

**Seminar on Current Developments in Monetary and Financial Law
Washington, D.C., October 23-27, 2006**

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**The Price Stability Mandate of the European System of Central Banks:
A Legal Perspective**

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The ESCB is entrusted with one overriding objective: to maintain price stability. This goal is its single most important objective, the reason for which the System is created, briefly: its raison d'être. It is with a view to this that the central banks of the European Community are to be endowed with a large measure of independence: it is with the ultimate objective of maintaining price stability that the ESCB will be put on a separate footing from the political organs of the Community.

- René Smits²

1. Introduction

The European System of Central Banks (ESCB), comprising the European Central Bank (ECB) and the national central banks (NCBs) of the Member States of the European Union (EU), is established under the provisions of the Treaty Establishing the European Community (the 'Treaty' or the 'EC Treaty'), to which the 27 EU Member States are party.³ Under the Treaty the primary objective of the ESCB shall be to maintain price stability and, without prejudice to this primary objective, the ESCB shall support the general economic policies in the Community.⁴

This paper will examine the ESCB's objectives from a legal perspective. *First*, the paper will outline the relevant provisions of the Treaty setting out the ESCB's mandate. *Second*, the paper will explain the overriding importance that the Treaty has assigned to the ESCB's objective to maintain price stability, and summarise the main economic and historical influences on the evolution of this objective. *Third*, the paper will explore the ESCB's price stability objective in more precise terms, and outline

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² René Smits, *The European Central Bank: Institutional Aspects*, Kluwer Law International, 1997, 184.

³ The central banking system of the euro is comprised only of the ECB and the national central banks of the (at the time of writing) 13 EU Member States which have adopted the euro, commonly referred to as the 'Eurosystem'.

⁴ EC Treaty, Article 105(1), first and second sentences.

the extent to which this objective is susceptible to judicial oversight by the European Court of Justice. *Fourth*, the paper will describe the key link identified by the Court of Justice in the *OLAF* case⁵ between the principle of central bank independence and the objective of price stability. *Fifth*, the paper will discuss the ESCB's secondary objective to support the general economic policies in the Community, against the background of a coordinated, but not a single, economic and fiscal policy in the euro area. *Sixth*, the paper will explain how the ESCB's mandate helped to clarify the constitutional position of the ECB within the Community legal order in the *OLAF* case, where the Court of Justice showed a strong appreciation that the objective to maintain price stability is one of the cornerstones of economic and monetary union, and, therefore, of the European Community as a whole. *Seventh*, the paper will explore whether the ESCB price stability mandate is applicable to all 27 national central banks in the ESCB, and not only the ECB and the central banks of Member States which have adopted the euro. *Finally*, the paper will assess the manner in which the proposed European Constitution addresses the mandate of the ESCB.

2. Treaty-based mandate of ESCB

The objectives of the ESCB are set out in Article 105(1) of the Treaty, which provides as follows:

The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the primary objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 of the Treaty. The ESCB shall act in accordance with the principle of an open market economy with free competition, ensuring an efficient allocation of resources, and in compliance with the principles set out in Article 4.

The objectives of the Community laid down in Article 2 are as follows:

The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.

For the purposes set out in Article 2, Article 3(1) of the Treaty identifies the full range of the Community's activities, including the prohibition of customs duties and quantitative restrictions on the import and export of goods between Member States; a common commercial policy; an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital; the approximation of the laws of Member States to the extent required for the functioning of the common market; a system ensuring that

⁵ Case C-11/00, *Commission of the European Communities v. European Central Bank*, [2003] E.C.R. I -7147.

competition in the internal market is not distorted; measures concerning the entry and movement of persons; common policies in the spheres of agriculture, fisheries and transport; coordination between employment policies; policies in the social sphere (the European Social Fund), the environment and development cooperation; the strengthening of economic and social cohesion and the competitiveness of industry; the promotion of research and technological development; the development of trans-European networks; contributions to health and consumer protection, education, training and culture; and measures in the spheres of energy, civil protection and tourism.

As noted above, the ESCB is required under Article 105(1) of the Treaty to act in compliance with the principles of Article 4 of the Treaty, which identifies the activities of the Member States and the Community concerning economic and monetary union. In particular, Article 4(3) of the Treaty provides as follows:

These activities of the Member States and the Community shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments.

3. Overriding importance of price stability

The Treaty establishes a clear hierarchy of objectives for the ESCB and assigns overriding importance to maintaining price stability.⁶ The maintenance of price stability can be properly characterised as the *Grundnorm* or *raison d'être* of the ESCB.⁷ Because the primary objective of price stability is written into the EC Treaty, it can only be amended by means of an inter-governmental conference followed by ratification of the amendments by all the Member States in accordance with their respective constitutional requirements.⁸

The ESCB's primary objective to maintain price stability has often been contrasted with the multiple goals of the U.S. Federal Reserve System, whose Board of Governors and Federal Open Market Committee are required to 'maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates.'⁹ The basic economic thinking behind setting price stability as the primary objective of the ESCB's monetary policy is that, *first*, it is the task of other economic actors than central banks, notably those responsible for fiscal and structural policies, to enhance the growth potential of the economy, and, *second*, that assigning to monetary policy an objective for real income or employment would be problematic since, apart from the positive impact of price stability, monetary policy has no scope for exerting any lasting influence on real income or employment.¹⁰ By focusing the monetary policy of

⁶ See European Central Bank, *The Monetary Policy of the ECB* (2004), 9-10.

⁷ See Smits, *supra* note 2, at 184; Chiara Zilioli & Martin Selmayr, *The Law of the European Central Bank*, Hart Publishing, 2001, 35-36.

⁸ Article 48, Treaty on European Union; see also Matthias J. Herdegen, *Price Stability and Budgetary Restraints in the Economic and Monetary Union: The Law as Guardian of Economic Wisdom* (1998) C.M.L.R. 9, at 21.

⁹ U.S. Federal Reserve Act, Section 2A, 12 U.S.C. § 225a. For a comparative commentary regarding the respective goals of the ESCB and the U.S. Federal Reserve System, see Carel C.A. van den Berg, *The Making of the Statute of the European System of Central Banks*, Dutch University Press, 2004, 51-60.

¹⁰ See European Central Bank, *supra* note 6, at 43-44; Hanspeter Scheller, *The European Central Bank: History, Role and Functions*, European Central Bank, 2004, 45-47.

the ESCB on this primary objective, the Treaty makes it clear that ensuring price stability is the most important contribution that monetary policy can make to achieving a favourable economic environment and a high level of employment.¹¹

Historically, the formulation of the ESCB's primary objective to maintain price stability evolved out of the blueprint for economic and monetary union put forward in the 1989 'Delors' report, based in large part on a contribution by the Deutsche Bundesbank.¹² Commentators have noted that this objective, together with the independence of the new ESCB, was a precondition to the willingness of the German authorities to sacrifice their national currency, the Deutsche Mark, which had become the strongest of European currencies because of its long record of low inflation.¹³ Commentators have also drawn attention to the particularly strong antipathy to inflation among the German public, dating back to the disastrous experience Germany had with hyperinflation during the 1920s.¹⁴

In broader international terms, commentators have noted that the 'oil shock' of 1973 - the quadrupling of oil prices which contributed to plunging much of the industrialised world into an era of soaring inflation and low and volatile growth, known in economic jargon as stagflation - is a historical development which marked a turning point in the understanding of the need for price stability. The oil shock destroyed the post-war pattern where governments had tried to buy a little more growth with a little more inflation (following the Philips curve), instead entrenching price stability as their primary concern. This development has had important legal implications nationally and internationally, particularly in the 1990s, as a substantial number of domestic laws, as well as international treaties such as the EC Treaty, have made this objective the primary goal of central banks and monetary agencies.¹⁵

4. Precise interpretation of ESCB's price stability mandate

The Treaty does not give a precise definition of what is meant by price stability. The term is generally understood as denoting internal price stability, meaning the volume of goods and services which can be obtained for one euro, as opposed to the stability or strength of the currency in terms of third currencies such as the U.S. dollar, Japanese yen or British sterling.¹⁶ This interpretation is supported by the fact that, under the Treaty, the decision as to which Member States fulfil the necessary

¹¹ See European Central Bank, *supra* note 6, at 10; Jean-Victor Louis, *L'Union économique et monétaire*, in Commentaire Megret, *Le Droit de la CEE*, Editions de l'Université de Bruxelles, 1995, 58; Scheller, *supra* note 10, at 45-47; Jean-Claude Trichet, *Why Price Stability?*, European Central Bank (2001), at 220.

¹² Committee for the Study of Economic and Monetary Union, *Report on Economic and Monetary Union in the European Community*, Office for Official Publications of the European Communities, 1989, para. 32; Karl Otto Pöhl, *The further development of the European Monetary System*, published in the Collection of papers submitted to the Committee for the Study of Economic and Monetary Union, *Report on Economic and Monetary Union in the European Communities*, Office for Official Publications of the European Communities, 1989, para. IIB.1; see also van den Berg, *supra* note 9, at 60-71.

¹³ See Louis, *supra* note 11, at 58; Philippe -Emmanuel Partsch, *La Politique Monétaire*, in Union européenne/ Communauté européenne, *Commentaire article par article des traités UE et CE*, Helbing & Lichtenhahn, 2000, 1000; van den Berg, *supra* note 9, at 51-52.

¹⁴ See Rosa M. Lastra, *Legal Foundations of International Monetary Stability*, Oxford University Press, 2006, 56; van den Berg, *supra* note 9, at 52-53; Christian Waigel, *Die Unabhängigkeit der Europäischen Zentralbank*, Nomos Verlagsgesellschaft, 1999, 21.

¹⁵ See Lastra, *supra* note 14, at 37-38.

¹⁶ See Charlotte Gaitanides, *Das Recht der Europäischen Zentralbank*, Mohr Siebeck, 2005, 18-20; Smits, *supra* note 2, at 184; Rainer Stadler, *Der rechtliche Handlungsspielraum des Europäischen Systems der Zentralbanken*, Nomos Verlagsgesellschaft, 1996, 100.

conditions for the adoption of the euro is made on the basis of a number of economic convergence criteria, including the achievement of a high degree of 'price stability'.¹⁷ This criterion on price stability means, in particular, that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1½ % that of, at most, the three best performing Member States in terms of price stability.¹⁸ This demonstrates that the term 'price stability', as referred to in the Treaty, refers exclusively to internal price performance.¹⁹

In the absence of any clarification in the Treaty regarding the specific level of price stability to be maintained by the ESCB pursuant to its primary objective, the ECB is in a position to determine for itself what level of price stability it considers acceptable.²⁰ The ECB has defined this price stability in quantitative terms as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below, but close to, 2% over the medium term, which makes clear that not only inflation above 2%, but also deflation, would be inconsistent with price stability.²¹

As a matter of strict legal theory the European Court of Justice, as the final arbiter regarding the interpretation of the Treaty, may be called upon to determine whether particular measures adopted (or not adopted) by the ECB are consistent with the ESCB's primary objective to maintain price stability.²² In this respect, some commentators have argued that particular inflation ranges expressed in precise quantitative terms (e.g., 0 to 3%, or less than 2%) would be compatible with price stability, and even that the ECB is legally bound to respect such precise limits.²³ It is submitted, however, that the Court would be reluctant to curtail the discretion of the ECB on what it is essentially a matter of monetary policy. In *Roquette Frères*²⁴ the Court stated that where 'the evaluation of a complex economic situation is involved', the Commission 'enjoys a wide measure of discretion', and that '[i]n reviewing the legality of the exercise of such discretion, the Court must confine itself to examining whether it contains a manifest error or constitutes a misuse of power or whether the authority did not clearly exceed the bounds of its discretion.' The Court may be expected to accord the ECB a similarly large degree of discretion with respect to the precise formulation of monetary policy, provided that the ECB's elaboration of what is meant by price stability is based on economically reasonable grounds.²⁵

¹⁷ EC Treaty, Articles 121(1) and 122(2).

¹⁸ Protocol (No. 6) annexed to the EC Treaty on the convergence criteria referred to in Article 121 (ex Article 109j) of the Treaty, Article 1.

¹⁹ See Martin Selmayr, *Wie unabhängig ist die Europäische Zentralbank?*, 49 Wertpapier Mitteilungen (1999), 2429, at 2431-32.

²⁰ See Partsch, supra note 13, at 1001; Smits, supra note 2, at 186.

²¹ See European Central Bank, supra note 6, at 50-55.

²² EC Treaty, Articles 230 (1)-(2), 232 (1), (4), 234; see also D.R.R. Dunnett, *Legal and Institutional Issues Affecting Economic and Monetary Union*, in *Legal Issues of the Maastricht Treaty*, Wiley Chancery Law, 1994, 137; Prof. Dr. Bernhard Kempen, *EUV/EGV Vertrag über die Europäische Union und Vertrag zur Gründung der Europäischen Gemeinschaft (Art. 105 EGV)*, Verlag C.H. Beck (2003), 1309; Smits, supra note 2, at 186.

²³ See Selmayr, supra note 19, at 2432; Smits, supra note 2, at 185-86; Stadler, supra note 16, at 103-4.

²⁴ Case 29/77, *S.A. Roquette Frères v. French State* [1977] E.C.R. 1835, paras. 19-20; see also Case 74-74, *Comptoir national technique agricole (CNTA) SA v. Commission of the European Communities* [1975] E.C.R. 533, paras. 16, 21-23.

²⁵ See Gaitanides, supra note 16, at 39-40.

5. ESCB's price stability mandate and central bank independence

In the *OLAF* case²⁶ the European Court of Justice was confronted with the question of whether conferring powers on the European Anti-Fraud Office (OLAF) – a bureau within the European Commission charged with combating fraud, corruption and other illegal activities affecting the Community's financial interests - to conduct internal investigations within the ECB would infringe the ECB's independence under the Treaty. The ECB's independence is established under Article 108 of the Treaty, which provides that, when exercising the powers and carrying out the tasks and duties conferred upon them by the Treaty, neither the ECB, nor a national central bank, nor any member of their decision making bodies shall seek or take instructions from Community institutions (including the Commission) or bodies, from any government of a Member State or from any other body.

While the Court ruled against the ECB on the facts of this particular case, the Court considered that 'it is appropriate to state at the outset that the draftsmen of the EC Treaty clearly intended to ensure that the ECB should be in a position to carry out independently the tasks conferred upon it by the Treaty.'²⁷ In considering the scope of the ECB's independence both the Court and the Advocate General, in his advisory opinion to the Court,²⁸ made a number of observations highlighting the important link between the objective of price stability and the principle of central bank independence.

Advocate General Jacobs expressed the following opinion regarding this matter:

It is ... clear that the independence thus established is not an end in itself; it serves a specific purpose. By shielding the decision-making process of the ECB from short-term political pressures the principle of independence aims to enable the ECB effectively to pursue the aim of price stability and, without prejudice to that aim, support the economic policies in the Community as required by Article 105(1) EC.²⁹

Advocate General Jacobs also noted that '[c]entral bank independence is thought to serve economic policy goals, notably to reduce inflation and, perhaps, promote economic growth.'³⁰ In this respect, he referred the Court to specific economic literature for what he referred to as 'an overview of the, not entirely conclusive, empirical evidence'.³¹ The economic literature cited by the Advocate General notes that '[t]he foremost argument put forward in favour of an independent monetary authority is that of price stability' because 'governments are tempted to create money for their own ends and in order to produce economic benefits in the short term, which eventually leads to an increase in the rate of inflation'.³² On the crucial question of the

²⁶ Case C-11/00, *Commission of the European Communities v. European Central Bank*, [2003] E.C.R. I -7147.

²⁷ *Ibid.*, para. 130.

²⁸ Under the Treaty it is the duty of the Advocate-General, acting with complete impartiality and independence, to make, in open court, reasoned submissions on cases brought before the Court of Justice, in order to assist the Court in the performance of its task. EC Treaty, Article 222, second para.

²⁹ Case C-11/00, *Commission of the European Communities v. European Central Bank*, [2003] E.C.R. I -7147, Advocate General Jacobs on 3 October 2002, paras. 150 and 155.

³⁰ *Ibid.*, para. 150, note 115.

³¹ *Ibid.* (citing Fabian Amtenbrink, *The Democratic Accountability of Central Banks*, Hart Publishing, 1999, 11-17 and 23-26).

³² See Amtenbrink, *supra* note 31, at 12-14.

rate (as distinct from the variability) of inflation, the literature cited by the Advocate General concludes that '[t]heoretical considerations on the relationship between central bank independence and the rate of inflation are backed by empirical evidence. On the basis of comparisons of the degree of independence of central banks and the inflation record of the respective country a negative correlation between the degree of independence and the inflation record has been generally acknowledged.'³³

The Court echoed the Advocate General's view in more succinct, but trenchant, terms:

Article 108 EC seeks, in essence, to shield the ECB from all political pressure in order to enable it effectively to pursue the objectives attributed to its tasks, through the independent exercise of the specific powers conferred on it for that purpose by the EC Treaty and the ESCB Statute.³⁴

6. ESCB's secondary objective to support general economic policies in European Community

The Treaty provides that, without prejudice to the primary objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community.³⁵ A number of points can be noted regarding this provision.

First, it is clear that the ESCB has only one overriding objective - price stability - and that the ESCB's secondary objective to support general economic policies does not imply any goal sharing.³⁶ This is not to suggest that the ESCB's secondary objective to support general economic policies is meaningless. One commentator has argued that where the ECB has the choice between two measures of monetary policy, both of which comply with the primary objective of price stability, but only one of which has the additional quality of assisting general economic policies, then the ECB must give priority to that measure.³⁷ It is emphasised, however, that the decision in this respect lies solely with the ECB.³⁸

Second, the secondary objective of the ESCB is to support the general economic policies (plural) in (rather than of) the Community. This wording reflects the fact that, under the Treaty arrangements for economic and monetary union, the primary responsibility for economic policy rests with the Member States rather than the Community, subject to the obligation of Member States to coordinate their economic policies within the EU Council and to avoid excessive government deficits, as further

³³ Ibid., 15 (citing, e.g., A. Alesina & L.H. Summers, *Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence*, 25 J. of Money Credit & Banking, No. 2 (1993), 151-62, at 159; A. Cukierman, S.B. Webb & B. Neyapti, *Measuring the Independence of Central Banks and Its Effects on Policy Outcomes*, 6 The World Economic Review, No. 3 (1992), 353-98, at 383).

³⁴ Case C-11/00, *Commission of the European Communities v. European Central Bank*, [2003] E.C.R. I -7147, para. 134 (emphasis added). For an analysis of this aspect of the Court's decision see Frank Elderson & Hans Weenink, *The European Court of Justice redefined? A landmark judgement of the European Court of Justice*, Euredia 2003 - 2, 273, at 291-94, 300.

³⁵ EC Treaty, Article 105(1), second sentence.

³⁶ See Prof. Dr. Ulrich Häde, *Kommentar des Vertrages über die Europäische Union und des Vertrages zur Gründung der Europäischen Gemeinschaft – EUV/EGV (Art. 105)*, Luchterhand, 1347; Kempen, supra note 22, at 1310; Louis, supra note 11, at 59; Selmayr, supra note 19, at 2431; van den Berg, supra note 9, at 55.

³⁷ See Louis, supra note 11, at 59.

³⁸ Ibid.

detailed in the EU Stability and Growth Pact.³⁹ The ESCB's primary objective to maintain price stability has to be understood against this background of a coordinated, but not a single, economic and fiscal policy.

Third, the ESCB's secondary objective is to support general – rather than specific – economic policies in the Community, implying that the ESCB should have regard to general trends in economic policies.⁴⁰ One practical way in which the ECB can support the general economic policies pursued in the Community is by expressing its views regarding economic developments and, like any central bank, offering suggestions for improvement.⁴¹ The mandate to support the general economic policies in the Community does not require the ECB to coordinate its independently formulated monetary policy *ex ante* with the economic policies in the Community. The existence of this secondary objective is, however, part of the rationale behind the ongoing dialogue between the ECB and economic policy-makers at Community level.⁴² This dialogue is underpinned by a number of institutional provisions in the Treaty. For example, the President of the EU Council of Finance Ministers (ECOFIN) and a member of the Commission may participate, without having the right to vote, in meetings of the Governing Council of the ECB.⁴³ The President of the ECB shall be invited to participate in ECOFIN meetings when the Council is discussing matters relating to the objectives and tasks of the ESCB.⁴⁴ The Member States, the Commission and the ECB each appoint not more than two members of the Economic and Financial Committee (EFC), which has the tasks, *inter alia*, of keeping under review the economic and financial situation of the Member States and of the Community, reporting thereon regularly to the ECOFIN and to the Commission, and contributing to the ECOFIN's work on the coordination and multilateral surveillance of the economic policies of Member States and the avoidance of excessive government deficits in connection with the Stability and Growth Pact.⁴⁵

7. Constitutional implications of ESCB's mandate

Prior to the *OLAF* case the precise constitutional relationship between the ECB and the European Community was the subject of academic controversy. Based, *inter alia*, on the ECB's independence and separate legal personality under the Treaty,⁴⁶ some commentators argued that the ECB is 'an independent specialised organisation of Community law, independent from (albeit associated with) the European

³⁹ EC Treaty, Articles 98, 99 and 104; Protocol annexed to the Treaty on the excessive deficit procedure; Resolution of the European Council on the Stability and Growth Pact, Amsterdam, 17 June 1997; Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, as amended; Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, as amended; see also Häde, *supra* note 36, at 1347; Kempen, *supra* note 22, at 1310; Louis, *supra* note 11, at 59; Smits, *supra* note 2, at 181-82, 187-88; van den Berg, *supra* note 9, at 55; Dr. Andreas Zahraknik, *Kommentar zu EU- und EG- Vertrag: Art. 105-124 EGV*, Manzsche Verlags- und Universitätsbuchhandlung, 2004, 5.

⁴⁰ See Smits, *supra* note 2, at 188.

⁴¹ *Ibid.*, at 189.

⁴² See Scheller, *supra* note 10, at 47.

⁴³ EC Treaty, Article 113(1). The President of the ECOFIN may also submit a motion for deliberation to the Governing Council of the ECB.

⁴⁴ EC Treaty, Article 113(2).

⁴⁵ EC Treaty, Article 114(2), (4).

⁴⁶ EC Treaty, Articles 107(2), 108.

Communities’, while others regarded the ECB, quite simply, as ‘the Central Bank of the European Community’.⁴⁷

In the *OLAF* case the European Court of Justice considered the ESCB’s mandate to be of particular relevance to understanding the constitutional position of the ECB within the Community legal order. Advocate General Jacobs made the following observations on this point:

[I]t may be recalled that Article 105(1) EC provides that ‘[w]ithout prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2’. That provision corresponds to Article 4 EC ... which provides that ‘[f]or the purposes set out in Article 2, the activities of the Member States and of the Community shall include ... the adoption of an economic policy’ and that ‘[c]oncurrently with the foregoing ... these activities shall include the ... definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Community in accordance with the principle of an open market economy with free competition’.... It follows ... that the ECB forms an integral part of the Community framework.... The ECB is subject to the general principles of law which form part of the Community and promotes the goals of the Community set out in Article 2 EC through the implementation of the tasks and duties laid upon it. It may therefore be described as the Central Bank of the *European Community*; it would be inaccurate to characterise it, as have some writers, as an organisation which is ‘independent of the European Community’, a ‘Community within the Community’, [or] a ‘new Community’.⁴⁸

Again, the Court echoed the opinion of the Advocate General:

[U]nder Article 4(2) and Article 105(1) EC, the primary objective of the ESCB, at the heart of which is the ECB, is to maintain price stability and, without prejudice to this objective, to lend support to the general economic policies in the European Community, with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 EC, which include an economic and monetary union and also the promotion of sustainable and non-inflationary growth. It follows that the ECB, pursuant to the EC Treaty, falls squarely within the Community framework.⁴⁹

In addition to clarifying the constitutional position of the ECB within the Community legal order, the *OLAF* case indicates a strong appreciation on the part of the Court that the ESCB’s primary objective to maintain price stability is one of the cornerstones of economic and monetary union, and, therefore, of the Community itself.⁵⁰ A number of

⁴⁷ Compare Zilioli & Selmayr, *supra* note 7, at 1-35, especially at 29-32, with Ramon Torrent, *Whom is the European Central Bank the central bank of?: Reaction to Zilioli and Selmayr*, (1999) C.M.L.R. 1229, at 1129-34.

⁴⁸ Opinion of Advocate General Jacobs, *supra* note 29, at paras. 57-60.

⁴⁹ Case C-11/00, *Commission of the European Communities v. European Central Bank*, [2003] E.C.R. I -7147, at paras. 91-92. For an interesting analysis of this aspect of the *OLAF* case, see Elderson & Weenink, *supra* note 34, at 281-87.

⁵⁰ See generally Herdegen, *supra* note 8, at 10-11, 14-17, 20-22.

Treaty provisions in addition to those cited by the Court and the Advocate General point towards the central role accorded to the objective of maintaining price stability within the Community legal order.⁵¹ *First*, the preamble to the Treaty on European Union, under which the provisions on economic and monetary union were introduced into Community law, notes the resolve of the Member States to establish ‘a single and stable currency’.⁵² *Second*, the activities of the Community and the Member States concerning economic and monetary union entail compliance with stable prices as a guiding principle.⁵³ *Third*, as noted above, the decision as to which Member States fulfil the necessary conditions for the adoption of the euro is made on the basis of an examination of, *inter alia*, the achievement of a high degree of price stability.⁵⁴ *Fourth*, as part of the legal integration of national central banks into the ESCB, most national central banks’ statutes were required to be adapted in order to reflect the primary objective of the ESCB to maintain price stability.⁵⁵ *Fifth*, in order to prevent central bank financing of the public sector from fuelling inflation, the Treaty imposes on ESCB central banks a prohibition on monetary financing.⁵⁶ *Sixth*, while the EU Council may, in the absence of an exchange-rate system for the euro in relation to non-Community currencies (such as the old Bretton Woods system of near-fixed exchange rates), formulate general orientations for exchange-rate policy in relation to these currencies, these general orientations shall be without prejudice to the primary objective of the ESCB to maintain price stability.⁵⁷

It is interesting to note the Advocate General’s suggestion that the close identification of the ESCB’s mandate with the European Community itself is also reflected in the obligation of the ESCB to act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources. In this respect, the adherence of the ESCB to open market economy principles must be seen against the ECB’s place within the framework of a Community one of whose main tasks is to establish an internal market based on the free movement of persons, goods, services and capital.⁵⁸

8. Application of ESCB mandate to central banks outside euro area

⁵¹ See Gaitanides, *supra* note 16, at 16; Stefan Tilch, *Europäische Zentralbank und Europäisches System der Zentralbanken*, Peter Lang, 154.

⁵² Treaty on European Union, Recital 6.

⁵³ EC Treaty, Article 4(3).

⁵⁴ EC Treaty, Articles 121(1) and 122(2); Protocol (No. 6) annexed to the EC Treaty on the convergence criteria referred to in Article 121 (ex Article 109j) of the Treaty, Article 1.

⁵⁵ EC Treaty, Article 109; see European Monetary Institute, *Convergence Report* (March 1998), 296, 307, 310, 313, 315-16, 318, 322, 330, 333, 337, 340, 344, 348.

⁵⁶ EC Treaty, Article 101(1), which provides that overdraft facilities or any other type of credit facility with the ECB or with the national central banks in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments. When drafting the Treaty prohibition on monetary financing, the Committee of Governors of the Central Banks of the Member States of the (then) European Economic Community noted that the prohibition ‘is generally regarded as necessary to ensure the System’s ability to achieve its primary objective’ of price stability. See Committee of Governors, *Explanatory Note on Certain Articles Contained in the Proposed Statute of the ESCB and of the ECB* (2 September 1991), 3.

⁵⁷ EC Treaty, Article 111(2). Moreover, the EU Council may only conclude formal agreements on such an exchange-rate system for the euro in relation to non-Community currencies, and adopt, adjust or abandon the central rates of the euro within the exchange-rate system, after consulting the ECB in an endeavour to reach a consensus consistent with price stability. EC Treaty, Article 111(1).

⁵⁸ See Smits, *supra* note 2, at 190-92.

At the time of writing only 13 of the current 27 EU Member States have adopted the euro. The remaining 14 Member States are treated, in the jargon of the Treaty, as 'Member States with a derogation', which entails that the key Treaty provisions relating to monetary union do not apply to the Member States concerned.⁵⁹ While all 27 national central banks are members of the ESCB, the central banks of Member States with a derogation retain their powers in the field of monetary policy according to national law.⁶⁰

The Treaty is unclear as to when the central banks of Member States with a derogation have to comply with the primary objective of price stability (i.e., either straight away, or only from the time the euro is adopted as the currency of the Member State in question).⁶¹ There is a technical inconsistency within the wording of the Treaty regarding whether the price stability objective is applicable to the central banks of Member States with a derogation. Within the main body of the Treaty, it is stipulated that a derogation shall entail that various specified Treaty articles, including Article 105(1) (the provision which sets out the ESCB's primary objective to maintain price stability), do not apply to the Member State concerned.⁶² However, the Treaty further stipulates that the exclusion of such a Member State and its national central bank from rights and obligations within the ESCB is laid down in Chapter IX of the ESCB Statute, annexed as a protocol to the Treaty.⁶³ Chapter IX of the ESCB Statute in turn stipulates that a derogation shall entail that various specified articles of the ESCB Statute shall not confer any rights or impose any obligations on the Member State concerned, but surprisingly does not list Article 105(1) among the excluded provisions.⁶⁴ This suggests that the primary objective of maintaining price stability applies to all ESCB central banks, and not only the ECB and the central banks of Member States which have adopted the euro (commonly referred to collectively as the 'Eurosystem').

Having regard to this conflict within the text of the Treaty, a number of points would appear to support the interpretation that the primary objective of the ESCB to maintain price stability applies to all ESCB central banks.⁶⁵

⁵⁹ EC Treaty, Article 122.

Denmark has an exemption the effect of which is that all provisions of the Treaty and the ESCB Statute referring to a derogation are applicable to Denmark. As for the abrogation of Denmark's exemption, the procedure for deciding whether Denmark fulfils the necessary conditions for the adoption of the euro shall only be initiated at the request of Denmark. See Protocol annexed to the EC Treaty on certain provisions relating to Denmark.

Unless the United Kingdom notifies the EU Council that it intends to move to the third stage of economic and monetary union, it shall be under no obligation to do so. The full legal consequences of the special status of the United Kingdom are spelt out in the Protocol annexed to the EC Treaty on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland (the 'UK Protocol').

⁶⁰ Article 43 of the ESCB Statute. In the case of the United Kingdom, the United Kingdom (as distinct from the Bank of England) shall retain its powers in the field of monetary policy according to national law. UK Protocol, paragraph 4.

⁶¹ See European Central Bank, *Convergence Report* (December 2006), p. 24, published on the ECB's website at <http://www.ect.int/pub/pdf/conrep/cr200612en.pdf>.

⁶² EC Treaty, Article 122(3), first sentence. Similarly, the UK Protocol stipulates that Article 105(1) of the Treaty shall not apply to the United Kingdom. UK Protocol, paragraph 5, first sentence.

⁶³ EC Treaty, Article 122(3), second sentence.

⁶⁴ ESCB Statute, Article 43.1 (which fails to refer to Article 2 of the ESCB Statute). Similarly, when identifying the articles of the ESCB Statute which shall not apply to the United Kingdom, the UK Protocol fails to refer to Article 2 of the ESCB Statute. UK Protocol, paragraph 8.

⁶⁵ The case of the Bank of England is less straight-forward in view of the particular provisions of the UK Protocol. See notes 66, 70 and 72, *infra*.

First, from a textual perspective the primary objective of the ESCB to maintain price stability is an objective that applies to the central bank members of the ESCB, rather than their respective Member States as such. Insofar as the main body of the Treaty sets out the legal implications of a derogation for Member States only, and then refers to the ESCB Statute for an understanding regarding the exclusion of both Member States and their national central banks from rights and obligations within the ESCB, the ESCB Statute would appear to be more directly relevant to understanding the specific implications of a derogation for the central bank of a Member State with a derogation.⁶⁶

Second, it is an established principle of interpretation endorsed by the Court of Justice that every provision of Community law must be placed in its context and interpreted in the light of the provisions of Community law as a whole, regard being had to the objectives thereof and to its state of evolution at the date on which the provision in question is to be applied.⁶⁷ In this respect, the objective to maintain price stability is accorded a central role in the Community legal order. As noted above, the objectives of the Community include the promotion of non-inflationary growth⁶⁸ and the activities of the Member States and the Community concerning economic and monetary union entail compliance with 'stable prices' as a guiding principle.⁶⁹ The application of the primary objective of the ESCB to maintain price stability to the central banks of Member States with a derogation would therefore appear more consistent with the overall scheme and purpose of the EC Treaty.⁷⁰

Third, this conclusion is also based on the underlying rationale of central bank independence, which is only justified if the overall objective of price stability has primacy,⁷¹ consistent with the close link between the ESCB's objective of price stability and the principle of central bank independence identified by the Court of Justice in the *OLAF* case.⁷²

9. Price stability and the European Constitution

In what was intended to mark an important step in the history of European integration, the Heads of State or Government of the EU Member States signed a Treaty establishing a Constitution for Europe in October 2004. While at the time of writing the Treaty has been ratified by a majority of Member States, the Treaty shall only

⁶⁶ This particular argument would appear less persuasive in the case of the Bank of England given that the UK Protocol stipulates that Article 105(1) of the Treaty shall not apply to the United Kingdom, and that in this provision 'references to national central banks shall not include the Bank of England'. UK Protocol, paragraph 5.

⁶⁷ See, e.g., Case 283/81, *CILFIT v. Italian Ministry of Health* [1982] E.C.R. 3415, 3430.

⁶⁸ EC Treaty, Article 2.

⁶⁹ EC Treaty, Article 4(3). The activities of the Member States and the Community concerning monetary union set out in Article 4(2) of the Treaty, to which Article 4(3) refers in part, shall not apply to the United Kingdom. UK Protocol, paragraph 5. However, the activities of the Member States and the Community concerning economic policy coordination set out in Article 4(1) of the Treaty, to which Article 4(3) also refers in part, apply to the United Kingdom, and these particular activities of the United Kingdom would therefore appear to entail compliance with 'stable prices' as a guiding principle.

⁷⁰ See European Central Bank, *supra* note 61, at 24.

⁷¹ See European Central Bank, *supra* note 61, at 24. This particular point is not persuasive in the case of the United Kingdom insofar as the UK Protocol stipulates that Article 108 of the Treaty, which enshrines the independence of ESCB central banks, shall not apply to the United Kingdom, and that in this provision references to national central banks shall not include the Bank of England. UK Protocol, paragraph 5.

⁷² See *supra* Section 6, 'ESCB price stability mandate and central bank independence'.

enter into force upon its ratification by all signatory States.⁷³ In this respect, the ratification process has been disrupted by the rejection of the European Constitution by the people in referenda held in two Member States in mid-2005 (France and the Netherlands). Following this, a lengthy period of reflection regarding the future constitutional development of the EU is underway, but the process of ratification has not been abandoned.⁷⁴

The European Constitution proposes to introduce a single constitutional text that would consolidate and simplify the existing EU/EC Treaties, reform the institutions of the EU and introduce a number of constitutional innovations.⁷⁵ It is of particular interest in the current context that the text of the Constitution confirms that the primary objective of the ESCB shall be to maintain price stability and, without prejudice to that objective, to support the general economic policies in the European Union in order to contribute to the achievement of the Union's objectives.⁷⁶ During the discussions of the draft Constitution in the Convention on the Future of Europe, some Convention members proposed that supporting sustainable growth and high levels of employment should be added, on an equal footing, to the primary objective of price stability. The vast majority of Convention members rejected this suggestion on the ground that the ESCB's current mandate to pursue price stability as a primary objective is based on a broad consensus of policy-makers and economists that maintaining price stability is the best contribution monetary policy can make with regard to the achievement of other economic goals, including growth and employment.⁷⁷

Members of the Convention also touched upon the question of the extent to which price stability should be an objective not only for the ESCB, but also for the Member States and the Union as a whole. There was general agreement that the Constitution should confirm that the activities of the Member States and the Union in connection with the single currency entail compliance with stable prices as a guiding principle.⁷⁸ However, a debate ensued on whether or not price stability should continue to be listed among the overarching objectives of the Union. In its contribution to this debate, the ECB stressed three points. *First*, non-inflationary growth is mentioned as one of the Community's objectives in the existing EC Treaty. *Second*, price stability is not only the ESCB's primary objective, but also forms part of the heart of monetary union for all European citizens; in this sense stable prices clearly benefit society. *Third*, the introduction of a simplified procedure to amend the part of the Constitution which includes the ESCB's primary objective of price stability rendered it necessary to include a reference to price stability among the Union's objectives in order to

⁷³ Article IV-447(2), Treaty establishing a Constitution for Europe.

⁷⁴ See European Commission, *Ratification of the Treaty establishing a Constitution for Europe*, published on the Commission's website at http://europa.eu/constitution/referendum_en.htm.

⁷⁵ See Koen Lenaerts and Piet Van Nuffel, *Constitutional Law of the European Union*, Thomson Sweet & Maxwell, 2005, 70-74.

⁷⁶ Articles I-30(2), second sentence, and III-85(1), Treaty establishing a Constitution for Europe.

⁷⁷ See European Central Bank, *The European Constitution and the ECB*, ECB Monthly Bulletin, August 2004, 58-59; Jean-Victor Louis, *Monetary Policy and Central Banking in the Constitution*, published in European Central Bank, *Legal Aspects of the European System of Central Banks: Liber Amicorum Paolo Zamboni Garavelli* (2005), 27, at 36; Dominique Servais & Rudolphe Ruggeri, *The EU Constitution: Its Impact on Economic and Monetary Union and Economic Convergence*, published in European Central Bank, *Legal Aspects of the European System of Central Banks: Liber Amicorum Paolo Zamboni Garavelli* (2005), 43, at 45-46.

⁷⁸ Article III-177(3), Treaty establishing a Constitution for Europe.

strengthen the Union's commitment to price stability.⁷⁹ The ECB's arguments were accepted, and the key objectives of the Union enshrined in the Constitution were reformulated to include the following reference to price stability:

The Union shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.⁸⁰

This close association of the ESCB's primary objective of price stability with the European Union's core objectives was reinforced by the Constitution's identification of the euro with the Union itself. In this respect the Constitution states that the 'the currency of the Union shall be the euro', and recognises the euro as one of the 'symbols of the Union', alongside the flag, the anthem, the motto and Europe Day.⁸¹ This underlines the role played by the euro in promoting a shared European identity.⁸²

10. Summary and conclusions

This paper has explored the price stability mandate of the ESCB from a legal perspective. The EC Treaty establishes a clear hierarchy of objectives for the ESCB which assigns overriding importance to maintaining price stability. Without prejudice to the ESCB's primary objective to maintain price stability, the ESCB has the secondary objective to support the general economic policies in the European Community.

The ESCB's mandate is often contrasted with that of the U.S. Federal Reserve System, which is required to promote the multiple goals of maximum employment, stable prices and moderate long-term interest rates, without establishing any hierarchy among these goals. By focusing the monetary policy of the ESCB on the primary

⁷⁹ See Letter from Jean-Claude Trichet, President, European Central Bank, to Brian Cowen, President, Council of the European Union, 16 April 2004, *Negotiations on the draft Treaty establishing a Constitution for Europe*, 1, published on the ECB's website at www.ecb.int/pub; see also European Central Bank, supra note 78, at 59; Servais & Ruggeri, supra note 78, at 45.

⁸⁰ Article I-3(3), first para., Treaty establishing a Constitution for Europe. Some commentators have questioned whether this wording refers to price stability as a goal, or rather as a means to achieve the sustainable development of Europe alongside balanced economic growth, a competitive social market economy, and so on. See Servais & Ruggeri, supra note 78, at 45.

⁸¹ Article I-8, Treaty establishing a Constitution for Europe. Under the existing provisions of the EC Treaty, the euro is referred to as the 'ECU' (alluding to the former European Currency Unit), and also as 'the single currency of those Member States' which have fulfilled the necessary conditions for its adoption. This reflects the procedure prescribed for the original introduction of the euro, which required the EU Council to adopt the conversion rates at which the currencies of the participating Member States 'shall be irrevocably fixed and at which irrevocably fixed rate the ECU shall be substituted for these currencies, and the ECU shall become a currency in its own right. This measure shall not by itself modify the external value of the ECU.' EC Treaty, Article 123(4), first and second sentences. The effect of this provision was that the old European Currency Unit (ECU), a basket currency whose value was derived from fixed sums of 12 component EC national currencies, provided the reference value, on a 1:1 basis, for the introduction of the euro on 1 January 1999. See Commission Recommendation 94/284 of 19 April, 1994 concerning the legal treatment of the ECU and of contracts denominated in ECU in view of the introduction of the single European currency, Recital 3 (OJ L 121, 12.05.1994, 43). The name 'euro' was formally established as from 1 January 1999 under the provisions of an EC regulation which refers to the euro as 'the currency of the participating Member States' (i.e., the Member States which have adopted the euro as their currency) and as 'the unit of account of the ECB and of the central banks of the participating Member States'. Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro (OJ L 139, 11.5.1998, 1), Articles 2, first sentence, and 4.

⁸² See Lenaerts & Van Nuffel, supra note 76, at 72; Louis, supra note 78, at 28; Servais & Ruggeri, supra note 78, at 46.

objective of price stability, the EC Treaty makes it clear that ensuring price stability is the most important contribution that monetary policy can make to achieving a favourable economic environment and a high level of employment.

Because the ESCB's primary objective of price stability is written into the Treaty, it can only be amended by means of an inter-governmental conference followed by ratification of the amendments by all Member States in accordance with their respective constitutional requirements. This makes the objective of price stability more robust than if it were a statutory objective enshrined in secondary legislation, as is the case for central banks in most countries, which are typically chartered under parliamentary legislation rather than international treaties.

The Treaty does not give a precise definition of what is meant by price stability. The term is generally understood as denoting internal price stability, meaning the volume of goods and services which can be obtained for one euro, as opposed to the stability or strength of the currency in terms of third currencies such as the U.S. dollar. In the absence of any clarification in the Treaty regarding the specific level of price stability to be maintained by the ESCB, the ECB is in a position to determine for itself what level of price stability it considers acceptable. The ECB has defined this price stability in quantitative terms as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below, but close to, 2% over the medium term. This makes clear that not only inflation above 2%, but also deflation, would be inconsistent with price stability. As a matter of strict legal theory the European Court of Justice, as the final arbiter regarding the interpretation of the Treaty, may be called upon to determine whether particular measures adopted by the ECB are consistent with the ESCB's primary objective to maintain price stability. In practice, the Court may be expected to accord the ECB a large degree of discretion with respect to the precise formulation of monetary policy, provided that the ECB's elaboration of what is meant by price stability is based on economically reasonable grounds.

In the *OLAF* case the Court highlighted the important link between the ESCB's objective of price stability and the principle of central bank independence. In particular, the Court emphasised that the independence granted to the ECB under the Treaty seeks in essence to shield the ECB from all political pressure in order to enable the ECB effectively to pursue the aim of price stability and, without prejudice to that aim, to support the economic policies in the Community.

Regarding the ESCB's secondary objective to support general economic policies in the Community, it is emphasised that the ESCB's secondary objective is to support general – rather than specific – economic policies in the Community. This implies that the ESCB should have regard to general trends in economic policies. This secondary objective partly explains the ongoing dialogue between the ECB and economic policy-makers at Community level, which is underpinned by a number of institutional provisions in the Treaty. In this respect, it is recalled that the ESCB must pursue its objectives in an environment of a coordinated, but not a single, economic and fiscal policy, since the main responsibility for economic and fiscal policy remains at the national rather than the Community level.

In the *OLAF* case the European Court of Justice considered the ESCB's mandate to be of particular relevance to understanding the constitutional position of the ECB as falling squarely within the Community legal order. In addition, the Court indicated a strong appreciation that the ESCB's primary objective to maintain price stability is

one of the cornerstones of economic and monetary union, and, therefore, of the Community itself. In this regard, this paper argues that the primary objective of maintaining price stability applies to the central banks of all EU Member States, and not only the ECB and the central banks of Member States which have adopted the euro.

The proposed European Constitution, whose future at the time of writing is uncertain, confirms that the primary objective of the ESCB is to maintain price stability and, without prejudice to that objective, to support the general economic policies in the European Union. The Convention on the Future of Europe that prepared the constitutional text rejected the arguments of some members that supporting sustainable growth and high levels of employment should be added, on an equal footing, to the primary objective of price stability. Indeed, the overarching objectives of the Union enshrined in the final text of the Constitution include an explicit reference to the Union working for the sustainable development of Europe based, *inter alia*, on balanced economic growth and price stability. This close association of the ESCB's primary objective of price stability with the European Union's core objectives was reinforced by the Constitution's recognition of the euro as one of the symbols of the Union, alongside the flag, the anthem, the motto and Europe Day. This underlines the role played by the euro in promoting a shared European identity.