About Policy Spotlights

This column includes short pieces explaining policy proposals that highlight, revise, or contest current monetary design. While we focus on contemporary proposals, historical episodes may be included occasionally. Columns are written by editors or by student authors and will be updated monthly. Students interested in becoming a Just Money columnist should contact Dan Rohde: editor@justmoney.org.

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Public Banking (Updated November, 2020)

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COVID-19 Update (November, 2020)

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As local businesses and economies struggle in light of COVID-19, public banking is continuing to gain traction as an attractive alternative to our current financial systems. Small business owners have seen large banks prioritize large, well-connected companies for government relief funding. Cities and states are facing massive revenue shortfalls, leading to layoffs and reduced services. And the economic crisis and efforts at relief have continued to perpetuate racial disparities in lending.

Meanwhile, in North Dakota, where a state-owned public bank has been operating for 100 years, public banking is once again proving its value in a time of crisis. For one, the state-owned Bank of North Dakota assisted small businesses in securing funds from the federal Paycheck Protection Program, which had a troubled roll-out. Thanks in part to that help, small businesses in the state secured more funds, relative to the state's workforce, than businesses in any other state, according to a Washington Post analysis. The bank has also established two COVID-19 relief–loan programs for North Dakota businesses in the state, offering low-interest loans in partnership with local financial institutions.

These developments in North Dakota and across the country have contributed to the public banking movement's growing momentum. From New York to California, advocates are pointing to public banking as a way to provide more immediate and equitable emergency economic relief while keeping loan fees in-state. Although the efforts to establish public banks are not new, the COVID-19 crisis has lent new urgency to the movement.

COVID-19 and the flaws of our financial system

The COVID-19 economic crisis and attempts at relief have underscored the flaws of the current financial system and the alternatives public banking might offer.

Firstly, the rollout of the federal Paycheck Protection Program highlighted preexisting disparities in lending as large, well-connected businesses took precedence over smaller businesses in receiving loans and Black business owners faced disparate treatment compared to white business owners. The program was intended to help businesses with less than 500 employees keep workers employed, providing low-interest loans that can be forgiven if certain criteria are met. In order to receive the funds, businesses had to submit applications to banks. But smaller businesses had difficulty accessing that money — instead, larger companies with preexisting connections to major banks got “priority treatment,” according to an Associated Press analysis. Although loans to smaller businesses picked up later on, the analysis shows they lagged behind larger companies.

Minority-owned businesses also likely faced steeper hurdles in securing PPP loans given historical disparities in lending. A study sending “testers” to banks to apply for PPP loans found that Black borrowers were offered different products and were treated worse than white borrowers with similar profiles in 43 percent of tests. Although it is not possible to fully analyze the racial breakdown of PPP loans due to lack of data collection, businesses located in minority communities were less likely to receive assistance than those located in majority-white communities, according to a Washington Post analysis.

Given the current design of the monetary system and the government’s decision to distribute lending through commercial banks, these results are not surprising. From the start, the system favored large banks that had already worked with the federal Small Business Administration, more readily approving their ability to lend out PPP funds. Those banks then favored their existing customers, likely both because it was easier to vet applicants due to a preexisting relationships and because banks have their own financial interest in their customers’ businesses — for example, some customers already had significant outstanding loans at the banks prior to seeking out PPP loans. Banks also prioritized larger customers, likely because they carry the most potential to generate revenue for the bank through loan fees and the possibility of a long-term relationship leading to later loans and interest payments. Finally, a system that favors large, well-connected players is likely to perpetuate existing disparities in our financial systems.

In North Dakota, meanwhile, the state-owned Bank of North Dakota assisted the state's local financial institutions in securing more PPP funds for local businesses, relative to the state's workforce, than any other state. According to a Washington Post analysis, small businesses in North Dakota secured more than $5,000 per private-sector worker as of May 8, the highest of any state. The contrast was particularly stark in the troubled first round of funding, when many small businesses throughout the country struggled to get loans. According to the Post analysis, North Dakota was the only state to secure more than $4,000 per private-sector worker during that period, which ran through April 16. More than half of states secured less than $3,000 per private-sector worker in that same period. Much of that success likely stemmed from the BND's ability to provide support to local banks, as well as local banks' deep ties to their communities — North Dakota has nearly six times as many local financial institutions per person than the country overall, according to the Institute for Local Self-Reliance. So even if small banks were similarly prioritizing existing customers, their integration with small communities allowed them to more quickly connect with small businesses.

Second, the PPP has highlighted the fact that loan fees and interest payments serve to boost large banks' profits. Although that process generally draws little attention when the bank itself is the one making the loan, the fact that banks stand to receive $14.3 billion to $24 billion in fees from PPP loans has drawn prominent headlines. Loan fees generally cover the costs of administering loans and offer banks a way to profit on their lending in addition to charging interest on outstanding loans. To incentivize bank participation in the PPP, the Small Business Administration paid lenders loan fees, or "processing fees," ranging from 1 percent to 5 percent of the loan amount, depending on the size of the loan. Lenders will also earn 1 percent interest on PPP loans that aren't forgiven.

Although many banks don't expect to profit from the low rates and some have said they will donate any profits they do make, the set-up underscores another potential benefit of public banking: loan fees and interest payments are funneled back into the community instead of flowing to shareholders and high salaries. Although such fees and payments do similarly contribute to the operation expenses of a public bank, any profits beyond those operating costs can be directed back into the community through appropriations to a state general fund or through community development programs. For example, the Bank of North Dakota has contributed more than $1 billion back to the state's general fund since its first transfer of $1,725 in 1945. In the past decade, the BND's annual contribution has varied widely, from $2.8 million in 2011 to $186.9 million in 2017. Additionally, public bank employees may be more accountable to the public and earn much lower salaries than their private counterparts. For example, the Bank of North Dakota's CEO had a salary of $310,000 in 2020, according to the North Dakota Office of Management and Budget. The JPMorgan Chase CEO's salary in 2019 was $31.5 million — that's roughly three times the entire payroll of BND.

Thirdly, the Bank of North Dakota has rolled out its own COVID-19 relief programs, augmenting the PPP and demonstrating how public banks can help respond to an economic crisis. Typically, when an economic crisis hits, access to credit becomes more difficult as banks become more reluctant to lend. This then leads to further economic decline. Central banks — like the U.S. Federal Reserve — generally try to counteract this credit contraction by buying up bank debt to provide more liquidity to banks so they keep lending. State and local public banks can provide a similar countercyclical effect in times of crisis, and they have the potential to respond in a more efficient and targeted manner given their community ties and smaller geographic scope. In North Dakota, BND has helped local financial institutions weather financial crises by buying up loans and residential mortgages, thereby expanding their capital ratios. BND also partners with local banks and credit unions to make joint loans, further expanding the lending capacity of smaller institutions. In response to COVID-19, BND has developed two low-interest lending programs, with one for small employers charging only 1 percent interest. Hundreds of North Dakota businesses have received loans under these programs.

Lastly, local and state governments are facing massive budget shortfalls in light of COVID-19, highlighting the need for sustainable local funding. Some estimate that the state and local government revenue shortfall could amount to nearly $1 trillion by the end of 2021. State and local efforts to balance budgets amid such a large revenue shortfall can stall economic recovery as governments lay off employees, cut services, and raise taxes. Local public banks have the potential to cushion this hit by increasing lending to local and state governments. Given that public banks do not need to satisfy investors or cover high employee salaries, they can generally afford to charge lower interest rates. Public banks can also counter revenue shortfalls through the methods discussed above, including by fostering the overall financial health of the community and keeping loan profits within the community.

New urgency in the public banking movement

These concerns — along with some of the successes in North Dakota — have contributed to growing urgency and momentum around the public banking movement, which had already gained significant traction in recent years.

Public banking in the U.S. is not a new idea – early banks in the U.S. were sometimes owned partially or entirely by states, like in Vermont, and the Bank of North Dakota just celebrated its 100th anniversary last year. Since the 2008 crisis, the idea has gained new attention and momentum – American Samoa established a public bank in 2018; California passed legislation in 2019 providing municipalities the authority to establish public banks; the governor of New Jersey signed an executive order in 2019 creating a public bank implementation board; and 17 states and 12 municipalities, as well as Washington, D.C., had taken official steps to explore public banking by the end of 2019, according to the Public Banking Institute.

Now, the COVID-19 economic crisis is adding urgency to the movement. In New York, Massachusetts, and elsewhere, the economic downturn and the faulty response of big banks have galvanized efforts to enact public banking legislation that was already on the table. In California, legislators have introduced a new bill that would establish a state bank to help with recovery from the economic downturn. California already has an infrastructure and economic development bank, IBank, that was created in 1994. The bill would expand IBank's lending authority, move 10 percent of the state's Pooled Money Investment Account into the IBank's loan fund, and convert the IBank into a depository institution, allowing it to leverage capital and engage in money creation. At the national level, a handful of U.S. Representatives have also pushed Congress to include a public banking option for state and local governments as part of COVID-19 relief packages.

There are still many challenges of public banking, and it won't be a quick fix to the current economic downturn. Many worry about the significant short-term costs of establishing a public bank, as well as public banks' susceptibility to political influence. The idea also faces steep opposition from some portions of the banking industry. Despite these challenges, public banking has the potential to increase accountability and provide governments with the ability to respond more nimbly to economic downturns — needs that have become particularly stark amid a global pandemic.

Public Banking

The public banking movement has gained significant momentum in recent years, with groups across the country looking into the viability of government-owned banks for their communities. From a “pot bank” in Los Angeles to a “public infrastructure bank” in Massachusetts, proponents of public banking view it as a way to address community needs and better leverage taxpayer funds to benefit the public.

The idea of public banking in the U.S. isn’t a new one — the state-owned Bank of North Dakota has been operating for 100 years, gaining widespread bipartisan support despite initial political opposition. And early banks in the U.S. were sometimes owned partially or entirely by states, like in Vermont. But the idea has gained new momentum in the years since the 2008 financial crisis. According to the Public Banking Institute, 15 states and 11 municipalities are taking official steps to explore public banking, and more than 50 organizations are promoting public banks.

The public banking movement is not without its critics, however. In 2011, the Federal Reserve Bank of Boston produced a feasibility report advising against the idea, and members of the banking industry have mounted opposition to the idea in New Mexico and elsewhere. Some of the greatest challenges public banks face include high up-front costs, risks of corruption, and the overall difficulty of integrating a new institution into the banking industry.

This article will provide an overview of public banking, including a discussion of the Bank of North Dakota and the growing public banking movement nationwide.

What is a public bank?

Put simply, a public bank is a financial institution that is owned by the government and funded by public revenues. It has many characteristics similar to commercial banks but is run by the state, city, or other government entity and is beholden to the public rather than shareholders.

Understanding the structure of public banks therefore requires some discussion of the current design of commercial banking. Commercial banks have three main functions that are important for this explanation: money creation, revenue production, and credit allocation.[1]

Money creation

Commercial banks create money through the joint use of loans and deposit accounts. (For more detail, see Roundtable No. 1 on Banking and Money Creation.) When a bank lends $100 to a customer, the bank does not lend out $100 of its own reserves. Instead, it “creates” the $100 by simultaneously recording a $100 loan that the customer owes the bank and crediting the customer’s deposit account with $100. The customer can then start using that $100 that didn’t exist prior to the transaction, although it must eventually pay $100 back to the bank. The bank’s balance sheet meanwhile remains in balance because both its assets (the loan) and its liabilities (the deposit account) increase the same amount.

Revenue production

Banks profit from this money creation system by charging interest on loans. If the loan in the example above has an interest rate of 10 percent annually, the customer then owes $10 in interest by the end of the first year of the loan, in addition to the $100 principal. This $10 becomes the bank’s revenue.

An additional way commercial banks earn revenue is through interest from the Federal Reserve. Banks have accounts at the Federal Reserve that function similarly to individual deposit accounts. In 2008, banks started earning interest on these accounts, providing another source of revenue.

Credit allocation

With the ability to create money and profit from that money creation, commercial banks are then able to decide where to allocate credit. If, say, the housing sector seems very profitable, banks can expand credit in that sector while declining to extend credit in a less lucrative area. They additionally decide who to loan to and how much interest to charge based on markers like income, employment history, repayment history, and credit score.

Banks are the only way money enters the economy other than government spending, so this ability to inject money in certain sectors affords banks the opportunity to significantly shape the economic landscape. And this power comes with a past and present of discriminatory lending practices, both by private banks and by government organizations.

How public banks fit in

Public banks would function similarly to commercial banks, but all of these powers would be vested in the public and their representatives instead of shareholders and executives. This means that money creation would be done by the public, the public would earn revenues from that money creation, and the public could decide how and when to allocate credit. The exact way this operates depends greatly on the design and mission of the particular bank, but some options include prioritizing low-interest student loans, small business development, or agriculture loans. The Bank of North Dakota offers one example of these principles in practice.

The Bank of North Dakota

The Bank of North Dakota was established in 1919 in response to frustration among farmers about high interest rates from big banks. Its founding mission was to promote agriculture, commerce, and industry in North Dakota while being helpful to and assisting in the development of other financial institutions.

In keeping with that mission, BND provides most of its services in partnership with local banks and credit unions instead of working directly with individuals. The main way it does this is through participation loans, which are originated by local banks and credit unions and funded in part by BND. In terms of money creation, these participation loans resemble individual loans to the banks originating the loans — the originating bank has an account with BND, and BND both creates a loan on its balance sheet and credits the originating bank's account with the funding. The difference is that the individual borrower, not the originating bank, is responsible for paying the principal plus interest. The originating bank then distributes that payment to BND according to the terms of their participation agreement. About half of the bank's $4.6 billion loan portfolio in 2018 consisted of this type of loan. The remainder was comprised of state loans, residential mortgages, and student loans. Student loans are the only significant area in which the bank works directly with borrowers. The bank's residential mortgages are mostly purchased on the secondary market, allowing local banks to free up lending capacity without giving new business to competitors.

The bank also operates in some ways like a small central bank, providing coin and currency, clearing checks, holding deposit accounts for banks, and offering the ability to settle Federal Reserve activity through BND accounts. It also assists local banks with short-term liquidity needs and buys up loans from banks during financial downturns to help increase their capital ratios.

In terms of design, the bank has several interesting features that distinguish it from commercial banks. Firstly, all state funds and funds of all state penal, education, and industrial institutions must be deposited in BND under state law. Consequently, the majority of BND's deposits come from state taxes and fees, with the rest coming from corporate accounts, city and county governments, and residents. Additionally, in contrast to most commercial banks, BND is not a member of the Federal Deposit Insurance Corporation, instead guaranteeing all BND deposits with the full faith and credit of the State of North Dakota.

Many agree that BND played a positive role in stabilizing the state's economy through the Great Recession, but there is uncertainty about how large that role was, especially given the state's oil boom and strong agricultural sector. The bank's more quantifiable impacts include contributing to the state's general fund and supporting local banks and credit unions. Since its first transfer of $1,725 in 1945, BND has contributed more than $1 billion back to the state's general fund. In the past decade, its annual contribution has varied widely, from $2.8 million in 2011 to $186.9 million in 2017. For reference, the state's 2017-2019 two-year budget was $13.55 billion, with $4.3 billion of that coming from the general fund.

BND's support to smaller banks has meanwhile fostered a diverse local lending market, with nearly six times as many local financial institutions per person than the country overall. According to the Institute for Local Self-Reliance, banks and credit unions with less than $10 billion in assets accounted for only 29 percent of deposits nationally in 2014 – in North Dakota, they accounted for 83 percent of the market.

The growing public banking movement

States and municipalities around the country are realizing the potential benefits that public banking may provide. As of early 2020, fourteen states, as well as Washington, D.C., and multiple municipalities, had initiated studies, task forces, or ballot initiatives to explore public banking feasibility. Much of this momentum has developed from efforts led by community groups. Local organizations opposed to major Wall Street banks have partnered with government officials, unions, and local businesses to advocate for public banks that will prioritize economic development and funnel profits back into the community.

In New Mexico, for example, community-based groups began to pursue the idea of public banking in 2012. After determining that New Mexico’s political climate was not yet receptive to a statewide public bank, activists centered their attention on municipal efforts in Santa Fe and Albuquerque. Although an initial Santa Fe report found that a public banking initiative would be feasible, a city task force later determined that Santa Fe’s finances were not sufficient to establish a bank at the municipal level. Consequently, multiple groups have united efforts in the Alliance for Local Economic Prosperity to pursue public banking at the state level.

In California, activists successfully advanced legislation that will make it easier for municipalities to establish their own public banks. Signed into law in October 2019, Assembly Bill 857 gives municipalities the power to establish public banks and provides a framework for that process. In tandem with that legislation, major cities like San Francisco and Los Angeles have been examining the feasibility of municipal banks, and New York legislators started considering a similar proposal for their state.

In Massachusetts, meanwhile, public banking advocates have galvanized the movement around local concerns about infrastructure. The Mass Public Banking working group has advanced legislation that would establish a public bank tailored to offer infrastructure financing to Massachusetts municipalities. The idea is currently being studied in the Massachusetts Legislature.

New Mexico, California, and Massachusetts are a small sample of the states where public banking movements have been growing. Efforts to establish a public bank in the U.S. territory American Samoa succeeded in 2018, and more than fifty organizations around the country are working to promote public banking.

Rationales for public banking

The touted benefits of public banking are numerous, including everything from spurring economic development to funding public infrastructure projects. The specific impact of a public bank would depend greatly on its structure, its mission, and the community in which it exists. Some of the potential benefits public banking proposals have focused on thus far include:

- Enhancing accountability: Given that a public bank is owned by the government and funded by public revenues, including taxpayer money, proponents of the system view it as a way to enhance accountability and transparency in banking.
- Lowering debt costs for local governments and funding public infrastructure projects: Because public banks are dedicated to serving the public instead of investors, they can charge lower interest rates on loans to state and local governments, making enough revenue to operate without the need to pay high salaries or investors.

- Funneling interest profits back into the community: In commercial banking, interest payments on loans go to banks’ and shareholders’ profits. In public banking, interest payments on loans similarly go toward bank profits, but these can then be funneled back into the community through appropriations to a state general fund or through community development programs. In 2018, BND had a net income of $160 million, with a return on equity of approximately 18.5 percent. For reference, JPMorgan Chase’s return on equity was 11.9 percent at the end of 2018.
- Strengthening local banks: In line with the Bank of North Dakota model, new public banks could partner with local banks and credit unions to boost their lending capacity.
- Benefitting from Federal Reserve interest rates: In 2008, the Federal Reserve started paying interest to depository institutions on their reserves. A public bank can similarly earn interest on its reserves, using that interest to further benefit the public. BND, for example, earned $1.545 million on its reserves in 2018.
- Spurring economic development: Depending on its structure and the needs of the community, a public bank can provide additional credit to the community through small business loans or other types of funding. The Bank of North Dakota, for example, uses its profits to fund “mission-driven loan programs,” including interest buydowns and below-market-rate loans for economic development and infrastructure projects.
- Providing banking access to the cannabis industry: In states where it is legal to grow and sell marijuana, processors and retailers are still operating largely on a cash-only basis due to ongoing federal prohibition. Some are looking to public banks as a way to fill that banking need, although the federal government is also considering a bill that would allow banks to maintain accounts for state-approved cannabis businesses.

- Stabilizing the economy: Although many agree a public bank would not single-handedly save an economy, it may have the potential to cushion the blow by expanding credit at a time when the rest of the economy is contracting.
- Lowering interest rates on student loans or other lending: Public banks could additionally provide low-interest loans directly to individuals if the community identifies such a need. The Bank of North Dakota, for example, expanded its services in recent decades to include student loans. Its loans for North Dakota students for the start of the 2019-2020 school year have a fixed interest rate of 4.74 percent, higher than the federal undergraduate rate of 4.53 percent but lower than many private lenders. Its variable interest rate is meanwhile 3.93 percent but hovered around 2 percent from late 2009 until 2016. Although the bank still encourages students to utilize federal loans first, it offers a state alternative to private lending.

Public banking challenges

With its growing momentum, public banking has also attracted a host of critics. Many worry that starting a public bank will have significant short-term costs that may not be outweighed by any long-term gains. A Los Angeles inquiry into public banking costs described the ultimate price of a public bank as "exorbitant." San Francisco similarly found that public banking would be an uncertain investment regardless of design.

Outside of the initial costs, some critics are concerned about public banks' susceptibility to political influence. Without proper safeguards, loans could be given based on political clout rather than creditworthiness, fostering corruption and potentially destabilizing the banks.

The idea of public banking has also faced opposition from the banking industry. The president and CEO of the Bank of North Dakota has stressed that the bank is successful because it partners with North Dakota’s financial institutions instead of acting as a competitor. But some activists have specifically rallied around the idea of public banking as an alternative to big banks, setting up a potentially steep political hurdle.

Despite these challenges, the problems that the public banking movement intends to solve, whether economic inequality or infrastructure investment, are not going away. If designed well, public banks could offer one way to address these concerns.

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[1] For a more thorough discussion of these functions, see Morgan Ricks, *The Money Problem: Rethinking Financial Regulation* (2015) and Andrew Jackson & Ben Dyson, *Modernising Money: Why Our Monetary System is Broken and How it Can be Fixed* (2012).

Lacewell v. OCC

Author: Lev Menand & Morgan Ricks

When it comes to U.S. monetary policy, the Federal Reserve looms large. But a lesser-known agency also plays an important role: The Office of the Comptroller of the Currency ("OCC"). Congress created the OCC in 1863 – fifty years before it set up the Fed.[1] Congress charged the OCC with chartering, regulating, and supervising a system of "national banks." Today there are 1,200 of these privately-owned federal instrumentalities. They issue and maintain $15 trillion of deposit balances, and these balances – not the paper notes issued by the Fed – make up the vast majority of the U.S. money supply.

Exactly two years ago, the OCC announced that it would begin granting new "special purpose" national bank charters to financial technology ("fintech") companies that do not issue or maintain deposit balances. These new national banks would be exempt from federal regulations governing depository institutions, while still benefitting from the federal status national banks enjoy. Thus, they would be entitled to ignore many state business regulations as well as large portions of the federal securities laws (from which banks are explicitly exempt).

In September 2018, the Superintendent of the New York State Department of Financial Services ("DFS") challenged the OCC's proposed charter in federal court.[2] It argued that a nondepository national bank was an oxymoron. In October 2019, the Honorable Victor Marrero agreed, entering judgment in favor of New York and enjoining the OCC from issuing its proposed charter. In December, the OCC appealed. The substantive question presented in the appeal is whether the OCC has the authority under the National Bank Act ("NBA") to charter nondepository national banks.

This week, thirty-three banking law scholars[3] filed a brief in support of the DFS.[4] The brief – available below – argues that the OCC has no such authority. It explains that the OCC's position is based on a fallacy: that "banking" is just another word for "lending." As the amici put it:

> *Banking involves lending, but mere lending does not constitute banking. When a bank makes a loan, it posts a credit in the amount of the loan to the borrower's deposit account. It need not have any cash on hand. By contrast, before a nonbank lender can lend, it must procure cash or its equivalent. Thus, while nonbank lenders "deal" in money, "banks do not merely deal in[,] but are actually a source of, money." United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 326 (1963) . . . [I]t is for this reason that banks are subject to strict federal oversight.*

A ruling in favor of the OCC would conflate banks' *permissible* activities with their *essential* activities. While, under prevailing doctrine, national banks are permitted to engage in a wide range of financial commerce, the OCC does not have the power to charter entities that do not augment the money supply. The OCC's contrary position contravenes not just the text and purpose of the NBA, but also the Federal Deposit Insurance Act, the Bank Holding Company Act, and the Federal Reserve Act, the last of which it would undermine by giving nondepository companies that play no role in monetary policy the ability to participate in selecting six of the nine members of the Boards of the regional Federal Reserve Banks. The consequences of a judgment in favor of the OCC would also extend far beyond money and banking – opening up the possibility of general business incorporation at the federal level for much of the financial sector and perhaps large portions of the nonfinancial sector.

For those who are interested in the case, we have included links below to other public documents, including an amicus brief filed by Wharton Professor David Zaring in support of the OCC's position and several amicus briefs filed in support of DFS.

Documents Related to Spotlight:

District Court Opinion

Brief of 33 Banking Law Scholars

Brief of the OCC

Brief of the DFS

Brief of David Zaring

Brief of ICBA

Brief of Consumer Groups

Brief of State Credit Regulators

Brief of State Conference of Banking Supervisors

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[1] And twenty-five years before it created the Interstate Commerce Commission, what is often erroneously considered to be the country's first regulatory agency.

[2] DFS is the oldest banking agency – and oldest independent regulatory agency in the country – predating the OCC by twelve years. *See* Lev Menand, *Why Supervise Banks? The Forgotten Past and Uncertain Future of a Distinctive Form of Governance*, 71 Vand. L. Rev. __ (forthcoming).

[3] Hilary J. Allen, Dan Awrey, Mehrsa Baradaran, Lawrence G. Baxter, Prentiss Cox, John Crawford, Nakita Cuttino, Christine Desan, Adam Feibelman, Gina-Gail S. Fletcher, Anna Gelpern, Erik F. Gerding, Jeffrey N. Gordon, Robert Hockett, Kristin N. Johnson, Jeremy Kress, Adam J. Levitin, Da Lin, Jamie

McAndrews, Patricia A. McCoy, Lev Menand, Saule Omarova, Christopher K. Odinet, Nadav Orian Peer, Christopher L. Peterson, Katharina Pistor, Sarah Bloom Raskin, Morgan Ricks, Heidi Mandanis Schooner, Graham Steele, Joseph Sommer, Jennifer Taub & Arthur Wilmarth.

[4] Brief of Thirty-Three Banking Law Scholars as Amici Curiae in Support of Appellee in *Lacewell v. OCC*, No. 19 Civ. 4271 (2d Cir. July 29, 2020).

The Phenomenon of Complementary Currencies

Author: Christian Gelleri

The Phenomenon of Complementary Currencies

In times of crisis, people often become creative in order to ensure the survival of themselves, their family, their peer-groups and their environment. Unconventional ideas, which are considered strange and weird in normal times, appear in a completely different way in times of need. When a collective creates its own currency, it tries to solve problems in a material world by definining a unit of account and medium of payment accepted by everyone within that community (Desan 2014, S. 6). Governments have often held a monopoly on the design and issue of money. In modern history, however, a private-public-partnership model has emerged in which the state defines the currency, but delegates most money creation to commercial banks (Desan 2017). Monetary policy in this framework aims to secure the value of a currency over time and foster high employment, economic growth and other goals of the state.

What motivates people to initiate complementary currencies? A common motivation is a sustained economic shock on the demand side, leading to low turnover and unemployment. A complementary currency offers the possibility of self-help by the participants buying goods from each other using a clearing unit. In this case, the complementary currency only serves to fill a gap in demand. Yet, people who create complementary currencies often have further aspirations. They dream of fair exchanges, of sustainable ways of life, and are critical of money-making for its own sake. These dreams result in very diverse complementary currencies reflecting different visions of their founders and different economic realities. The founder of American time banks, Edgar Cahn, fought for a lifetime against poverty and the deprivation of poor citizens. Cahn had the vision that, through his time bank, differences in the worth of labour could be mitigated, and thus community could be strengthened. Other visionaries in the field of complementary currencies were Margrit Kennedy and Bernard Lietaer, who dreamed of a resilient economic system without the compulsion to grow. For them, money was to serve people through tailor-made design and constant circulation (Kennedy et al. 2012).

When it comes to complementary currencies, one may first observe their variety on a spectrum between idealism and pragmatism. Communities make complementary currencies for many different reasons and according to a wide range of designs. Complementary currencies can be regarded as social innovations that respond to economic, social and environmental challenges. They must be distinguished from other parallel currencies which primarily pursue the objective of maximising profits. Those are not the object of this article.

We can distinguish between five types of complementary currencies (Kennedy et al. 2012; Gelleri 2008; Martignoni 2012; Seyfang und Longhurst 2013)

1. mutual credit currencies,
2. reserve-backed complementary currencies,
3. fiat complementary currencies,
4. digital peer-to-peer currencies, and
5. sectoral currencies.

1. Mutual credit currencies

Mutual credit currencies are the "mother of complementary currencies." They are created within a community without the need for an external reference or reserve currency. They are used locally in noncommercial settings, between companies or in different areas of social life. Mutual credit currencies provide access to credit and liquidity for all those who can and want to contribute to the community. Credit creation is carried out by the participants themselves, but the credit limit is set by the joint institution. The more participants take part the higher is the potential limit. It's mutual because the limits are mostly oriented on the capacity to perform for other participants.

1.1 Noncommercial mutual credit currencies

Local exchange trade systems (**LETS**) and **time banks** focus on the informal and noncommercial sector. The idea is to connect people beyond the logic of economic markets and match their respective capacities with their demand.

Both systems generally define one working hour as the internal accounting unit. Most exchange is done using this unit to measure exchange value. In times when conventional family structures and village communities are dissolving, LETS offer an opportunity to build social networks on a reciprocal basis. Participants start with accounts set at zero and get a credit limit to “buy” services from other participants. The community defines the limit for each participant. When the limit is ten hours you can buy goods and services that are worth ten hours of work.

When Scotsman Michael Linton introduced the first LETS system in 1983 he used a simple folder in which the hours were accounted for as “minus” for the buyer and as “plus” for the seller. Each booking was personally signed by the other participant. Today software is used for this bookkeeping purpose but the principle remains the same: With a minus, I owe services to other participants with a plus. There are a few thousand LETS worldwide, each with between 10 and a few hundred members. A spectacular development took place in Argentina in 2002, when exchange rings took over the function of official money with millions of people trading within LETS (Colacelli und Blackburn 2009).

Many participants in LETS reject the designation of their system as “money”. They perceive the current monetary system as highly unfair and prefer the term “exchange” or “barter”, even though the concept of barter does not really capture the kind of exchange facilitated by LETS. In fact, credit units are being created and circulated.

Time banks set the value of the internal currency unit to one hour of work and try to motivate participants to exchange one hour for one hour. They cooperate more often than LETS with local government agencies and philanthropic foundations. There are large timebank networks in the US, as well as in Australia and the UK. Statistics in the US on timebanks show more than 2.5 million hours worked over a fifteen-year period. British timebanks have run up more than 4 million hours in the last ten years. Some participants report that they have lived completely from such noncommercial mutal credit systems not using any official money for several years.

The work exchanged through time banks includes care work for the elderly and children, assistance for people with special needs and neighbourly exchanges. In many places, time banks operate to redefine the concept of work and to strengthen social cohesion.

1.2 Commercial mutual credit currencies

Commercial mutual credit currencies are often used to "fill the economic gap" in times of deeper recessions. Usually they are called "barter systems". Again, the term is as misleading as in the case of LETS. Sometimes commercial mutual credit currencies are also designated as counter trade exchange or credit-clearing exchange. Typically these systems have no central lending authority, which distinguishes these mutual credit currencies from credit moneys produced by banks.

Most of these systems refer to the national currency as the unit of account. Internal credit is created by the act of purchase. Each participant is accorded a purchase limit that is based on simple criteria, like the number of their employees or the expectation of future performance in the network. While the buyer incurs a liability, the seller receives a transferrable general claim which cannot be exchanged into national currency. The purchase of goods results in a minus (mostly interest-free) for the buyer and a plus for the seller. This process can be described as an act of decentralized money creation insofar as the positive balance can be used to make further purchases from other participants. Once the network reaches a critical mass, the possibilities for reusing the credit currency multiply and the system becomes more efficient. Large networks use digital platforms with trading and marketplace features that have low transaction costs – lying between the costs of debit cards and credit cards. The ongoing exchange gives the internal unit the character of money. The process of credit creation and currency circulation only comes to an end when all participants spend their positive account balances matching exactly the negative balances of the other participants.

Successful networks often work with personal intermediaries that bring supply and demand together. They operate mostly on the national level or in larger geographical areas. Examples are Bartercard in New Zealand and Australia with about 6,000 businesses and a turnover of $150 million per year, and the Sardex in Sardinia with more than 3,000 businesses and a volume of more than $50 million in 2019. A few hundred commercial mutual credit currencies exist globally. Most of them operate digitally only. Many are members of the International Reciprocal Transaction Association.

The oldest system in this field is the Swiss WIR, which is licensed to operate as a bank under Swiss law. The cooperative was founded in 1934 and is still active with many thousands of businesses participating. The currency creation of the WIR bank approaches that of a conventional central issuer. Participants borrow the internal currency from the WIR bank and circulate it within in the network. With more than 60,000 small and medium enterprises, the network reached turnovers of more than two billion Swiss francs and relevant shares of GDP in the 1990s when Switzerland was in a recession. Several studies have documented the anticyclical effect of mutual credit currencies (Stodder und Lietaer 2016).

The advantages of such systems are the synergies arising from network effects. Businesses can optimize their sales by using the possibilities of the regular market while also benefitting from secondary market of the network. Difficulties in the regular market can thus be bridged and compensated in many cases.

2. Reserve backed complementary

currencies

Reserve-backed complementary currencies operate with the national currency or certain goods functioning as a reserve in order to enhance confidence in the complementary currency.

2.1 Regional currencies

Reserve-backed **regional currencies** are the most common form. They are emitted by local associations mainly to promote local business cycles, but also to promote further social aims.

Most initiatives begin with paper currencies set at an exchange rate of one-to-one against the national currency. Citizens buy the regional currency from the issuer and bring it into circulation by using it for purchases from local businesses that have agreed to accept the regional currency. The national currency serves as a reserve. Only businesses, not citizens, can exchange the regional currency back into the national currency. When they do so, they are charged a fee between zero and ten per cent, part of which is sometimes used for donations to local organizations. Re-exchange draws on the regional currency's reserves. Therefore credit can only be extended up to a fraction of the reserves. Small systems often take no risks, and therefore usually hold reserves at 100%. Some regional currencies cooperate with cooperative and savings banks to use the reserve as a basis for loans to businesses.

Most regional currencies are time-limited and have maturities that are comparable to purchase vouchers. Individual regional currencies, such as the Chiemgauer, also operate with a negative interest rate, a strategy recommended for national currencies by Silvio Gesell (Gesell 1958/1916) a hundred years ago and advocated today by some economists, like Kenneth Rogoff (Rogoff 2017). The time limitation is used to keep the circulation of money high and stable. Comparisons of the speed of money circulation ("velocity") show that regional currencies circulate at higher speed than national currencies (Gelleri 2009). Unlike national currencies, regional currencies do not function as a store of value, but only as a means of payment.

Regional currencies have shown their greatest benefits in times of deflation and depression. In 1932, a regional currency was created by the municipality of Wörgl. The city hired unemployed workers to repair streets and buildings, and paid them in the newly-created currency. Workers had the incentive to spend the currency, which was losing value because it was subject to a negative interest rate of one per cent per month. Local businesses could use the local currency to pay municipal taxes. Thus, a local business cycle was established. Nobody was interested in hoarding the local currency. Within a very short period of time, unemployment was reduced by a quarter (Broer 2013). A legal ban, however, ended the experiment, prevening its spread to other municipalities.

Today, regional currencies still face legal hurdles. The key to the success of regional currencies is often that municipalities accept and make payments in them. Those actions may, however, put a municipality at odds with state authorities. When local taxes can be paid with local money, the importance of a reserve decreases. Digital forms have evolved in addition to the paper currencies, but only few regional currencies are digital only, such as the Sarubobo Coin in Japan.

2.2 Complementary currencies backed with energy or other goods

Some regional currencies do not use the national currency as reserve, but real goods such as food baskets or raw materials. In times of high inflation in the 1920s, some local communities in Germany issued emergency currencies (German

“Notgeld”), backed by cereals. In the 1930s, a proposal was drafted to cover the currency with a basket of goods and ressources. Bernard Lietaer has taken up this idea again with his proposal of the global “Terra” (Kennedy et al. 2012). Individual regional currencies also use this idea and, for example, write a specific shopping cart of regional products on the back of a paper note. Another popular idea are energy-backed currencies going back to Shann Turnbull’s idea regarding a “renewable energy dollar” in 1977. The distribution is currently very limited because it is difficult to convince businesspeople to use currencies that require their own pricing. Digitalization may overcome this hurdle.

3. Fiat complementary currencies

Fiat complementary currency are the most difficult complementary currencies to imagine. Most national currencies can be understood as fiat currencies. They gain value because they can be used to pay taxes (Grubb 2012). In addition, there is the legal requirement in most countries that tax debts can only be paid in the national currency (Desan 2017).

We can thus imagine a community issuing a complementary local currency that it accepts (in addition to the national currency) for tax payments.

The American colonies made use of “colonial scrips” since the end of the 17th century, thus providing the basis for a regional economic upswing. In the beginning, guarantees were given for redemption, but these were abandoned over time because the provinces rarely had the means to make a material guarantee, while confidence in a currency that could be used for tax redemption increased (Grubb 2012). Similarly to taxation, faith could be a strong anchor insofar as it created demand for coins that were certified by temples and could be used as a means of sacrifice (Braun 2014). For complementary fiat currencies, it is therefore most important to have a working anchor like taxes.

4. Digital Peer-to-Peer Currencies

Peer-to-Peer-Currencies are the youngest type of complementary currencies. They are a variant of fiat currencies, but with decentralized money creation and circulation. Cryptocurrencies are fiat currencies and derive their value from the participants' trust. The model is cash passed from one person (peer) to another person (peer). No third party is needed to execute the transaction. It was a long dream of complementary currency pioneers like Michael Linton and Bernard Lietaer to implement digital peer-to-peer-currencies that would be easier to use than centrally-organized systems. Since the 1990's, cryptographers like Whitfield Diffie and Ralph Merkle have proposed different software solutions, though none have gone into effect.

The inventor of Bitcoin drew on these ideas and proposed a technological solution based on distributed ledger and blockchain technology. Currently, cryptocurrencies are the dominant technical form for the implementation of peer-to-peer currencies. The rules are implemented in the software algorithm and they can only be changed within this design framework. Initially, only few people believed in bitcoin and 10,000 bitcoin were paid for two pizzas. Today, bitcoin is used as a store of value and is compared to "digital gold" because of the limitation on the creation of bitcoin. To the extent that this form of currency serves only to increase inequality and dependence on power structures, a purely technology-oriented debate leads to a dead end.

Peer-to-peer currencies are sometimes used to address social challenges. The point of departure for such currencies is not the technical creation of money, but a collective agreement on shared objectives and values. This agreement is then followed by the design of a currency as an instrument to achieve these objectives. In this process the community may opt for a design that allows for P2P transfers.

Currently, a few hundred cryptocurrencies with distributed ledger technologies are used to promote social purposes. A basic income, for example, could be easily implemented through a decentralized distribution option. The Mannabase project based in Virginia distributes a basic income weekly to all who register for the currency project. According to coinmarketcap, more than 660 million Manna are in circulation. However, a Manna is worth less than a thousandth of a dollar. Currently, only few business accept payment in Manna.

A lurking problem for cryptocurrencies is that the added value of the technology currently does not, in many cases, exceed the costs of technical implementation (Pinos 2019).

5. Sectoral currencies

Sectoral currencies are issue-specific currencies aiming, for example, to finance care for the elderly, environmental protection, youth work and incentive schemes. They operate in a similar manner as the systems described. Like time banks, sectoral currencies counteract individuation and forge community and social networks (Kennedy et al. 2012). They differ from LETS and time banks in their design for particular problems like education, care work or their temporary deployment in the event of a crisis.

An example is the Torekes in Ghent in Belgium. The city rewards social and environmental work with a paper voucher that can be spent in rent for a garden plot or organic food. In the Japanese “Hurei Kippu” or Austrian “Zeitpolster” system, hourly credits are earned through work for the elderly. The credits can be redeemed in old age for care work or they can be transferred to relatives for immediate use. Other schemes include bonus systems, such as a climate bonus, where customers collect bonus points and redeem them for goods and services.

In times of disasters, sectoral currencies have been used repeatedly, for example within refugee camps to organise mutual aid. The prospect of receiving valuable recognition for one's own actions motivates people to participate. Issuers are often aid organisations, municipalities and grassroots initiatives. There are also combinations like the Banco Palmas initiative in Brazil. They sometimes cooperate with local authorities to pay subsidies to poor families on prepaid accounts. The families can spend the money in the local area with a smartphone or card.

Sectoral currencies are the specialists among complementary currencies because they often cover only a manageable sub-range, but can therefore be very effective.

The following table provides an overview over the characteristics and differences in the universe of complementary currencies:

Type / Criteria	Commercial mutual credit	Noncomm. mutual credit	Reserve-backed currencies	Fiat-/P2P-Currencies	Sectoral currencies
Examples	Sardex, Bartercard, WIR	LETS, SEL, Timebanks	Chiemgauer, Eusko, Sarubobo Coin	Colonial Scrip, Mana, Sarafu	Torekes, Banco Palmas
Goals	Increase utilization	Use skills on private level	Strengthen local business, promote non-profits	All kind of societal goals	Social and ecological goals
Systems carrier	Trading agents, WIR-cooperative	Associations, groups	Associations, cooperatives	Networks, associations, authorities	Associations, local authorities
Unit	National currency	Time, national currency	National currency or goods	Own fiat unit	Time, energy, food, points
Emission	Mutual credits; WIR with central loans	Mutual credits	Exchange and loans	Fiat	Reward, exchange, loans
Issuer	Borrower or bank (WIR)	Borrower	System carrier	Individual, network	System carrier
Reserve	Mutual commitment, security	Mutual commitment	National currency, goods, ressources	Often without reserve or contract	Commitment of the community
Convertible to national currency	No official convertibility	No convertibility	Limited with fees, often used for charity purposes	Floating exchange rate	No convertibility or limited
Medium	Digital	Digital or cash	Digital and/or cash	Digital	Digital or cash
Financial laws	allowed, no central issuer	allowed, no central issuer	mostly allowed, limited networks	money trade is regulated	allowed, limited networks
Taxation	1 to 1, to be paid in official currency	Mostly no taxation when sales are low	1 to 1, to be paid in official, sometimes in local currency	Depends on the purpose	Mostly no taxation with low amounts
Access	Only members	Only members	Only members	Market, Network	Limited purpose
Currency holder	Businesses	Private persons	Users in the region	Global or defined	Users within target group
Structure	Closed circle	Closed circle	Closed circle with limited exchange	Circles, often with open exchange	Mostly closed circle
Geographical reach	Network, mostly regional	Network, mostly local	Certain territory, often interconnected	Global and local adaptions	Community, mostly local
Decision-Making	Owner of third party provider	Mostly democratic	Mostly democratic	Designer of technology	Often by stakeholders
Relations	B2B	C2C	B2B, C2B, I2B	B2B, C2B, I2B	I2C, C2B, B2B
	P=Peer, B=Business, C= Consumer, I=Institution like local authority, 2=to				

Discussion

While it is helpful to categorize complementary currencies in order to understand their commonalities, it is also clear that the borders among the different types are fluid. Successful complementary currencies take advantage of the features of different types, and constantly adapt their design to collective goals and challenges. The Chiemgauer, for example, is a reserve-backed system and is currently developing a sectoral currency to promote climate protection. The Sardex engages consumers via a bonus system and tries to activate euros for the network. Consumers make purchases with the official currency and get a bonus in Sardex. This “top-up currency” can be spent within the network without having to offer a good or service for sale like a business. The colonial scrip in the US and the example of Woergl paved the way for integrating regional currencies into state structures, thus alleviating the need for reserves.

When complementary currencies pursue social objectives, they should be supported by a tolerant legal framework and incentives. In some places, cooperation between complementary currencies and public institutions already exists as “public-commons-partnership”: timebanks are used as an instrument to promote social cohesion and are exempt in some countries from taxes. Some regional currencies are recognized by municipalities that allow payments of taxes in the local currency. Other sectoral currencies are promoted by local governments in order to help them achieve their objectives.

An important aspect of complementary currencies is their constitution. If they are to make a contribution to society, they must be participatory and democratic, so that they can contribute to raising awareness of a society’s monetary system. If the complementary currency is directly in the hands of a municipality, decisions are made within the existing democratic structures. If associations or cooperatives are chosen as the organizational, then their members set the rules of participation. Guaranteeing inclusive participation becomes more difficult when the service structures are managed by private companies, and the question arises as to how the character of social innovation can be sustained in the long term. Geographic reach also plays an important role in this context. A smaller area constrains the number of exchanges but increases the impact of individuals in the democratic decision-making process.

Complementary currencies may work successfully if the following conditions are met:

1. Existing productive capacities are underutilized or can be further developed.
2. A deficit exists in purchasing power.
3. A critical mass of participation is reached and revenue exceeds transaction costs.
4. An accommodating/non-prohibitive legal framework exists.

Conclusion

Complementary currencies offer the opportunity to pragmatically expand the concept of money. Money, as made by state monopoly or conceptualized as a purely competitive medium, does not exhaust the potential of monetary design for social innovation. Complementary currencies can expand our capacities. They can also prompt new forms of value creation based on social justice and sustainability. They may serve to forge financial citizenship and democratize society. Of course, to achieve these aims, complementary currencies have to be supplemented by other policies and reforms. Yet, the stakes are too high to wait for “one big solution”. With decentralized monetary forms, we can start to transform society right now.

Further Reading on Complementary Currencies

Bernard Lietaer et al: Money and Sustainability

International journal of community currencies

People Powered Money

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The Constitution and the Fed after the COVID-19 Crisis

Authors: Christine Desan and Nadav Orian Peer

The COVID-19 financial response brought a seismic shift in the allocation of authority between Congress, the Treasury, and the Federal Reserve. Between them, those power centers provide the public structure for the material economy. Congress claims the “power of the purse” or the authority to appropriate public funds; the Treasury holds responsibility over the spending and taxing that puts those orders into effect; and the Federal Reserve literally makes the money we use by creating the dollar reserves that anchor our sovereign money supply. So when events re-order the relationship between Congress, the Treasury, and the Federal Reserve, the change goes to the heart of our economy as well as our constitutional system.

We understand that emergencies call for action early and explanations later. But the Financial Crisis of 2008 realigned the triangle of authorities we identify above in lasting ways. The COVID-19 Crisis looks to have restructured (collapsed?) that triangle altogether. To date, the federal government’s responses displace the authority of Congress for discretion held by the Treasury. They load the Fed with an enormous amount of ammunition that will determine who wins (large corporations? indebted fossil fuel companies?), and who loses (minority businesses and lenders? low income tenants? educational institutions?). They operate through a financial infrastructure that is inaccessible to many Americans and opaque to virtually all others.

So even as emergency operations continue, it’s time to start taking stock. We focus here on a series of lending facilities at the center of the government’s COVID-19 response. Established by the Fed, these facilities are anticipated to lend $4.5 trillion over the coming months (see below). The Treasury’s expanded powers lie in the key role that Treasury guarantees play in determining the lending that will be done by these new facilities. We do not know how the Treasury selects assets and industries to guarantee, how it sets terms for the guarantees, or who is in the room as those terms are hammered out. Surely the Fed and the Treasury are working together but where, then, is the Fed’s independence? And where is Congress as the details of an amount – $4.5 trillion – as large as the federal budget in 2019 – are being determined?

1. *The Constitution and Traditional Lender of Last Resort*

First, let's return to basics. Why does the Federal Reserve wield such enormous authority to dispense credit in money and how is that power supposed to be channeled? How is that authority consistent with the separation of powers that should leave critical appropriation responsibilities with Congress? And how do the COVID lending facilities square with the fact that the Fed is supposed to operate within safeguards that give it political independence from the Treasury?

Congress established the Federal Reserve to support the nation's banking system. By the early 20th century, Congress had endorsed commercial banks as the vehicle for amplifying sovereign base money: banks could make credit, denominated in dollars, available when they lent. The idea, argued in iconic form by Walter Bagehot, was that those lenders could make the best substantive decisions about how to allocate credit; acting with local knowledge, they could judge which borrowers were most likely to be productive.[1] But a decentralized network of banks was also fragile. Banks operate by giving out long-term loans in the form of deposits that can be used at any time – "maturity transformation" in the jargon. Bank panics, where depositors withdraw funds en masse, can destroy banks even if they have only good loans on their books.

In response, Congress designed the Fed as a "lender of last resort." The central bank was supposed to extend a life-line to banks to get them through a liquidity crunch so that they could continue as fundamentally solvent institutions. The Fed can do this because, unlike any other public or private actor, its balance sheet is unconstrained. While other actors must borrow, the Fed has the legal power to issue money: it makes the cash value of the longer-term loans held by stressed lenders immediately available in dollars that the government recognizes as its own liability to those lenders so that they can ride out a panic. See Secs. 10B and 13(3) of the Federal Reserve Act, 12 U.S. C. 347(b); 12 U.S.C. 343. Note that the Fed's capacity means that it is, effectively, creating money – a capacity that could threaten Congress's power over appropriations.

Given its enormous power, the Fed was controversial from the start. Traditionally, Congress has jealously guarded its power over the purse, including its authority to create sovereign money. That authority to spend public resources lies at the root of our democracy. In fact, the claim by young colonial legislatures that they had the authority to tax and spend was the matter that split Americans from British rule in the eighteenth century.[2] Fast forward to the early twentieth century: we can see how the Fed's design as a fallback lender for banks was essential to its political acceptance. The Fed was understood merely as a backstop for banks making the real decisions, as opposed to a source of funds that would compete with Congress.

Consistent with that theory, lender of last resort operations typically extend only to supporting solvent commercial banks. We emphasize that legally, those operations traditionally involve lending, not purchases. As long as the banks are solvent, any losses on bank loans would accrue to the borrowing bank and its investors, not to the Fed. Insofar as those Fed lending operations aim to protect the credit system from contagions of panic, as opposed to changing the character and destinations of private lending, they can be understood as instrumental support to the network of private banks. We'll come back to the oddity of this narrative as an account of the Fed's authority, but take its logic seriously here for the purpose of exposing recent changes.

2. *The Constitution and Traditional Monetary Policy*

Central banking posed a second challenge to constitutional bounds. Following European models, Congress gave the Fed authority to purchase assets directly, rather than merely lend. (See Section 14 of the Federal Reserve Act, 12 U.S.C. 353-359.) That authority allowed the Fed to conduct open market operations; over the course of the twentieth century, that activity became an essential tool in monetary policy over interest rates. But Section 14 authority also threatens congressional sovereignty over spending. For one, it clearly creates money: the Fed buys assets by crediting a seller with an increase in dollar credit. (Technically, this is done by crediting the seller's bank account at the Fed with newly created reserves). Moreover, purchasing assets obviously intervenes into the market for those assets, changing their supply and, in turn, affecting asset prices.[3]

Here, a series of safeguards, both conceptual and legal, have long kept the Fed's purchasing power from breaking the surface of constitutional concern. Again, they operate to categorize the Fed's purchasing authority as a stabilizing tool.

On the conceptual side, Americans adopted approaches to central banking that cast purchasing operations as simply supporting a healthy market for credit. As opposed to "picking winners and losers," that activity was seen as loosening or tightening credit conditions in general. In fact, the Fed seemed to control those conditions with modest asset purchases that, by successfully affecting the price of credit, spread economy-wide.

For good measure, Section 14 limited Fed discretion by specifying the assets eligible for purchase, primarily U.S. treasuries, and obligations "fully guaranteed by the United States as to the principal and interest." In the case of purchases, as opposed to loans, the Fed directly bears the risk of profit or loss. In the absence of the private filter, Fed purchases seem an awful lot like spending decisions, and those should reside in Congress. By restricting Fed purchases (mainly) to assets already fully backed by the U.S., Congress can be understood as preserving its power of the purse: such obligations have already been vetted by Congress.[4]

The same reasoning – understanding the Fed's work as reactive and constrained – went some distance towards distinguishing its responsibilities and role from those of the Treasury department. The economic imagination emptied "monetary policy," rightly pursued, of political content compared to fiscal policy on spending. Here, limits on the President's removal power over the governors and Reserve Bank presidents kick in.[5] That constraint arguably liberates the Fed to hold its own course without bowing to political demands for monetary stimulus, a concern conventionally captured by the notion that the Fed should operate independently. We note here that this traditional conception of central bank independence fails to capture important external influences to which the Fed is subject, including cooperation with Treasury in wartime, sensitivity to Congressional pressures during recessions, as well as accommodation of private banks in monetary policy implementation.[6] These pressures notwithstanding, the division of labor between fiscal and monetary policy has long oriented expectations and argument about who was wielding power and how they did so.

3. *The Constitution and the 2008 Crisis*

The 2008 crisis brought about significant changes in lender of last resort and monetary policy alike. From the constitutional perspective we sketched above, those 2008 changes – changes that seemed so transformative in their time—now appear subtle in comparison to the COVID-19 response.

First, the Fed expanded its lender of last resort support from commercial banks to "shadow banks" under its emergency Section 13(3) authority.[7] That expansion was arguably consistent with the traditional ways of distinguishing Fed lending of last resort from congressional spending. Specifically, 2008

Fed lending was still limited to entities that created liquid forms of credit to end-borrowers. Notable exceptions aside,[8] the supported shadow banks were, by and large, considered solvent, so the notion of a "private filter" over credit decisions remained.[9] What is more, those shadow banks suffered from run-like dynamics that could destroy the money supply and cripple the economy. So, while the recipients of support were new in ways that triggered various anxieties, the constitutional modes of legitimacy actually remained comfortably familiar.

Second, the Fed innovated in making monetary policy. Traditionally, the Fed had used its ability to control short-term borrowing costs between banks – the "fed funds rate" – to influence a range of longer-term borrowing costs in the economy, and ultimately, overall economic conditions (employment, price level, growth). With interest rates already at the zero bound and the financial sector in disarray, Bernanke and Yellen discovered that the Fed's ability to "transmit" monetary policy through the Fed funds rate had run down. Enter Quantitative Easing, the Fed's Section 14 attempt to shape long-term borrowing costs more directly given economic conditions. Gone were the smallish purchases to control the fed funds rate. In their stead, the Fed purchased two trillion in long-term treasuries and agency mortgage-backed securities (MBS) to reduce their supply, thereby lowering the yield investors demanded to hold them. In turn, lower yields on these public safe-assets would help reduce rates on long-term private borrowing.

Radical as that seemed at the time, note again the continuity with traditional modes of constitutional legitimacy. Despite its enormous size, QE was carried out through Section 14, using assets that were *already backed* by the U.S. in ways vetted by Congress or, in the case of agency MBS, that had a tenable claim to that status.[10] Limiting QE to these assets meant minimizing potential encroachment on the power of the purse.

4. *The Constitution and COVID-19 Liquidity Facilities*

The Fed's response to the COVID-19 crisis breaches traditional modes of constitutional legitimacy which, miraculously, survived the 2008 vintage. Following that precedent, the Fed in March 2020 began by authorizing emergency lending to shadow banks under 13(3) (e.g., here, and here), and launching a new QE in treasuries and agency MBS. But by month's end, these once extraordinary measures seemed woefully inadequate to the distressed COVID-19 economy. Enter the Fed's new COVID-19 liquidity facilities, first announced on March 23, following the initial congressional impasse, and expanded in various ways since. Those facilities subvert the traditional modes of constitutional legitimacy in a number of ways.

First, the Fed's facilities are offering support not to credit providers but to the end-borrowers: corporations, local and state government, consumers etc. These recipients are not in the business of maturity transformation and are not vulnerable to runs. Here, recall that its use to support private credit allocation and to prevent runs was the condition that distinguished central bank money creation from Congressional spending. With COVID-19, this limitation is gone.

Second, setting some nuance aside, the COVID-19 facilities are structured in ways that leave each facility directly exposed to the credit risk of end-borrowers (corporations, local and state government, consumers). That risk further undermines the appearance that real decisions over credit, like a private filter, stay with private lenders. COVID-19 facilities engage in a kind of credit distribution that makes it impossible to ignore that public authority is "picking winners and losers." That sounds a lot like power of the purse.

Third, while the COVID-19 facilities are stylized as doing Section 13(3) loans of last resort, those facilities' direct exposure to borrowers makes us wonder whether they are really making “purchases” regulated by Section 14 – a mashup that breaks new statutory ground as a kind of “Section 14(3).” In some facilities, like the Secondary Market Corporate Facility, the facility will literally purchase corporate bonds in the open market. In other facilities, the transactional structures are more complex, but the result is similar (again, leaving some nuance aside[11]). That is, the goal of the facilities is reminiscent of QE, and, at an anticipated $4.5 trillion, they are certainly QE sized. Here at the COVID-19 vanguard, lender of last resort support and monetary policy are blending in to the point they are indistinguishable.

Recognizing that the new facilities are making de facto purchases also exposes that they are reaching far beyond the assets eligible for purchase under Section 14, primarily treasuries and debt fully guaranteed by the U.S. With minor exceptions, the corporate, local and state government, and consumer debt purchased by the Fed is clearly not Section 14-eligible. Fed officials are likely aware of this: the transactional structures they chose seem like a kind of regulatory arbitrage, one that dresses-up Section 14 purchases as Section 13(3) loans. The Fed can, for example, set up a special purpose vehicle (SPV), *lend* to that SPV, and have the SPV *purchase* a corporate bond. That may or may not comply with the statutory terms in some superficial sense, but it leaves the deeper constitutional legitimacy of the facilities just as vulnerable. In the 2010s QE, Section 14’s requirement that assets eligible for purchase be guaranteed by the U.S. worked to maintain ultimate vetting with Congress. Clearly, this no longer holds.

Finally, the Fed’s lending facilities appear to depend on political direction from the Treasury. This development follows from the requirements in Section 13(3), added by Dodd-Frank, that the Fed receive “the prior approval of the Secretary of the Treasury” before establishing a lending facility, and even more crucially, that "security for emergency loans is sufficient to protect taxpayers from losses." With the Fed providing direct support to end-borrowers in the distressed COVID-19 economy, the no-loss requirement becomes a tall-order. Traditional lender of last resort meant a private capital buffer between the Fed and the end-borrower. That buffer is now gone, and the Treasury has stepped into its place through use of its Exchange Stabilization Fund (ESF), first established during the Depression to stabilize the dollar as the U.S. abandoned the gold standard. The legalities of the ESF raise their own questions, which are beyond our scope here.[12]

Use of the ESF began with a deceptively small amount – $50 billion in March 2020.[13] If one assumes anticipated losses of ~10% of lending, $50 billion in loss guarantees can support Fed lending to the tune of $500 billion. No small change, but nowhere near the size required. So as part of the CARES Act (passed March 27), Treasury requested from Congress – and received – an appropriation for $450 billion to the ESF. Now, with this additional $450 billion, the Treasury can support $4.5 trillion (10X) in Fed lending.[14] That is, with a relatively small appropriation of $450 billion, the Treasury and the Fed get to determine whether and how to use an additional $4.5 trillion, including the amount added by Congress to the ESF and the lending done when that amount is used as loss protection.

5. *Closing Thoughts: The Constitution and Monetary Reform*

We are left to ask how innovations in the Fed's lending and purchasing authorities fit with the constitutional framework we had come to assume. In particular, do they preserve the appropriations authority to Congress? And is there a coherent division of responsibilities between the Treasury and the Fed, one that renders presidential powers transparent and justifies the Fed's relative insulation from popular accountability?

We fear that Congress has basically delegated the power of the purse to the Treasury. Treasury's discretion over the character of the new lending facilities is extremely broad and the oversight mechanisms correspondingly weak. This arrangement marks a fundamental reorientation in the relationship between the legislative and executive branch. Recall that Congress initially deputized the Fed, not the Treasury, to engage in money creation, according to a theory that came to distinguish its rescue and policy roles as stabilizing operations. Contrast the situation today: the Fed now uses its enormous authority to create money according to the Treasury's judgment about how to save the economy.

The arrangement marks an equally important reorientation in the relationship between the Treasury and the central bank. The Federal Reserve and the Treasury are, between themselves, determining what sectors to support and, as importantly, how to support them – under what conditions, with what distribution of costs and risks, and through what kind of process. Despite their crucial nature, we have no idea how the conditions defined by the "term sheets" are determined or by whom.[15]

We are also concerned that the arrangement obscures the exercise of power by the Treasury, while misusing the notion that a central bank should have independence. The latter is an organizing principle of modern central banking, intended to insulate the power of money creation from improper manipulation for short-term electoral gain. What we're seeing now is a kind of backward use of central bank independence. On the one hand, the Fed, which is timid to make loans that can result in losses, is taking cover in loan guarantees from the politically accountable Treasury. On the other hand, the Treasury, which is effectively controlling $4.5 trillion in Fed lending (based on the original ESF amount, expanded by the CARES Act appropriation), is taking cover in the notion that lending is administered by the Fed, a neutral institution, based on Fed expertise, rather than political influence. In this way, the Treasury gets to avoid the very same political accountability that the Fed cites as justification for its risk taking.

What is to be done? For starters, we believe it would be far better if Congress itself allocates the risk capital among Fed programs, and takes true accountability for its decisions. But that injunction may well have been mooted by events: the pandemic requires fast action and collaborative decision-making. Congress does not seem capable of either. This raises the possibility of more structural reform.

The narrative that located the Fed as simply backstopping private initiative and stabilizing the wider economy has always been a fiction. Most dangerously, it arrested an intense American debate about how we should make and allocate credit in money – public or partly public banks?[16] federal provision of credit to farmers or homeowners?[17] money directly issued outside of banks? postal banking? It romanticized as local lenders those that would consolidate into financial behemoths. And it ordained the investor instruments, modes of profit, and particular markets that would be supported.

Our point here is not that the COVID-19 response represents a fall from grace, from a time when central banks kept to their proper and humble role. Our point is that COVID-19 makes impossible to ignore what we argue has always been the case: money creation is inherently political and greater democratic input is required into its large distributive outcomes.

If we want to understand the distributive impact of these huge lending facilities, we need to analyze the way Fed credit flows, the targets it supports, as well as the communities it leaves behind. At broadest level, Fed facilities appear to privilege lending to corporations, as well as to those established businesses and consumers fortunate enough to enjoy access to mainstream financial services.

Communities of color – where centuries of discriminatory policies made such access painfully lacking – once again appear to be left out. According to Fed data, black families are 3.5 times more likely to be unbanked than white families (14% and 4% respectively). A staggering 35% of black families is underbanked, as compared to 11% of white families. Credit denial rates for black families are substantial (59% and 41% for families earning less than $40,000 and $40,000-$100,000 respectively) and double the size of their white counterparts. These black communities, that are so much less likely to benefit from the Fed's facilities are also those hardest hit by COVID-19, in terms of public health and economic distress alike. As lawyers, we believe it is important to scrutinize the civil rights implications of government channeling of emergency lending through channels that inherently disfavor minorities.

Minority, and other vulnerable communities, will also suffer disproportionately from the emerging crisis in municipal finance, and the disruption in essential social services it will bring. While we welcome the Fed's Municipal Liquidity Facility, the amounts committed remain woefully inadequate (only 20% of 2019 revenues). We are struck by the ways in which term sheets provide credit to different actors – e.g., municipalities and corporations – on widely different terms, without apparent justifications. Here at JustMoney.org, we plan to continue analysis into the distributive outcomes of Fed COVID-19 lending in a number of ways. We will update this spotlight as we do so.

Twice in two decades, shocks have destabilized our financial and economic system with such violence that the Fed's action, directed in convoluted ways by the Treasury and questionable in terms of constitutionality, became necessary. There could be no more clear demonstration that we need to restructure our financial architecture. Neither the crises, nor their distributive effects, nor the way their remedy eludes accountability, are sustainable in a democratic society.

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[1] Walter Bagehot, *Lombard Street: A Description of the Money Market* (New York: John Wiley and Sons, Inc., 1873, 1999), 89.

[2] Jack P. Greene, *The Quest for Power; the Lower Houses of Assembly in the Southern Royal Colonies, 1689-1776* (Chapel Hill: University of North Carolina Press, 1963); Terry Bouton, *Taming Democracy: "The People," The Founders, and the Troubled Ending of the American Revolution* (Oxford, UK: Oxford University Press, 2007).

[3] Traditional monetary policy was carried through a combination of outright purchases, and repurchase agreements with primary dealers, which are purchases in name, but secured loans in essence. Both types of operations shape asset prices, though the effects of the former method (outright purchases) are generally considered greater. The COVID-19 developments we discuss below are generally similar to outright purchases.

[4] Contrast this with collateral the Fed accepts as a lender of last resort to commercial banks under Sec. 10B, which is extremely broad. Why this difference you ask? Recall that when the Fed lends to a commercial bank, that bank's capital protects the Fed from losses. Outright purchases involve no such capital.

[5] See 12 U.S.C. sec. 242; 248(f), 614. For analysis of the weirdly conflicting character of presidential control over Bank presidents and the status of the Chair of the Board of Governors, see Peter Conti-Brown, "The Institutions of Federal Reserve Independence," *Yale Journal on Regulation* 32, no. 2 (2015): 302-03, 3, http://digitalcommons.law.yale.edu/yjreg/vol32/iss2/3.

[6] See *e.g.*, Richard H. Timberlake, *Monetary Policy in the*

United States: An Intellectual and Institutional History (Chicago: University of Chicago Press, 1993), 300-15 (wartime coopration with Treasury); Sarah Binder and Mark Spindel, Independence and Accountability: Congress and the Fed in a Polarized Era, (2016) (considering political sensitivity of Fed to congressional disagreement); Kumhof and Jakab, JustMoney, Banking Roundtable, Jan 29, 2020 (considering pressure for continuing expansion of reserves to accommodate private banks). See also the statutory qualification to the Fed's authority in 12 U.S.C. 246. Its reach is uncertain as far as we know.

[7] In a nut shell, shadow banks are institutions that issue money-like liabilities to fund holdings of securities. While these money-like liabilities are subject to run risk similarly to commercial banks, shadow banks lack a bank charter, and do not enjoy deposit insurance, nor access to Fed lending of last resort under ordinary Section 10B. authority.

[8] One such interesting exception is the Fed's facilitation of the Bear Stearns-JPMC merger through a special purpose vehicle known as Maiden Lane LLC (more on Fed SPVs below). Maiden Lane did not merely *lend* to Bear, but *purchased* $30 billion of its assets. JPMC apparently found these assets too risky to assume in the merger, and was only willing to extend a small amount of loss protection ($1 billion, or 3%) to the Fed. This arrangement violated norms around lender of last resort, and was part of the impetus for Dodd-Frank amendments of Section 13(3). A full decade later, the Maiden Lane portfolio was liquidated at a small profit.

[9] It is telling that when the government contemplated *purchasin*g bank assets –a plan later turned into *recapitalization* of banks by the Paulson Treasury– the plan was not carried through Federal Reserve lender of last resort authority. The so-called Troubled Assets Relief Program (TARP) was subject to direct congressional appropriation in the Emergency Economic Stabilization Act of 2008.

[10] The legal basis for Fed purchases of agency MBS raises important questions. Fannie Mae and Freddie Mac – the GSEs issuing the agency MBS – entered government (FHFA) conservatorship in Sept. 2008. The legal framework for conservatorship is complex and includes the Housing and Economic Recovery Act of 2008 and a series of Senior Preferred Stock Purchase Agreements. While various forms of support were extended to the GSEs, as far as we know, the government never provided permanent blanket guarantees of their liabilities. This raises the possibility that Fed lawyers were (and still are) willing to interpret Section 14 in ways that appear to go beyond the text. See 12 U.S.C. 355.

[11] The nuance comes in two flavors, light and medium. An example of nuance light is the Mainstreet Loan Lending Program, which requires financial institutions to retain relatively small participations (5%-15%) in the business loans they are essentially selling to the Fed. An example of nuance medium is the Term Asset-Backed Securities Facility (TALF), which provides non-recourse loans, but requires haircuts of 5%-22%. This arrangement essentially operates as a Fed purchase, with the haircut amount acting as limited loss protection to the Fed (In effect, this works similarly to Maiden Lane, discussed in note 8, an arrangement that even in 2008 pushed the envelope of legality).

[12] The Gold Reserve Act (31 U.S. Code § 5302) allows the Secretary of the Treasury, with the approval of the President, to “deal in gold, foreign exchange and *other instruments of credit* and securities the Secretary considers necessary.” In 2008, the Treasury controversially used this authority to guarantee the money market fund industry. Congress was upset, and attempted to prevent the recurrence of such guarantees for the money fund industry. That didn’t help much. The provision of $10 billion in ESF loss protection to the Fed’s Money Market Mutual Fund Facility (MMLF) in March 2020 has a similar effect to the 2008 guarantees.

[13] By our tally: $10 billion equity investment in the Commercial Paper Funding Facility (March 17), $10 billion in loss protection to the Money Market Mutual Fund Liquidity facility (March 18; note this facility is of a more "traditional" 2008 variety); and then, in the March 23 announcement, $10 billion in loss protection to each of the following: the Primary Market Corporate Credit Facility, the Secondary Market Corporate Facility, and the Term Asset-Backed Securities Loan Facility. These amounts were increased to about $200 billion subsequent to the passage of the CARES Act on March 27. Note that prior to the CARES Act, the ESF had only $40 billion in equity. Depending on the size of losses anticipated on the $50 billion in loss protection, the ESF may have been technically insolvent during that initial period.

[14] The approximate 10-to-1 ratio has been assumed in various Fed and Treasury statements. See, e.g., Chair Powell's congressional testimony on May 19, 2020 (here at 1:11:50).

[15] An aside here: It's not clear whether the Treasury's determination to provide loss protection to Fed facilities neutralizes the legislative requirement that the Fed take "security for emergency loans …sufficient to protect taxpayers from losses." Section 13(3), 12 U.S.C. 343. The CARES Act provides in Section 4003(c)(3)(B) that "For the avoidance of doubt, any applicable requirements under section 13(3) of the Federal Reserve Act (12 U.S.C. 343(3)), including requirements relating to loan collateralization, taxpayer protection, and borrower solvency, shall apply with respect to any program or facility described in subsection (b)(4) [Treasury supported facilities]." On the other hand, Congress's grant to Treasury of authority to provide loss protection suggests that the legislature may consider that lending facility losses up to that ceiling do not violate the Section 13(3) prohibition. In that sense, Congress may be creating a caveat to the normal operation of Section 13(3). In accord with that reading, neither legislators nor Treasury department officials

seem focused on the constraint imposed by the provision. Rather, legislators in the first oversight hearing pressured Fed Chair Powell and Treasury Secretary Mnuchin to take more, not less, risk.

We flag and set aside language in the CARES Act, Sec. 4020,(b)(2), to the effect that the Oversight Committee should determine whether the Fed/Treasury activities were effective in "minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers." In our view, the fact that this language concerns congressional oversight indicates that it does not alter the substantive responsibilities of the Fed under Section 13(3).

The bottom line in our view: the tension between the dictates of Section 13(3) and those of the CARES Act add to our argument that the current solution exposes the fragility and inadequacy of the current architecture.

[16] See also Edwin J. Perkins, *American Public Finance and Financial Services, 1700-1815*, Historical Perspectives on Business Enterprise, (Columbus: Ohio State University Press, 1994), 236-38.

[17] See, *e.g.*, St. Louis Convention Southern Alliance, "Report of the Committee on the Monetary System on the Sub-Treasury Plan," in *A Populist Reader*, ed. George Brown Tindall (New York: Harper Torchbooks, 1966).

Working Paper: In the Name of

the People? – The German Constitutional Court's Judgment on the European Central Bank's Public Sector Purchase Programme

Author: Isabel Feichtner

On Tuesday, 5 May 2020, the Federal Constitutional Court of Germany (FCC) issued its judgment in the proceedings on the European Central Bank's (ECB) Public Sector Purchase Programme. The pronouncement of the judgment at the courthouse in Karlsruhe was originally scheduled for 24 March 2020 and had been moved "in order to prevent the spread of COVID-19." When it did take place on Tuesday, only 5 of 8 judges of the FCC's Second Senate were present and seated at safe distance from each other. Before pronouncing the judgment, the court's president and presiding justice of the Second Senate Andreas Vosskuhle advised the claimants, government representatives and other attendees to keep their distance also after the pronouncement when they would gather in conversation.

He must have anticipated the tumult that this last judgment under his presidency would cause. For the first time, the court in this judgment rules that EU institutions (the Court of Justice of the European Union and the ECB) exceeded their powers and that the resulting *ultra vires* acts were not binding in Germany. A journalist later humorously remarked the judgment was "something about viruses." The judgment not only sounds of virus. It might seriously affect how Europe will emerge from the COVID-19 pandemic.

The judgment only addresses the ECB's Public Sector Purchase

Programme, a quantitative easing programme under which the ECB and national central banks purchase government bonds to bring up inflation rates in the euro area. The FCC finds this programme to be illegal, yet holds that illegality may be remedied if the ECB conducts a proportionality review and substantiates that the bond purchases do not have disproportionate economic effects. The judgment does not rule on the Pandemic Emergency Purchase Programme that the ECB announced on 18 March 2020 to address the effects of the COVID-19 pandemic. Yet, it calls into question also the legality of this programme. More disturbingly, the judgment may undermine efforts to strengthen transnational solidarity and democratize the European Union. It comes at a time when inequality in Europe makes itself most acutely felt, when solidarity albeit constantly invoked, is hardly practiced. For the FCC at this moment to tell the highest court of the European Union that its reasoning is incomprehensible and to order the German government to work on the ECB so that it will duly take into account its policies' effects on German savings accounts, to many (including myself) appears not only puzzling, but dangerous. Dangerous as it cloaks German hegemony in the mantle of democracy.

The Judgment in Brief

The FCC ruled on a number of constitutional complaints brought by individuals who claim that their individual rights under the German constitution (the Basic Law/Grundgesetz) are violated (for an English translation of part of the judgment, see here). Their complaints were primarily directed against the ECB's Public Sector Purchase Programme (PSPP). Complainants argue that with the PSPP the ECB overstepped its competence to conduct monetary policy. They hold the view that the PSPP is primarily an economic policy measure that – in violation of the prohibition of monetary financing – assists EU Member States who run budget deficits in refinancing their debts and at the same time negatively affects private savings in Germany.

The PSPP forms part of the ECB’s Asset Purchase Programme (APP). The Governing Council of the ECB adopted a decision establishing the PSPP in March 2015 (Decision (EU) 2015/774) and has amended the programme several times since. Under the PPSP central banks of the EU Member States whose currency is the euro and the ECB (the Eurosystem central banks) may purchase euro-denominated marketable debt securities issued by central, regional or local governments of a Member State as well as bonds issued by international organisations and multilateral development banks located in the euro area (Art. 3(1) Decision (EU) 2015/774). These purchases complement the purchase of private assets under the APP. According to the ECB the PSPP, thus, aims to “further ease monetary and financial conditions, including those relevant to the borrowing conditions of euro area non-financial corporations and households, thereby supporting aggregate consumption and investment spending in the euro area and ultimately contributing to a return of inflation rates to levels below but close to 2 % over the medium term.” (Decision (EU) 2015/774, preambular para. 4). The volume of the APP was initially set at €60 billion per month, was scaled up to €80 billion in 2016 and reduced again in 2017 and 2018. The APP was discontinued between January and October 2019 and was restarted on 1 November 2019 with a monthly purchase volume of €20 billion. By 8 November 2019 the purchases under the PSPP had amounted to EUR 2,088,100 million, i.e. 81.63% of the APP’s total volume at that time.

In its judgment on the constitutional complaints, the FCC agrees with the complainants that the ECB by establishing the PSPP exceeded its powers to conduct monetary policy. Yet, it does not make a categorical finding that the PSPP cannot be qualified as a monetary policy measure. Rather, it finds the decisions to establish and implement the PSPP to be procedurally deficient because the ECB “neither assessed nor substantiated that the measures provided for in the decisions on PSPP satisfy the principle of proportionality" (para. 116). The ECB, thus, can remedy illegality by conducting a proportionality review.

Before rendering its final judgment, the FCC had referred the question whether the ECB had complied with EU law to the Court of Justice of the European Union (CJEU) who had answered in the affirmative. As a matter of EU law, the FCC is bound by the CJEU's interpretations of EU law. The FCC justifies its departure from the CJEU's ruling on the question whether the ECB acted within its power to conduct monetary policy by holding that the CJEU's opinion on this question was "simply not comprehensible and thus objectively arbitrary" (para. 116). In the view of the FCC, the CJEU with its incomprehensible reasoning exceeded its power to interpret and apply EU law. Consequently, the part of the CJEU's judgment that finds that the ECB when establishing the PSPP legally exercised its power to conduct monetary policy was not binding in Germany (para 119).

The FCC orders parliament (Bundestag) and federal government (Bundesregierung) to take steps in order to ensure that the ECB conducts and documents the legally required proportionality assessment, *i.e.* a proportionality assessment that takes into account "the actual effects of the PSPP" and includes an "an overall assessment and appraisal in this regard" (para. 123). In case the ECB fails to do so within three months, the Bundesbank may no longer participate in the PSPP by purchasing bonds or contributing in increasing the purchase volume and must sell the bonds it purchased under the PSPP.

Reception of the Judgment

Since the judgment was issued, there has been a constant flow of – rather more than less outraged – commentary by legal scholars and economists. On the widely read constitutional law blog Verfassungsblog alone, eleven posts and one podcast seeking to explain and critically assessing the judgment have been published by the time I am writing this. Most commentators are baffled – by the legal reasoning, the court's (mis-)understanding of monetary policy and EU law, the tone, the ignorance or conscious acceptance of the political fallout this judgment may fuel within the European Union, the potential consequences for the "rule of law" and judicial cooperation, and the list could be continued. EU law scholar Federico Fabbrini and political scientist R. Daniel Kelemen write in the Washington Post of 7 May 2020 that "the German court's decision didn't just open Pandora's box, it ripped the lid off and smashed it to bits" encouraging courts in Poland and Hungary to likewise disrespect EU law.

By contrast, some voices in Germany present the judgment as an act of resistance against the ECB's "pumping of billions of euros into ailing government budgets." Such language is familiar from the eurocrisis – the effects of which the PSPP was established to address. At the time, German media commentary repeatedly called out Southern European states, and especially Greece, for "not doing their homework" or "spending beyond their means". Such sentiment was also behind the constitutional complaints. One of the claimants was Bernd Lucke, who in 2013 co-founded the "Alternative for Deutschland" as an anti-Euro party (today at the far right of the political spectrum and represented in the Bundestag and a number of state parliaments).

I add to the flood of commentary with this "case note" to flag the impact that this decision may have at a critical moment not only on the ECB's Pandemic Emergency Purchase Programme. The judgment implicates far-reaching questions as to the relationship between monetary policy and economic politics as well as the potential for democratizing money and the economy. These questions reveal themselves with great acuity during the pandemic and guide my reading of this judgment. Like many of my colleagues in Germany and internationally, I am puzzled and concerned by the judgment. Like them, I ask myself what may have ridden the seven justices supporting the opinion (one voted against it, but did not write a separate opinion). Some have suggested that hubris was at play, that the court that had barked so much in the past felt it had to show it could bite to maintain its position as “guardian of the treaties”. Without seeking to rebut these explanations, in this comment I try to read the judgment as giving an impetus to the democratization of the European Union – even though it probably has harmed this cause.

In the following, I render a relatively detailed account of the court’s reasoning in order to shed some light on the relationship between monetary and fiscal/economic policy in the European Monetary Union and the various explicit and implicit conceptions of democracy at play in the judgment. I then briefly address the judgment’s potential implications for the PPEP. Finally, I attempt to make my case that we might read this judgment as promoting democratization.

The Court’s Reasoning Explained

The cause of action: constitutional complaint based on the “right to democracy”

German constitutional law allows individuals to bring constitutional complaints to the FCC who substantiate that their individual rights under the Basic Law are violated by acts of state power. In a series of earlier judgments on European integration (starting with its judgment on the Maastricht treaty), the FCC has interpreted the Basic Law to contain an individual right to democracy that goes beyond the right to participate in elections. According to the FCC this right is violated either when too much power is transferred to the European Union – thus hollowing out the powers of the German parliament (Bundestag) – or when EU institutions manifestly exceed their competences (act *ultra vires*).

The FCC's reasoning is as follows: The Basic Law with the right to vote in elections of parliament also protects "the basic democratic contents of the right to vote." By demanding that all state power derives from the people (Art. 20(2) GG), the Basic Law requires that "any act of public authority exercised in Germany can be traced back to its citizens" (para. 99). At the same time, the Basic Law allows for European integration through a transfer of sovereign powers to the European Union and the FCC consistently stresses the Europe-friendliness of the German constitution. To ensure that such transfer of powers can be traced back to German citizens, it requires an "act of approval" (Art. 23(1) GG) – the law ratifying the EU treaties. If EU institutions act outside the powers transferred to them (*ultra vires*) this link between the will of the citizens as expressed in the "act of approval" and the exercise of power by the EU is interrupted – the individual right to democracy is affected. The FCC has specified that determination that EU institutions act *ultra vires* requires a "manifest and structurally significant" exceeding of powers.

Transfer of powers to the EU, moreover, faces limits: "Indispensable elements of the constitutional principle of democracy" (para. 104) must be retained at the national level as required by the Basic Law's so-called eternity clause (Art. 79(3) GG). In order to protect a core of democracy in Germany, the EU may only be granted specific competences, not however a general competence to determine its own competences (no *Kompetenz-Kompetenz*). Moreover, the FCC has found that the budgetary responsibility of the Bundestag belongs to the core democratic powers that may not be hollowed out by a transfer of powers to the EU. If a transfer of powers to the EU or the exercise of powers by EU organs detracts from this core and thus affects the "constitutional identity," the FCC also holds the "right to democracy" to be violated.

The PSPP proceedings centered on the *ultra vires* doctrine (even though constitutional identity also played a role) – the question whether the ECB manifestly and in a structurally significant way exceeded its competences. As explained above an *ultra vires* act, according to the FCC, affects the right to democracy. Yet, the finding of an *ultra vires* act alone would be insufficient for a constitutional complaint to be successful. European institutions are not bound by the German Basic Law and constitutional complaints only provide redress for a violation of individual rights by public authority, *i.e.* German public authority. The FCC takes this hurdle by reasoning that the constitutional organs, in particular parliament and the federal government have an obligation to "continuously monitor the execution of the European integration agenda" (Integrationsprogramm) for violations by EU institutions (para. 108). If they fail to do so and if they do not take action when EU institutions act *ultra vires*, their inaction may result in a violation of the individual right to democracy.

Thus, the Court has in its many judgments on European integration incrementally created for itself a way to control – in the name of popular sovereignty of the German people – the bounds of European integration upon the complaints of individual German citizens, i.e. also in situations when the German parliament itself agrees with the transfer of powers or action by EU institutions in question. This is explosive stuff: Not only because the FCC understands democracy as an individual right that it can – in the realm of European integration – enforce against the will of the democratically elected government. But also because the FCC makes acceptance of the primacy of EU law (over national law), that shall ensure EU law's uniform application and effectiveness throughout the EU, conditional upon compliance by EU institutions with the "agenda of integration" as agreed to with the "act of approval."

In recent judgments the FCC– in the name of European cooperation – has shown itself slightly more conciliatory. It conceded that before ruling that EU institutions manifestly exceeded their competences and therefore acted *ultra vires*, it would make use of the preliminary reference procedure (Art. 267 Treaty on the Functioning of the European Union (TFEU)) and ask the CJEU for its interpretation of EU law. It did so in previous proceedings directed against the OMT (Outright Monetary Transactions) Programme (resulting in the CJEU's *Gauweiler* judgment) and has done so again in the PSPP proceedings (resulting in the CJEU's *Weiss* judgment). As indicated above, the CJEU is mandated with the interpretation of EU law (Art. 19(2) TEU). Its interpretations are binding for the EU Member States. Yet, the FCC finds that the CJEU with part of its reasoning in *Weiss* itself has acted *ultra vires*, i.e. in excess of the powers conferred to it. According to the FCC the CJEU's ruling therefore lacks the democratic legitimation of the "act of approval" and is not binding on the FCC.

Conformity of the PSPP with EU Law – Diverging Views of the FCC and CJEU

With order of 18 July 2017 the FCC had stayed the PSPP proceedings and referred several questions of EU Law to the CJEU for a preliminary ruling (Art. 267 TFEU) – not without expressing its serious doubts as to the compatibility of the PSPP with EU law. The CJEU consequently ruled *inter alia* on the questions whether the ECB acted within its powers to conduct monetary policy when adopting the decisions on the PSPP (Decision (EU) 2015/774 and subsequent decisions modifying the PSPP) (1) and whether the PSPP is compatible with the prohibition of monetary financing (Art. 123(1) TFEU) (2). It answered both in the affirmative, yet the FCC only followed its interpretation in part.

1. Did the ESCB exceed its competence to conduct monetary policy?

The EU institutions may only exercise the powers conferred to them – not only as a matter of German constitutional law as laid out above, but also as a matter of EU law, namely Art. 5(1) of the Treaty on European Union (TEU): "The limits of Union competences are governed by the principle of conferral." EU primary law (i.e. the treaties, including Protocol 4 on the statute of the European System of Central Banks and the European Central Bank) confers to the European System of Central Banks (ESCB) – consisting of the ECB and the central banks of the Member States whose currency is the euro – the power to conduct monetary policy. This power is exclusive, meaning that the Member States whose currency is the euro no longer may conduct a monetary policy of their own (Art. 3(1)(c), 127(2) TFEU). In conducting monetary policy, the ESCB must pursue price stability as its primary objective. Without prejudice to this aim, the ESCB must also "support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union" (Art. 127(1) TFEU). EU primary law does not define price stability. The ECSB specified this aim as an inflation rate below, but close to 2% in the medium term.

In determining whether the ESCB with adoption and implementation of the PSPP remains within its competence to conduct monetary policy, the CJEU looks to the programme's objective (does it pursue price stability?) as well as to the instruments employed (are they included in the arsenal of monetary policy instruments set out in the ESCB and ECB's statute?), an approach the CJEU developed in earlier judgments (*Pringle* and *Gauweiler*). The CJEU finds that the ESCB with the PSPP pursues price stability (bringing the inflation rate up) and with the purchase of government bonds and bonds of international organisations uses the instrument of open market transactions explicitly provided for in Art. 18.1 ESCB/ECB Statute.

The CJEU clarifies, in a way that will alarm the FCC, that the mere fact that the programme has foreseeable effects on commercial banks and the costs for Member States in financing their deficits does not turn the PSPP into an economic policy measures not covered by the ESCB’s competence. Economic and monetary policy are not absolutely separate, according to the CJEU. In order to achieve the desired inflationary effects the ESCB has to adopt measures that “may entail an impact on the interest rates of government bonds, because, inter alia, those interest rates play a decisive role in the setting of the interest rates applicable to the various economic actors” (*Weiss*, para. 66).

While the effects on Member States’ refinancing costs, according to the CJEU, do not negate the monetary policy character of the PSPP, the CJEU recognizes proportionality as a limit to the ESCB’s exercise of monetary policy. Art. 5(1) TEU postulates proportionality as a principle governing the use of Union competences and Art. 5(4) TEU clarifies that “[u]nder the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.” Art. 282(4) TFEU specifically addresses the European Central Bank who “shall adopt such measures as are necessary to carry out its tasks”.

The CJEU consequently asks whether the measures in question are proportionate to the objectives pursued; whether they are (1) suitable and (2) do not go beyond what is necessary. Regarding the standard of review, the CJEU notes the ESCB must be allowed broad discretion regarding the choice of suitable and necessary action. The CJEU does not find any manifest error on the side of the ESCB in adopting the PSPP in order to promote investment activities and thus inflation in the euro area. It refers *inter alia* to the fact that before the PSPP was adopted inflation was at -0,2%. The CJEU further finds that the PSPP does not go beyond what is manifestly necessary to attain the ESCB’s inflation target. Relevant here is the fact that before adopting the PSPP the ESCB had already implemented a programme of private sector asset purchases that had not shown the desired effect in raising inflation. The CJEU agrees with the ECB that there was “no more limited action available to the ESCB” in order to attain its price stability objective. The CJEU then – still as part of its necessity review – looks at the PSPP’s design and finds that it includes safeguards to limit its effects and circumscribe the risk of losses to the ESCB. These safeguards include eligibility requirements (from which exceptions can be granted and have been granted for Greece) to ensure that no high risk bonds are purchased as well as purchase limits – compliance with both being monitored by the ECB.

This, in abbreviated form, is the reasoning that the FCC declares to be “simply not comprehensible,” “objectively arbitrary,” “not tenable from a methodological perspective.” The FCC states that the CJEU “manifestly fails to give consideration to the importance and scope of the principle of proportionality” (para. 119). What rather seems to have triggered this harsh critique by the FCC is that the CJEU does not review proportionality “German-style.” That it does not focus on what for the FCC is the third stage of proportionality review – appropriateness or proportionality in the strict sense. According to the FCC proportionality review of the PSPP requires that the CJEU “give consideration to the economic and social policy effects of the PSPP”; that it ascertains that the ESCB takes into account “the effects that a programme for the purchase of government bonds has on, for example, public debt, personal savings, pension and retirement schemes, real estate prices and the keeping afloat of economically unviable companies, and – in an overall assessment and appraisal – weigh[s] these effects against the monetary policy objective that the programme aims to achieve and is capable of achieving” (para. 139).

The CJEU in its proportionality review had focused instead on the question of suitability and necessity. It did not weigh the benefits for price stability against general effects on the economy as the FCC would have wanted. Rather, when the CJEU agrees with the Advocate General that “the ESCB weighed up the various interests involved so as effectively to prevent disadvantages which are manifestly disproportionate to the PSPP’s objective” it appears that it was concerned with a weighing of the effects on price stability against the risk of loss for the ESCB (and consequently fiscal loss for the Member States).

A finding that this kind of proportionality review is incomprehensible is difficult to grasp (see also Toni Marzal’s critique). Especially since it remains unclear how the ESCB could possibly carry out the kind of review the FFC is demanding.

What makes the FCC’s proportionality review of the ESCB’s competence to conduct monetary policy so problematic becomes clear by comparison with the realm of fundamental freedoms and individual rights, where proportionality review by CJEU and FCC is routine: A measure that restricts fundamental freedoms/individual rights must pursue a legitimate regulatory objective and the measure must be such that it can contribute to the attainment of this objective (suitability); no measure may be reasonably available that is as effective in attaining the objective, but less restrictive on the right/freedom in question (necessity); the restrictions on the right/freedom may not outweigh the benefits pursued by the measure (balancing test/proportionality in the FCC’s “strict sense”). In this constellation, we see clearly what is to be put into proportion to/weighed against what – the pursuit of the public policy objective against infringement of a freedom/right.

The constellation in the PSPP proceedings is different. Here proportionality is to be employed to delimit the scope (FCC)/exercise (CJEU) of a competence. When applying proportionality to the exercise of a competence it is less clear how a least restrictive measure test is to be applied and how balancing shall proceed, i.e. what is to be weighed against the pursuit of price stability. The CJEU appears to have opted for "risk of loss to the ECB and national central banks" or – as the FCC interprets the CJEU's necessity test – "the budgetary autonomy of Member States" (para. 133).

The FCC, by contrast, wants the monetary policy objective (price stability) to be balanced against the effects of the measure on the competences of Member States to conduct economic policy. It then appears to equate effects on Member State competences with effects on the economy – including real estate prices, interest on savings accounts, viability of corporations. It thus implies that damaging impact to a Member State's economy would itself detract from the competence of the Member State to conduct economic policy. It is true that monetary policy has economic effects and that these economic effects may affect the scope of possible economic policy measures available to Member States – in international economic law we might say they affect the "right to regulate". Yet, different from the constellations in international economic law when the "right to regulate" is invoked, the FCC does not point to particular (types of) measures that Member States no longer can adopt due to the ESCB's implementation of the PSPP. It is therefore difficult to comprehend – to say the least – how a proportionality test that shall take into account potential impacts of monetary policy on unspecified policy options might be operationalized. Applying this kind of proportionality test is further complicated/made impossible as the effects of the ESCB's monetary policy on "the economy" vary widely across the euro area.

This question is no further illuminated when the FCC – having concluded that it is not bound by the CJEU's *ultra vires* finding of proportionality – goes ahead with its own assessment of proportionality. As indicated, the FCC demands that an asset purchase programme's monetary policy objectives be weighed and balanced against its economic policy effects.

Here, another curiosity appears in the court’s reasoning: While proportionality review, generally, is understood to be a matter of judicial review (with higher or lower levels of scrutiny), the FCC suggests that the ESCB itself needs to conduct and document a proportionality review. It thus imposes a procedural requirement on the ESCB’s conduct of monetary policy.

Holding proportionality review to constitute an obligation of the ESCB, allows the court to leave unanswered the question whether the PSPP is or is not proportional. And since for the FCC proportionality is a question of competence, it consequently does not make a final judgment whether the PSPP is a monetary policy measure or not. What the court does instead, is to list economic effects that the ESCB should take into account when conducting the required proportionality review. The FCC’s list (paras. 170-175) includes: improvement of Member States refinancing conditions, improving the economic situation of banks, risk of real estate and stock market bubbles, risks of losses for private savings and reduced income on pension schemes, increased real estate prices, allowing unviable economic companies to stay on the market and finally “risk that the ESCB becomes dependent on Member State politics as it can no longer simply terminate and undo the programme without jeopardizing the stability of the monetary union” (para. 175).

The court does not engage in a weighing and balancing exercise itself – this is the ESCB’s tasks – but simply makes “the point […] that such effects, which are created or at least amplified by the PSPP, must not be completely ignored.” (para. 173). Many commentators have pointed out that the ECB is far from ignoring these effects – as demonstrated by the manifold publications available via the ECB’s website. The FCC, however, holds a different view: “It is not ascertainable that any such balancing [of these effects against the expected positive contributions to achieving the ECB’s monetary policy objective] was conducted, neither when the programme was first launched nor at any point during its implementation;[…] Neither the ECB’s press releases nor other public statements by ECB officials hint at any such balancing having taken place” (para. 176).

And thus it remains unclear how such a balancing should be conducted. As explained above, proportionality, according to the FCC, is to protect Member States’ competence to conduct economic policy. Yet, it remains obscure how, for example, improved refinancing conditions for Italy – a major worry for the FCC – detract from Germany’s power to make economic policy and how such encroachment should be weighed exactly. Moreover, what may appear as a reduction of economic policy space for one Member State, may expand another Member States’ policy options.

The reasoning of the FCC reveals that what is at stake here for the FCC is less economic policy space of Member States, but rather a particular design of European Monetary Union. According to this design, a common monetary policy is complemented with strict fiscal discipline for the Member States. While it may be correct that, as the FCC insists, Member States have “conferred” few economic policy competences to the EU, EU law imposes many restrictions on Member States economic policy space. It does so in order to ensure sound government budgets and avoid “excessive deficits”. Among these are preventive measures of budget control and economic coordination (Art. 121 TFEU and secondary law) as well as reactive measures such as the excessive deficit procedure (Art. 126 TFEU and secondary law). Further pillars in this architecture of common monetary policy and fiscal discipline are debt brakes (Fiscal Compact) and the prohibitions of government bailouts (Art. 125 TFEU) and monetary financing (Art. 123 TFEU).

When the FCC singles out the improving of refinancing conditions for certain Member States and the consequent “risk

… that necessary consolidation and reform measures will either not be implemented or discontinued” (para. 170) as effects that need to be included in the balancing exercise, its focus seems motivated by the concern that this architecture is under threat. This threat follows rather from an expansion of fiscal policy space (for Italy who can refinance her deficit at lesser cost) than a restriction of economic policy competences (for Germany).

This concern of the FCC for fiscal discipline of Member States takes us to the other question referred to the CJEU for a preliminary ruling.

2. Is the PSPP compatible with the prohibition of monetary financing?

The PSPP’s potential impact on Member States’ fiscal discipline was squarely addressed by the FCC’s questioning whether the PSPP was compatible with the prohibition on monetary financing in Art. 123(1) TFEU. Art. 123(1) TFEU prohibits ECB and Member State central banks from providing governments with overdraft facilities or any other type of credit facility and from purchasing debt instruments directly from governments. The CJEU already in its judgment in *Gauweiler* had addressed the question whether and under which circumstances a government bond purchase programme could violate the prohibition of monetary financing. At issue in the proceedings in *Gauweiler* was the ESCB’s Outright Monetary Transactions (OMT) programme, which provided for the selective purchase on the secondary market of sovereign bonds from Member States who received financial assistance. The programme’s stated objective was to neutralize interest peaks on the bonds of crisis-ridden Member States and ensure the transmission of monetary policy throughout the euro area. In *Gauweiler* the CJEU found that the programme did not violate Art. 123(1) TFEU as long as safeguards were in place to ensure, *inter alia*, that purchases on the secondary market did not amount to direct purchases from governments and thus circumvent the prohibition of monetary financing. From the ruling in *Gauweiler* it was predictable, that the CJEU in *Weiss* would not find the PSPP to constitute monetary financing in violation of Art. 123(1) TFEU either.

The CJEU in *Weiss* first points out that under the PSPP the central banks of the Eurosystem purchase bonds only on the secondary market and not directly from governments. The CJEU recognizes, however, that also purchases on the secondary market may constitute a violation, namely when they have an effect equivalent to direct purchases. The ESCB is thus obliged to make sure, through programme design and monitoring, that no such effects arise. It must further ensure that the programme does not “reduce the impetus which that provision [Art. 123 TFEU] is intended to give the Member States to follow a sound budgetary policy” (*Weiss*, para. 127).

The CJEU sees sufficient safeguards in place to ensure that the secondary market purchases are not equivalent in effect to direct purchases. In this respect, it is of particular importance to the CJEU that purchasers of government bonds do not act as *de facto* intermediaries of the ESCB. This would be the case if they can be certain that the ESCB will purchase the government bonds they hold. The CJEU agrees with the ECB that several programme features protect against such *de facto* intermediation. Among them are the so-called blackout periods, which prohibit the central banks to purchase bonds immediately after their issuance, the ESCB’s option to reduce monthly purchase volumes, limits on purchase volume, the variety of bonds eligible under the programme (including regional and local government bonds), and the restriction of purchases to 33% of a particular bond issuance and issuer.

The CJEU further finds that the PSPP does not reduce the impetus on Member States to conduct sound budgetary policy. On this issue, the CJEU points to the programme’s limitation in time, the possibility to re-sell the purchased bonds, the restrictions on volume, the distribution of purchases among the national central banks according to the key for ECB capital subscriptions, the purchase limits per issue and issuer as well as the programme's eligibility criteria based on a credit quality assessment of the bond issuer. The CJEU adds that even when the central banks hold the purchased bonds to maturity they do not therewith waive their right to debt payment. As all national central banks only buy bonds from their Member State's governments and no provision has been made for the sharing of losses incurred by national central banks, a central bank does not bear the risk of losses on bonds purchased by another national central bank. The only losses subject to loss sharing are those incurred on the purchases by the ECB of international bonds, which are limited to 10% of the book value of all purchases under the PSPP.

The FCC accepts the CJEU's conclusion that PSPP does not violate the prohibition of monetary financing in Art. 123(1) TFEU. Yet, while it agrees with the CJEU's criteria to determine whether a violation of Art. 123 (1) TFEU occurs, it criticizes their application by the CJEU. It takes particular issue with the CJEU's treatment of blackout periods. According to the FCC, the CJEU failed to review whether they were suitable (not only to avoid certainty on behalf of governments that their bonds would be purchased, but also to protect the formation of market prices) and indeed observed. The FCC further critiques the CJEU's treatment of the practice of holding bonds to maturity, which according to the FCC needs to remain the exception to the rule to ensure that the Eurosystem does not become a "permanent source of finance" (para. 197) for the Member States. Moreover, in view of the FCC, the CJEU fails to determine whether the ESCB with adoption of a programme like the PSPP must also adopt a binding exit strategy.

Despite this criticism, the FCC concludes that after the required overall assessment, it cannot ascertain that the adoption and implementation of the PSPP amounts to a qualified violation of the prohibition of monetary financing in Art. 123 (1) TFEU. Thus, even though the FCC does not agree in all points with the CJEU and even though the FCC holds that the CJEU did not fully discharge its duty to effectively review monetary policy, it does not find that on the issue of monetary financing the CJEU acted *ultra vires*. The FCC consequently accepts as binding the CJEU's ruling on this count. The FCC underlines as of particular importance the safeguards against selectivity, among them the limitations of purchases to 33% per issuance/issuer and the distribution of purchases according to the ECB's capital subscription key. The latter was an "objective criterion that is independent of the economic and budgetary situation of the respective Member States" and it could therefore "be ruled out that this criterion could be used to purposely direct bond purchases to support struggling Member States" (para. 203).

The FCC's Ruling: Violation of the Individual Right to Democracy and Its Remedy

As laid out above, the FCC finds that the CJEU exceeded its judicial mandate under EU law (Art 19 (1) TEU) with its ruling that the PSPP is a monetary policy measure and thus falls within the ESCB's competence. As an *ultra vires* act, the ruling did not bind the FCC. Moreover, according to the FCC, due to the exceeding of judicial competence the decision also "lacks the minimum of democratic legitimation necessary under [the Basic Law]" (para. 113).

Not bound by the CJEU's ruling on competence, the FCC conducts its own assessment. It concludes that the ESCB did not engage in the required balancing exercise to determine proportionality (and consequently competence). As the violation of the principle of proportionality (Art. 5(1), (4) TEU) by the ESCB was "structurally significant" the ECB (like the CJEU) had acted *ultra vires*.

As outlined above, an *ultra vires* act, according to the FCC, lacks binding effects in Germany and triggers the integration responsibility of parliament and federal government, i.e. the responsibility to make sure that the EU institutions remain on the path of integration, legitimated by the "act of approval." A violation of this responsibility results in a violation of the individual right to democracy of German citizens (voters). Since the FCC finds a lack of balancing by the ESCB, but does not itself resolve the issue of proportionality, it concludes that no violation of the integration responsibility can be determined, yet:

"At present, it cannot yet be determined whether the Federal Government and the *Bundestag* did actually violate their responsibility with regard to European integration *(Integrationsverantwortung)* by failing to actively advocate for the termination of the PSPP. This determination is contingent upon a proportionality assessment by the Governing Council of the ECB, which must be substantiated with comprehensible reasons. In the absence of such an assessment, it is not possible to reach a conclusive decision as to whether the PSPP in its specific form is compatible with Art. 127(1) TFEU" (para. 129).

While the FCC does not find that integration responsibility was violated, it does find that the federal government and parliament must "take steps seeking to ensure that the European Central Bank conducts a proportionality assessment in relation to the PSPP." In order to do so they "must clearly communicate their legal view to the ECB or take other steps to ensure that conformity with the Treaties is restored." (para. 232) They shall further "continue monitoring the decisions of the Eurosystem on the purchases of government bonds under the PSPP and use the means at their disposal to ensure that the ESCB stays within its mandate" (para. 233). Contrary to many commentators, the FCC does not see any conflict with central bank independence. Rather it argues that independence must go hand in hand with a strict monitoring of the boundaries of monetary policy.

Finally, if within three months the ECB Governing Council has not adopted “a new decision that demonstrates in a comprehensible and substantiated manner that the monetary policy objectives pursued by the ECB are not disproportionate to the economic and fiscal policy effects resulting from the programme” (para. 235) then the Bundesbank may no longer participate in the PSPP and must sell the bonds it purchased under the PSPP and still holds (para. 235).

Already in the *OMT* proceedings, Justice Gertrude Lübbe-Wolff ‘s had expressed dismay in her separate opinion at the court’s ultra-vires-and-integration-responsibility-constructions: “In an effort to secure the rule of law, a court may happen to exceed judicial competence. In my view, this has occurred here” (para. 1). A sentiment that is shared by many after the *PSPP* judgment. In the meantime the EU Commission considers treaty violation proceedings against Germany for not accepting as binding the CJEU’s interpretation of EU law. The ECB issued a press release in which it takes note of the judgment, states its commitment to its mandate and refers to the CJEU’s ruling “that the ECB is acting within its price stability mandate.”

Implications for the PEPP

At the judgment’s pronouncement, FCC president Vosskuhle made sure to stress that it did not apply to the ECB’s Pandemic Emergency Purchase Programme. Yet, a number of the court’s findings are relevant to the PEPP, which the ECB announced on 18 March 2020 and was adopted by the Governing Council on 24 March 2020 with Decision (EU) 2020/440 to address the effects of the COVID-19 pandemic.

With the PEPP the ESCB seeks to address the devastating economic effects of the COVID-19 pandemic. Under the PEPP, which is is to complement the ESCB’s Asset Purchase Programme that includes the PSPP, Eurosystem central banks purchase private and public sector securities. The PEPP has an initial volume of €750 billion. The ECB announced that the Governing Council may increase this volume “by as much as necessary and for as long as needed”. The PEPP is to run until the Governing Council assesses that “the coronavirus crisis phase is over” and at least until the end of 2020. As concerns government debt securities, allocation of purchases shall be guided by the ECB’s capital subscription key (Art. 5(1) Decision (EU) 2020/440). Yet, the PEPP also provides for flexibility in this respect: “Purchases under the PEPP shall be conducted in a flexible manner allowing for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions” (Art. 5(2) Decision (EU) 2020/440).

The policy objective of the PEPP is set out in Decision (EU) 2020/440. The decision stresses the economic shock caused by the pandemic. It states in its preamble that “economic activity across the euro area is declining and will inevitably suffer a considerable contraction” and points to “acute strains on the cash-flows of businesses and worker” that “put the survival of businesses and jobs at risk.” Only thereafter does it make a connection to the monetary policy objective of price stability. According to the decision the current situation hampered “the transmission of the monetary policy impulses and add[ed] severe downside risks to the relevant inflation outlook”. In this context, the PEPP was a “proportionate” measure “to counter the serious risks to price stability, the monetary policy transmission mechanism and the economic outlook in the euro area, which are posed by the outbreak and escalating diffusion of COVID-19.”

ECB president Christine Lagarde specifies in her statement after the PEPP’s announcement: “Monetary policy has to keep the financial sector liquid and ensure supportive financing conditions for all sectors in the economy. This applies equally to individuals, families, firms, banks and governments.” In its announcement of the programme, the ECB furthermore formulates a "whatever it takes approach": "To the extent that some self-imposed limits might hamper action that the ECB is required to take in order to fulfil its mandate, the Governing Council will consider revising them to the extent necessary to make its action proportionate to the risks that we face. The ECB will not tolerate any risks to the smooth transmission of its monetary policy in all jurisdictions of the euro area."

In light of these characteristics, it is doubtful whether the PEPP would pass judicial review as envisaged by the FCC. If the ECB failed to properly substantiate proportionality with respect to the PSPP, it also failed to do so here. The question (for the FCC) would be whether it can substantiate that the programme is proportionate and thus falls within the ambit of monetary policy. The decision as well as the ECB's announcement refer to proportionality between the action taken and "the risks that we face" due to the COVID-19 pandemic. To maintain this kind of proportionality the ECB makes clear that it is determined to revise any limitations in order to enhance the programme's effectiveness. This account of proportionality differs significantly from the FCC's account. If the FCC were to review proportionality with respect to the PEPP, it most likely would take issue with the following two characteristics: (1) the wide and rather vague description of the policy objectives – stressing *inter alia* the need to support financing conditions including those of governments; (2) the "whatever it takes approach" that is guided merely by effectiveness in achieving the programme's objectives and does not take into account the potential effects on Member States' ability to autonomously decide on their economic policies.

Furthermore, the FCC's pronouncements on the prohibition of monetary financing have increased the likeliness that the PEPP will become the target of constitutional complaints. While the PEPP by reference to Decision (EU) 2020/188 on PSPP provides for a blackout period and the 33% limit on purchases per issue/issuer, it also provides for flexibility in the allocation of bond purchases (Art. 5(2) Decision (EU) 2020/440). This characteristic, which may lead to selectivity in government bond purchases, opens the programme to challenge given the *OMT* and now also *PSPP* precedents.

As indicated above, selectivity had been an issue specifically in the *OMT* proceedings because the ESCB's OMT programme had envisaged selective bond purchases from crisis-ridden Member States. To ensure that selectivity would not lower the impetus for fiscal discipline, FCC and CJEU both found it to be crucial that Member States whose bonds were eligible for purchase under the OMT programme were recipients of financial assistance *inter alia* by the European Stability Mechanism (ESM) and as such subjected to strict conditionality (securing fiscal discipline and consolidation).

By contrast, financial assistance to deal with the effects of the COVID-19 pandemic will not be extended within the framework of the ESM – *inter alia* due to the strong resistance by Italy and Spain. It will not be subject to conditionality. The lack of conditionality may expose the PEPP to the challenge that it functions – in the words of the FCC – "to support struggling Member States." Possibly, Art. 122(2) TFEU, that constitutes and exception to the bail-out prohibition in Art. 125 TFEU during crises caused by natural disaster, might come to the rescue here. It does not allow for financial assistance by the ESCB. Yet, an argument may be made that in a situation when the treaties allow the bail-out of governments and EU rules on budget discipline are suspended, the prohibition of monetary financing should be interpreted more narrowly.

A Case of German Rule of Law Fetish or Impetus for Democratization?

"In the name of the people" the court issued a judgment identifying explicitly and implicitly various dangers to democracy. In this last part of my comment, I wish to raise the question whether the judgment may indeed provide an impetus for democratization or whether it is yet another manifestation of an antidemocratic German obsession with the rule of law (Rechtsstaat).

German constitutional lawyer Helmut Ridder was a harsh critic of this obsession. Frequently, he pointed out how German legal scholarship and courts interpreted the written constitution in light of a higher rule of law and thus undermined efforts at democratization. Democratization for him was to extend not only to the institutions of the state, but to society as a whole, including the economy. One of his examples on how democracy is being obstructed in the name of the "the rule of law" fits particularly well the context of the *PSPP* judgment. In his monograph "Die soziale Ordnung des Grundgesetzes" (1975) he describes how in 1924 justices in the Weimar Republic announced that they would not comply with a legislative act that prohibited the judicial revaluation of mortgages to compensate for losses from inflation. They justified their disobedience on the basis of a higher moral law. This higher law that in view of the justices mandated revaluation, obviously benefited creditors. Whereas the legislative act prohibiting revaluation would have had the effect that debtors only owed the face value of their obligations, now lightened by depreciation of the currency. On the basis of such judicial practice (and supporting legal scholarship) Helmut Ridder formulated his critique that jurisprudence and scholarship in the name of a rule of law above the legal order continuously consolidated power structures and undermined the progressive, democratizing potential of the written constitution.

The *PSPP* ruling might be an instance of such constitutional law jurisprudence despite its framing as a defense of democracy. The individual right to democracy, as interpreted by the FCC, allows the court to sidestep parliament in order to control European integration. Moreover, the FCC construes a proportionality test by reading a balancing requirement into the treaties that is nowhere to be found in the written text. The proportionality test advocated by the FCC would not only restrict monetary policy for the benefit of Member State competence, but would also obstruct monetary policy supporting poorer Member States’ budgets. To the FCC, the CJEU is an unreliable guardian of this “rule of law.” It therefore reserves for itself the power to disregard the CJEU’s interpretation of EU law.

The construction of democracy by the FCC, moreover, seems to locate democracy only in state institutions that derive their power from the people (even if indirectly) by way of elections. It does not envisage that also an institution like a central bank that acts independently from such institutions might be a place of democratic politics. The FCC not only holds democracy at the supranational level to be deficient (it made this very explicit in its *Lisbon* judgment). It also turns the German parliament and the federal government into watchdogs over EU institutions in the name of the individual right to democracy (yet the suspicion arises that the FCC here is less concerned with democracy than with national sovereignty). Might the judgment nonetheless be read to further democratization?

First Reading: Democratization of Monetary Policy from Within?

I would like to suggest for a moment that we (re)interpret the PSPP judgment as envisaging a democratization of monetary policy. A democratization of monetary policy-making by the central banks itself, not through greater control from the outside by the political organs of the EU or Member States.

The FCC asks that the ESCB consider, weigh and balance a wide range of economic and social effects when adopting and implementing monetary policy and that it document this process in a way that is accessible to the public. Admittedly, the effects that the FCC primarily wants to see taken into consideration reflect a preoccupation with fiscal discipline. Yet, taking the FCC at its word could just as well support the claim that the ESCB should also take into account the monetary policy effects on – say – (gender) inequality and climate change mitigation. Such a claim is in in line with calls for a diversification of perspectives, which consequently would also require a diversification of the central banks' staff, in the making of monetary policy. These calls are receiving growing attention since the financial and euro-crisis, even within the ECB. In 2010, then ECB president Claude Trichet called for "input from various theoretical perspectives and from a range of empirical approaches" and formulated the view that an "open debate and a diversity of views must be cultivated—admittedly not always an easy task in an institution such as the ECB." Better communication between central bank policy-makers and the public could play a part in forging what Annelise Riles calls financial citizenship – a dedication on the part of central bankers and the public to dialogue and mutual understanding – that consequently leads to more legitimate monetary policy.

To be sure, such a conception of democratic central bank politics is at odds with a conception that holds the ECB to have a narrow mandate and to stand beyond politics, a conception that also figures prominently in the judgment. Even when read through this lens, however, the judgment may act as an impetus for democratization.

Second Reading: Democratization through European Economic Politics

In several parts of its judgment, the FCC refers back to its treatment of central bank independence in the 1993 *Maastricht* judgment. In *Maastricht,* the court held that central bank independence constituted a deviation from the principle of democracy, albeit one that was justified since only an institution independent from parliamentary politics could be trusted to maintain the value of the currency. Because central bank independence is an exception to the democracy principle, monetary policy, thus the FCC, must be understood narrowly. The FCC recognizes that a narrow construction of monetary policy cannot be achieved by way of a definition or strict rules. This explains its rather hapless attempt in *PSPP* to reign in monetary policy through the proportionality principle and judicial review.

Also already in *Maastricht* the FCC had taken note of what many consider a fundamental design flaw in the European Monetary Union – namely that the single currency is not complemented with a common fiscal and economic politics. A politics that could, for example, address structural imbalances across the euro area and prevent one Member State through its labour politics to gain a competitive advantage over other Member States (as economists argue Germany has done, see e.g. here). At the time it pronounced its *Maastricht* judgment, the FCC pointed out that it was not up to the court, but to politics to provide a fix to monetary union without political union. A treaty amendment providing for an EU economic and fiscal policy competence could be a remedy. As the discussion on Corona bonds shows, there are (limited) options to allow for some common fiscal politics even without a treaty amendment. So far, however, attempts to institute a common economic and fiscal politics within the EU have been obstructed, *inter alia* by Germany. In this impasse the ESCB’s rather wide interpretation of its monetary policy mandate could do some work in addressing inequalities caused by the European Monetary Union. With its *PSPP* judgment the FCC now seeks to reign in and police the ESCB.

The COVID-19 pandemic might make us see the consequences of a combination of narrow monetary policy, fiscal discipline and lack of common democratic economic and fiscal politics even more clearly than we would without the virus: Member States who benefit least from European Monetary Union and who have been hit hard by the eurocrisis and once more by the COVID-19 pandemic will only receive financial assistance either as an act of charity (even if called solidarity) or in combination with conditionality and a commitment to austerity. This will further increase inequality in Europe and undermine even the last bit of transeuropean solidarity.

If this is not an impetus to work towards a transnational European democratic politics – what is?

A Sense of an Ending

This is where I would have left it. Had not my friend said: Your text needs an ending. If a reader followed you for that long you cannot leave her in the cold like this. Her admonishment kept me awake during a lonely full moon COVID-19 night. What should I say to a reader who would like to stay for a coffee and chat about my take on the judgment or the potential for democracy in Europe? I would probably say: Forget my lies. I wrote this comment because I am upset – not only with the judgment, but also idealizations of the EU and German democracy, inequality and lack of solidarity. Possibly, I also want to prove that I can talk the talk, add my voice to the conversation among (male) colleagues. Yet, while I used the words, applied the rules, I realized that joining this conversation might leave me even more dissatisfied. That I long for a different language, a game that is a little fun to play. That I miss promise in the democracy, poetry in the justice that lie at the horizon of my reading of the judgment. Eventually, I remembered a little poetry to offer as a parting gift. It is from Gertrude Lübbe-Wolff’s dissent in *OMT*: “If they want to take you on a long desert walk that will not lead to a spring – resist.”

Frankfurt, 13 May 2020.

The Narrow Bank Update: SDNY dismisses TNB suit

Author: Gavriel Schreiber

UPDATE: On March 25, 2020, the Southern District of New York dismissed TNB's complaint. The court found that the Federal Reserve Board of New York had not constructively denied TNB's application for a Master Account by delaying the decision 18 months (the application form says a decision "may take 5–7 days"). The Court therefore held that TNB had not suffered an injury and therefore lacked standing to sue.

In a Nutshell

The Narrow Bank (TNB) is a state-chartered passthrough bank that proposes to hold only one asset: account balances at the Federal Reserve. Providing an ultra-safe option for large investors to hold their high-powered money is meant to increase financial stability and extend the benefits of Federal Reserve accounts, which are currently available only to depository institutions and select governmental entities, to a wider set of economic actors. Opponents worry that the spread of narrow banking, pioneered by TNB, would undermine the business model of existing banks, hamper economic growth, and amplify economic shocks.

The Problem: How Safe is High-Powered Money?

Small Investors/Depositors: Totally Safe

Small investors and depositors can hold cash – money that is recognized unconditionally as payment and is therefore “high-powered money (HPM)” – in bank accounts that are completely safe.

Consider a small investor/depositor with $100 of HPM. By placing her HPM in a commercial bank, she exchanges HPM for a bank deposit, which is a promise to pay $100 of HPM on demand.[1]

While the bank remains solvent, the investor/depositor can be certain that the bank will convert her deposit to HPM on demand.

If the bank goes bankrupt, the investor/depositor’s HPM remains safe. The Federal Deposit Insurance Corporation (FDIC) is a government agency that insures bank deposits up to $250,000. If a bank can’t return HPM to its depositors, the FDIC will do it instead. Relatively small amounts of HPM (under $250,000) can therefore be stored without any risk of loss.

Commercial Banks: Totally Safe

Commercial banks can also hold HPM in bank accounts that are completely safe.

Consider a commercial bank with $5 million in HPM (from depositors). This bank can place its HPM in a special Federal Reserve account available exclusively to commercial banks. Just like regular depository accounts, the Fed promises to pay its depositor HPM on demand. But because the Fed's promise to pay *is* money (unlike deposit banks, who promise to pay *with* money), commercial bank reserves kept at the Fed are completely safe. HPM held by commercial banks, if deposited in the Fed, can therefore be kept completely safe.

Most of the time, commercial banks would prefer to invest their HPM rather than park it safely at the Fed. Nonetheless, commercial banks maintain positive balances in their Fed accounts for a few reasons:

First, the Fed serves as a type of "clearinghouse" with other commercial banks. When a depositor puts money in Commercial Bank A, they receive a deposit, essentially an IOU stating "Commercial Bank A promises to pay HPM to the depositor or anyone to whom the depositer transers the right to his HPM." A depositor can use this IOU to buy goods, for example, by swiping his debit card at a coffee shop and transferring his right to the coffee shop. The right to the deposit (called a "check drawn against Bank A") might then make its way into the hands of the coffee shop's bank, Commercial Bank B, which can demand HPM from Commercial Bank A (the bank that issued the deposit).[2] Because Banks A and B (and all other commercial banks) frequently receive these checks written on deposits issued by one another, settling their accounts with money parked in their Fed accounts saves them the hassle of transporting cash back-and-forth.

The Fed also serves as a clearinghouse for deposits that banks issue to *borrowers*. When an individual borrows money from Commercial Bank A, they receive a deposit credit. Unlike depositors, however, **borrowers** provide the bank with a long-term IOU rather than HPM (e.g., borrowing $100 for a 5-year term means receiving a $100 deposit in exchange for a promise to pay the bank $100 plus interest at the end of five years).[3] As before, the depositor can write a check to a person with an account at Commercial Bank B, which can then demand HPM from Commercial Bank A (the bank that issued the deposit). This time, however, if Commercial Bank B demands dollars issued to *borrowers* who did not provide Commercial Bank A with HPM in exchange for their deposits, Bank A may not have enough HPM to meet its obligations to Bank B.[4]

This is where the Fed's clearinghouse function becomes essential. Though Bank A's lending leaves it open to demands for liquid resources that exceed its reserves, all commercial banks lend using this same model. Bank B is the recipient of checks drawn against Bank A, but Bank A is the recipient of checks drawn against Bank B as well. Their reciprocal deposit demands generally "cancel out," leaving Bank A on the hook only for the difference.[5] This Fed-facilitated reciprocal cancelling-out undergirds our financial system by allowing banks to issue deposits beyond their reserves.[6]

The second set of reasons commercial banks keep some money in their Fed account relates to legal obligations and risk aversion. The financial crisis of 2008 highlighted the importance of holding sufficient liquidity at the Fed.

For the most part, however, ensuring sufficient commercial bank reserves (and thus sufficient liquidity) has been a higher priority for the government than for commercial banks. Historically, the government has mandated commercial banks keep a certain amount of money in their Fed accounts (Required Reserves, or RR). Banks had to simply absorb the costs of keeping their money at the Fed instead of investing.[7]

Around the time of the financial crisis, Congress authorized the Fed to pay banks interest on their reserves held at the Fed.[8] More recently, the Fed expanded this tool, giving interest on both RR[9] *and* additional interest on any reserves kept at the Fed above the RR baseline (this is called Interest on Excess Reserves, or IOER). This is a massive expansion—as of January 2020, excess reserves totaled $1,350 billion, dwarfing the merely $200 billion of RR. Furthermore, the IOER rate is not insubstantial—standing at the time of writing at over 1.5%.

It’s essential to bear in mind that the enviable position enjoyed by commercial banks—being able to deposit large amounts of cash safely and receive relatively high interest rates on it—is a result of policy choices made by the U.S. government. Guided by congressional directive, the Fed decides which banks receive Fed accounts and decides to give IOER (TNB claims that Congress *mandates* opening Fed accounts for state-chartered depository institutions. The Fed maintains it has some discretion). With a different set of policy decisions, our financial system could look much different.

Large Investors: Less than Totally Safe

In contrast to small depositors and banks, large investors like money market funds, pension funds, and businesses with large cash balances like Apple and Microsoft *cannot* store HPM in bank accounts that are completely safe.

These large investors cannot put their HPM safely in a bank, because the FDIC only insures deposits up to $250,000. Though they hold large amounts of unsecured deposits, if the bank collapses, these investors could be left with large losses. Nor can they put their HPM in ultra-safe Federal Reserve accounts, because the Federal Reserve Act only permits depository institutions and certain governmental entities to deposit money with the Federal Reserve Banks. Even though these funds are major economic players, they are still shut out.

By and large these investors turn to putting their funds into the money market, often using overnight general collateral repurchase agreements (repo). Repo is simply a secured loan, backed by collateral. In a repo, a large investor like a pension fund uses its HPM to buy an asset like a Treasury bond from a large financial institution like a broker/dealer or investment bank. In exchange, the financial institutions promises to repurchase that asset from the investor the following day. This sale-and-repurchase arrangement is functionally equivalent to a one-day loan from the buyer-lender (the pension fund) to the seller-borrower (the broker/dealer). The seller-borrower is happy—it gets to use the pension fund's money to invest. The buyer-lender (the investor) is happy too—though its money isn't totally safe, if the seller-borrower collapses and is unable to return the HPM, the investor will still have a Treasury bond (or other debt instrument) to sell. The investor then rolls these agreements over, day after day.

These repo agreements are a good option for large investors, but many would probably prefer to simply deposit their cash at the Fed (like commercial banks). TNB wants to help them do just that.

The Proposal

The Narrow Bank extends the unique benefit of Fed accounts, currently conferred only upon depository institutions and certain governmental entities, to large cash investors. TNB plans to take deposits from large investors and park them in its Federal Reserve account. That's it. The money will earn interest, TNB will take a cut and pass the rest along to its depositors.

All money deposited at TNB will be in the Fed. Thus, there is no risk of TNB being unable to meet demands for deposits (unlike commercial banks, who could be unable to meet their obligations if they make poor investments). TNB deposits will be incredibly safe.

Arguments For

Advocates of TNB have said that…

1. TNB will reduce the nation's vulnerability to financial crises. Because TNB would store all deposits in the Fed, it will be immune to runs. Additionally, it will provide a floor to stabilize repo markets. Large investors will only use repo markets to store their money if the return offered by those markets is larger than the return offered by TNB. During times of economic uncertainty, large investors will be able to safely keep their money in the Fed (through TNB) rather than being forced to accept high risk and low returns in volatile markets.

- TNB will provide an additional tool for the Fed to control inflation. Related to point (1), the "floor" set by TNB depends on the IOER rate set by the Fed. The Fed could raise or lower the IOER in order to encourage or discourage participation in repo markets. Alternatively, the Fed could further differentiate IOER rates and fine-tune liquidity flows between safe deposit facilities and competitive investment markets.

- TNB will restore agency to investors. Large investors have little option but to maintain large balances with commercial banks, who often engage in risky investments. Some investors don't mind the risk, others do. TNB provides a safe choice for investors who care about safety above all else.

- TNB will reduce unfair government favoritism. The federal government advantages commercial banks to the exclusion of other major economic players in two important ways: First, it perversely subsidizes banks' costs by giving them interest in excess of what they provide their depositors. Second, it allows them the security of Fed accounts. TNB, as a passthrough, will allow other investors to reap the same benefits afforded commercial banks.

- TNB is not so different from a normal bank. Regular banks take deposits and invest them. Today, Federal Reserve accounts are an investment that many economic actors indirectly hold—from foreign banks to money market funds. TNB would do the same.

- TNB would promote competition by providing their depositors higher interest rates than those currently offered by commercial banks.

Arguments Against

Opponents of TNB have said that…

1. TNB will reduce economic activity. Commercial Banks, investment banks, and other financial entities rely on repo markets to fund trading and investment activities. With many institutional investors putting their money in TNB, a large swath of large investors will have less money with which to invest. This could raise the cost of credit for households, businesses, and other banks.

Individuals and investors may be more risk-averse than necessary,[10] so employing a fractional reserve banking system forces people to use their money in productive ways rather than keeping it under the proverbial mattress.

- TNB will reduce the Fed’s ability to implement monetary policy. Institutional investors depositing their money at TNB will leave short-term debt markets, making those rates more volatile and more difficult for the Fed to control. Specifically, TNB will render Fed’s Overnight Reverse Repurchase facility (ONRRP) obsolete. ONRRP, a tool of monetary policy implementation, offers to execute repo agreements at a certain rate. Because no money fund would lend repo to a broker-dealer for a rate that is lower than the one offered by the Fed, ONRRP sets a “floor” on money market lending rates. If TNB obviated the need for money markets and ONRRP, it would undermine the Fed’s ability to set the lower bound of its interest rate target range. TNB will also drastically increase the Fed’s balance sheet, which will limit its ability to implement monetary policy.

- TNB will compound financial instability. In times of mild economic stress, investors will run from financial markets into TNB. Small shocks will turn into large ones.[11]

- TNB will force taxpayers to subsidize money market funds. By increasing the Fed’s IOER payment obligations, TNB will reduce the Fed’s remittances to the Treasury. Taxpayers will have to make up the difference.

- Commercial banks uniquely deserve the advantage of Fed accounts. Commercial banks do things that are socially necessary but less profitable (like providing credit to households and small businesses). By subsidizing commercial banks and using regulation to insulate competition, the Fed allows them to continue their socially beneficial activities.[12] TNB will benefit exclusively "the most financially secure institutions," so it doesn't deserve the same advantage.[13]

- TNB represents a radical redesign of the monetary system that should be undertaken in a more thoughtful and centralized way. The Fed was designed to be a banker's bank—commercial banks are arms of the central bank. If we want to adopt a new system of money augmentation, we do so by amending the Federal Reserve Act after broad and democratic debate, rather than letting one upstart profit-seeking company upend the system.

What's the Status of TNB?

Connecticut granted TNB a bank charter. Normally, the Federal Reserve grants state-chartered banks accounts at the Fed as a matter of course. Here, the Fed has refused to act on TNB's application.

TNB sued the Fed for refusing to act on its application. The Fed filed a motion to dismiss and then proposed a rule which would bar pass-through investment entities like TNB from receiving IOER. Below, a summary:

August 31, 2018 – TNB Files Complaint:

LINK:
https://faculty.chicagobooth.edu/john.cochrane/research/papers/Complaint%20(filed).pdf

SUMMARY:

1. Relief Sought:[14]
   1. TNB seeks declaratory relief and an injunction to compel the Federal Reserve Bank of New York (FRBNY) to open a Federal Reserve "Master Account" for TNB.

- The applicable statute compels FRBNY to provide TNB a Master Account[15]
  - The statutory framework requires the Fed provide services to all depository institutions.
  - Fed services cannot be accessed without a master account.
  - TNB is a depository institution duly chartered in Connecticut.
  - Therefore, FRBNY must grant TNB a master account.

- FRBNY has delayed and shows no intention of opening TNB a Master Account.[16]

- TNB will have a positive effect on the Fed and the broader economy.[17]
  - TNB would pass along IOER rates to its depositors,

setting a more solid interest rate floor than the current target federal funds rate.
    - TNB will place competitive pressure on all banks to raise depository interest rates for all depositors.
    - TNB will provide a similar function to the Fed's current Overnight Reverse Repurchase Agreement Facility ("ON RRP") and the Foreign Repo Pool ("FRP").

March 8, 2019, Federal Reserve files Motion to Dismiss

LINK:
https://www.tnbusa.com/wp-content/uploads/2019/03/2019.03.08-HNC-Motion-to-Dismiss-Brief.pdf

SUMMARY:

1. TNB has no standing to sue.[18]
    1. They have not been denied an account, and therefore have suffered no injury.

- TNB's Claim is not Ripe.[19]
    - The Fed's review of TNB's application is ongoing, and so TNB cannot claim injury based on potential denial of their application.

- The court should decline jurisdiction over the declaratory judgement request because the request is contrary to the public interest.[20]

    - The Fed is carefully evaluating the impact granting a Master Account might have on the economy, and the court should allow the Fed to finish its inquiry.

- Providing Master Accounts is discretionary – TNB is not entitled to a Master Account.[21]
    - The Fed has discretion to reject deposits, and therefore reject granting Master Accounts.
    - An obligation to create Master Accounts would impermissibly undermine the Fed's ability to execute its statutory mandate.

NOTE: the Federal Reserve Board of Governors requested permission to file an Amicus brief in support of the motion to dismiss. That request was granted, and their Amicus brief is forthcoming.

March 12, 2019, Federal Reserve Files Notice of Proposed Rulemaking[22]

LINK: https://www.federalregister.gov/documents/2019/03/12/2019-04348/regulation-d-reserve-requirements-of-depository-institutions

SUMMARY:

Status:

The comment period closed on May 13, 2019. As of January 1, 2020, the Fed's decision was still pending.

Proposal:

Lower the IOER rate paid to institutions that hold a very large proportion of their assets in the form of balances at Reserve Banks. (Such institutions, like TNB, are termed Pass-Through Investment Entities or PTIEs).

Reasons:

1. Large scale migration of short-term investments from federal funds markets to PTIEs would make other interest rates more volatile, making it more difficult for the Fed to implement policy.
2. PTIEs would diminish the availability of capital for those institutions that benefit from short-term lending markets.
3. The ultra-safe option provided by PTIEs would exacerbate economic downturns by fueling runs from money markets to PTIEs.

March 25, 2020 – SDNY Dismisses TNB's Suit for Lack of Standing

Link:
https://www.tnbusa.com/2020/03/judge-grants-frb-nys-motion-to-

dismiss/

SUMMARY:

Holding:

Judge Andrew L. Carter Jr., writing for the United States District Court for the Southern District of New York, granted the Federal Reserve Bank of New York's ("FRBNY") motion to dismiss on March 25, 2020.[1] The Court first found that FRBNY had not yet denied TNB's application for a Master Account. Next, it found that TNB did not have standing to sue because a *delay* in deciding on an application, as opposed to a denial, did not result in an actual or imminent injury to TNB. Finally, it held TNB's claim to be unripe both because TNB had suffered no injury and because any decision on the merits could be rendered moot by the FRBNY's subsequent actions.

Facts and Procedural Posture:

The Court opened with background on the Federal Reserve System, the federal funds rate, and IOER.[2] It explained that TNB had received a temporary charter from the Connecticut Department of Banking in the form of a temporary Certificate of Authority ("CoA"), which would become a final CoA upon proof that the FRBNY would open a master account for TNB.[3] TNB began the application process in August 2017. After extended back-and-forth, in late 2017 the FRBNY indicated to TNB that it would soon have a master account.[4] However, the Federal Reserve Board raised policy concerns about TNB, and the FRBNY reversed course in February 2018. Despite TNB's extensive responses to the Board's policy concerns, the FRBNY has failed to act on TNB's application (which TNB formally filed on August 31, 2018).[5]

TNB's experience was unusual. "[T]he master account application process is typically straightforward and short. The applicant completes a one-page form agreement and waits 'no more than one week' for a response."[6] The FRBNY's form itself explains that "[p]rocessing [an application] may take 5–7 business days."[7] TNB seemed to be counting on a realtively expedient process, as its temporary CoA was set to expire in early 2019.

TNB filed a complaint. Shortly thereafter, the Board issued an advance notice of proposed rulemaking and the FRBNY filed a motion to dismiss.

The Holding:

The Underlying Injury – or Lack Thereof

The Court found that the FRBNY had not denied TNB's application. TNB argued that the FRBNY had constructively denied the application by telling TNB in February 2018 that it was unlikely to receive a Master Account, by beginning a rulemaking process that would destroy narrow banks like TNB, and by spending 18 months (and counting) on a process that should have taken only a few days. The Court rejected these claims. It found that TNB only presented facts indicating that the Fed would *likely* be hostile to TNB, not that it already was. Distinguishing other cases, it further found that the application-processing timeline was not guaranteed.

The Standing Issue

The Court found that TNB did not have standing because it had suffered no injury in fact. Standing requires an actual or imminent injury, not one that is conjectural or hypothetical.[8] Noting that TNB's application had not been denied, only delayed, it held that TNB had not asserted any actual or imminent injuries, only hypothetical ones.[9]

The Ripenss Issue

The Court found that TNB's claim was not ripe. Constitutional ripeness is a subset of the injury-in-fact analysis. Because TNB suffered no injury, its claim was constitutionally unripe. Prudential ripeness concerns a claim's "fitness . . . for judicial decision."[10] Because any decision on the merits could be rendered moot if the FRBNY subsequently grants TNB's application (or denies it for an unanticipated reason), TNB's claim was not ripe according to the Court. The Court therefore granted the FRBNY's motion to dismiss. TNB plans to appeal.

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[1] *TNB USA, Inc. v. Fed. Reserve Bank of N.Y*, 1:18-cv-7978 (ALC) (S.D.N.Y. March 25, 2020)

[2] *Id.* at 1–3.

[3] *Id.* at

[4] *Id.* at 4–5.

[5] *Id.* at 6–7.

[6] *Id.* at 4 (quoting TNB's complaint).

[7] *Id.* (quoting TNB's complaint) (first emphasis in original).

[8] *Id.* at 12 (citing *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992)).

[9] *Id.* at 13–14. The Court also found that TNB's alleged ongoing injuries, like operating expenses, were too "unclear" to confer standing. *Id.* at 19–20.

[10] *Id.* at 17 (quoting *Vullo v. Office of the Comptroller of the Currency*, 17 Civ. 3574, 2017 WL 6512245, at *8 (S.D.N.Y. Dec. 12, 2017)).

Further Reading

Background:

- General background on the dispute between the Fed and TNB.

- JP Koning provides insight about the genesis of TNB and highlights a concern about its long-term viability.

Advocates of TNB:

- TNB’s CEO James McAndrews introduces and advocates narrow banking.

- John Cochrane provides a robust defense of narrow banks generally and picks apart the Fed’s arguments against TNB.

- The WSJ explains how narrow banks benefit depositors

- John Crawford argues that the Fed’s denial of TNB’s application amounts to an indictment of our current monetary system.

Critics of TNB:

- George Selgin defends the Fed’s decision to deny TNB a Master Account.

[1] *See* Andrew Jackson & Steve Dyson, Modernising Money: Why our Monetary System is Broken and How it Can be Fixed, 53 – 63 (Positive Money, 2012).

[2] *See* Jackson & Dyson, *supra* note 1 at 57 – 68.

[3] This is called "maturity transformation," turning productivity in the future (i.e. an individual's ability to pay $100 plus interest in five years) into money in the present (i.e. $100 in deposits). *See* C. Desan, *Commercial Banking: Financing through Money Creation (aka Endogenous Credit Creation), A Short Overview* 2–3 (Sep. 3 2019) (unpublished manuscript) (on file with Christine Desan, Harvard Law School).

[4] *See id.*

[5] A bank's books must balance daily. If there is a shortfall, they have to pay the other bank or default. Generally they make up the sortfall by borrowing from other banks in the federal funds market or from the Federal Reserve Banks through the discount window. The repo market is also an option.

[6] *See id.* If a bank becomes a chronic "debtor" to other banks, lending more money than it receives in deposits, the Fed also facilitates inter-bank lending, whereby banks with too few depositors can borrow HPM from banks with too many. *Id.* at 3–4.

[7] Morgan Ricks, *Money as Infrastructure*, 2018 Colum. Bus. L. Rev. 757, 787 – 88 (2018).

[8] *Id.*

[9] See Gary Gorton, Clearinghouses and the Origin of Central Banking in the United States, 45 J. Econ. Hist. 277 (1985).

[10] Some scholars describe widespread investment as a type of collective action problem – society is better off when everyone invests, but the individual cost-benefit calculus promotes penny-pinching. Financial systems need to be complex in order to mask the true risks of investment to overcome individuals' stingy inclinations. *See* Steve Randy Waldman, *Why is Finance so Complex?*, Interfluidity Blog (Dec. 26, 2011) https://www.interfluidity.com/v2/2669.html.

[11] *See* Regulation D: Reserve Requirements of Depository Institutions, 84 Fed. Reg. 8829, 8829 – 31 (proposed Mar. 12, 2018).

[12] This is known as "cross-subsidization." For a succinct explanation, read this piece by Scott Sumner. For a critique, check out this piece by Cochrane.

[13] Complaint for Petitioner TNB USA at 1, (S.D.N.Y. 1:18-cv-07978-ALC) (filed Aug. 31, 2018).

[14] *Id.* at 1 – 4.

[15] *Id.* at 5 – 10.

[16] *Id.* at 11 – 15.

[17] *Id.* at 15 – 22.

[18] Law in Support of the Federal Reserve Bank’s Motion to Dismiss at 10 – 11, (S.D.N.Y. 1:18-cv-07978-ALC) (filed Mar. 8, 2019)

[19] *Id.* at 11 – 13.

[20] *Id.* at 13 – 14.

[21] *Id.* at 14.

[22] Regulation D: Reserve Requirements of Depository Institutions, 84 Fed. Reg. 8829, 8829 – 31 (proposed Mar. 12, 2018).

Italy’s mini-BOT Proposal

Author: Michael Svedman

The proposal by Italy’s Lega Norda (or League) political party to introduce a currency-like instrument called the mini-BOT that would circulate alongside the euro has generated significant commentary and criticism. These debates shed light on the public dimension of money by forcing us to consider the relationship between monetary authority and political sovereignty. With implications reaching far beyond the economic impact of such an instrument, the mini-BOT raises urgent questions about the stability of the European Union, the rise of populism on the Left and Right, and the coherence of the neoliberal political and economic consensus that underwrites the EU project.

The proposal by Italy’s Lega Norda (or League) political party to introduce a currency-like instrument called the mini-BOT that would circulate alongside the euro has generated significant commentary and criticism. These debates shed light on the public dimension of money by forcing us to consider the relationship between monetary authority and political sovereignty. With implications reaching far beyond the economic impact of such an instrument, the mini-BOT raises urgent questions about the stability of the European Union, the rise of populism on the Left and Right, and the coherence of the neoliberal political and economic consensus that underwrites the EU project.

Background

While several prominent figures associated with the League, including former Deputy Prime Minister Matteo Salvini and former president of the Senate Finance Committee Alberto Bagnai, have expressed support for the idea of using small denomination government bonds to pay public arears, there is no “official” mini-BOT proposal. A unanimous vote in Parliament on May 30, 2019 to adopt a motion inviting the government to accelerate the payment of public arrears by issuing mini-BOT was non-binding and did not spell out the details of such a plan.

Most discussions of the mini-BOT center on a detailed overview of the plan advanced by Claudio Borghi, the chief financial advisor to the League, in a 2018 pamphlet titled *Mini BOT: Democracy and Sovereignty*. The name ‘mini-BOT’ refers to small denomination, non-interest-bearing treasury bonds (or Buoni Ordinari del Tesoro). The government would use large issues of the notes to pay a portion of its public arears. The notes in turn would be redeemable against future tax obligations as well as in exchange for public goods and services. According to Borghi, the guaranteed liquidity these public uses would provide would allow the mini-BOT to circulate widely throughout Italy at par with the Euro and even encourage their acceptance in private commercial exchanges.

But the mechanical aspects of the mini-BOT only tell part of the story, and throughout his pamphlet Borghi articulates a powerful link between national political sovereignty and the state's power to issue money. On his account, the state without monetary sovereignty lacks the meaningful authority to realize its political goals. This inability to actualize the will of the electorate in turn vitiates the very notion of a democratically elected representative body. In short, monetary sovereignty is one of the key powers in the structure of the state as a political expression of the popular will. Along with the power to make laws and control the national border, monetary sovereignty is foundational to Borghi's account of the sovereign state.

Two features of this argument should be noted. First, it is antithetical to the basic premise of the EU project, which rests on the idea that economic convergence across the eurozone is compatible with sovereign political diversity. This idea reflects neoliberal orthodoxy in treating the market as a distinct sphere of human activity governed by its own internally consistent and apolitical logic. Second, Borghi's rhetoric mines deep veins of populist sentiment. He invokes the image of the state as the agent of technocratic elites in Brussels rather than its proper master the Italian people and channels this resentment into an agenda that joins economic stimulus with political self-determination.

The ongoing budget conflict between Italy and the EU illustrates the practical dimensions of this ideological contest. On June 5, 2019, the European Commission issued a report under Article 126(3) of the TFEU concluding that Italy’s 2018 budget had not complied with EU budget criteria and recommending that Excessive Deficit Procedure (EDP) was appropriate. In response, the Italian government adopted a mid-year budget on July 1, 2019 with the headline deficit expected to reach 2.04% of GDP as compared to the Commission’s spring projection of 2.5%. On July 4, in recognition of the mid-year budget and a 2019 spending freeze clause, the Commission determined that opening EDP would no longer be warranted as Italy had signaled its commitment to sound fiscal policy. Yet with public debt above 132% of GDP, well in excess of the 60% limit enshrined by EU policy, Italy remains at the center of a budget crisis. The tension between the Italian government’s political priorities and EU fiscal guidelines demonstrates the political pressure the Commission can exert through the European Central Bank, budgetary surveillance, and constraints on public spending. Indeed, this conflict animates some of the central issues not only in

Italian politics but across the EU’s shifting political landscape.

In the view of many commentators, the recent vote by Italy’s Five Star to form a new ruling coalition with the center-left Democratic Party (PD) signals the resolution of a prolonged crisis in Italian politics. Following the 2018 general election, the Italian government had been controlled by a fractious political alliance between the hard-right League and the left-populist Fiver Star Movement. Both the League and Five Star campaigned on broadly euro-skeptical platforms playing to widespread Italian resentment over economic stagnation, immigration, and sweeping austerity measures entailing cuts to government spending and public benefits. In response to these issues, both parties have expressed support for a parallel currency like the a mini-BOT. The formation of a new government alliance may blunt these fears, but the debate surrounding the mini-BOT proposal continues to trace the economic and political fault lines running through the EU project.

Policy Debate

The mini-BOT proposal articulates two goals. First, to stimulate the Italian economy and give the Italian government the freedom to increase spending without running afoul of EU budget constraints. And second, to restore Italy's political legitimacy as a sovereign state. The policy debate surrounding the mini-BOT forks at both of these major points. Simply put, what are the economic and political consequences of introducing a de facto parallel currency within the eurozone?

According to its supporters, the mini-BOT would promote Italian economic growth by increasing productive capacities across the economy and lifting the burden of austerity imposed by EU fiscal and monetary policy. The basic idea is that productive potential is lying dormant in the economy because limits on public spending have restricted aggregate demand while the deflationary effect of sweeping austerity measures across the EU has depressed wages and growth. By injecting liquidity into the economy in the form of fiscal money, the government could stimulate demand and reverse these downward pressures. Bossone and Cattaneo have written perhaps most extensively about the potential benefits of a parallel currency system like the mini-BOT for Italy's economy. Their work concentrates on the Keynesian multiplier effect of increased government spending, which would improve wages, production, and fiscal revenues. Their model holds that such spending would generate enough tax revenue to offset the cost of the tax rebate.

Critics of the mini-BOT, however, argue that the mechanism would weaken Italy’s fiscal position precisely because it would decrease the overall tax take. By accepting mini-BOT for tax payments in place of euros, the Italian government would dilute its tax revenue stream and increase the burden of its euro-denominated debts. Skeptics also question whether the mini-BOT would actually trade at par value with the euro. Borghi is notably vague about exactly how the mini-BOT would maintain par value with euros, and several commentators have predicted that their value would be discounted in private transactions, in turn driving up the cost to the government of mini-BOT denominated contracts relative to contracts for similar goods and services in exchange for euros. Papadia and Roth suggest that the mini-BOT would be most attractive to risk-loving traders, and thus shift wealth from budget-constrained taxpayers selling them at a discount to actors who could afford to speculate on their value.

Perhaps more urgent than the debate over the mini-BOT’s probable economic outcomes are the questions it raises about the political consequences of introducing a parallel currency within the European monetary union.

The threshold question is whether the mini-BOT proposal is legal under TFEU rules. Article 128 restricts the issue of legal tender within the monetary union to the European Central Bank. According to Borghi and others, the mini-BOT would not have “legal tender” status and therefore would comply with TFEU guidelines. Borghi points out, for example, that private sector actors could not be compelled to accept or recognize them. There is also a question of whether the mini-BOT would constitute debt such that the parameters set by Stability and Growth Pact (SGP) guidelines would apply to any issue of the notes. For the proponents of fiscal money schemes, such notes are not properly thought of as debt because they are not redeemable for anything and no ‘put’ date or maturity attaches to them. Borghi argues that, rather than contributing to Italy’s public debt, the mini-BOT would simply repackage existing debt into a liquid vehicle in order to free up public resources. Critics counter that the mini-BOT proposal is a blatant effort to circumvent SGP guidelines. Indeed, according to the Bank of Italy, the mini-BOT and all fiscal money would constitute debt from an accounting perspective. In general, these questions are matters of political and legal determinations as much as they are economic.

Finally, many critics and proponents alike recognize the mini-BOT as a covert method of going off the euro and ultimately precipitating a so-called Ital-exit, or Italy’s withdrawal from the European Union. Borghi’s emphasis on sovereignty clearly signals the euro-skeptical valence of the mini-BOT proposal. He characterizes the wide circulation of the mini-BOT his proposal envisions as a “spare tire” that would allow Italy to transition seamlessly to its own currency in the event of an Ital-exit. Likewise, Stiglitz has also argued that introducing a parallel currency represents an effective blueprint for a European Union member state to leave the monetary union. Its critics see in the mini-BOT a fundamental threat to the liberal consensus of the entire European Union project. To borrow language from a recent article appearing the New York Times, the mini-BOT "would threaten to bring the entire eurozone tumbling down because it would erode the very premise of the euro as a single monetary unit." In short, the mini-BOT debate traces the same fault lines as the rise of far-right and otherwise populist political factions across Europe.

Additional Resources

- For a summary of the features of the mini-BOT proposal, see Francesco Papadia and Alexander Roth, Mini-BOT in the government programme of the Five Star Movement and the League, Breugel (June 5, 2018), https://bruegel.org/2018/06/mini-bots-in-the-government-programme-of-the-five-star-movement-and-the-league/#_ftnref3.
- For an overview of the policy debate, see Silva Merler, *The Italian mini-BOT debtate*, Breugel (June 11, 2018), https://bruegel.org/2018/06/the-italian-mini-bot-debate/.
- For more theoretical work on parallel currencies in the EU, see Biagio Bossone et al., *A parallel currency for Italy is possible*, Politico (July 7, 2018, 10:10 AM), https://www.politico.eu/article/parallel-currency-italy-possible-eurozone.