

# Central Bank Accountability and Judicial Review<sup>1</sup>

By Charles Goodhart and Rosa Lastra

## Independence and Accountability

Independence in the context of central banking is not absolute, but relative. Independence is freedom from political instruction on the one hand and from financial markets on the other hand (the central bank acts in the public interest while financial market participants are driven by private interests). This double dimension goes hand in hand with their dual role as government's bank and bankers' bank. However, what is considered to be 'lack of dependence' has nuances across central banks, across jurisdictions, across time and across functions. Between full independence and full dependence there is a gradation with various degrees of operational autonomy (etymologically autonomy means the ability to give norms to itself) and control.

Accountability is not simply an 'add-on' to justify independence. Hence the term 'accountable independence'.<sup>2</sup> Accountability - *ex ante* and *ex post* - is a constitutive part of the design of an independent agency in a democratic system, whose aim is to bring back the central bank to the system of checks and balances, (*trias politica*).

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<sup>1</sup> This contribution draws substantially on Charles Goodhart and Rosa Lastra, "Populism and Central Bank Independence", *Open Economies Review* (2017), <https://doi.org/10.1007/s11079-017-9447-y>

<sup>2</sup> See Lastra, "The Independence of the European System of Central Banks", *Harvard International Law Journal*, Vol. 33, No. 2, 1992, pp. 475-519; Lastra, *Central Banking and Banking Regulation*, Financial Markets Group, London School of Economics, London, September 1996, chapter 1.

*[I]ndependence is only one side of the coin, for in a democratic community accountability is also necessary. Such accountability should be diversified, dispersed through the three branches of the state, through institutions with differing obligations to the electorate hereby granting the democratic legitimacy that an independent central bank would otherwise lack. This institutional articulation of accountability should be complemented by other forms of accountability, namely public support, disclosure and performance control (...). The optimal trade-off between independence and accountability varies from country to country<sup>3</sup>*

Accountability does not necessarily politicize a central bank, rather it means that the central bank should provide a justification of its actions. The design of accountable independence is a balancing act. Too much independence leads to an undesirable state within the state. Too much accountability threatens the effectiveness of independence. When Parliament is dominated by the executive branch of government or when parliamentary accountability is limited we must rely also on other mechanisms to hold the central bank to account.

A central bank, lest we forget, is both an agency and a bank<sup>4</sup> and, thus, it needs a special accountability regime.

### Legitimacy and Accountability

Legitimacy pre-exists and is a requisite of accountability. Legitimacy in turn is rooted in the concept of sovereignty.<sup>5</sup> There are two aspects to legitimacy: formal and societal.<sup>6</sup> According to the former, the creation of an independent central bank must be the fruit of a democratic act: an act of the legislator, a constitutional decision or a treaty provision. (Non-democratic regimes also have a notion of formal legitimacy embedded in their systems). ‘Societal’ legitimacy refers to the support by the public, and is determined by the acceptance of or loyalty to the system. Of course, societal legitimacy can be fickle since public acceptance is also influenced by politics, the media, current events, change in circumstances, sentiment, and others factors. In any case, when societal legitimacy weakens or is no longer present, the law is bound to change.

Any democratic regime can alter the mandate of the central bank following the required normative procedure (a statute for example can always be replaced by another statute; Constitutions and Treaties are more difficult to revise, but they are not immutable).

While the initial legal basis ‘legitimizes’ the establishment of the independent central bank, it cannot by itself legitimize on an ongoing basis the exercise of the powers delegated to such agency. It is then in the continuing life

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<sup>3</sup> “Any recent discussion of accountability often includes a reference to transparency and vice versa. This poses the question of the relationship between the two concepts. Accountability is an obligation to give account of, explain, and justify one’s actions, while transparency is the degree to which information on such actions is available. The provision of information is clearly an element of accountability. But accountability is not merely about giving information. It must involve defending the action, policy, or decision for which the accountable is being held to account. The provision of information (transparency) is hardly ever a neutral account of what happened or of what is happening; hence the need for an explanation or justification of the agency’s actions or decisions (accountability).” See Rosa Lastra (1996), above note 2, at p. 93.

<sup>4</sup> Lastra, above note 2, chapter 2.

<sup>5</sup> The attributes of sovereignty are not fixed. As John Jackson noted in his seminal contribution - “*Sovereignty-modern: a new approach to an outdated concept*”, (2003), 97 *American Journal of International Law*, 782-802 - sovereignty moves through a ‘vertical ladder’ and ‘horizontally’ from, and through, different power bases.

<sup>6</sup> See Rosa Lastra, above note 2, at pp. 84-85, and Amaryllis Verhoeven, *The European Union in Search of a Democratic and Constitutional Theory* (The Hague: Kluwer Law International, 2002) 10-11 and 364.

of that entity that accountability becomes necessary to ensure legitimacy. An accountable central bank must give account, explain and justify the actions or decisions taken, against criteria of some kind, and take responsibility for any fault or damage.

Compared with other government agencies, central banks are very powerful entities since they are guardians of monetary stability (and financial stability) and dictate price levels, influencing the level of risk-taking in the economy.<sup>7</sup> Central banks' monetary policies also have important redistributive effects. That is why accountability is of the essence.

As the mandate has become fuzzier, broader and more complicated – with unconventional monetary policies and the renewed emphasis on financial stability – the consensus which surrounds the goal/s crumbles and with it the importance of independence diminishes.<sup>8</sup> The delegation of *macro-prudential supervision and financial stability* to the central bank could become more problematical than inflation targetry, because it is so much harder to monitor, and you cannot really tell whether the authorities are on the right track or not. It is remarkable: (1) that almost all of the criticism of CBs relates to their monetary policy actions, rather than giving them extra powers to achieve financial stability, and (2) that CBs have also been the 'only game in town',<sup>9</sup> so one might have expected inactivity in fiscal policy and supply side measures to have been more vocal, whereas the criticism seems to be focussed on the only institution trying to do much. Moreover, an independent central bank – as a specialised technocratic agency – operating without electoral or partisan influences or constraints can do a better job at preserving monetary and financial stability than a political authority that seeks re-election and is thus subject to time inconsistency problems.

The question of excessive reach, that is whether central banks have abrogated to themselves powers which are not in the mandate, and the legal interpretation of whether a central bank is abiding by the mandate or exceeding its powers, are fundamental issues in a democratic system.

What is clear is that if the mandate gets overstretched the balance between independence and accountability should tilt towards accountability. This can take many forms: additional disclosure requirements, further parliamentary oversight and judicial scrutiny. And ultimately a change in the law – reflecting the expanded mandate – might be the right course of action in a democracy, since any expansive interpretation of delegated central bank powers within a given legal structure should be limited in time.

An accountable central bank should be judged for the reasonableness of its actions, by Parliament, by the executive, by the public and of course by the competent Courts of Justice. While the debate on accountability has focused primarily on parliamentary scrutiny, performance control and transparency, in the ensuing section we focus on judicial review.

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<sup>7</sup> See C-62/14 *Peter Gauweiler and Others vs Deutscher Bundestag* [2014] OJ C129/11., paragraph 110: "Moreover, the conduct of monetary policy will always entail an impact on interest rates and bank refinancing conditions, which necessarily has consequences for the financing conditions of the public deficit of the Member States".

<sup>8</sup> As noted by Wolfgang Münchau, writing in the FT (20 February 2017, 'Central bank independence losing its lustre'): "Once the consensus about the goals of monetary policy breaks down, the notion of central bank independence becomes harder to defend on democratic grounds".

<sup>9</sup> See Mohamed A. El-Erian, *The only game in town*, Random House Publishing Group, January 2016.

## Judicial Review

The judicial review of administrative actions to prevent an arbitrary and unreasonable exercise of discretionary authority is an important element of the rule of law.<sup>10</sup> That the judiciary should control the lawfulness of the central bank's actions and decisions in the fulfilment of its functions should be beyond question.

Up until the global financial crisis, courts dealt sparsely with central banking actions and decisions. In the USA, there is no mechanism to review the monetary policy actions and decisions of the Federal Reserve System,<sup>11</sup> though the Fed's actions and decisions concerning supervision, financial stability and payment systems are subject to judicial review. In the UK, the Northern Rock case led to a lively debate about discretion, financial stability and moral hazard with regard to the LOLR of the Bank of England.<sup>12</sup> However, in the EU, with the Pringle case<sup>13</sup> and the Gauweiler case,<sup>14</sup> the role of supreme court judges in the formation of economic and monetary policy has become the subject of heated legal and political debate.

When reviewing central bank policies or decisions to assess whether or not a central bank has exceeded its powers, the competent Courts (in the case of the ECB only the Court of Justice of the European Union is competent) may exercise judicial restraint – deferring to central bank discretion and expertise – or more robust judicial control.

While judicial restraint is justifiable in the presence of other strong mechanisms of accountability, notably parliamentary scrutiny, one should question whether it may be less justifiable when judicial review emerges as the main mechanism of scrutinising the domain of expanded central bank powers and assessing whether or not they have exceeded their legal mandates.

Central bank discretion (a key component of independence) is the freedom to act within a legal framework. Judicial review does not extend to the 'content of the decision' (the aim of the Court is not to supplant or replace the decision taken), but it does extend to the parameters and legal framework that surround such decision in order to determine whether or not the central bank mandate has been exceeded.<sup>15</sup> For example, discretion in the context of monetary policy means that the central bank can choose whichever monetary policy instrument it

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<sup>10</sup> The 'rules versus discretion' debate has a long-standing tradition in administrative law. Judicial review of administrative acts is a requirement of a rule of law based system. There are procedural elements that determine the legality of an administrative act, such as the competence of the entity that issues the act or the procedure to prepare and approve such act, and the existence of a public interest. The more difficult issue is the standard of review judges should apply when they conclude that the administrative act they are reviewing is not legal or legitimate and must therefore be changed or substituted.

<sup>11</sup> See Peter Conti Brown, *The Power and Independence of the Federal Reserve* (2016) p. 94. See also pp 117-120 on judicial review of the FOMC. See also David T. Zaring, Law and Custom on the Federal Open Market Committee (June 27, 2015). *Law and Contemporary Problems*, Vol. 78, No. 3, 2015. Available at SSRN: <https://ssrn.com/abstract=2624111>

<sup>12</sup> See *SRM Global Master Fund LP v The Commissioners of HM Treasury* [2009] EWCA Civ 788 and [2009] EWHC 227 (Admin).

<sup>13</sup> C-370/12 *Pringle v Government of Ireland* [2012] ECLI:EU:C:2012:756.

<sup>14</sup> Case C-62/14 *Peter Gauweiler and Others vs Deutscher Bundestag* [2014] OJ C129/11.

<sup>15</sup> The CJEU 'has developed a fairly consistent standard of judicial review of crisis-related measures (...). It comprises a close scrutiny of the purposes of a mandate or competence, a check whether the instruments deployed serve the mandate, and an analysis whether the effects are proportionate to the objectives'. See Matthias Goldmann, "Constitutional Pluralism as Mutually Assured Discretion", *Maastricht Journal of European and Comparative Law*, Vol. 23, Issue 1 (2016), p. 125.

deems appropriate in the pursuit of the goal; discretion also means that the central bank can define what a generic goal such as price stability actually means. The content of such discretionary decision is not reviewable. Discretion in the context of ELA, means that National Central Banks (NCBs) acting as LOLR in bilateral lending operations (market liquidity assistance via open market operations is the responsibility of the ECB) can choose to provide assistance or not to a credit institution (at their own risk and liability), but they must act in accordance with the Treaty provisions (notably Article 123 on the prohibition of monetary financing), the ECB Emergency liquidity assistance (ELA) procedures<sup>16</sup> and EU state aid rules.

During the twin financial and sovereign debt crisis in the eurozone, the ECB expanded its toolkit of monetary policy instruments into ‘unconventional measures.’ One of those measures was the Outright Monetary Transactions programme (which was never activated).<sup>17</sup> The legality of OMT was challenged<sup>18</sup> by some German citizens (Gauweiler and others) in the German Federal Constitutional Court, *Bundesverfassungsgericht*, which referred the case to the Court of Justice of the European Union (CJUE) for a preliminary ruling to determine whether the ECB had exceeded its mandate, acting *ultra vires*, with this announcement. The CJEU made its final ruling in June 2015, declaring the conditional OMT programme to be legal, since it ‘does not exceed the powers of the ECB in relation to monetary policy and does not contravene the prohibition of monetary financing of EU nations’.<sup>19</sup> The CJEU focused on the objectives of monetary policy rather than the effects of the measures under review.<sup>20</sup>

A key feature in the Gauweiler case is the deference to the broad discretion of the ECB. As Advocate General Cruz Villalón stated in his Opinion:

*The ECB must accordingly be afforded a broad discretion for the purpose of framing and implementing the Union’s monetary policy. The Courts, when reviewing the ECB’s activity, must therefore avoid the risk of supplanting the Bank, by venturing into a highly technical terrain in which it is necessary to have an expertise and experience which, according to the Treaties, devolves solely upon the ECB. Therefore, the intensity of judicial review of the ECB’s activity, its mandatory nature aside, must be characterised by a considerable degree of caution.*<sup>21</sup>

<sup>16</sup> The ECB ELA procedures – in accordance with Article 14.4 ESCB Statute – were first published in 2013 and revised in 2014 [https://www.ecb.europa.eu/pub/pdf/other/201402\\_elaprocedures.en.pdf](https://www.ecb.europa.eu/pub/pdf/other/201402_elaprocedures.en.pdf)

<sup>17</sup> See European Central Bank, Technical features of Outright Monetary Transactions (6 September 2012) [http://www.ecb.int/press/pr/date/2012/html/pr120906\\_1.en.html](http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html)

<sup>18</sup> In July 2017 the German Constitutional Court referred to the CJEU a request against the Quantitative Easing measures adopted by the ECB. The defendant in this *Weiss case* is the Parliament, accused of not having acted to impede the ECB from adopting these measures. The arguments are the same as in Gauweiler: (i) *ultra vires*? (ii) monetary financing? (iii) if full loss sharing, monetary financing and infringement of constitutional identity? The German Constitutional Court has referred only questions relating to the Public Sector Purchase Programme not to other asset purchasing programmes – ABS, covered bonds etc.

<sup>19</sup> Case C-62/14 *Peter Gauweiler and Others vs Deutscher Bundestag* [2014] OJ C129/11. The Court also concluded the OMT did not infringe the principle of proportionality.

<sup>20</sup> Takis Tridimas and Napoleon Xanthoulis, *A Legal Analysis of the Gauweiler Case*, 23 MJ 1 (2016), p. 38: “The emphasis on the objectives rather than the effects of a measure as the determining factor for deciding whether it falls within monetary or economic policy, coupled with a low standard of review, grants the author of the measure enormous discretion”.

<sup>21</sup> Opinion of Advocate General (AG) Cruz Villalón in the OMT case, delivered on 14 January 2015 <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62014CC0062>, paragraph 111. See also paragraph 109.

The risk of ‘supplanting the Bank’ justifies the ‘degree of caution’ that should characterize the intensity of judicial review.<sup>22</sup> “Judges should not overstep the limits of their competences in order to enforce the limits of other actors’ competences.”<sup>23</sup> However, the deference to the ECB’s ‘broad discretion’ on the basis of the latter’s experience and technical expertise strengthens the case for expertise and adequate preparation of the judges that will assess those complex issues. This happens in other areas of economic regulation. Judicial activism has become the norm in the field of EU competition policy.

It can be argued that expanding judicial review of monetary policy decisions requires more than a growth in judicial CB expertise because, as Will Bateman indicated in comments to our paper,<sup>24</sup> common law judiciaries avoid judicially reviewing government functions with high-stakes macroeconomic consequences and tend to focus on issues of procedural justice or fairness rather than redistributive justice.<sup>25</sup>

US Supreme Court Justice Stephen Breyer has argued that it is not possible to understand and evaluate what agencies do without having some sense of the regulatory policy as well.<sup>26</sup> The need for specific expertise when it comes to the adjudication of complex financial and monetary matters is a relevant issue not only for the CJEU but also, for example, for the UK Supreme Court. If judicial restraint in monetary matters is advocated on the basis of [limited] technical expertise and qualifications of the judges adjudicating such matters,<sup>27</sup> the counter-argument to not ‘being equipped’ is to actually equip judges.

Given the specificity and complexity of monetary policy and other central banking functions (and the added difficulty in the EU context of determining whether a measure is of monetary policy – an exclusive competence of the Union – or economic policy<sup>28</sup>) and considering that only the CJEU can judge the ECB (Article 35 ESCB Statute), the need for competence and expertise in the exercise of judicial review could be served by the establishment of a specialised chamber within the CJEU to deal with these issues. Having dedicated specialised judges with expertise in financial and monetary matters when adjudicating cases related to the ECB would enhance the legal framework of ECB accountability in light of the significantly expanded mandate of the ECB.

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<sup>22</sup> In a different context, the case against an undesirable ‘government of judges’ is in line with the separation of powers (*trias politica*) to which we referred above. See inter alia Michael H. Davis, “A Government of Judges: An Historical Re-View”, *The American Journal of Comparative Law* Vol. 35, No. 3 (1987), pp. 559-580.

<sup>23</sup> See Matthias Goldmann, ‘Adjudicating Economics? Central Bank Independence and the Appropriate Standard of Judicial Review’ (March 2014, *German Law Journal*, 15 *German L.J.* 265), p. 280. Goldmann advocates judicial review on the basis of ‘rationality checks’ which in his view stand in between ‘full judicial review’ and ‘full discretion’. He also refers to the fact that while the perspective of the Judiciary is ‘retrospective’, monetary policy involves ‘forward-looking’ estimates (p.268).

<sup>24</sup> *Supra* note 1. This paper was presented at a CRASSH seminar organized by the University of Cambridge on 21 March 2018. Will Bateman was the discussant of our paper.

<sup>25</sup> Lord Hoffman (R (Hooper) v Secretary of State for Work and Pensions (2005) [32]): “[i]n a ... system ... concerned with the separation of powers ... decisions about social and economic policy, particularly those concerned with the equitable distribution of public resources ... are ordinarily recognised by the courts to be matters for the judgment of the elected representatives of the people.”

<sup>26</sup> See ‘A Workable Democracy. The optimistic project of Justice Stephen Breyer’, by Lincoln Caplan, *Harvard Magazine*, March-April 2017, p.51.

<sup>27</sup> See e.g. Goldmann, above note 2, at p. 268 and p. 271.

<sup>28</sup> Monetary policy is an exclusive EU competence in accordance with Article 3(1)(c) TFEU while economic policy is coordinated at the EU level (positive integration in accordance with Article 119 TFEU and negative integration in terms of the prohibitions applicable to Member States of the eurozone) but the competence remains at the national level. See Rosa Lastra, *International Financial and Monetary Law* (Oxford University Press, 2015), Chapters 7 and 8.

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