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System of Central Banks (ESCB), which is governed by the decision-making bodies of the ECB, is banks (Pisani-Ferry and Wolff, 2012a), at a time when the interbank market had become dysfunctional and several countries in the south of the euro area were undergoing a sudden stop in external financing (Merler and Pisani-Ferry, 2012a). In October 2008, the ECB introduced a policy of 'full allotment', for all ECB liquidity-providing operations. Under this procedure, the control of central bank liquidity is effectively moved from the central bank to the banking system, as banks can access all the central bank liquidity they need at a fixed rate (if they priovide sufficient eligible collateral). The maturity of liquidity operations were initially extended from three months to six and twelve months, and in December 2011 and in February 2012 the ECB also conducted two extraordinary Longer Term Refinancing Operations (LTROs) with maturities of three years, from which banks in the euro area borrowed almost €1 trillion. These operations, along with the collateral policy (see below) allowed liquidity-strained banks to refinance a large portion of their balance sheets through central bank lending, available at a low interest rate and long-term maturity. In a heavily bank-based system, such as the euro area's (Darvas, 2013a), these measures were essential to avoid financial and economic meltdown.

Another crucial element during the crisis was Emergency Liquidity Assistance (ELA), an emergency liquidity line provided by national central banks to solvent banks that exceptionally and temporarily do not have enough (or sufficiently high quality collateral) to access normal Eurosystem operations. The ECB's Governing Council can at any time order an ELA programme to be stopped[4]. The ELA statistics are opaque, yet most likely the central banks of Greece, Ireland and Cyprus have used ELA extensively, while it was used for a few days in Belgium. Recent rumours suggest that Portugal also made use of ELA.

Task 4: Collateral policy

Complementing its credit operations, the ECB has changed its collateral framework several times

2. We note that in July 2013 the ECB added a major new element to its communication strategy: forward guidance, which is a way for central banks to give indications about their future policy intentions, by making it more (like the FED and the BOE) or less (like the ECB) explicitly conditional on the assessment of the current and future economic developments and outlook.

3. For detailed reviews of the ECB crisis responses, see Cour-Thimann and Winkler (2013) and ECB (2011a).

4. For a very detailed review of the legal technicalities of the ELA see Boyer and Lemangnen (2013).

since 2008, expanding and changing assets' eligibility requirements in order to mitigate possible constraints arising from collateral shortage. It is worth mentioning that certain credit claims have been included among eligible collaterals. Also, while initially the ECB denied the need for country-specific collateral rules, credit-rating requirements were completely abolished for government bonds of countries under financial assistance programmes.

Task 5: Quantitative easing: targeted credit easing through asset purchases

The ECB introduced two asset purchase programmes – though at a much smaller scale than the Fed, BOE and BOJ. Under the first Covered Bond Purchase Programme (CBPP), launched in 2009 and terminated in June 2010, the Eurosystem committed to buy covered bonds up to €60 billion, while in November 2011 the second CBPP commitment was up to €40 billion until October 2012[5]. The goals of these programmes were *"(a) easing funding conditions for credit institutions and enterprises; and (b) encouraging credit institutions to maintain and expand lending to their clients"*.

Task 6: Sterilised government bond purchases

The ECB launched two government bond purchasing programmes: the Securities Market Programme (SMP) on 10 May 2010, which on 6 September 2012 was terminated and replaced by the Outright Monetary Transactions (OMTs). While monetary financing of governments is strictly prohibited, Article 18(1) of the ESCB Statute allows national central banks and the ECB to buy or sell (among others) marketable instruments on the financial markets. Both programmes had similar aims: the SMP's *"objective is to address the malfunctioning of securities markets and restore an appropriate monetary policy transmission mechanism"* and the OMTs *"aim at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy."* In the framework of the SMP, the Eurosystem bought on the secondary market about €220 billion of the sovereign bonds of Greece, Ireland, Portugal, Italy and Spain. At the end of 2011, the ECB's holding was estimated to amount to about 23 percent of total outstanding in Greece, 16 percent in Ireland, 11 percent in Portugal, 6 percent in Italy and 5 percent in Spain (Merler and Pisani-Ferry 2012b)[6]. All the purchases were sterilised (ie the liquidity provided was re-absorbed by the Eurosystem) to ensure that the monetary stance was not affected. The SMP could not bring definitive relief to markets, while the OMT has to date been more successful (see Darvas, 2012). It is based on explicit conditionality: compliance with a full or precautionary macroeconomic adjustment programme by either the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM). Countries exiting current adjustment programmes could also be considered. ECB intervention will not be automatic, but the Governing Council will decide on a case-by-case basis when and to what extent it will intervene. OMTs will be unlimited in principle; limited only by the outstanding stock of eligible bonds, which should have residual maturity of between one and three years (the relevant horizon for monetary transmission). The ECB will not have any preferential treatment in the case of a credit event (ie *pari passu* treatment with other creditors). Since the programme's inauguration, no country has qualified for OMT.

Task 7: Designing, approving and monitoring financial assistance programmes

The Troika of the IMF, the EU and the ECB was inaugurated in spring 2010 to negotiate the Greek financial assistance programme. The participation of the ECB, and of the IMF, was demanded by the heads of state or government in their 25 March 2010 statement[7]. The Troika also negotiated the financial assistance programmes for Ireland, Portugal and Cyprus, and the new programmes for Greece, and concluded joint missions to assess compliance.

The ESM Treaty formalises the ECB's role in covering the whole process of granting and monitoring financial assistance programmes. *"The European Commission, in liaison with the ECB, shall be entrusted with"* several tasks, such as *"assessing the existence of a risk to the financial stability of the euro area as a whole or of its Member States; Assessing whether public debt is sustainable; Assessing the actual or potential financing needs*

5. Cour-Thimann and Winkler (2013) estimate that the size of the first programme represented about 2.5 percent of the outstanding covered bonds.

6. De Sousa and Papadia (2013) estimate that the SMP would have been a profitable operation under mark to market acounting.

7. See www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/113563.pdf.

light this role, because this is a major task that will likely have an impact on the reputation of the ECB for its supervisory mandate and beyond.

Task 10: Macro-prudential supervision

The ECB's macro-prudential tasks are related to the European Systemic Risk Board (ESRB) and the SSM.

The ESRB was set up in 2010, gathering representatives from national central banks and supervisors from all EU countries. The ESRB became part of the European System of Financial Supervision (ESFS) and it will be required to cooperate closely with the other participants in the ESFS[8]. The ESRB, according to its mandate, *"shall be responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability [...] that arise from developments within the financial system and taking into account macro-economic developments, so as to avoid periods of widespread financial distress*". The ESRB was not given any direct authority over policy instruments, but it has the power to issue recommendations and warnings about systemic risks to national authorities. The decision-making body of the ESRB, the General Board, is chaired by the president of the ECB. The ESRB Secretariat is located at the ECB.

The SSM Draft Regulation provides a role for both the ECB and national supervisors in macro-prudential policy, under the principle of 'the stronger wins'. While the ECB can express objections to measures proposed by a national authority, the authority concerned only has to *"duly consider the ECB's reasons prior to proceeding with the decision"* (Article 4a(1)). The ECB cannot block such measures. On the other hand, the ECB is given the power to apply higher requirements for capital buffers and more stringent measures than those set by the national authorities, with the aim of addressing systemic or macro-prudential risks. And again the ECB is only obliged to *"duly consider"* the objections of national supervisor, if any, but these objections do not have blocking power. It is important to highlight that the macro-prudential tools available to the ECB will be more limited than the arsenal available to national supervisors. National supervisors can apply *"any [other] measures aimed at addressing systemic or macro-prudential risks provided for, and subject to the procedures set out, in the Directives 2006/48/EC and 2006/49/EC"*, but the ECB can only apply *"higher requirements for capital buffers ... in addition to own funds requirements ... including countercyclical buffer rates"*. Therefore, the ECB can apply those tools seeking to influence lenders' behaviour, as categorised by Blanchard, Dell'Ariccia and Mauro (2013), but the ECB cannot apply tools aimed at controlling borrowers' behaviour, such as loan-to-value ratios and debt-to-income ratios.

Task 11: Possible participation in macroeconomic surveillance missions

The so-called six-pack, which governs the EU's new Macroeconomic Imbalances Procedure (MIP), foresees a possible role for the ECB in macroeconomic surveillance missions. Article 9 of Regulation No 1176/2011 dealing with *"Monitoring of corrective action"* says that: *"The Commission may carry out enhanced surveillance missions to the Member State concerned, in order to monitor the implementation of the corrective action plan, in liaison with the ECB when those missions concern Member States whose currency is the euro..."*. Article 13(3) clarifies the role of the ECB in these surveillance missions: *"Where the Member State concerned is a Member State whose currency is the euro or is participating in ERM II, the Commission may, if appropriate, invite representatives of the European Central Bank to participate in surveillance missions".*

Therefore, it seems that the ECB will have only a low profile in macroeconomic surveillance missions, but no specific tasks and responsibilities are related to such missions, nor to other elements of the MIP process.

Task 12: Agent for the secondary market activities of the ESFS and ESM

In December 2011, the ECB agreed to act as an agent for the secondary market activities of the EFSF and the same role is foreseen for the ESM[9]. The ESCB statute allows such operations (under the prohibition of overdraft or any other kind of

8. As well as the ESRB, the ESFS comprises: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Securities and Markets Authority (ESMA), the Joint Committee of the European Supervisory Authorities (ESAs), and the competent or supervisory authorities in the member states as specified in the legislation establishing the three ESAs.

9. See question 36 on page 19 of the Frequently Asked Questions on the ESM: http://www.esm.europa.eu/pdf/FAQ%20ESM%20010072013.pdf

credit facilities). In this role, the ECB would merely execute the EFSF/ESM's decisions on secondary market operations.

by, the ECB in light of this lesson. There are several interactions between the ECB's task. Here we focus on five issues that we regard as most important, starting with the easiest to solve, and ending with the most difficult.

Long-term liquidity operations: easy to remedy the dangers

In normal times, central banks did not engage in really long-term liquidity operations (recall that before the crisis, the maturity of ECB's LTROs was three months). A reason for this is related to moral hazard: long-term central bank financing at rates funding at the ECB for rainy days, or purchased higher yielding government bonds. Thereby, the LTROs in effect supported liquidity, ensured stable long-term (3-year) financing, subsidised the banking system and helped to restore profitability, and temporarily supported distressed government bond markets. When the alternative was a potentially escalating financial crisis, these achievements were beneficial.

But Belke (2012) and Pill (2013) rightly argue that the LTROs delayed the bank restructuring efforts and prolonged the existence of non-viable banks, with major negative side effects.The remedies for this are obvious: the ECB can foster bank restructuring by performing in the toughest possible way the comprehensive balance-sheet assessment (task 9 in section 2) before it takes over the single supervisory role. After that, the ECB's micro-prudential supervisory powers (task 8) should be used to ensure that all banks receiving liquidity support have indeed only a liquidity problem, and not a solvency problem.

This is even more relevant in the context of the ELA, where the dividing line is less clear and where the pressure is the highest, because the impact of a decision for or against the granting of emergency liquidity can have significant financial stability consequences. The case of Cyprus, where the existence of major banking problems was probably known well before the dramatic days in March 2013 (when banks were closed down for several days and uninsured depositors suffered massive losses), but where ELA was provided to banks on a massive scale, is exemplary in this respect. Furthermore, to dispel all doubts that liquidity provision to banks is back-door financing of public debt (whereby banks borrow cheap from the ECB to purchase government bonds), longer-term ECB financing could be conditioned that banks do not increase their net lending to the government and/or increase their net lending to the real economy (see Darvas, 2013b).

There can be significant synergies between monetary policy and supervision. ECB president Draghi himself has stressed that *"it is an established fact that stronger supervision facilitates the conduct of monetary policy"* (Draghi, 2012). One reason for this is that the banking system plays a crucial role in the transmission of monetary policy impulses to the economy and therefore in the achievement of the central bank's goal. This is especially the case in times of crisis, when the banking system comes under heightened stress, the monetary transmission mechanism can be impaired and the standard monetary policy tools (the short-term interest rate) can become powerless. This synergy constitutes a rationale for the central bank to have an interest in the stability of the financial system (Constâncio, 2013) and therefore in its effective supervision, as the latter *"contributes to a stable financial system [and] can only benefit the smooth transmission of monetary policy"* (Draghi, 2012). Therefore, if it is true that in crisis times the line between (unconventional) monetary policy and financial supervision becomes less clear, it is also true that in such a situation output and inflation are subject to downside risks, and financial stability and price stability actions would go in the same direction, making a conflict unlikely.

Also, as we concluded at the start of this section, using supervisory information will help the ECB in deciding which banks are solvent but illiquid, and which banks are insolvent, which would be essential for its function as the lender of last resort to banks. As pointed out by Whelan (2012), the experience with Northern Rock in 2007 shows how coordination of different authorities can be insufficient to solve the problems associated with the lender of last resort not being involved in supervision. The fact that the removal of banking supervision from the Bank of England – decided in 1997 – is now being reversed, can perhaps be taken as a sign that strictly separating bank supervision and monetary policy may be suboptimal.

A more practical question is if a full organisational separation of the two functions within the ECB is possible. The Supervisory Board will consist of five representatives of the ECB and potentially the representatives of all euro-area central banks. As pointed out by Beck and Gros (2012), it is very difficult to imagine how national central bank representatives could not be in very close contact, especially since one (the governor) would be hierarchically superior to the other (the head of supervision). The final decision will anyway remain with the Governing Council, even though the latter is supposed to operate *"in a completely differentiated manner"* when dealing with monetary policy and with supervision. But it would be the same people deciding and it is hard to see how they would not use all the information at their disposal, when taking a decision.

It is also noteworthy that in the Bank of England, such a separation was not sought:

> *"The new system ... encourages co-operation and co-ordination across the different policy bodies. [...] There is overlap between the memberships of the FPC, the PRA Board and the MPC, including the Governor and the Deputy "in ah.iesa. The fl haonfrmn and co-ordination latter thes the d05g the8(v*

10. In their final agreement before the 12 September 2013 vote of the European Parliament, EP President Martin Schulz and ECB President Mario Draghi agreed over transparency, under which the ECB will send detailed confidential accounts of the minutes of its bank supervisory board meetings.

11. For an extensive evaluation of the Troika's operate and set-up see Pisani-Ferry, Sapir and Wolff (2013). Preliminary assessments of the specific role played by the ECB and of the potential conflicts of interest for the central bank had been conducted also by Merler, Pisani-Ferry and Wolff (2012). This section is largely based on these two works.

part of the Eurosystem, the ECB could not have been left out. However, the ECB sits on the same side of the table with lenders (IMF and the European Commission), while in a typical IMF programme, the central bank of a country with its own currency would sit with the national authorities.

Third, there is a potential conflict of interest with the ECB's bond-purchase programmes. By buying bonds of vulnerable countries in the context of the SMP or OMT, the ECB becomes formally a creditor of the governments receiving financial assistance, and this may influence its position in the negotiations. Fear of losses stemming from its bond holdings might lead the ECB to be especially tough on fiscal consolidation or especially timid on debt restructuring – if the latter were needed – to reduce the likelihood of losses on its holdings. The Greek case, in which the ECB loudly rejected debt restructuring even a few weeks before such a decision was made by euro-area heads of state, and then negotiated a special position so that ECB holdings of Greek government bonds were not restructured, clearly underlines this threat. Also, a highly problematic issue with respect to the ECB's OMT is the introduction of an explicit conditionality set-up in the conduct of monetary policy, which is particularly delicate and dangerous, and is dealt with in the next section.

In conclusion, the unclear nature of the ECB's hybrid role in the Troika raises concerns about possible conflicts of interest that the ECB could

US-style system, in which state-level pubic debt is small, there is no federal financial bail-out for states, the central bank does not purchase state debt and banks do not hold state debt. Under such conditions, markets would discipline state public finances well and an eventual default of a state government would not undermine financial stability. Since public debts in most euro-area countries are high, steps toward such a system should involve a much higher level of fiscal integration, including the mutualisation of a significant share of public debt (like the 'Blue bonds' of von Weizsäcker and Delpla, 2010). Holding the remaining national debt ('Red Bonds') could be prohibited for banks, or at least higher capital requirements could apply. This would reduce the impact of a sovereign default on the country itself and reduce contagion fears (Darvas, 2011). However, by drawing a parallel with US history, O'Rourke and Taylor (2013) remind us that even after the US political integration, it took a very long and painful process to reach a high level of fiscal integration. It is unfortunately unrealistic for the euro-area to embark on such an immense change in the foreseeable future.

4 CONCLUSION

After gaining a strong reputation as the guardian of price stability in the euro area, the European Central Bank's roles have been greatly extended during the crisis, taking in monetary policy and other areas. The good news is that the new tasks have not endangered (at least so far) the ECB's ability to anchor the inflation expectations of market participants: five-year-ahead expectations continue to be anchored at the two percent target.

Nevertheless, the new tasks pose major challenges for the ECB and give rise to both synergies and conflicts of interests. We have reviewed the new tasks and assessed five major interactions between them.

First, while liquidity provision to banks at a massive scale can stabilise financial markets in a stress situation, it can keep alive otherwise insolvent banks, encourage excessive risk taking and indirectly finance governments (when banks borrow cheaply from the ECB to purchase government bonds). The new EMU architecture has the potential to limit these adverse side-effects: the ECB can foster bank restructuring by performing in the toughest possible way the comprehensive balance sheet assessment before it takes over the

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