DIRECTORATE GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICIES

The ECB's Role in Financial Assistance Programmes

NOTE

Abstract

This paper reviews the role the ECB has played in financial assistances programmes in the Euro area, focusing in particular on Ireland. The ECB's involvement in Ireland—in particular its policy in relation to senior bank debt—has raised questions about whether it has over-stretched to act beyond its mandate. The ECB is not providing official assistance to the Irish government and its involvement in monitoring the programme has confused the public about the nature of the programme's conditionality and contributed to undermining its legitimacy. I recommend that future financial assistance programmes should not feature the ECB as a member of a Troika tasked with monitoring the programme. The ECB's relationships with other crisis countries are reviewed. I conclude that Europe needs to clarify its policies on bank resolution and systemic risk—and the role of the ECB in relation to these policies—before it is too late.

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1. INTRODUCTION

The crisis that has hit the Euro area has placed enormous pressure on all the institutions of the European Union, forcing many to play roles that were never previously envisaged. Of all the European institutions, it is the European Central Bank that has been placed under the most pressure.

The ability to create money is a substantial power, so it is not surprising that the ECB has been called upon to solve many of the Euro area's economic problems. Because of its narrowly-defined legal mandate, which places price stability above all, and because of its concerns about its own balance sheet, these demands have placed the ECB in the middle of a wide range of politicised controversies. Nowhere has this been more evident than the ECB's involvement with countries receiving financial assistance programmes or at risk of requiring them.

In Section 2 of this paper, I describe the ECB's involvement in the Irish financial assistance programme, both before and after its negotiation and draw some conclusions. In particular, I recommend that future financial assistance programmes should not feature the ECB as a member of a troika tasked with designing and monitoring the programme. Section 3 then discusses other examples of ECB involvement in Euro area countries experiencing economic crises. The evidence points towards a dogmatic approach to the question of debt default, an excessive concern with protecting its own balance sheet and an increasing involvement in political intrigue. Section 4 draws some conclusions.

2. THE ECB AND IRELAND

2.1 Prior to the Programme

Prior to the global financial crisis, Ireland appeared to most people to be a model for success among European economies. Though there has since been plenty of revisionism by international organisations, prior to the crisis Ireland was hailed as a model of fiscal and financial stability by the IMF and the European Commission.[1]

By mid-2008, it became clear that much of the economic growth Ireland had achieved in the final years of its expansion had been built on shaky grounds. A gigantic property boom had seen per capita housing completions running at four times the rate seen in the US during the peak of its housing boom and house prices quadrupling between 1996 and 2007. As the global economy began to slow down, house prices in Ireland began to slide and construction activity collapsed.

The construction bust had severe implications for Ireland's public finances. The tax base had become increasingly reliant on what turned out to be temporary revenues from the construction sector and the large increase in unemployment due to the sector's contraction put huge pressure on public spending on welfare benefits. Ireland moved swiftly from running a small budget surplus to deficits that were double-digit shares of GDP.[2]

[1] For example, the IMF (2007) reported that "Economic performance remains very strong, supported by sound policies" that "Fiscal policy has been prudent … In the past couple years, windfall property-related revenues were saved and the fiscal stance was not procyclical, in line with Fund advice" and that "Banks have large exposures to the property market, but stress tests suggest that cushions are adequate to cover a range of shocks."
[2] See Whelan (2010, 2011) for detailed discussions of Ireland's economic boom and bust.

That said, Ireland was well positioned to cope with a large fiscal shock. It had a gross debt-GDP ratio in 2007 of 25% and a sovereign wealth fund worth close to this amount. On its own, the large fiscal shock could possibly have been coped with without requiring official financial assistance. The aspect of Ireland's crash that pushed it over the edge was the effect of the construction bust on the banking sector.

By mid-2008, it was clear to international bond markets that the Irish banks had made enormous loans to the construction sector for speculative development loans and that the losses on these loans would be substantial. These banks had relied on issuing bonds to international capital markets to finance their rapid growth and suddenly found they were unable to roll over this funding. The banks began to borrow from the Eurosystem to pay off maturing bonds. When Anglo Irish Bank ran out of Eurosystem-eligible collateral in September 2008, the Irish government choose to offer a blanket guarantee to all depositors and the vast majority of bondholders in the domestic Irish banks.

While this guarantee temporarily stabilised the condition of the Irish banks, the severity of Ireland's recession and growing international realisation of the huge size of recapitalisation costs of the banking sector (now put at €63 billion or about 40 percent of GDP) meant that the state guarantee became essentially useless to the Irish banks during 2010.

In September 2010, the Irish banks failed to raise funds to roll over large quantities of two-year bonds that had been guaranteed in September 2008. Ratings were cut, non-resident deposits began to move out of Ireland and the dependence of the guaranteed banks on ECB funding increased sharply. There was also a sharp increase in Emergency Liquidity Assistance (ELA), i.e. loans from the Central Bank of Ireland against collateral that is not eligible for standard Eurosystem operations. While the risk associated with ELA is borne by the issuing central bank, these loans must still be approved by the ECB's Governing Council.

Figure 1 on the next page illustrates the evolution of Eurosystem borrowing by the guaranteed Irish banks while Figure 2 shows trends in resident and non-resident deposits at these banks. By the end of October 2010, the guaranteed Irish banks were taking up €76 billion of the total €557 billion of Eurosystem refinancing credit. In addition, ELA had risen to €33 billion. Measured against Irish nominal GDP of about €160 billion, these were extraordinary statistics, indicating a systemic banking crisis.

2.2 The ECB and Ireland's Application for Programme Funds

At his most recent press conference on June 6, 2012, ECB President Mario Draghi responded to a question about the economic situation in Spain by saying[3]

> *Let me say that, I do not view it as the ECB's task to push governments into doing something. It is really their own decision as to whether they want to access the EFSF or not.*

Mr. Draghi may be correct that pushing governments into EFSF programmes is not a task assigned to the ECB. However, the historical record shows that the ECB played the decisive role in the timing of the Irish government's decision to request funds from the EFSF and the IMF.

[3] Transcript: http://www.ecb.int/press/pressconf/2012/html/is120606.en.html

Figure 1: Borrowings from the Eurosystem of Guaranteed Irish Banks (Billions of Euros) Source: Central Bank of Ireland, Monthly Money and Banking Statistics

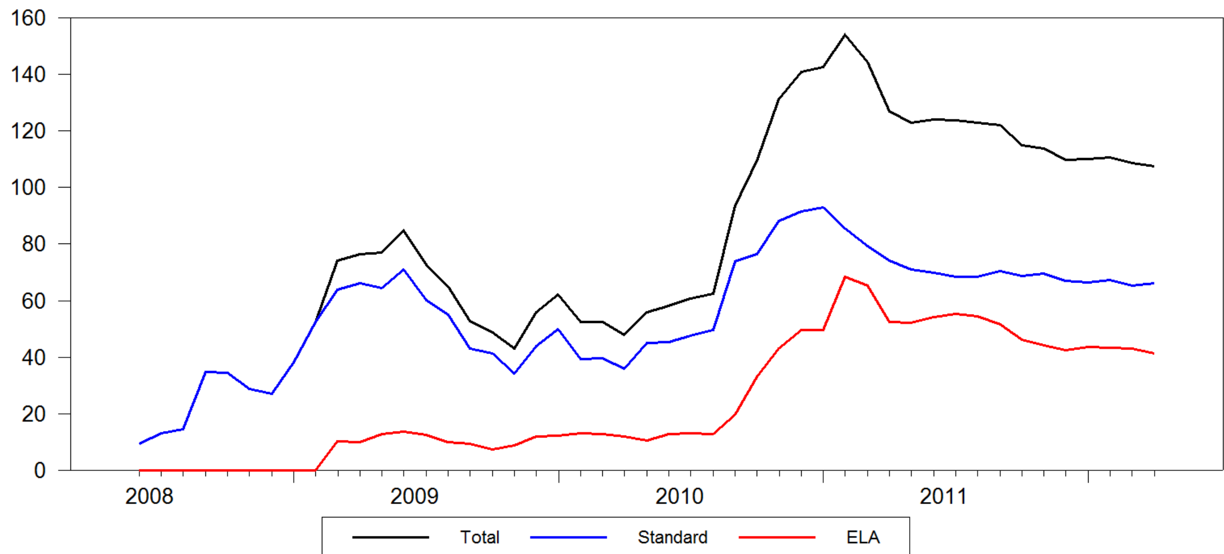

Figure 2: Resident and Non-Resident Deposits in Guaranteed Irish Banks (Billions of Euros) Source: Central Bank of Ireland, Monthly Money and Banking Statistics

In the months leading up to Ireland's application for funds, the ECB had become increasingly concerned about the extent of borrowing from Irish banks. Senior ECB officials apparently believed the financial crisis was largely over and were spending lots of time giving speeches about their plans for an "exit strategy" from non-standard measures (something which still has not happened). The reliance of the Irish banks on Eurosystem funding did not fit with the ECB's plans to revert to auctioning off fixed amounts of credit. Lead by Jean-Claude Trichet, ECB officials began briefing widely about their concerns about "addict banks" who were overly reliant on ECB funding.[4]

In addition to their concern that Ireland representing a problem for executing an exit strategy from non-standard measures, it also appears that the ECB had growing concerns that losses on loans to Irish banks could have an impact on the balance sheet of Eurosystem central banks: Operating procedures see losses on regular refinancing operations shared among member national central banks according to their capital key.

A more official indication that the ECB was intending to intervene in Ireland came on October 9, 2010 when they issued a statement tightening the Eurosystem's "Risk Control Framework".[5] These guidelines had already stated that "the Eurosystem may suspend or exclude counterparties' access to monetary policy instruments on the grounds of prudence" and had previously contained the line "The Eurosystem may exclude certain assets from use in its monetary policy operations." This latter statement was augmented to include "Such exclusion may also be applied to specific counterparties, in particular if the credit quality of the counterparties appears to exhibit a high correlation with the credit quality of the collateral submitted by the counterparty." Since the Irish banks had substantial assets either guaranteed or issued by the Irish government, this clause could be used to limit their access to ECB funding, which would have led to an inability to meet requests for deposit withdrawals or pay off maturing bonds.

What happened next is a little murky. However, it appears that the ECB observed another large decline in Irish deposits and a large increase in ELA during October and decided that it needed to intervene.

On Friday November 12, 2010, Reuters reported that Ireland was in talks with the EU to receive emergency funding.[6] In response, the government denied that any official talks were taking place and stressed that the government could meet its budgetary needs through until the summer of 2011. Brian Lenihan, Ireland's Minister for Finance at the time, subsequently stated that he received a letter from Jean-Claude Trichet on November 12, advising him that Ireland should enter an EU-IMF programme.[7] Within weeks, Ireland had applied and been approved for an EU-IMF financial assistance programme.

An Irish journalist, Gavin Sheridan, has requested the ECB provide him with a copy of letters sent from the ECB to Brian Lenihan in November 2010. The ECB responded by supplying one letter relating to payments system but refused to supply another letter that the ECB states was dated November 19 (one week after the Reuters' story and one day

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[4] See, for instance, this story by Ralph Atkins of the Financial Times from September 13, 2010: http://www.ft.com/intl/cms/s/0/580109dc-bf43-11df-a789-00144feab49a.html

[5] Statement here: http://www.ecb.int/press/pr/date/2010/html/pr101009.en.html

[6] Here is a link to the Reuters story here http://uk.reuters.com/article/2010/11/12/uk-g20-ireland-idUKTRE6AB0NV20101112

[7] See http://www.thejournal.ie/the-bbc-bailout-documentary-some-choice-quotes-126048-Apr2011/ for some quotes from Mr. Lenihan given to a BBC documentary.

after Central Bank of Ireland Governor Patrick Honohan conceded that a bailout deal was likely).[8] The ECB's justifications for not releasing the letter included the following paragraph:

> *The letter, dated 19 November 2010, is a strictly confidential communication between the ECB President and the Irish Minister of Finance and concerns measures addressing the extraordinarily severe and difficult situation of the Irish financial sector and their repercussions on the integrity of the euro area monetary policy and the stability of the Irish financial sector.*

While the content of the letter was alluded to as follows:

> *The ECB must be in a position to convey pertinent and candid messages to European and national authorities in the manner judged to be the most effective to serve the public interest as regards the fulfilment of its mandate. If required and in the best interest of the public also effective informal and confidential communication must be possible and should not be undermined by the prospect of publicity.*
>
> *In this case, the confidential communication was aimed at discussing measures conducive to protecting the effectiveness and integrity of the ECB's monetary policy and fostering an environment that ultimately contribute to restoring confidence among investors in the overall solvency and sustainability of the Irish financial sector and markets, which, in turn, is of overriding importance for the smooth conduct of monetary policy.*

My interpretation of these events is that there was some form of communication between Jean-Claude Trichet on November 12, 2010 (perhaps resulting in a formal letter sent a week later) and that this communication suggested that the ECB would withdraw liquidity support for Irish banks unless the government agreed to an EU-IMF programme that would include a significant recapitalisation of the banking sector. However, this is only my interpretation. I believe that the Irish and wider European public deserve a better explanation of the events of November 2010 from the ECB and the public release of the letter from Mr. Trichet to Minister Lenihan should be part of this explanation.

2.3 The ECB and the Irish Banks During the Programme

An important aspect of Ireland's financial assistance deal has been the central role played by the ECB in both its negotiation and its subsequent monitoring. Three aspects of the ECB's involvement have received considerable attention.

Senior Bank Bonds

By November 2010, Ireland's original near-blanket guarantee had been replaced by a less sweeping guarantee that only covered new issues. This left outstanding a relatively large amount of unguaranteed senior and subordinated bank bonds that had been issued by institutions such as Anglo Irish Bank and Irish Nationwide which were grossly insolvent and wholly reliant on Irish state assistance to pay off their liabilities.

[8] Here is a link to Sheridan's story.
http://thestory.ie/2012/02/12/ecb-president-mario-draghi-refuses-to-release-lenihan-letter/

During the negotiations of the programme, the Irish government and the IMF were in favour of putting Anglo and Irish Nationwide through bank resolution regimes that would see large haircuts on the senior bonds of these institutions. The widespread expectation that this might happen was reflected in the low prices of the bonds and their downgrades by ratings agencies. These downgrades meant that the bonds had to be off-loaded by many investment funds and banks who were not allowed to hold low-grade bonds as part of their investment portfolio. Indeed, it seems likely that by late 2010, a significant fraction of the bonds were owned by hedge funds and distressed-debt specialists willing to gamble that the bonds might still be paid out on.

The ECB, however, were adamant that all unguaranteed senior bonds should be paid back in full with the funds provided by the Irish state. The ECB have maintained this position over the past year as the new government elected in February 2011 repeatedly expressed its wish to impose senior bond write-downs.[9] The requirement to repay senior bond holders does not feature as an official part of the EU-IMF programme as it has never been mentioned in any of the various Memoranda of Understanding relating to the programme. However, it is generally understood that the ECB has argued that it would react to senior bank bond haircuts by either withdrawing liquidity support for Irish banks or perhaps placing these banks into a special liquidity facility and charging them a higher interest rate on their loans. Whatever the arguments used by the ECB, they have been sufficient to deter any unilateral action on this front by the Irish government.

The Deleveraging Programme

While it was widely agreed among the various parties negotiating the programme that the Irish banks needed to be recapitalised in line with a realistic stress test exercise, the ECB also placed significant emphasis on the need for the Irish banks to deleverage so that they could repay their ECB loans.

It appears that the ECB's original plans for this deleveraging programme were very ambitious, involving large-scale asset sales in 2011 that would substantially reduce Irish bank borrowing from the Eurosystem. Such a programme would have triggered large fire-sale losses and substantially increased the already-huge recapitalisation costs being shouldered by the Irish taxpayer. In practice, the final *Financial Measures Programme* (FMP) agreed in March 2011 envisaged a gradual reduction over three years in the reliance of Irish banks on Eurosystem support.

As Figure 1 shows, total Eurosystem borrowing of the domestic Irish banks has declined over the past year, falling from its peak of €154 billion in February 2011 to €107 billion April 2012. Some of this decline reflects the direct use of the €16.5 billion in recapitalisation funds recommended by the FMP to pay off Eurosystem debts (particularly ELA). The rest of the decline reflects asset sales and a reduction in loans. As such, the FMP targets appear to have contributed to the tight credit conditions that continue to constrain activity in the Irish economy.

Promissory Notes

As the enormous scale of the losses at Anglo Irish Bank and Irish Nationwide began to emerge during 2010, it became clear that Irish government could not borrow from financial

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[9] See Irish Independent, June 20, 2012. "Noonan says ECB's Trichet vetoed debt write-down" http://www.independent.ie/business/european/noonan-says-ecbs-trichet-vetoed-debt-writedown-3144728.html

markets to recapitalise these banks. Instead, the government issued these banks with so-called promissory notes that pay principal and interest gradually over time. In turn, these notes were used by the banks as collateral to obtain ELA from the Central Bank of Ireland. By the end of 2010, the Irish government had issued €31 billion in promissory notes to the Irish Bank Resolution Corporation (IBRC), the institution created by merging Anglo and Irish Nationwide.

The official schedule for the promissory notes sees the Irish government pay €3.1 billion per year, about two percent of GDP, into the IBRC over the next decade followed by a sequence of smaller payments until 2031. However, as discussed in Whelan (2012), it is likely that the IBRC can be wound up and the promissory notes scrapped by about 2022. This means that, at present, the payment structure on the notes is equivalent to issuing bonds worth 20 percent of GDP with an average maturity of five years.

When added to the refinancing demands associated with Ireland's privately-issued sovereign debt and its official debts to the EU and IMF, the payment schedule on the promissory notes makes very significant near-term financing demands on the Irish government independent of its need to finance future budget deficits. The Irish government have requested that the ECB Governing Council agree to a rescheduling of the payments on the promissory note and the IMF have made it clear that they agree that such a rescheduling would contribute towards a successful resolution of the Irish programme. The ECB, however, have insisted that the current schedule be held to because they wish to see the ELA provided by the Central Bank of Ireland be repaid according to the original agreement.

2.4 The ECB and Ireland: An Assessment

To summarise the role of the ECB in the Irish programme, I will start with the most positive aspect. Despite the controversy over the ECB's role in Ireland's application for official funds, there is little doubt that the ECB officials were correct in their diagnosis of the health of the Irish banking sector in November 2010.

The Irish banks had lost the confidence of international investors and depositors and there was nothing in the mix of prevailing Irish government policies that was likely to undo this trend. The ECB's hope that the announcement of the availability of a large quantity of funds to recapitalise the banking system would quickly stabilise the situation did not turn out as well as might have been expected. As Figures 1 and 2 above show, even after the announcement of the EU-IMF agreement, deposits continued to flow out of the Irish banks and reliance on Eurosystem funding increased for a number of months. However, once the Financial Measures Programme was announced at the end of March 2011, combining a realistic assessment of potential loan losses with a commitment to over-capitalise the banks, the funding situation stabilised.

The situation of the Irish banks remains precarious. They have not been able to re-access international bond markets and are still heavily dependent on Eurosystem funding. There are increasing concerns that loan losses at these banks will come close to the stress scenarios outlined in the Financial Measures Programme, which would likely require further recapitalisation. Still, the EU-IMF programme does deserve credit for stabilising a situation that was out of control and which could have ended up inflicting even more damage on the Irish and European economies than actually occurred.

The fact that Ireland was unable to regain market access once it had stabilised its banking sector shows that claims the ECB is "responsible" for Ireland's status as a programme country are largely unfair. The underlying fundamentals in late 2010 were moving Ireland towards a bailout programme and while one can quibble about the diplomatic handling of the negotiations, the ECB's advice that accessing such a programme was required turned out to be correct.

Those positives acknowledged, there are a number of negative aspects to the ECB's involvement in the Irish programme, with some being quite serious. I will break my comments here into two areas: The first being the confusion of mandates and of programme conditionality caused by the ECB's involvement and the second being the poor precedents that the programme set for systemic financial risk in Europe.

Confusion of Mandates and Conditionality

The "Troika" as the combination of European Commission, ECB and IMF has come to be known, was born during the negotiations for the Irish deal. While everyone is now used to the idea of this Troika being involved in monitoring financial assistance programmes, it is worth noting that the involvement of the ECB in negotiating and monitoring of such a deal is actually something of an anomaly.

Ireland's EU-IMF programme involves borrowing of €45 billion from the EU (in the form of the EFSF and EFSM) and €22.5 billion from the IMF. For these reasons, it is clear that the programme should be monitored by the IMF and also by the EU, in the form of the European Commission.

What is less clear is why the ECB is involved in programme design and monitoring. The ECB is not lending money to the Irish government as part of the programme, as such loans would be illegal. Instead, the Eurosystem is lending money to Irish banks. The terms and conditions for such loans must fit within the Eurosystem's common monetary policy guidelines. In general, the current Eurosystem monetary policy allows banks to borrow as much as they wish in refinancing operations provided they have sufficient eligible collateral. In practice, it appears that the ECB is using its risk control measures to determine which banks it is willing to lend to and how much it is willing to lend. Still, it is unclear that the why the ECB's risk control framework should extend to involving them in designing and monitoring a package of fiscal measures rather than assessing each bank on its own merits.

As an indication of how various lines have been blurred due to the ECB's involvement in programme design and monitoring, consider the following quote from Klaus Masuch, former head of the European Central Bank mission to Ireland, as spoken to the BBC:[10]

> *People in Ireland were not aware of the enormous support that they get from the Eurosystem. This is a privilege, of course. The partners in the Eurozone also expect that every partner – every government in the Eurozone – is doing its own homework. This means keeping public finances stable and, of course, keeping the banking sector stable.*

It is hard to imagine a representative of the Federal Reserve telling the citizens of Texas they should realise that it is a privilege that their banks can borrow from the Fed so one might ask why ECB officials believe there is a good reason to lecture Irish citizens in this

[10] See http://www.thejournal.ie/the-bbc-bailout-documentary-some-choice-quotes-126048-Apr2011/

manner. Moreover, the enormous support that was referred to in this quote was largely channelled towards seeing that non-Irish bondholders and depositors were able to pull their money out of Irish banks. In linking the performance of the public finances with the privilege of "receiving support" from the Eurosystem, these kinds of statements suggest a role for the ECB in monitoring the fiscal policies of member states that I do not believe exists in the European treaties.

The ECB's approach to senior bank bonds has also lead to confusion in Ireland and elsewhere about the conditionality associated with the EU-IMF programme. The programme makes no reference to the requirement that private unguaranteed bondholders be repaid. Indeed, such a clause would unprecedented in an IMF programme document. However, the involvement of the ECB in the Troika monitoring of the programme alongside its insistence that these bonds be repaid has meant that most Irish citizens believe that repayment of unguaranteed bonds is a condition of the programme. This perception has undermined the popularity and legitimacy of the programme.

Systemic Risk Precedents

A question arises as to the grounds on which the ECB made the decision that Ireland should pay out on all senior bonds, even for banks that were seriously insolvent.

One can point to Article 3.3 of the ECB statue which says that "the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system." However, it is unclear what the "competent authorities" were in relation to this decision. The Central Bank of Ireland has a mandate for maintaining financial stability in Ireland but it appears that their approach to this issue mirrored that of the government and the IMF. A stronger argument was that the ECB was acting in the interests in EU-wide financial stability, in the belief that haircuts for senior bank bonds could have caused a wider collapse in European bank funding markets (something which happened anyway in 2011) even if it was perhaps unclear who the relevant competent authorities would be in this case.

Whether there were legal grounds for this decision or not, I believe the ECB made the wrong call on this issue. The ECB's approach of pinning all bank losses on sovereigns has greatly increased the systemic nature of European debt crisis. The past year has seen a continued pattern of weakening economies affecting bank balance sheets, with this risk being transferred onto sovereigns and the increased sovereign risk creating further uncertainty which further weakens economies. The Irish EU-IMF programme can perhaps be seen as the point where this vicious circle intensified.

3. GREECE, ITALY AND SPAIN

I have chosen to focus on the Irish financial assistance programme because I have a greater familiarity with this programme relative to events elsewhere. However, I do briefly want to point out that I believe that some of the patterns that have occurred in Ireland that raise questions about the role of the ECB have been repeated elsewhere.

I noted above that the ECB's concern about its own balance sheet has played an important role in its attempts to reduce its exposure to Irish banks as quickly as possible. This issue has also played an important role in the ECB's dealings with Greece and Spain:

- ECB concern about its own balance sheet meant they were unwilling to accept a write-down on sovereign bonds they had purchased in secondary markets as part of the Securities Market Programme (SMP). By demanding a senior status relative to other creditors that did not exist in law, the ECB has contributed to the de facto subordination of privately-owned sovereign debt in other countries where SMP purchases have been made, which has raised sovereign yields in these countries and contributed to a worsening of the crisis.
- Concerns about its own balance sheet appear to have arisen again recently in the case of the Spanish government's recent plans to recapitalise Bankia via directly placed government bonds (a la promissory notes) rather than cash raised from the markets. The ECB appear to have been unwilling to allow the Banco de Espana to take on the risk associated with such bonds. This effectively triggered Spain's request for ESM funds to recapitalise its banking sector.

These are two examples of where the ECB's consistent focus on its own balance sheet has raised the systemic risk associated with the current crisis. Given that the Eurosystem has combined capital and revaluation reserves of over €500 billion, one could question whether these decisions represent a failure to prioritise the needs of the European public over the sensitivities of ECB officials about their willingness to risk someday having to request an unpopular recapitalisation.

The ECB's dealings with Greece also reflected two other issues that featured in Ireland:

- *Liquidity Supply Threats*: While the ECB has been willing to supply enormous amounts of liquidity to the European banking system over the past few years, they have also been willing to use the threat of the denial of liquidity as a bargaining chip. As in Ireland, the various threats to remove Greek banks as eligible counterparties or to remove Greek debt from its eligible collateral list contributed to undermining confidence in the stability of the banking system.

- *Debt Denial*: At no point in the ECB's approach to Ireland has it conceded that the burden of sovereign debt may be too high or that actions may need to be taken to alleviate that burden. The ECB's record in Greece indicates that this may simply be an indication that they are out of touch with reality. From the first moment that it became clear that Greece's public debt problem may be unsustainable to the final moment in July when an official restructuring deal for Greek debt was agreed, Trichet and other ECB officials remained adamantly opposed to the idea that any sovereign debt restructuring was desirable or conceivable. As late as the July 2011 Governing Council press conference, right before the first agreement to restructure Greek debt, Trichet was repeating his mantra "*our message is "no credit event, no selective default – no default!" It is as simple as that!*"[11] The message may have been simple. Unfortunately, the issue at hand was not.

Finally, I've noted the ECB's involvement in encouraging Irish politicians to apply for a bailout. While this has caused some resentment in Ireland, these actions were limited when compared with the ECB's interference in Italian politics. It is widely agreed that the ECB's interactions with the Italian government in relation to its willingness to use the SMP to

[11] See transcript http://www.ecb.int/press/pressconf/2011/html/is110707.en.html

purchase Italian bonds in late 2011 lead to the downfall of Prime Minister Berlusconi and his replacement with the unelected Mario Monti. It is hard to imagine the founders of EMU, with their grand visions of an independent ECB floating above politics, imagining the institution playing such a key role in high stakes political intrigue.

4. CONCLUSIONS

There can be little doubt at this point that Europe requires a new economic policy architecture if the euro is to survive. Indeed, the ongoing governmental policy dialogue increasingly accepts this point. A full review of the ECB's relationship with countries undergoing sovereign and bank crisis needs to be part of this process.

The ECB's involvement in Ireland—in particular its policy in relation to senior bank debt—has raised serious questions about whether it has over-stretched to act beyond its mandate. The ECB is not providing official assistance to the Irish government and its involvement in monitoring the programme has confused the public about the nature of the programme's conditionality and contributed to undermining its legitimacy. I recommend that future financial assistance programmes should not feature the ECB as a member of a Troika tasked with monitoring the programme.

While these comments may read as critical of the ECB, I want to acknowledge that the ECB has been placed in a number of very difficult positions by the crisis. So, for example, in the absence of a consistent EU policy on bank resolution, the ECB has effectively stepped in and constructed a policy that it was perhaps not designed to implement. In addition, the stop-start nature of the ECB's Securities Market Programme and the controversies associated with these programmes partly reflect the failure of Euro area politicians to put in place significant long-term structural solutions to the debt crisis that are consistent with the ECB's legal mandate. One can only hope that Europe will clarify its policies in relation to bank resolution and systemic risk—and the role of the ECB in relation to these policies—before it is too late.

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