



# The primacy of the European Central Bank: Distributional conflicts between theory and practice in the pursuit of price stability

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## Abstract

Whether fighting inflation or deflation, it has been a decade since the European Central Bank (ECB) managed to successfully attain its Treaty-mandated objective, that is, price stability. This is defined by the Bank itself as maintaining an inflation target of 'below but close to 2% over the medium term' and, since 2021, as '2% over the medium term'. The further reality has veered from policy, the more attention has been brought to the redistributive choices, both implicit and explicit, in the ECB's pursuit of price stability. The current article analyses this debate in the context of the legal terms stipulated in the Treaty on the Functioning of the European Union, conceptualised as a function of monetarist theory. It claims that the ECB's failure to deliver on its price stability objective has contributed to intensifying the re-politicisation of monetary policy, cast doubt on the presumed legitimacy of foundational monetarist theory and caused a legal struggle within EU constitutionalism to sustain a stable distinction between economic and monetary policy.

## Keywords

European Central Bank, Inflation, Monetarism, EU constitutionalism, Economic and Monetary Union, Economic distribution

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## Introduction

To say that we live in interesting times is an understatement. After years of unconventional monetary policy that has tried to stimulate inflation and unstick interest rates from the zero lower bound, the eurozone, and the global economy in general, is going through the most aggressive monetary—and soon, fiscal—policy tightening since the 1970s (Tooze 2023; Nielsen 2023).

The European Central Bank (ECB) has fully halted the use of its various quantitative-easing instruments, which had seen it pump billions into the economy, subsidising the value of assets and becoming one of the biggest holders of eurozone sovereign debt. The Bank is now resolutely committed to ‘monetary policy normalisation’ through a series of extreme interest rate hikes that have keen and knowledgeable observers increasingly lose hope of a soft landing for the economy. In this transition from encouraging to fighting inflation, the ECB has gone from promoting government spending with promises of guaranteed serviceability (Committee on Economic and Monetary Affairs, European Parliament 2020) to urging the parallel fiscal consolidation efforts of member states, which now have to reconsider spending their still-much-needed Recovery and Resilience public investment funds.

Recently, Olivier Blanchard (2023) reminded the bubble of central-bank watchers and experts that inflation (and deflation) is, fundamentally, the outcome of the distributional conflict between firms, workers, taxpayers, and—as Claudia Sahn (2023) has rightly added—consumers and shareholders. In his now-infamous note, Blanchard claimed that, in the absence of a successful corporatist negotiation between interested parties, stabilising the economy to optimal levels would fall to the central bank, which could either hamper or speed up the economy through its own capacity and of its own volition, thereby forcing all the parties involved to accept certain financial, welfare and economic conditions. Critically for our purposes, Adam Tooze (2023) pointed out that this policy dichotomy between stakeholder negotiation and monetary intervention remains a purely theoretical concept in systems ‘deliberately and strategically closed against the discussion of distributional issues in the name of higher values like “price stability”’. The eurozone is no exception in this regard.

What follows is a discussion of the manner in which the EU legal system has dealt with this conflict. The first section examines the EU’s approach to money in the historical framework of monetarist theories, before contextualising the legal approach of the economic constitution signed at Maastricht. The discussion on price stability that follows serves as a focal point for understanding the constitutional pressures borne of ECB monetary interventions against inflation. The last section deals with the legal challenges to the ECB’s distributive choices to date, which have developed on the cusp of the economic–monetary divide. From looking at the doctrine of the Court of Justice of the European Union (CJEU) on the separation of competences and extent of monetary powers, developed since the sovereign debt crisis, what can we surmise about the legal interpretation of the distributive effects of aggressive monetary tightening?

## Monetarism and the depoliticisation of money

The European economic constitution, which came together with the Treaty of Maastricht (1992) and established the Economic and Monetary Union, embraced one of the most radical versions of money theory circulating at the time—monetarism. In reaction to the inflationary chaos of the 1970s and the collapse of Bretton Woods, a new logic of fiscal discipline and anti-inflationary politics had come to dominate the global economy. By the mid-1980s it was well-established that these objectives could only be attained by politically independent central banks free from the pro-cyclical pressures of politics. The new system would err on the side of rules rather than discretion in both fiscal and monetary matters. This turnabout was conveniently rationalised upon the two main tenets of monetarism—the claim that ‘inflation is always and everywhere a monetary phenomenon’ (Friedman 1963) and the theory of the neutrality of money. Both of these tenets were held to be valid ‘in the long run’ of economic cycles with wilful indifference to short-term conditions and effects.

The first premise justified the discretionary powers that independent central banks were vested with as the guardians of economic (price) stability. It was especially useful for repudiating any misapprehensions left over from the 1970s that central banks could ‘enhance economic growth by expanding the money supply or keeping short-term interest rates at a level inconsistent with price stability’ (ECB 2023b). It was therefore made clear that the only utility of central banking for the growth potential of the economy is to ensure the maintenance of stable prices, that is, to control inflation within certain optimal parameters.

The claim of money neutrality entirely insulated central banks’ pursuit of said price stability from democratic incursions, that is, it rationalised their independence (ECB 2023b; Eich 2022, 203; Lokdam and Wilkinson 2022, 462). Monetarists held that in the long run, once the economy has reached its equilibrium, monetary policy affects neither incomes nor employment levels, which on the whole will always average for economic efficiency and are, in any case, ‘determined by real factors, such as technology, population growth or the preferences of economic agents’ (ECB 2023b). Thereby, it was held that whatever short-term ‘adjustments’ there were to monetary policy, these would not constitute real distributive social choices; as such, technocratic money decisions would therefore not need to be subject to any kind of democratic oversight.

As Stefan Eich has brilliantly argued, this technocratisation of money effectively allowed for its depoliticisation, treating it as a ‘purely economic medium’ (Eich 2023, 195) that was therefore best left to expert management. While it seemed counterintuitive for politicians to willingly bind themselves to the mast of rulebooks and deny themselves—and their electorates—the democratising power of money, the premise of monetarism promised something more. The willing surrender ‘came in part out of policymakers’ desire to avoid taking responsibility for making distributive decisions. Central bankers shielded from the political process would by contrast be free to steer

without having to bear the burden of democratic justification for the distributive consequences of their actions' (Eich 2023, 195; see also Lokdam and Wilkinson 2022, 462).

## The economic constitution

The architects of Maastricht could not have asked for a more brilliant solution than monetarism to their problem of how to put together a governance framework for a single currency shared between 11 fiscal sovereigns which each sought to maximise the returns from a common market, while minimising the possibility of cross-border fiscal risk-sharing. Whether the politicians and learned men behind Maastricht truly believed in the power of price stability and independent central banking is irrelevant, for they most truly believed in their profligate neighbours' potential to harm the fiscal balance of the joint venture and, by extension, pick each other's pockets. In this regard, monetarism and the keystone doctrine of price stability provided a convenient solution with which to press ahead with the most peculiar of constructs—an asymmetric economic and monetary union.

In 1992 at Maastricht, Europeans constitutionalised their faith in monetarism with the main tenets of the system taking shape in but a few Treaty articles, which have become increasingly salient with each economic crisis faced by the eurozone in the last decade. Premised on the wholehearted embrace of money as a purely technocratic medium, the EU instituted an unnatural division between the fiscal and monetary policy realms—that is, between economic and monetary governance. This was achieved by creating what is perhaps the most independent monetary authority on a global level to date—the ECB (art. 130 Treaty on the Functioning of the European Union (TFEU)). The ECB is responsible not only for conducting the monetary policy of the eurozone, but, in fact, for *defining* the monetary policy of the eurozone (art. 127(2) TFEU). That is, the central bank, in essence, defines the boundaries of its own mandate. Furthermore, while tasked with the objective of attaining price stability (art. 127(1) TFEU), the ECB also defines the parameters of price stability. This was the case with its Governing Council decisions in 1998, 2003 and, most recently, 2021. By design, and by the logic of the monetary theory of inflation, the ECB's sole concern has remained price stability, even if this has resulted in a rather unaccommodating monetary stance for some eurozone governments. In fact, this dynamic was meant to act as a straitjacket for sovereign fiscal profligacy, just in case the economic rulebook instituted under Articles 121 and 126 TFEU did not produce the desired convergence effects.

## Price stability

Price stability was positioned at the core of the EMU as an 'indispensable prerequisite' to the successful attainment of Union objectives. Early on it had been made clear that although 'economic union and monetary union form two integral parts of a single whole . . . the principal features of an economic union depend significantly on the agreed monetary arrangements and constraints' (Committee for the Study of Economic and Monetary Union 1989, para. 21). In other words, this was to be a monetary-authority-led union.

Indeed, price stability constrains the possible outcomes of distributional choices in society and the economy at large, in line with the monetarist understanding of the value of capital as a function of controlled scarcity and fiscal discipline. To this end, the ECB is, in fact, instructed to conduct its activities in the pursuit of price stability ‘in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources’ (art. 127(1)TFEU), and in line with ‘stable prices, sound public finances and monetary conditions and a sustainable balance of payments’ (art. 119 TFEU).

In this sense, price stability is a predetermined and accepted distributional choice about the design of the political economy of the eurozone. It should come as no surprise, then, that the further economic, price and financial conditions have deviated from these pre-negotiated parameters, the more attention has been brought to the redistributive choices, both implicit and explicit, inherent in the management of EU money. In other words, it would seem that the implicit social acceptance of the neutrality of money theory only holds within the boundaries set by price stability. Therefore, it is no coincidence that the re-politicisation of money has occurred contemporaneously with the continued failure to achieve price stability (Eich 2023, 213). Because in the EU monetarism is constitutionalised, these conflict dynamics are conditioned to play out through the law.

### **Renegotiating boundaries: constitutionalised monetarism**

The depoliticisation of monetary policy, based on both the neutrality and inflation theories of money, has empowered the ECB’s exclusivity over its mandate and independence to pursue it beyond democratic oversight as it sees fit. Therefore, it could be said that the depoliticisation of money is the premise behind the very foundation of the EU Treaty framework, which institutes a legal and functional distinction between economic and monetary policy. It follows then, that failure on the part of the Bank to deliver on its price stability objective casts doubt on the presumed legitimacy of monetarist theory, simultaneously intensifying the re-politicisation of monetary policy. In other words, the ECB’s struggles with price stability over the past decade would legally translate into a struggle to sustain a stable distinction between economic and monetary policy in EU constitutional thought. Even a glance at the docket of the Court of Justice of the European Union (CJEU) since the sovereign debt crisis evidences the renegotiation of core monetarist tenets and, by extension, the powers vested with the European Treaties, through the contestation of the divide between economic and monetary competences. The cases in question may be limited in number, but they are not so in terms of scope: *Pringle*, *Gauweiler* and *Weiss*, as interpreted by the CJEU and the German Federal Constitutional Court (FCC). Here, we are concerned with the latter.

The ECB’s pursuit of price stability causes disparate, in fact contrasting, distributive effects for the asset-holder and labour classes depending on whether the Bank is intervening to stimulate or to hamper inflation to achieve price stability. Arguably, while the stability objective remains unchanged, the secondary effects produced by these interventions, and that become subject to contestation at the legal boundary between economic

and monetary competences, vary greatly and are not of equal legal standing in the Treaties.

Whether targeted through conventional or unconventional instruments, the bottom line of monetary policy is the value of credit and, by extension, the inherent distributional effects of the power of credit in society. The easily and cheaply available credit of the past decade diminished the power and profit from savings, the rationality of business and asset investments and, by extension, the logic of the market. Conversely, artificially high interests rates—such as those we are currently witness to—significantly benefit the asset-holders in society, constrain business investment and inhibit employment due to low aggregate demand. To a certain extent, the EU Treaties provide for these distributional effects and attempt to mandate the ECB to conduct its monetary policy in a balanced manner—both ‘in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources’ (art 127(1) TFEU), and in support of the general economic objective of the Union, as laid down in Article 3(3) of the Treaty on European Union, that is, ‘aiming at full employment’. The fact is, however, that the monetarist vision of price stability constitutionalised at Maastricht is inherently antithetical to the concept of full employment and innately embedded with the understanding of an open market economy and competition. Theoretically, then, a legal challenge to the ECB’s pursuit of price stability from the lower bound, such as was the case with *Weiss*, should have a higher chance of success than the Bank’s current fight against inflationary pressures.

To date, the CJEU has only dealt with the Bank’s struggle with deflationary pressures, which saw it pump billions of euros into corporate assets, sovereign bonds and the banking system through the net purchases of public sector securities under the Public Sector Purchase Programme (PSPP), which was in place from 9 March 2015 to 19 December 2018. The German plaintiffs in the *Weiss* case were concerned with the indirect effects these unconventional monetary policy measures were having on the real economy and wondered whether the ECB had not perhaps acted beyond its monetary policy mandate (CJEU 2018, 13–16). To be clear, the plaintiffs and consequently the FCC, did not find the existence of indirect economic consequences itself problematic, even though the separation of monetary policy underpins the monetarist conception of the Economic and Monetary Union. The issue at hand was about the extent of the indirect effects and the fact that they allegedly stemmed from an erroneous interpretation of the ECB’s monetary mandate.

The *Weiss* saga is notorious in legal and policy circles for good reason. Part of the curiosity surrounding the legal interpretation involved in the cases has to do with the two Courts’ understanding of monetarism as constitutionalised in the Treaties. Bizarrely, while the German plaintiffs and the FCC used monetarism to censure certain ECB monetary interventions, the CJEU used monetarism to shield the Bank from any scrutiny. The issue with these contrasting interpretations comes down to identifying the ultimate arbiter of the definition of monetary policy. In other words, it comes down to respecting the constitutionalised nature of pure monetarism in the Economic and Monetary Union.

The CJEU response in its preliminary ruling on *Weiss* was a wholehearted embrace of the monetarist technocratisation of money, which placed monetary policy solely and entirely within the exclusive purview of the ECB's expert management. Following a complete deferral to the Bank's broad discretion due to the technical nature of its expertise (CJEU 2018, paras. 22, 24, 30, 73, 91 and 92), the Court simply could not engage in interpreting the scope of monetary policy and, by extension, the legality of the ECB's PSPP programme or its effects on economic policy. The CJEU further precluded itself from engaging in a balancing exercise on monetary policy's indirect effects by referring to its settled case-law on proportionality, wherein the validity of EU institutional acts is only tied to the pursued objective and the necessity of the measure—with both concepts incidentally falling within the purview of the ECB—rather than the external effects those might produce (CJEU 2018, para. 72). Should there be any such effects, the Court nevertheless affirmed the legality of monetary policy's indirect effects on the real economy (CJEU 2018, para. 66), by claiming—amazingly in the context of the Treaty articles guaranteeing the full independence of the ECB—that ‘the authors of the Treaties did not intend to make an absolute separation between economic and monetary policies’ (CJEU 2018, para. 60). Moreover, the *Weiss* judgment insulated the Bank from responsibility for the distributive ‘indirect’ effects of its monetary policy by claiming that their *ex ante* consideration and weighing against the objective of price stability would, in effect, ‘represent an insurmountable obstacle to [the ECB] accomplishing the task assigned to it by primary law’ (CJEU 2018, para 67). In other words, by reaffirming its own, generally monetarist, history (Orphal et al. 2023, 15–16), the Court not only agreed that the ECB has absolute authority over monetary policy, but that it does not have to take into consideration the indirect effects its decisions might produce in the conduct of its monetary policy. Most importantly, the nature of the challenge to the Bank's exclusive competence proved irrelevant in the CJEU's interpretation.

The dispute in *Weiss* was notoriously continued with the German FCC's consequent revision of the CJEU's judgment (Germany, FCC 2020). While the German Court was concerned with the indirect effects of the PSPP, it is important to understand that the FCC challenge was not targeted at precluding the distributional effects of monetary policy in general. On the contrary, the FCC was willing to accept the distributional effects of *precluding* the ECB from conducting its PSPP operations—for instance, in terms of rising unemployment due to stagnant business investment and the culling of underperforming companies—but only for as long as these fell within the previously agreed to boundaries of Maastricht, where the economic effects of monetary policy could remain ‘neutral’ and insulated within the contractual terms for price stability. In this sense, the bottom line of the entire *Weiss* enterprise was ideological—it was a challenge that aimed to recertify the sanctity of the free market through law or, put otherwise, to re-enact monetarist boundaries, which promised a conservative monetary policy conducted for the sole purpose of price stability.

The FCC also disagreed with the CJEU in its interpretive approach. The nature of the indirect effects produced by the PSPP was fundamental in its challenge of the ECB's free rein in monetary policy. The FCC would have had the ECB provide *ex ante* and dynamic safeguards capable of neutralising the intended, unintended and future distributional effects of its monetary policy on asset bubbles, zombie companies, bank savings, credit

ratings and property markets (Germany, FCC 2020, 139). Furthermore, these safeguards would have had to be capable of withstanding the threat of a continuous legal review through proportionality testing aimed at balancing the indirect effects of monetary policy on the real economy. This approach aimed to protect the unadulterated relationship between states, business ventures and the free market, absent interference by the ECB. Under the FCC's reading, the ECB would have been free to do 'whatever it takes' with the PSPP—just as long as it was not very effective.

## Conclusion

The challenge brought in *Weiss*, first with the CJEU and consequently with the FCC, pitted the monetarist promise of neutral money through a constitutionalised price stability anchor against the practical demands and difficulties of pursuing said price stability, for the first time lifting the veil on the distributive effects of monetary policy in the eurozone. The CJEU's judgment in the matter confirmed the ECB as the sole and ultimate authority on European money. While the Bank has since acknowledged the FCC's intervention and there of allowed for wider considerations in its policy decision-making (ECB 2021), the balancing exercise between primary Treaty norms such as price stability, the free market and employment,—typically reserved for constitutional courts—has been officially bequeathed to the discretion of the monetary authority in Frankfurt.

Most importantly perhaps, the tale of two courts told with *Weiss* negates the possibility that the Court could seriously consider any future legal challenges to the current round of aggressive monetary tightening, which is likely to cause a rise in unemployment should the Bank miss the opportunity to create a soft landing due to a protracted period of restrictive interest rates (ECB 2023a). For one, the ECB's absolute authority in making decisions for the eurozone economy has been affirmed. Moreover, if protecting the Treaty-enshrined value of credit did not meet with the CJEU's favour during the ECB's deflationary interventions, one holds little hope for the lofty economic objectives of the Union—including the *aim* of full employment—in a balancing exercising against the value of credit *and* price stability that is to be conducted in Frankfurt.

To a certain extent then, the constitutionalisation of the monetarist narrative about money within the exclusive competences of the most independent European institution—the ECB—has further depoliticised its distributive effects, insulating the Bank's decisions from both democratic and judicial oversight (Mudge and Vauchez 2022, 601).

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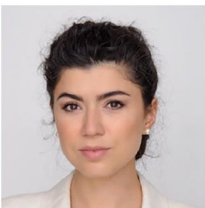
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