n. 19.

[76] De Grauwe, *supra* n. 19. See Chapters 1-5 generally and, in particular, p. 133.

[77] Dyson and Featherstone, *supra* n. 20; James, *supra* n. 20; Moravcsik, *supra* n. 20.

[78] R.M. Lastra, 'The Evolution of the European Central Bank', 35 *Fordham International Law Journal* (2011-2012) p. 1260.

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the powers conferred upon it by the Treaties'.[79] Indeed, the Bank argues that its legal framework 'ha[s] gained "constitutional" status'.[80]

The functions and objectives of the Bank are enshrined in Article 127 TFEU. Paragraph 1 circumscribes the primary objective of the Bank to maintaining 'price stability' (i.e. the control of inflation). This stands in contrast with, for example, the dual mandate of the US Federal Reserve, which provides that it conducts its monetary policy in pursuit of full employment and stable prices.[81]

Insofar as a measure of flexibility is embedded within the mandate of the Bank, its primary objective is to be pursued without prejudice to the secondary objective of supporting the general EU economic policies with a view to contributing to the achievement of the EU objectives as laid down in Article 3 TEU. Although the primary objective of the Bank is to maintain price stability, 'financial stability' is an enumerated objective pursuant to Article 127(5) TFEU. However, this objective is to be pursued within the rule-based restrictions on its powers.

As we have seen, central banks are historically in charge of both monetary policy and lender of last resort functions.[82] Not so with the Bank. Instead, the treaty instruments curtail the ability of the Bank to act as a lender of last resort to the member states of the Eurozone and the banking system. Article 123 TFEU prohibits, inter alia, the provision of any credit facility by the Bank to a member state. Further, the Bank is prohibited from purchasing a debt instrument directly from a member state. Accordingly, this article is widely interpreted as creating a prohibition on monetary financing, albeit a close reading of the text shows that it is more ambiguous. Though the subject of less judicial scrutiny, Article 125 TFEU is relevant insofar as it prohibits the Union from assuming a liability on behalf of a member state, or the member states doing so on behalf of one another, save for in a narrow exception relating to joint venture public projects (the 'no bailout' provision). The second indent of Article 18.1 of the ESCB Statute

[79]Art. 7 of Protocol (No. 4) – statute of the European System of Central Banks and of the European Central Bank (hereafter 'ESCB Statute').

[80]The Bank goes on to say that 'An independent central bank, removed from the political decision-making process, is indeed in a better position to achieve the primary objective of price stability, as it can look ahead over a longer horizon, which politicians have short-term objectives in line with election cycles': *ECB Monthly Bulletin*, January 2010, p. 74. *See also* C. Zilioli and M. Selmayr, 'The Constitutional Status of the European Central Bank', 44 *Common Market Law Review* (2017) p. 355.

[81]*See* 2010 OJ C 83, 17 17. It is noteworthy that the wording of these provisions was heavily influenced by Art. 12 of the 1957 Bundesbank Law. During the Maastricht negotiations, the Federal Reserve model, favoured by the French due to its more effective arrangements for democratic accountability, lost out to the German model because of the political-economic strength of Germany in the negotiations and because the strength of the German economy offered an argument in favour of imitating its central bank as a model. *See* Dyson and Featherstone, *supra* n. 20, p. 795; Lastra, *supra* n. 78.

[82]Campbell and Lastra, *supra* n. 72, p. 459.

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protects the Eurosystem from counter-party risk when dealing with private financial institutions by requiring that lending be based 'on adequate collateral'. There is no explicit reference to a banking lender of last resort in either the treaty instruments or the ESCB Statute, however, credit was extended to financial institutions in Ireland, Greece, Cyprus and elsewhere during the crisis. This took place at a national level whereby national central banks provided emergency liquidity assistance to domestic credit institutions. Pursuant to Article 14.4 of the ESCB Statute, the Governing Council (by a majority of two thirds of the votes cast) may declare that the emergency liquidity assistance interferes with the objectives and tasks of the European System of Central Banks.[83] The Governing Council can attach conditions to their assent, as exemplified by the 2010 correspondence from the President of the Bank to the Irish Minister for Finance advising him that '[i]t is the position of the Governing Council that it is only if we receive in writing a commitment' to, inter alia, fiscal consolidation and structural reforms agreed and overseen by the Commission, International Monetary Fund and Bank that 'we can authorise further provisions of [Emergency Liquidity Assistance]'.[84]

Fiscal coordination was distinctly less institutionalised. Absent from the instruments are a fiscal union, a banking union (with risk sharing), or an explicit sovereign lender of last resort. Instead, the Stability and Growth Pact set, under threat of sanction, an annual budget deficit of 3% of GDP and the stock of public debt of 60% of GDP that, according to Eichengreen (writing in 2003) 'has no basis in economic logic'.[85] These rules are counterproductive as, per Eichengreen, 'actually imposing the 2 per cent of GDP fines provided for by the pact would only aggravate the financial problems of a heavily indebted government and provoke the very debt crisis that the mechanism was designed to avert'.[86] Likewise, more recently Tirole has argued that 'sanctions aggravate deficits at a time dis-

[83]*See* ECB (2013) 'ELA Procedures', 17 October 2013, ⟨www.ecb.europa.eu/pub/pdf/other/elaprocedures.en.pdf?3711be9539245568ac03563f983ac062⟩, visited 16 February 2021, and ECB (2017) 'Agreement on emergency liquidity assistance', 17 May 2017, ⟨www.ecb.europa.eu/pub/pdf/other/Agreement_on_emergency_liquidity_assistance_20170517.en.pdf⟩, visited 16 February 2021; Whelan, *supra* n. 30; Steinbach, *supra* n. 30.

[84]Available at ⟨www.ecb.europa.eu/press/html/irish-letters.en.html⟩, visited 16 February 2021. *See also* Beukers, *supra* n. 15.

[85]B. Eichengreen, 'What to Do with the Stability Pact', 38 *Intereconomics* (2003) p. 7 at p. 8. Art. 121 TFEU is the primary legal basis of the preventative arm of the Stability and Growth Pact. Article 126 TFEU is primary legal basis for the corrective arm of the Stability and Growth Pact. See further ⟨ec.europa.eu/info/sites/info/files/economy-finance/ip101_en.pdf⟩, visited 16 February 2021.

[86]B. Eichengreen, 'European Monetary Integration with Benefit of Hindsight', 50 *Journal of Common Market Studies* (2012) p. 123 at p. 128.

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tressed countries have difficulties controlling them'.[87] From near inception the Commission sued the Council for its effective suspension of the excessive deficit procedure against France and Germany, to little avail.[88] In any event, Ireland and Spain enjoyed debt to GDP ratios of 40% and were running budget surpluses in the run-up to the crisis.

The absence of a fiscal union is important because:

> A LOLR that provides assistance to sovereigns or to banks may unwittingly serve as a device for transferring resources from one sovereign nation to another, if the country whose banks or sovereign has borrowed from the LOLR later decides to default and exit the currency union.[89]

By contrast, Mody argues that in the United States the sovereign lender of last resort activities of the Federal Reserve could leave it with a loss on the government bonds purchased and the US Treasury would have an obligation to use taxpayer funds to replenish the Federal Reserve's capital.[90] There is no Eurozone treasury to absorb such losses and the other member states may well bear indirect fiscal consequences.[91] Sims points out that in the event of a capital injection 'Germany would bear a large part of the burden, and it would be clear that German fiscal resources were being used to compensate for Bank losses on other countries' sovereign debts'.[92]

De Grauwe provides a useful way of thinking about the intended effect of these legal instruments: member states are required to issue debt in a 'foreign' currency.[93] In the event of economic difficulty, the instruments imply that the member states will be forced to resolve their difficulties by way of internal devaluation, disposal of assets, procuring credit facilities from other member states, borrowing

[87] J. Tirole, *The Euro Crisis: Some Reflexions on Institutional Reform*, April 2012, Banque of France Financial Stability Review, ⟨publications.banque-france.fr/sites/default/files/medias/documents/financial-stability-review-16_2012-04.pdf⟩, visited 16 February 2021.

[88] Case C-27/04, Commission of the European Communities v Council of the European Union [2004] ECR I-06649.

[89] Calomiris et al., *supra* n. 54. On the monetarist versus economist advocacy coalitions during the Economic and Monetary Union negotiations, *see* Dyson and Featherstone, *supra* n. 20.

[90] Mody, *supra* n. 16, p. 312.

[91] Although the foreseeable fiscal implications are contested. *See* for example P. De Grauwe and J. Yuemei, 'Fiscal implications of the ECB's bond-buying programme', *VoxEU.org*, 14 June 2013, available at ⟨www.voxeu.org/article/fiscal-implications-ecb-s-bond-buying-programme⟩, visited 16 February 2021.

[92] C. Sims, 'Gaps in the institutional structure of the Euro Area', 16 *Banque de France Financial Stability Review* (2012) p. 217 at p. 221, ⟨publications.banque-france.fr/sites/default/files/medias/documents/financial-stability-review-16_2012-04.pdf⟩, visited 16 February 2021.

[93] De Grauwe, *supra* n. 19.

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on international markets, etc. However, in a serious economic crisis, absent a sovereign lender of last resort, the instruments empower sovereign bondholders to force the default of the constituent member states. Although there is no express provision providing for withdrawal from the Eurozone other than exiting the EU,[94] Greek exit from the Eurozone (amongst others) was a widely assumed possibility during the crisis.[95] Indeed, policy responses that pre-supposed temporary 'sabbaticals' from the monetary union for the purposes of restoring growth and competitiveness were seriously considered.[96]

As we have seen, these legal instruments attempted a revision of the pre-existing lender of last resort norm whereby the member states issued their sovereign bonds in a currency controlled by their central banks, thereby providing an implicit guarantee that their central bank could act as a lender of last resort in times of crisis.

Credibility of the constitutional architecture of the euro

Prior to its introduction, US economists such as Feldstein and Friedman, who were strong proponents of the single market project, were deeply pessimistic about the prospects for, or need for, a common currency for the common market.[97] Feldstein warned that it may well be possible to launch a single currency and perhaps even sustain one; however, it would result in longer-term negative economic and political costs including higher average unemployment. Friedman cautioned that a common currency did hold out the advantage of lower transaction costs and the imposition of external discipline on some member states, but it was nevertheless a dangerous idea unless there existed adjustment mechanisms capable of absorbing economic shocks in the absence of flexible exchange rates.[98]

[94] *See* Art. 50(1) TEU.

[95] *See* for instance ⟨www.ft.com/content/d69ceb4c-22ff-11e5-bd83-71cb60e8f08c⟩, visited 16 February 2021; M. Wilkinson, 'The Euro Is Irreversible! … Or is it?: On OMT, Austerity and the Threat of "Grexit"', 16 *German Law Journal* (2015) p. 1049.

[96] B. Eichengreen, 'The Crisis and the Euro', *Elcano Newsletter* (2009) p. 20; M. Feldstein, 'Let Greece Take a Eurozone "Holiday"', *Financial Times*, 16 February 2010, ⟨www.ft.com/content/72214942-1b30-11df-953f-00144feab49a⟩, visited 16 February 2021.

[97] M. Feldstein, 'The Case Against the Euro', *The Economist*, 13 June 1992; M. Feldstein, 'EMU and International Conflict', *Foreign Affairs*, November/December (1997); M. Feldstein, 'The Political Economy of the European Economic and Monetary Union: Political Sources of an Economic Liability', 11 *Journal of Economic Perspectives* (1997) p. 4 at p. 23; M. Friedman, 'The Euro: Monetary Unity to Political Disunity', *Project Syndicate*, 28 August 1997, ⟨www.project-syndicate.org/commentary/the-euro–monetary-unity-to-political-disunity?barrier=accesspaylog⟩, visited 16 February 2021.

[98] Similarly, US legal academics such as Scott, who published 'When the Euro Falls Apart' in 1998, were ventilating the break-up of the Eurozone: H.S. Scott, 'When the Euro Falls Apart', 1 *International Finance* (1998) p. 207.

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From a foundational macro-economic perspective, Robert Mundell's 'Theory of Optimum Currency Areas', an eight-page article published over half a century ago, provides the framework for identifying the preconditions required for a smoothly functioning monetary union.[99] In particular, Mundell's theory, when supplemented with the insights of Kenen, emphasises economic convergence, labour mobility, and fiscal integration.[100] This focus is a by-product of the requirement that the economic structures of the constituent states be similar which in turn would act to minimise asymmetric shocks. In 1992 Bayoumi and Eichengreen[101] building on Mundell's Theory of Optimum Currency Areas, considered the ability of the Economic and Monetary Union architecture to handle asymmetric shocks across the then proposed member states, drawing a strong distinction between shocks to 'core' and 'periphery' member states.[102]

The Varieties of Capitalism literature developed analysis of the asymmetry of fiscal and monetary policy preferences between northern European export-orientated market economies and the southern demand-based European countries (plus Ireland[103]).[104] The pursuit of dual growth strategies to complement differing institutional arrangements underpinned by differing monetary policy requirements,

[99]R.A. Mundell, 'A Theory of Optimum Currency Areas', 51 *The American Economic Review* (1961) p. 657.

[100]P. Kenen, 'The Theory of Optimum Currency Areas: An Eclectic View', in R. Mundell and A. Swoboda (eds.), *Monetary Problems in the International Economy* (University of Chicago Press 1969); T. Bayoumi and B. Eichengreen, 'Shocking Aspects of European Monetary Unification', National Bureau of Economic Research (1992) Working Paper 3949, ⟨www.nber.org/papers/w3949⟩, visited 16 February 2021; B. Eichengreen, 'European Monetary Integration with Benefit of Hindsight', 50 *Journal of Common Market Studies* (2012) p. 123; T. Bayoumi and B. Eichengreen, 'Aftershocks of Monetary Unification: Hysteresis with a Financial Twist', *Journal of Banking & Finance* (2018) p. 1.

[101]Bayoumi and Eichengreen (1992), *supra* n. 100.

[102]Eichengreen, both alone and together with Bayoumi, reviewed the application of the Theory of Optimum Currency Areas to the Economic and Monetary Union. Eichengreen queried the extent to which Theory of Optimum Currency Areas accounted for banks acting as propagators of asymmetric shocks. Perhaps this is, at least in part, attributable to developments in banking (de)regulation since Mundell's paper was first published in 1961, itself intertwined with the legacy of the Chicago School: Eichengreen, *supra* n. 100 and Bayoumi and Eichengreen, *supra* n. 100.

[103]Broadly speaking analogous to the core/periphery division in Bayoumi and Eichengreen's Theory of Optimum Currency Areas analysis.

[104]Iversen et al provide a particularly illuminating review of the literature. More generally, *see* D. Soskice and T. Iversen, 'Multiple Wage-Bargaining Systems in the Single European Currency Area', 14 *Oxford Review of Economic Policy* (1998) p. 110; P.A. Hall, 'The Economics and Politics of the Euro Crisis', 21 *German Politics* (2012) p. 355; P.A. Hall, 'Varieties of Capitalism and the Euro Crisis', 37 *West European Politics* (2014) p. 1223; A. Johnston et al., 'Comparative Institutional Advantage in the European Sovereign Debt Crisis', 47 *Comparative Political Studies* (2014) p. 1771; A. Johnston and A. Regan, 'European Monetary Integration and the Incompatibility of National Varieties of Capitalism', 54 *JCMS* (2015) p. 318; Iversen et al., *supra* n. 5.

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presaged conflict between the core and periphery. The Treaty was the lowest common denominator upon which the member states could agree during the negotiation process leading up to it.[105]

The concerns raised by Theory of Optimum Currency Areas and Varieties of Capitalism scholarship regarding the minimalist legal architecture, in turn, highlight the important role that rational-expectations theory played in providing justification for it. In the wake of the stagnation in the 1970s, Keynesian policies were undermined. In particular, the long-term benefits of manipulating monetary policy were challenged by Chicago School economists such as Friedman, who argued that market actors gradually adapt their expectations based on past outcomes for inflation.[106] Appeals to rational-expectations economics helped justify the sparse legal framework. Market actors, in this case actors in the sovereign bond market, would account for the implications of the information contained in Articles 123 and 125 TFEU, along with the minimalist architecture of the Economic and Monetary Union more generally. They would adapt to the risk implied by the legal instruments – i.e. the absence of a sovereign or banking lender of last resort. Accordingly, they would individually and collectively coordinate their behaviour pursuant to the proposed new norm. In particular, the risks arising from member states issuing sovereign bonds in a currency that they did not control, and in the absence of a sovereign leader of last resort, would be priced into assets, in particular sovereign debt yields.

In sum, the member states effectively established a monetary framework without a clear, transparent sovereign or banking lender of last resort. Moreover, they guaranteed that this would be so by enshrining measures expressly circumscribing assistance by way of monetary accommodation. The Treaty of Maastricht implied two relevant pieces of information regarding risk-sharing. First, Article 123, and possibly 125, TFEU constrained the Bank from acting as sovereign lender of last resort to the member states so that market actors could force sovereign default. Secondly, there was no fiscal or banking union to share the risks associated with default and/or bailouts.[107] This information had the purpose of establishing a new norm: that the Bank would not act as a sovereign lender of last resort. The market actors were, inter alia, an audience for this proposed new norm and those actors were expected to adapt their decisions accordingly. However, the then prevailing US macroeconomic and Varieties of Capitalism frameworks doubted the ability of the euro to absorb an asymmetric shock and doubted the efficacy of the new rules that were inconsistent with the longstanding (even if varied) norms that there would be a lender of last resort.

[105]Hall (2014), *supra* n. 104, p. 1225.

[106]M. Friedman, 'The Role of Monetary Policy', 68 *American Economic Review* (1968) p. 1.

[107]A. Pizzolla, 'The Role of the European Central Bank in the Single Supervisory Mechanism: A New Paradigm for EU governance', 43 *European Law Review* (2018) p. 3.

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The lived experience of the legal instruments

In theory the constitutional framework of the euro constrained the Bank from acting as a sovereign lender of last resort to the member states. In reality, from the announcement of the Economic and Monetary Union financial markets lent to periphery states at historically low interest rates which moved towards near convergence of spreads. So much so, the spreads in 10-year government bond rates were close to zero prior to the crisis; a phenomenon disassociated from changes to the economic fundamentals of the member states.[108] In effect, the interest rates of the member states decreased and converged upon that of Germany and stayed at that level until the global financial crisis.[109]

In fact, Whelan demonstrates that market actors priced in almost no default risk in the pre-crisis years.[110] Investment in the sovereign debt of periphery member states did not command a higher risk premium (relative to the core member states) following the introduction of the Economic and Monetary Union because, in the eyes of the bondholders, the chances of default were significantly diminished notwithstanding the legal provisions.[111] The convergence of interest rates suggests that the market did not view the no-bailout provision as credible. Assuming that the core member states were unlikely to enjoy the fiscal capacity, let alone democratic will, to bailout the large periphery member states such as Italy and Spain (let alone collectively) without risk of contagion in the absence of cooperation from the Bank, then this also undermines the credibility of Article 123 TFEU.

And so, prior to the global financial crisis, the decision-making of market actors is better explained through an expectation that the periphery member states would have the liquidity to meet their debt obligations at maturity, implying that the Bank would adhere to the pre-existing sovereign lender of last resort norm if necessary.

As the crisis began to unfold, it became apparent that the decision-making of the Bank was not being guided by the pre-existing sovereign lender of last resort norm but

[108] P. De Grauwe and Y. Ji, 'Disappearing Government Bond Spreads in the Eurozone Back to Normal?', 369 *Centre for European Policy Studies Working Document* (2014) p. 1 at p. 2. For an alternative perspective, *see* the Kronberger Kreis (and cited literature): L. Feld et al., 'Dismantling the Boundaries of the ECB's Monetary Policy Mandate', *Kronberg Circle Study* 61 (2016), ⟨www.stiftung-marktwirtschaft.de/fileadmin/user_upload/KK-Studien/KK_61_OMT-Judgement_2016.pdf⟩, visited 16 February 2021.

[109] For a visualisation of the near convergence of sovereign debt yields *see* figure 1 in K. Whelan, 'Sovereign Default and the Euro', 29 *Oxford Review of Economic Policy* (2013) p. 478.

[110] Whelan, *supra* n. 109.

[111] For clarity, I do not purport to provide a complete account of market decision-making. There are multiple intersecting causes. For instance, during the 'great moderation' the prospect of sovereign default was considered unlikely. *See* for instance R. Lucas, 'Macroeconomic Priorities', 93 *The American Economic Review* (2003) p. 14.

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rather by that embedded within the treaty.[112] As spreads diverged, the Bank did not signal a 'whatever it takes' commitment to provide the necessary liquidity to the member states such as to interrupt the flight to safety. Between 2010-12 the periphery member states experienced a significant increase in their spreads relative to those of the core member states. According to De Grauwe and Ji the marked increase in the spreads of the periphery countries could not 'be accounted for by fundamental developments, in particular by the changes in the debt-to GDP ratios'.[113]

This is not to say that the Bank took no action. For example, on 14 May 2010, the Bank announced its temporary Securities Markets Programme.[114] Unfortunately, according to Mody and Nedeljovic, the Bank's measures led to a reduction in median bond spreads but also to a stronger perception that spreads on Greek bonds would rise and spreads on Spanish, Portuguese and Irish bonds would also rise and remain elevated. They conclude that the market was largely unsure about the Bank's strategy.[115]

As the decision-making of the market actors departed from the pre-existing lender of last resort norm, their coordination shifted toward a new focal point; the Bank would not act as sovereign lender of last resort. The effect: a cascading dynamic of self-perpetuating crisis or in common parlance: a bank-run dynamic and flight to safety.

What 'it' took – the exercise of interpretive control over operational norms

Through the provision of emergency liquidity assistance, national central banks acted as lenders of last resort to their banking systems during the crisis.[116] From May 2010 periphery member states began receiving bailouts and, on 2 February 2012, the European Stability Mechanism was agreed, thereby institutionalising a

[112]For example, on 6 January 2010, European Central Bank Executive Board member Jürgen Stark made the claim that 'The Treaties set out a "no bail-out" clause, and the rules will be respected. This is crucial for guaranteeing the future of a monetary union among sovereign states with national budgets. The markets are deluding themselves when they think at a certain point the other member states will put their hands in their wallets to save Greece': *see* ⟨www.telegraph.co.uk/finance/comment/ambroseevans_pritchard/6942680/Euro-brinkmanship-escalates-as-ECB-shuts-door-on-Greek-bail-out.html⟩, visited 16 February 2021.

[113]De Grauwe and Ji, *supra* n. 108, p. 3.

[114]ECB (2010) 'Decision of the European Central Bank of 14th May 2010 establishing a securities markets programme'. OJ L124/8 20.5.2010, ⟨www.ecb.europa.eu/ecb/legal/pdf/l_12420100520en00080009.pdf⟩, visited 16 February 2021.

[115]They go on to suggest that this was likely exacerbated by the lack of transparency surrounding the Bank's operation of the Securities Markets Programme: A. Mody and M. Nedeljkovic, 'The ECB's Performance during the Crisis: Lessons Learned', *VoxEU.org*, 14 January 2019, ⟨voxeu.org/article/ecb-s-performance-during-crisis⟩, visited 16 February 2021.

[116]Albeit not without controversy or de facto conditionality. *See* Beukers, *supra* n. 15; Steinbach, *supra* n. 30; Kilpatrick, *supra* n. 21.

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permanent crisis resolution mechanism funded by bond sales and capital from member states.[117] Nevertheless, the situation continued to deteriorate.

On 26 July 2012, Mario Draghi announced that the euro was irreversible and that '[w]ithin our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough'.[118] In August 2012, the Bank announced its policy of OMT.[119] On 6 September 2012, a press release on decisions taken by Governing Council of the Bank set out the technical features of OMT.[120] The Bank announced that it would purchase the debt of distressed member states absent any ex ante quantitative limit. The sum and substance of these communications was to signal to the market that the Bank would act as a sovereign lender of last resort subject to conditions.[121] Pursuant to Article 123(1) TFEU the Bank is not prohibited from purchasing government bonds in the secondary markets.[122] Formally in doing so it is not directly providing credit to the member state. In reality, however, the Bank is providing liquidity to the holder of that bond, typically a financial institution within that member.[123] What are the analytical and normative implications for the legitimacy and authority of the Bank in the eyes of market actors?

Transnational organisations can and do exercise significant authority over a variety of audience actors in the absence of a traditional formal or 'solid' legal architecture and accoutrements.[124] To do so, Krisch argues that they must establish and maintain their own authority in the eyes of their audience. One manner in

[117]Treaty Establishing the European Stability Mechanism, signed on 2 February 2012. The Eurozone Members had to ratify the Treaty and so it came into effect on 27 September 2012.

[118]ECB (2012), 'Verbatim of the remarks made by Mario Draghi', *supra* n. 4.

[119]The program allows the Bank to purchase the sovereign debt of distressed Members in secondary markets, subject to conditions: ECB (2012), 'Introductory statement to the press conference', *supra* n. 4.

[120]ECB (2012), 'Technical features of Outright Monetary Transactions', *supra* n. 4.

[121]The key condition is that the Member had agreed, and abides by, a programme of macroeconomic adjustment with the European Stability Mechanism or its predecessor. The programme will focus on short-term debt of one to three years, the purchases will be on secondary markets, the Eurosystem has 'pari passu' creditor status and full steralisation of the liquidity effect is promised. The Court pronounced the program compatible with the treaties in *Gauweiler*: *Gauweiler*, *supra* n. 1.

[122]*Gauweiler*, *supra* n. 1, para. 82.

[123]The Bank also pursued policies of quantitative easing most controversially by way of the Public Sector Purchase Programme. The Court approved the measure, although the German Federal Constitutional Court expressed dissatisfaction with that review: ECJ 11 December 2018, Case C-493/17, *Weiss and Others*, EU:C:2018:1000. *See further* M. Dawson and A. Bobić, 'Quantitative Easing at the Court of Justice – Doing Whatever it Takes to Save the Euro: Weiss and Others', 56 *Common Market Law Review* (2019) p. 1005; M. Dawson et al., 'Reconciling Independence and Accountability at the European Central Bank: The False Promise of Proceduralism', 23 *European Law Journal* (2019) p. 75.

[124]N. Krisch, 'Authority, Solid and Liquid, in the Postnational Sphere', in M. del Mar and R. Cotterell (eds.), Transnational Legal Authority (Edward Elgar, 2016) p. 25-48.

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which they do so is through building perceived functional effectiveness. The 'liquid' nature of their authority renders unavailable to them the traditional tools for norm revision by threat of sanction (penalties, fines, etc.). Instead, they must appropriate for themselves an endogenous, as opposed to exogenous, authority based more on deference than on command and control. Put another way, scholars such as Renan remind us that the exercise of power can be augmented and constrained by norms of legitimate and respectworthy behaviour.[125] Krisch complements this by arguing that power can also be established and maintained through adherence to those norms.[126]

The Bank does not fall neatly into the category of a purely 'liquid' institutional actor. The treaties provide a level of solidity not enjoyed by many transnational institutions, and implied departure from the pre-existing norm of a sovereign lender of last resort at a time of crisis.[127] Yet, treaty revision to reinstate that historical norm was not feasible.[128]

But Krisch's distinction between 'liquid' and 'solid' authority is not just binary. The metaphor and ancillary vocabulary has been extended by Black, herself developing and extending the work of Raz, to usefully capture the output legitimacy paradox arising from such interventions. The Bank sought to exercise control over its operational norms through an authority that was more 'liquid' than formally legal (solid).[129] The intervention enjoyed a high level of dynamism, was delivered in a relatively informal manner (a conference for investors in London), the features of OMT were communicated in technocratic terms (a press release) over a month later, and the exercise of authority was not (and could not be) accompanied by a formal sanction aimed at bondholders such as a fine or penalty. In the eyes of its audience (market actors), the commitment of the Bank to save the euro, along with its technical ability to do so via OMT, removed any doubt about the operational lender of last resort norm; the Bank would act as de facto lender of last resort, albeit one only operating on secondary bond markets and subject to certain conditions, despite what a narrow, originalist reading of Article 123 TFEU had, until the press conference and the subsequent judgment of the Court, suggested.[130] In effect, the Bank signalled its decision to be guided by the pre-existing lender of last resort norm so long as member states entered into a credible programme

[125]Renan, *supra* n. 21.

[126]N. Krisch, 'Liquid Authority in Transnational Regimes', 9 *International Theory* (2017) p. 237.

[127]The solidity of the Bank is reflected in the extensive powers and duties set out at Chapter 2 of Title VIII TFEU as opposed to international regulators.

[128]D. Hodson and I. Maher, *The Transformation of EU Treaty Making* (Cambridge University Press 2018).

[129]J. Black '"Says Who?" Liquid Authority and Interpretive Control in Transnational Regulatory Regimes', 9 *International Theory* (2017) p. 286; Krisch, *supra* n. 126; J. Raz, *The Authority of Law: Essays on Law and Morality* (Oxford University Press, 1979).

[130]Iversen et al., *supra* n. 5, p. 179.

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of adjustment thereby ensuring the medium-term viability of their debt obligations. The Bank assured market actors that they could trust in this commitment and they did,[131] a trust later validated by the Court.[132] The role of perceived authority cannot be understated because once a lender of last resort norm is considered credible the chances of it actually becoming engaged become significantly diminished.

The decision of the Court in *Gauweiler* was justified (in part) on the distinction that the Bank is not primarily (as it claims) acting as a sovereign lender of last resort through the promise of OMT.[133] The Bank claimed that OMT was not aimed at supporting the financing conditions of the member states but rather to unblock monetary policy transmission channels.[134] In this respect, the Court found that the objectives and instruments of OMT contributed to monetary policy and that any indirect effects on economic policy did not classify it as so. Furthermore, the Court placed weight on the fact that the purchases would not be directly from a member. Suffice it to say these were not ordinary times. It would have been better had the Bank not been obliged to push its mandate, but it was.

In any event, the Court clearly signalled that the 'whatever it takes' intervention of the Bank, the absence of any ex ante quantitative limit on the size of its bond purchasing powers, and the broad institutional discretion that the Bank assumed for itself, all survived legal challenge.[135] This suggests that, at least from the audience perspective of market actors, the Bank's signal to the effect it would act as a sovereign lender of last resort, as per the historic norm, was credible and trustworthy, especially when endorsed by the Court.[136] In this way, the Court could be said to have acted as a solidifying agent rendering exogenous the endogenous authority and legitimacy of the Bank. Indeed, in doing what was perceived as necessary to save the euro, just like the Bank before it, the Court might be said to have played an active role in maintaining its own authority and legitimacy.

This brings into focus the danger implied by the German Federal Constitutional Court's decision in *Weiss*. In describing the legal analysis of the

[131]De Grauwe, *supra* n. 19; Iversen et al., *supra* n. 5, p. 179.

[132]In *Gauweiler* and to a much lesser extent in *Weiss*. Albeit, it is worth bearing in mind the welfare consequences for Europeans had the Court not lent its support to the actions of the Bank.

[133]Hinarejos, *supra* n. 15. Editorial, *supra* n. 1. *See also* Y. Listokin, *Law and Macroeconomics* (Harvard University Press 2019) p. 89; M. King, *The End of Alchemy: Money, Banking and the Future of the Global Economy* (Norton 2016) p. 386; Mody, *supra* n. 16, p. 314.

[134]*Gauweiler*, *supra* n. 1, para. 104.

[135]Editorial, *supra* n. 1, p. 234. *See also* Hinarejos, *supra* n. 15.

[136]Constraints on space have focused this study on the decision-making of market participants. Yet, other stakeholder audiences were likewise attuned to, and welcoming of, the development. It is particularly noteworthy that the actions of the Bank were not challenged by the German government but rather by an 'eclectic mix of businessmen, academics and retired politicians': 'Germany's ECB Critics Toast Courtroom Success' *Financial Times*, 8 May 2020, ⟨www.ft.com/content/8a92ad59-50de-4907-bf65-4086960ac161⟩, visited 16 February 2021.

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Court of Justice as 'not comprehensible', one that 'manifestly exceed[s] the judicial mandate conferred upon it' and the judgment no more than an 'ultra vires act that is not binding upon' Germany, the Federal Constitutional Court too is sending a signal to market actors about the extent of the Bank's capacity and, by extension, authority to market actors.[137] To be clear, the Bank's Public Sector Purchase Programme is consistent with EU law as adjudged by the Court of Justice. Nevertheless, as the Bank operationalises the Pandemic Emergency Purchase Programme, and possible successor programmes, the prospect that one of the national central banks may find itself restrained by its domestic constitutional apex court as it carries out its obligations as a constituent of the European System of Central Banks, creates unhelpful uncertainty that may serve to undermine the authority of the Bank.

Conclusions

For all the legal ink spilt on the Eurozone crisis, perhaps its genesis story is one of a legal instrument that was in strong conflict with a prevailing norm rendering it ineffective at times of crisis. That historic norm had emerged to solve a problem.

In any event, the fact remains that prior to the 'whatever it takes' intervention there was a clear mismatch between the framing of important treaty provisions and political-economic exigencies required to sustain the currency created by those treaties. Market actors during the crisis did not trust that the Bank would act as lender of last resort. For the institution tasked with adhering to the legal norm, the European Central Bank, the welfare costs associated with doing so became overwhelming. The Bank persuaded actors to trust its 'whatever it takes' intervention, but that persuasion was inextricably bound up with the operation of norms through which the choices of market actors were channelled. But the Bank was also able to successfully speak a second language to another audience, persuading the Court that it would operate in a manner consistent with the treaty, as now interpreted. The Court was itself sensitive to the political-economic reality. By acting as a bulwark against an undermining of the Bank's authority, the Court maintained and solidified not only the legitimacy of the Bank but of itself.

In the wake of this experience, the European monetary infrastructure is dealing with a profound shock arising from the economic consequences of the Covid-19 pandemic. The Eurocrisis required the Bank and Court to depart to a disconcerting degree from originalist readings of treaty provisions to accommodate the sovereign lender of last resort function of the Bank. Underwriting the expansion of the European Stability Mechanism, Coronabonds, sovereign debt restructuring and other unconventional measures now under discussion imply a further dissolution

[137] *Weiss*, *supra* n. 12, paras. 133 and 154.

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of the constraints imposed by the treaties, giving rise to legitimate concern.[138] This, in part, may have prompted the unconventional rhetoric of the German Federal Constitutional Court in *Weiss* whereby it, in effect, sought to assert for itself greater capacity to scrutinise and constrain the Bank's crisis response.

But, just as importantly, there are constraints imposed by the hard core reality that the formal legal framework enshrined a profoundly inadequate lender of last resort function for the Bank. The fact that even policy measures necessary to save the euro or to promote growth – such as quantitative easing, pursued by central banks around the world – require the Bank to speak two languages does not bode well. Yet there is hope in the observation of Oliver Wendell Homes Jr. that '[t]he life of the law has not been logic: it has been experience'.[139] Therefore, as this latest shock brings political actors back together to find new compromises regarding the distribution of the burden of adjustment arising from it, they do so with the benefit of the authority that the Bank and Court have appropriated for themselves in the eyes of market actors. They also do so with the benefit of a greater sense of the strength and robustness of the trust placed in the legal instruments at their disposal.

This time, reform proposals cannot operate on a latent assumption that member states can, in uncomplicated ways, lay down new rules for market actors to follow. Cold water must be poured over calls for rule adherence or judicial review that is insensitive to the norms that guide the decisions of market actors. Poorly designed legal instruments and ill-considered judicial interventions that take inadequate account of prevailing norms and the exigencies of the circumstances function to destabilise the economic constitution of the Eurozone and the credibility of EU law more generally. Thus, the ability of member states to effectively solve coordination problems through credible commitments enshrined in law requires sensitivity to the dynamic authority, legitimacy, and capacity of those legal instruments and the institutions they establish. The construction of a functional constitutional framework that reinforces desirable norm-governed behaviour, yet manifests the capacity to revise targeted legal provisions, will guard against the erosion of the euro by the economic shock visited upon it by Covid-19.

[138]European Council (2020), "Joint statement of the Members of the European Council", 26 March 2020, ⟨www.consilium.europa.eu/media/43076/26-vc-euco-statement-en.pdf⟩, visited 16 February 2021; A. Bénassy-Quéré et al., 'A proposal for a Covid Credit Line', *VoxEU.org*, 21 March 2020; L. Codogno and P. van den Noor, 'COVID-19: A euro area safe asset and fiscal capacity are needed now', *VoxEU.org*, 25 March 2020.

[139]O.W. Holmes, *The Common Law* (Macmillan 1882) p. 1.

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