The European Central Bank

Introduction

The European Central Bank (ECB) is the ***central bank*** of the ***eurozone***. It is a key part of the European System of Central Banks (ESCB), which aims to co-ordinate the ***monetary policy*** of EU member states. The ECB controls the monetary policy of all the member states that use the Euro. Its main aim is to maintain stable prices by keeping ***inflation*** under control and it uses interest rates to do this. The ECB has many of the powers of a national central bank. However, questions have been raised over whether it can ever really successfully manage the competing monetary demands of eurozone members while maintaining independence from them and while only controlling one strand of economic policy.

History

The structure of the ECB was outlined in the Maastricht Treaty (1992) as part of the programme to create Economic and Monetary Union (EMU). The Treaty set up the ESCB and a European Monetary Institute (EMI). The ECB came into being in 1998 when those member states that decided to join the Euro agreed to fix their exchange rates. At this point the EMI was closed and the ECB took over its responsibilities. The Lisbon Treaty (2007) formally established the ECB as an EU institution.

The ECB is based in Frankfurt, Germany. The first President of the ECB was Wim Duisenberg. He oversaw the launch of the Euro on 1 January 1999 and the Euro notes and coins in 2002. He was replaced by Jean-Claude Trichet in 2003. In its first two years, the ECB was much criticised due to the drop in the value of the Euro after its launch, although later the exchange rate against the dollar recovered well. However, the ECB is also often held responsible for poor economic growth and high unemployment in several eurozone countries.

In June 2011, Italian Mario Draghi was voted in to be the next President of the ECB for the period November 2011 to October 2019. The appointment was not without controversy, however, as consequently the Executive Board contained two Italians, and there was no longer a French presence.

How does the ECB work?

The ECB is headed by an Executive Board made up of the President, Vice-President and four members nominated by eurozone countries. Decision-making is led by the Governing Council, which is made up of the Executive Board members plus the heads of the thirteen eurozone central banks. The system operates like a web, with the ECB at the centre setting monetary policy and the Eurozone central banks on the outside implementing it. Eurozone central bankers can advise on policy, but the final decisions rest with the ECB. The ECB also has relations with non-Eurozone EU members through the General Council, which brings together the President, Vice-President and the heads of the central banks of all EU member states. However, because non-eurozone members are still free to set their own monetary policy, the ECB does not have the same influence over them. The most important goal of the ECB is to maintain stable prices. It tries to keep the rate of inflation below (but close to) 2% by controlling interest rates. This presents serious problems because the economies of eurozone countries grow at different speeds and the bank cannot influence member states' taxation and spending.

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In May and June 2010, following problems with Greece's sovereign debt, the ECB bought €60 billion of eurozone governments' ***bonds*** as part of an international rescue plan to restore confidence in the single currency. Whilst it was common for national central banks to buy government bonds, this was the first time that the ECB intervened in such a direct way.

Facts and figures

- Nearly 50% of the ECB's €4 billon reserve comes from the German Bundesbank and the French Banque de France.

Arguments

For

- The ECB is vital for the smooth operation of the Euro.
- A central monetary policy helps to mould the EU into a single market.
- Because the ECB is above national politics it is a 'safer pair of hands' to control sensitive monetary policy.

Against

- It is impossible to create a unified monetary policy for countries with different patterns of growth because they need different conditions at different times.
- The ECB is not fully independent because it is dominated by the most influential eurozone members.
- Because the ECB only controls one part of economic policy, it is difficult to prevent member states from acting against the Bank's wishes.

"I would like the European System of Central Banks to speak with one voice… and we are doing our utmost to achieve that by organising, let's say… at least a harmonious choir."

Wim Duisenberg, ECB President, 1999

Technical Terms

- ***Central Bank:*** a central authority that regulates monetary and financial institutions and markets.
- ***Eurozone:*** the nickname commonly used to describe the thirteen member states that use the Euro.
- ***Monetary Policy:*** the policies employed by Governments or Central Banks to control money supply and interest rates in order to achieve economic goals.
- ***Inflation:*** upward movement in the average level of prices.
- ***Bond:*** loan typically given to banks by investors over a fixed term, in return for a fixed rate of interest upon repayment.

Links

- http://www.ecb.int/ecb/history/emu/html/index.en.html
- http://www.ecb.int/pub/pdf/other/ecbhistoryrolefunctions2004en.pdf

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