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Policy-making of the European Central Bank during the crisis: Do personalities matter?

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Policy-making of the European Central Bank during the crisis:

Do personalities matter?

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Abstract: The European sovereign debt crisis represents an interesting opportunity to investigate the reaction of the European Central Bank as a crisis fighting institution and the importance of central bank personalities in policy execution. Accordingly, this paper aims at investigating to what extent the policy-making of the ECB during the crisis has been influenced by Trichet's and Draghi's different personalities. Based on Friedman's hypothesis that "accidents of personality" have a great impact on the functioning of a rule-based institution, we find that the clear differences in policy-making between Trichet and Draghi can be explained by specific features of their respective personalities. Institutions matter, but so do personalities.

Keywords: European Central Bank, Central Bankers, Personality Theory, European Sovereign Debt Crisis; Monetary Policy

JEL Classifications: E5, E6

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1. Introduction

In the context of the financial and European sovereign debt crisis, the European Central Bank (ECB) has taken on new importance. The inability of policymakers to adequately address the issues surrounding the crisis has expanded the role of the ECB as a crisis fighting institution. Crucially, in an institution that has prided itself on its independence from political influence, the role of leadership is more relevant than ever. The Eurozone crisis in particular offers an interesting period for careful examination because of the change in leadership with regards to the debate over institutional flexibility. The ability of any independent institution to adapt to external circumstances like the Eurozone crisis necessarily highlights the role of leadership, as established norms and customs may need to be changed at the discretion of the policy decision-makers.

Academic debate over the importance of central bank personalities in policy execution has undergone a substantial shift. Friedman's (1962: 234) hypothesis that "accidents of personality" can have serious consequences for rule-based institutions has lost academic weight. A near consensus has developed that central banks would become independent, consensus-oriented, rule-based institutions centred upon the maintenance of price stability, and the disappearance of strong, leading personalities (Blinder, 1999). However, even the most sceptical contributions admit that, "while personalities can at times matter more than the institutions they lead, it is the intersection of personalities with infrequent crises that gives rise to the hypothesis" (Siklos, 2002: 81). Unfortunately for sceptics, but quite happily for Friedman's hypothesis, the world is often beset by economic crises of varying magnitudes, which are transmitted to public institutions and the personalities that lead them.

Based on these considerations, we intend to investigate how far policy-making differs between Trichet and Draghi in the context of the Eurozone crisis and what factors can account for these differences. In the first part, we will review several relevant theoretical approaches, upon which we will derive our analytical framework and overarching arguments. In order to assess whether policy change was evident, we will then look at the concrete policy measures taken by Trichet and Draghi during the financial and Eurozone sovereign debt crises. Once established, we seek to explain these differences by looking at their personal backgrounds and their involvement with the ECB institution-building process. We will end this paper with a discussion and conclusion.

2. Theoretical framework

Academic debate over the underlying dynamic of the European integration process has produced many theoretical approaches that can be applied to explain the logic behind the creation, structure and operation of both the European Monetary Union and the European Central Bank. This paper will draw upon comparative politics and political economy approaches, which “provide potentially greater explanatory power as to the structure and operation of the ECB” (Howarth and Loedel, 2003: 2). After having provided a comprehensive overview of four different theoretical approaches, which are most relevant with respect to our research question (historical institutionalism, analysis of epistemic communities, cognitivism, and personality and public choice theories), we will attempt to systematically apply these theoretical approaches to our research question.

2.1. Historical institutionalism

In his attempt to understand why member states progressively lost control over European institutions and policies, Pierson (1996) first developed the concept of historical institutionalism (Pierson, 1996: 126). The central claim of historical institutionalism is that processes evolving over time produce unexpected and/or undesired outcomes. Actors seeking to maximize their own interests might undertake institutional and policy reforms that differ fundamentally from their own initial positions. Accordingly, “the current functioning of institutions cannot be derived from the aspirations of the original designers” (Pierson, 1996: 127). Pierson identifies different factors that are likely to produce significant differences between the institutional and policy preferences of member states and the actual institutional and policy outcomes at the European level (Ibid.: 131f.). First, in order to ensure efficient decision-making and enforcement at the European level, it was necessary to grant the European institutions sufficient authority and resources. The European institutions progressively became autonomous organizations seeking to increase their independence and resist the control of member states. Second, because of electoral purposes, political decision makers are more concerned with short-term consequences than long-run effects. As a result, the long-term functioning of a system does not correspond to the initial goals of the decision makers, but should be understood as “by-products of their purposive behavior” (Ibid.: 136). Third, because of the complexity of social processes that involve large numbers of actors, unanticipated consequences are likely to develop, even if policy makers do consider long-run effects. Finally, governments with significantly different preferences succeed each other over time and try to influence both institutions and policies in a way that might differ from the goals of the initial decision makers. Because institutions are path-dependent, these divergences are quite difficult to remove, once they have appeared. Pierson identifies several mechanisms through which path-dependency occurs (Ibid: 142ff.). First, the supranational institutions have acquired sufficient authority and resources to be able to resist any attempt by the member states to increase their control over supranational activi-

ties. Moreover, political institutions are often purposely designed to hamper reform attempts. Finally, initial institutional and policy arrangements can develop a self-reinforcing pattern over time. Establishing new arrangements generates substantial sunk costs, which make it unattractive to exit the current institutional and policy path.

Concerning the creation and functioning of the ECB, a historical institutionalist approach stresses the importance of the rules established in the Treaty on European Union and strengthened by following decisions, which, inspired by the success of the German Bundesbank, ensure central bank independence, price stability and low inflation (Campanella, 1995: 52). Therefore, current monetary policies “are not the result of ideas, per se, or the calculation of the interests of individual members of the ECB Governing Council” (Howarth and Loedel, 2003:13). ECB policies are constrained by the rules of the treaty, which were reinforced over time. Because of path-dependency, a shift in the conduct of monetary policy would threaten the credibility of the ECB and is considered as being highly unlikely.

2.2. Epistemic communities

Another line of research explains the creation and functioning of the ECB by focusing on the role of monetary experts and the emergence of a powerful epistemic community. The concept of an epistemic community was first developed by Haas (1992) as “a network of professionals from a variety of disciplines and backgrounds” (Haas, 1992: 3). In order to constitute an epistemic community, these networks must fulfil four conditions. First, the professionals must share a set of *normative beliefs* providing a value-oriented justification for their actions. Second, they should have shared *causal beliefs* according to which, implementing a particular policy measure will solve a particular problem. Third, they should share the same *notions of validity* and consequently use the same intersubjective criteria for assessing the validity of a specific knowledge. Finally, their professional competences should be directed to a *common policy enterprise*.

Since the creation of the European Monetary System in 1979, monetary experts such as treasury officials and central bankers started to meet on a regular basis and became used to work together.¹ According to Kapstein, three more conditions have to be met for the central bankers to become an epistemic community (Kapstein, 1992: 268). First, they should develop a stronger consensus on both theoretical and empirical knowledge of banking dynamics at the international level. Second, this knowledge, rather than national political beliefs, should constitute the basis for policy decisions. Finally, “a supranational regulatory agency” should be established in order to avoid domestic political pressures (Ibid). Verdun (1999) argues that an epistemic community of bankers had developed by the end of the 1980s (Verdun, 1999: 317). Central bankers had agreed on price stability

¹ Those meetings were the one of the EMS central bank governors, International Bank for Settlement, ECOFIN, EC monetary committee, Franco-German economic council, and Delors committee.

as being the central goal of monetary policy and on the need for monetary policies to be independent from any kind of political influence. For this purpose, an independent European System of Central Banks (ESCB) and eventually an independent European Central Bank should become responsible for monetary policy. Accordingly, Kapstein's conditions were fulfilled and monetary experts became a powerful epistemic community.

The epistemic community approach contends that it is not institutional path-dependency but the intensive cooperation of monetary experts within a coherent epistemic community that shapes the current functioning of the ECB. Even if central bankers and treasury officials do play an important role, this approach does not focus on individual personalities but on how these monetary experts managed to develop powerful networks with coherent ideas about appropriate monetary policy, i.e. central bank independence and price stability, and how this network influenced the process of monetary integration as well as the actual behaviour of the ECB.

2.3. Cognitivism

According to the cognitivist approach, it is neither institutional path-dependency nor the role of a powerful epistemic community of monetary experts, but the dominance of sound money ideas that explains the creation, functioning and policies of the European Central Bank. Cognitivists argue that a fundamental shift in economic beliefs towards neo-liberalism and monetarism occurred in the 1980s:

“Prior to the shift of 1980s, governments often implemented expansionary policies to stimulate growth and sustain employment, at the ‘cost’ of high inflation. The new belief was that price stability was the foundation for growth and employment in the long term”. (Sandholtz, 1993: 34)

Prior to the 1980s, most European governments, and notably the French, would have strongly opposed an institutional design based on central bank independence and rules corresponding to sound money ideas, such as the primacy of price stability and the convergence criteria. The ideational shift of the 1980s enabled the sceptic Member States to accept such a project (Howarth and Loedel, 2003: 15).

In his comprehensive work on the “ideational life-cycle”, Marcussen (1998) identifies the same shift towards sound money ideas and investigates the mechanisms underlying such an ideational shift. He defines ideas as “prevalent, relatively uncontested, but changeable knowledge structures which help to inform and legitimate the elite policy discourse about macro-economic cause-effect relationships within the macro- economic organizational field” (Marcussen, 1998: 3). According to Marcussen, ideas undergo an ideational life-cycle consisting of three steps. First, because of an

external shock², the validity of institutionalized ideas about economic causal relationships become undermined. The policy-makers experience a “state of cognitive dissonance”, which they seek to reduce by considering alternative macro-economic ideas (Ibid: 5). In the second step, new ideas will be selected through ideational transfer mechanisms and accepted as legitimate macro-economic knowledge.³ In the final step, these ideas will be institutionalized and “take on a rulelike status in social thought and action” (Meyer and Rowan, 1977 (1991): 42). Once the ideas about economic causal relationships have been institutionalized, the new ideational consensus will be difficult to change because of the resistance of those who benefit from it and of the high psychological sunk costs generated by an ideational shift.

Regarding the construction of EMU and the ECB, Marcussen argues that European central bankers constituted the decisive factor for the ideational shift that occurred at the end of the 1980s (Ibid: 9f.). Central bankers were both targets for, and sources of, new policy ideas. Through normative transfer mechanisms, they effectively adopted and promoted sound money ideas, which were institutionalized through the creation of both EMU and the ECB. So, according to Marcussen, “once a causal idea about the positive relationship between central bank independence and low inflation performance has become safely institutionalized in formal treaties, it starts to become difficult to avoid its constraining impact, because any deviance from this norm will be considered to be illegitimate” (Marcussen, 2000: 23).

While cognitivism recognizes the importance of both central bankers and ideational institutionalization, and thus entails elements from the institutionalist and epistemic community approaches, it does not explain the creation, design and policies of the ECB through the path-dependent character of institutions or the influence of a powerful network of monetary experts. Instead, they focus on how an ideational shift towards sound money ideas occurred in the 1980s and how it shaped monetary integration in the long run.

2.4. Personality and public choice theories

A last line of research emphasizes the role of the central bank governing councils and governors. Friedman (1962) first emphasized the “extraordinary importance of accidents of personality” in order to explain how monetary policies were strongly dependent on the behaviour of individual central bankers (Friedman, 1962: 234). According to Friedman and Schwartz (1963), it is the shift of power from Benjamin Strong to George L. Harrison at the head of the Bank of New York in 1928 and “the lack of understanding and experience” of Harrison that accounts for the contrast

² Marcussen (1998: 4) defines an external shock as a „radical changing environment“ because of military, political, economic, social or other crises. He refers to the World War II and the two oil crises of the 1970s.

³ Marcussen (1998: 8) identifies three different ideational transfer mechanisms: coercive, mimetic and normative.

between the monetary policy of the Federal Reserve before and after 1929 (Friedman and Schwartz, 1963: 411f.). Similarly, Boyle's biography of Montagu Norman (1967) emphasizes the importance of individual personalities. More recent works also investigated how the personalities of Paul Volcker and Alan Greenspan influenced the monetary policy of the Fed (Siklos, 2002: 83). Because they stress the importance of individual central bank governors, these personality theories are of great interest. However these are more biographical and descriptive than analytical and thus lack explanatory power.

Lebaron (2008) attempted to develop an analytical framework or "sociology of central bankers" in order to assess how the personality characteristics of leading central bankers can influence a central bank's behaviour and monetary policies (Lebaron, 2008: 122). In contrast to the concept of an epistemic community, this approach accepts the possibility of varying strategies regarding monetary and budgetary policies, even if central bankers all share neo-liberal economic beliefs. Lebaron's central claim states that these varying strategies depend to a great extent on the *social trajectories* of central bankers. Because of these different social trajectories leading to the position of a central banker, the governing councils of the different central banks display some systematic variations that can be categorized along three axes (Ibid: 135ff.). The first axis opposes a *political pole* consisting of personalities with a high level of seniority and symbolic capital to a more *academic pole* consisting of newcomers with strong educational capital. The second axis opposes an *economic-practical pole* consisting of personalities with experiences in the corporate world and practical competences to an *intellectual-academic pole* consisting of scholars and scientific experts. The last axis opposes a *private pole* consisting of personalities from the private sector to a *public pole* consisting of personalities from the political or central banking world. According to Lebaron, these systematic variations are reflected in specific central banks' behaviours (Ibid.: 141).

A last theoretical approach relevant to our research question belongs to public choice theories and focuses on how a central bank's behaviour is influenced by rational central bankers seeking to maximize their material benefits on the one hand and their self-preservation and prestige on the other hand. According to Toma (1986), central banks can be defined as "non-profit monopoly firms whose members are utility maximizers" (Toma, 1986: 38). Some authors consider central bankers as rent-seekers and argue that because of the institutional structure of the Fed linking its revenues to bond holdings, Fed officials will benefit from inflation and therefore support inflationary measures (Ibid.). Other authors argue that central bankers are less concerned with direct financial gains but rather with survival and prestige. Acheson and Chant (1986) argue that the members of a public administration will try to increase the prestige of their administration compared to other public administrations. Moreover, these actors will ensure the survival of their administration not only because they value its goals but also in order to protect their position within the administration

(Acheson and Chant, 1986: 131). Accordingly, the behaviour of a central bank will be influenced by its members' "preference function between prestige and self-preservation" (Ibid: 132).

While epistemic community and cognitivist approaches do not accept the possibility of individual central bankers influencing ECB strategies, personality and public choice theories emphasize how singular individuals are likely to shape the behaviour of the ECB either because of specific socialization patterns or because of rationale incentives related to self-preservation and prestige. In the following section, we will try to integrate these different theoretical considerations into our own analytical framework.

3. Analytical framework

In line with the institutionalist approach, we agree that the rules established in the Treaty and reinforced by subsequent decisions have shaped to a great extent the institutional structure and policy options of the ECB. The ECB is an independent central bank following the fundamental goal of price stability and low inflation. In accordance with both epistemic community and cognitivist approaches, we also agree that the emergence of a powerful network of central bankers and the ideational shift towards monetarism in the 1980s played a decisive role in the institution-building process of the ECB.

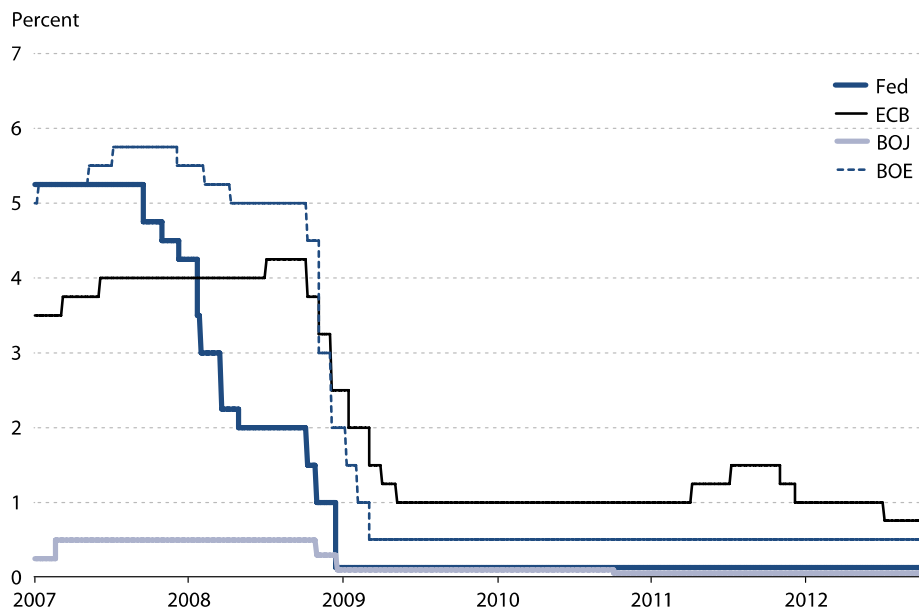
However, we believe that the decision makers of the ECB are allowed significant room for manoeuvre, despite the constraining character of the institutions and the underlying orthodox ideas. In line with personality and public choice theories, we accept the possibility of different policy makers choosing different monetary policy strategies. Therefore, we argue that there has been a shift in policy-making between Trichet and Draghi, which has been acknowledged in both the popular and academic literature but left unexplained. In accordance with the personality and public choice theories, we believe that the reason for these differences in policy-making rest in the different personal developments of these two decision-makers. For several reasons, Trichet was fundamentally more constrained by the institutional and ideational framework and therefore less flexible than Draghi was. Institutionally, while both men were equally constrained legally, Trichet was deeply involved in the institution building process, which prevented any significant departure in policymaking. Draghi, however, was not institutionally bound to the ECB, and because of his own personal development as an outsider that initiates change, he was able to adopt a flexible interpretation of the institutional mandate.

4. Policy-making of Trichet and Draghi during the Eurosystem crisis

In the following section we intend to show how far the policy-making of Trichet and Draghi differed in two distinct policy areas. The first criterion is the main interest rate set by the European Central Bank; the second is the net outcome of all standard and non-standard monetary policy instruments as measured by the balance sheet of the central bank. This will be supplemented by the legal and technical differences between the non-standard policy instruments. Finally, academic literature will be put forward to reinforce the argument that there was indeed a marked change between the two men in the hope of engaging with the academic debate as to why this change took place.

The following figure shows the development of the interest rates of the world's four major central banks (Figure 1). We can observe that the decision by the ECB to decrease interest rates in reaction to the financial crisis was delayed and more timid than in the Fed's case. While this observation is of interest, we are more concerned with the policy measures undertaken during the European sovereign debt crisis. In this regard, the figure shows a clear increase of the ECB interest rates over the summer of 2011, which was immediately reversed when Draghi took office in November 2011. The impression of change is further reinforced by subsequent decreases in 2012 to 0.75% and 0.5%, and 0.25% in 2013, the lowest interest rate in the history of the ECB.

Figure 1: Main interest rates - FED, ECB, BOJ, BOE

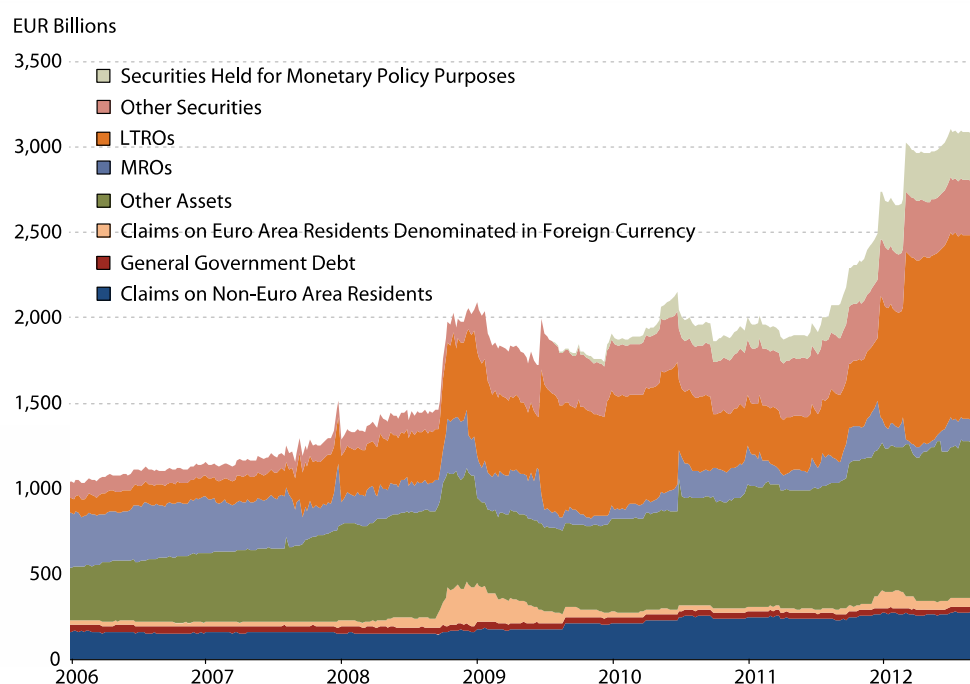


Source: Fawley, Neely (2013), p. 56.

Besides a change in interest rates, policy-making between Trichet and Draghi also differed regarding non-standard policy measures in general and the use of both Long-Term Refinancing Opera-

tions (LTROs) and the Securities Markets Programme (SMPs) in particular. LTROs are credit operations targeted at banks with the aim of providing liquidity, whereas the SMPs consist of the purchase of sovereign debt securities by the ECB (ECB, 2013: 234). While both Trichet and Draghi made use of LTROs, concrete implementation differed. Trichet increased the maturity from three months to one year, and Draghi further increased it to three years. Furthermore, Draghi decided two large-scale refinancing operations amounting to €1 Trillion in December 2011 and February 2012, which contrasted with Trichet’s hesitant use of refinancing operations (Fawley, Neely, 2013: 62). Similarly, while both men sought to restore monetary policy transmission through SMPs, Draghi progressively reduced the use of SMPs and eventually announced its replacement with Outright Monetary Transactions (OMTs) (Ibid.). In contrast to SMPs, OMTs are unlimited but tied to the conditions of the European Stabilization Mechanism (ESM). OMTs were not actually implemented and represented, therefore, a challenge to market participants. The effectiveness of this instrument was made credible because of Draghi’s previous decision regarding interest rates and liquidity provision. The net effect of the differences between the two policy makers can be clearly seen in the balance sheet of the ECB (Figure 2). Accordingly, the volume of all financial operations shows a dramatic increase in the end of 2011, as Draghi assumed the position.

Figure 2: ECB balance sheet



Source: Fawley, Neely (2013), p. 67.

This change was also recognized by academic experts who described “a split personality in response” to the financial and European sovereign debt crises (Bibow, 2012: 18). Bibow (2012) confirms the impression of policy change upon Draghi’s arrival:

“The ‘slow to ease, quick to hike’ mindset showed all over again as the bank hiked again in April and July 2011, perceiving upward inflation risks ahead of everyone else. These premature hikes were reversed under the new ECB president Mario Draghi before the 2011 year-end, whose arrival also marked other more fundamental changes. Until that time, the ECB’s crisis response had been rather timid by international comparison, both in terms of its interest rate easing and especially regarding any active measures for balance sheet expansion.”(Bibow, 2012, p. 18).

Besides a noticeable shift in policy-making, Draghi demonstrated a changing policy discourse in comparison to Trichet. While it is not necessary to detail Trichet’s use of discourse over his entire Presidency, his conception of building institutional credibility can be neatly summarized from his last press conference:

“Let me only mention that we are credible when you look at the past. We have delivered price stability... for 332 million of our fellow citizens, a price stability that is in line with our definition and is better than it was over the last fifty years before the euro. And for the future, we are equally credible with respect to delivering price stability over the next ten years.” (Trichet, 2011).

The focus on building credibility through price stability can be easily contrasted with Draghi’s more aggressive, confrontational language, exemplified best by his now well-known London speech “to do whatever it takes to preserve the euro” (Draghi, 2012).

Now that a change in policy-making between Trichet and Draghi has been established, we seek to explain why such a change took place by investigating their respective personal trajectories.

5. Impact of the personalities

The European Central Bank is considered one of the most independent central banks in existence. Such independence in practice means the president of the ECB has added influence over policy execution. The flexibility of the institutional mandate can either inhibit or encourage personal discretion, but in all cases decision-making still relies upon humans and all that shapes them. The ECB's mandate is very narrow, but in times of crisis leaders will have to use personal judgment to assess the economic climate and use their own discretion in policymaking. The two most recent leaders of the ECB are no different. Their personal development and professional careers have impacted not only the process of economic and monetary policy integration, but also their approach to ECB policymaking.

5.1. Empirical Evidence: Quantitative

The Gaullist politician Edouard Balladur's 8 January 1988 memorandum on Economic and Monetary Union (EMU) is taken as the starting date for the institution-building process. The official memorandum from the French *Tresor* introduced the idea of "a zone in which the same monetary unit will freely circulate in all the countries and in which there will be a common central institution and 'federal' banks in each country" (Balladur, 1988: 362). As France and Germany represented the 'motor' for European monetary integration, this document represents the first official formulation of the institution that would become the ECB. The end date of the quantitative period is different for each ECB President. The month of January, 2010 is used as the starting date of the European sovereign debt crisis, and the end of Trichet's institution-building period as he begins to manage the crisis. Draghi's institution-building period ends on 1 November, 2011 when he becomes President of the European Central Bank.

Trichet spent only two years outside public service, relating to his first degree at the *Nationale Supérieure des Mines de Nancy* as a civil engineer. After graduating from the *École Nationale d'Administration* in 1971 he maintained an uninterrupted career in public administration. Variation took the form of either internal switches within the French Ministry of Finance and Economics or the time spent in the realm of central banking, first at the Bank of France and later as President of the ECB. His career is marked by *institutional continuity* in public administration: first as a French civil servant and later as a central banker beginning in September 1993.

The quantitative results for Mario Draghi describe a different scenario, characterized by institutional diversity as a professional economist. Whereas Trichet can be easily classified as a professional civil servant, Draghi displays little continuity in his career-path although he remains always an economist by trade. He has undertaken four different institutional paths, all for extended periods: a professor of economics, an Executive Director of the World Bank, a civil servant for the Italian Treasury or at the Bank of Italy, and in private finance. His career is marked by *institutional diversity*. Draghi's time outside of public service also confirms the picture of a career dominated by change in surroundings, but not in his own personal or professional work.

While they each have comparable years of higher education, Draghi has a far greater degree of specialization with a Ph.D. in economics. Trichet, however, was exposed to a classical education in programmes that centred on network-building and leadership skills (Marshall, 1999: 100). Apart from the professional and educational distinction between a professional civil servant and professional economist, the quantitative evidence reveals other important differences between the two characters.

Table 1: Personal developments⁴

Education, Training and Career	Jean-Claude Trichet until 1 January 2010	Mario Draghi until 1 January 2010
Years of higher education	7	9
Institutional settings	2	5
Years of Public Administration	466 months	196 months
As Central Banker	195 months	69 months
In National Bureaucracy	271 months	127 months

Involvement with the ECB institution-building process is a key measure of affinity each President maintains with the institution he leads. The greatest disparity revealed is the number of months spent contributing to the institution-building process. Trichet's participation began earlier: drafting the Balladur memorandum, negotiating the Treaty of the European Union (TEU), Governor of the Bank of France, and as President of the ECB. One of the key indicators - *involvement in the ECB institution-building process* - shows Jean-Claude Trichet with far greater engagement, as measured in months.

Trichet had 264 months of institution-building when he began managing the European sovereign debt crisis in January 2010, equating to nearly three-times as much involvement with formal ECB institution-building. Draghi's participation in ECB institution-building is limited: his time as an Italian negotiator from *Tesoro* before Maastricht was signed and his work at the Italian Treasury before the Bank of Italy became formally independent in November, 1993 (Passacantando, 1996). Included as well are the 69 months as Bank of Italy governor during 2006-2011, a total of 102 months of institution-building upon becoming ECB President on 1 November 2011.

Dividing the process into two periods, the negotiation stage was clearly the most intense. The decisions reached by the participants would define the legal mandate and scope of operation for the new European institution. A second, extensive period of institution-building is no less important for the institution or for the two men. Trichet had more contact during both the intensive 'negotiation' period and afterwards during the extensive 'history' period.

⁴ Wall Street Journal, (n.d. (a)(b)); Dyson and Featherstone, (1999); James, (2012); Banca d'Italia, (2012); The Economist, (2006).

Table 2: Institution-building process⁵

ECB Institution Building	Jean-Claude Trichet until 1 January 2010	Mario Draghi until 1 November 2011
Involvement in Process	264 months	102 months
Intensive period	72 months	33 months
Extensive period	192 months	69 months

It is important to remember that throughout the institution building process, institutions are shaped by their members, but likewise, members can be shaped by the institution. This will be of particular concern when looking at the qualitative evidence, as the quantitative empirical distinction between the two Presidents of the ECB are accentuated, and their personal traits are brought to the fore - something that is not apparent if we look only at simple quantitative indicators.

5.2. Qualitative Empirical Evidence: Trichet

The Balladur memorandum reference point is also useful here as the *Tresor* - now headed by Trichet from September 1987 - was responsible for drafting the substance of the document even though "Trichet was actually new to EMU" at that time (Dyson and Featherstone, 1999: 164). Just as the memorandum of 1988 marked the formal beginning of the ECB, the drafting of the Balladur memorandum was the formal beginning of Trichet's involvement with the ECB, as he was originally an outsider and resistant to the idea of a *Tresor* stripped of monetary policy: "For Trichet the period from 1988 involved a steep learning curve with respect to EMU. He was by no means the originator of ideas or even the agenda-setter. Such roles did not accord with his self-image as the 'perfect' civil servant" (Dyson and Featherstone, 1999:178).

It is rare to have one influential figure span the entire process of regional economic and monetary integration. It offers insights into the process, and how it shapes the personalities involved. It is a position that only an unelected civil servant could hope to fill, as politicians can rarely remain in positions of power for thirty years. Indeed, it was the Gaullist Balladur that installed Trichet, whom watched his power grow until, "as one senior Belgian central banker was later to say, 'Trichet has his fingers into everything,'" but under the socialist Beregovoy a year later that Trichet saw the reality of EMU (Marshall, 1999: 109). The continuity of service allowed Trichet to follow the currents of political change, and shape his own professional career accordingly: "His [Trichet] skill

⁵ Wall Street Journal, (n.d. (a)(b)); Dyson and Featherstone, (1999); James, (2012); Banca d'Italia, (2012); The Economist, (2006).

was in responding to the shifting political climate: in reading the signals emanating from the highest political levels and adapting *Tresor* beliefs to those signals" (Dyson and Featherstone, 1999: 177).

The reality of EMU for the French *Tresor* and all European Treasuries was the loss of monetary policy from their portfolio. It was a political decision forged between two committed integrationists - Francois Mitterrand and Helmut Kohl - whose "astute strategy was to 'bind in' the central bankers and thereby strengthen the credibility of the project" (Ibid: 3). Simply put, "French governments sought to end the independent expression of German - that is, the Bundesbank's - monetary power" in exchange for the creation of an independent central bank modelled after the Bundesbank (Howarth and Loedel, 2003: 72). It was a point that was made exceptionally clear to Trichet as head of the Treasury on 27 April, 1989 at the Louvre Palace after the publication of the Delors report.

Jacques de Larosiere, in his personal capacity as Bank of France Governor, had drafted the Delors report with other European central bankers, forming the broad outlines of EMU. The blueprint of this 'epistemic community' was an independent central bank with a mandate of price stability that Mitterrand and Kohl had deemed necessary for *construction europeene* (Verdun, 1999: 317). It was a divisive proposal for those like the Socialist French Finance Minister Berezovoy and his *Tresor* officials. In a confrontation between the *Tresor* and Governor de Larosiere, the differences over the proposed ECB were made explicit:

"In essence, the Director [Trichet] said the Delors Report went too far in proposing a degree of independence for the European central bank that went even further than the independence of the Bundesbank. He thought that I had made excessive concessions. M. Berezovoy then said: "What do you have to say?" I said I had heard the word 'concessions'. That indicated I had ceded points during a negotiation to reach an accord. This was not the case." (de Larosiere, in Marsh, 2009:128)

Indeed, it was de Larosiere that would point out to an irate Trichet that it was President Mitterrand who "gave the green light to de Larosiere to hammer out a deal in the Delors Committee that would shock the Finance Ministry and its minister, Pierre Berezovoy" (Dyson and Featherstone, 1999: 125). The incident was an important one for Trichet. He had seen his personal power expand as Treasury Director. However, central bank independence was now presented to Berezovoy and *Tresor* as a *fait accompli*. A clear trend of diminishing *Tresor* power was already evident, and it now included monetary policy, one of the few remaining instruments of power: "Having lost powers with financial market liberalization and privatization during the *cohabitation*, many of its officials now saw the threat of powers being ceded to central bankers in an ECB" (Ibid: 186). The *Tresor* would be sacrificed in order to establish Mitterrand's *construction europeene* and regain influence in European monetary policy; Trichet was better placed than anyone to recognize the shift and

adapt accordingly.

Mitterrand's objective was clearer to Trichet than it was to his minister, as both Mitterrand and Trichet shared a common appreciation of the historical importance of EMU: "There was also a more personal theme to Trichet's new endorsement of EMU that stemmed from his literary interests and that brought him closer to Mitterrand's cultural conception of *construction europeene*" (Ibid: 177). Trichet had received a classical education in addition to his training as a civil servant. He held a deep-seated belief that France would benefit from the renewed enthusiasm of integration, where he would be a central figure. His personal sensibilities made him receptive to Mitterrand's vision of integration using the Delors blueprint: "'It was an enormous strategic move,' Trichet recalls. Mitterrand took his young aide aside afterwards and told him that he should heed the orders of Delors, the man charged with implementing the European vision. For Trichet, this became his mandate, and he would pursue it zealously. Regardless of criticism or what his finance ministers told him, he stubbornly held his course, confident that he was serving a higher purpose" (Marshall, 1999: 110). Mitterrand was keenly aware of this, and Trichet would continue to serve this purpose throughout his career in public administration, and after political currents had swept aside Mitterrand: "Mitterrand acquired a deepening trust in Trichet, recognizing a cultivated man who was also the 'perfect' civil servant" (Dyson and Featherstone, 1999: 177).

The importance Trichet assigned to Mitterrand's faith in the Delors report should not be underestimated. Once it had been established that the blueprint for the European Central Bank was non-negotiable it determined the scope of negotiations at Maastricht (Dyson and Quaglia, 2010:346). The French negotiating goal became the inclusion of as many Member States as possible to balance German power, and to assure a fixed date for adoption (Dyson and Featherstone, 1999: 241). For Trichet on the interministerial level negotiating the terms of the Maastricht Treaty, "the consequence was that he carried an enormous burden of personal responsibility" throughout the negotiations on what would constitute the participants and the irreversibility of EMU (Howarth, 2001: 124). The urgency was only accentuated as German unification became all but guaranteed and the need to bind Germany and her central bank into Europe became more pressing (Howarth and Loe-del, 2003:73). Trichet was not only responsible for building what would become the ECB, but also what would become his new calling: an independent central banker. His personal conviction for EMU was merging with his professional prospects and ambition as a civil servant.

Trichet was learning how to behave as an independent central banker even before Stage 2 of EMU. His previous difficulties with exchange rate crises at *Tresor* - first in 1986/7 and again during 1992/3 when he was chairman of the EC Monetary Committee - only confirmed his conviction that credibility in central banking was derived from the stability found in a comprehensively independent bank: "For Trichet this episode [86/87] was a major learning experience" (Dyson and Feather-

stone, 1999:160). The 1992/3 'battle of the franc' was particularly relevant as he was a key figure negotiating between French and German governments, defining the measures to be taken to avoid a breakdown in the monetary system. He saw again the importance of binding-in an obstinate Bundesbank and removing Germany's de facto monetary control over Europe (Howarth, 2001:157-158). But more importantly for Trichet, the situation presented a paradox: The *franc* had lower rates of inflation and stronger economic fundamentals, yet it was the *franc* under speculative attack. Trichet could claim personal statistical vindication for *franc fort* and *desinflation competitive* policies, but was being punished by the markets and a recalcitrant Germany: "The answer to this puzzle is rather simple. It centres on monetary credibility: the markets trusted the Bundesbank to bring the inflationary pressures in Germany under control; the markets did not believe the French" (Howarth and Loedel, 2003: 120). It was a steep learning curve for Trichet, but a familiar lesson in his mind: that of credibility and price stability.

Trichet became governor of the Bank of France in September 1993, just before it received formal independence from his old ministry. He found a fledging institution that was suspicious of central bank independence and a governing council that expressed open resistance to stability-oriented policies, and even sceptical of EMU (Howarth, 2009: 115). Despite these voices, and due to the legal independence and power concentrated in the position of Governor, "Europeanization brought about convergence in the monetary policy strategy of the Bank of France, which - emulating the Bundesbank - in 1994 adopted a two pillar monetary policy targeting inflation and M3" (Ibid: 127). It is not surprising that Trichet followed the Bundesbank model. It was, after all, the agreed upon format for *construction europeene*. Furthermore, Trichet had always been in indirect competition to outdo the Bundesbank on fundamentals in order to attract capital flows with the *franc fort* policy and '*desinflation competitive*' (Howarth and Loedel, 2003: 65). Extending these two convictions and the mandate of price stability to the newly independent bank was an easy task for Trichet, even if "four years previously, in the aftermath of the Delors report, he had virulently opposed just such a step. Trichet adapted smoothly to the new rules - and gave every sign that he had always been their most trenchant advocate" (Marsh, 2009: 186).

When the time approached for establishing the first President of the ECB in 1996, Trichet had become an independent central banker who was about to complete Mitterrand's *construction europeene*. Indeed, he felt that his future was already established as it became public that "a secret agreement on Trichet's appointment had been reached with the Germans in October 1993 when Frankfurt was selected over Lyon" (Howarth and Loedel, 2003: 48). Although another compromise would see his leadership position delayed, there was a more pressing risk that the third and final stage of EMU would be called off entirely. This would have been a significant loss for Trichet as a firm timetable for EMU was one of the few successes France achieved at Maastricht. The March 1997 meeting at the Bank for International Settlements saw European central bankers divided, and

the entire project in doubt due to a lack of Member State convergence. Hans Tietmeyer, the German President of the Bundesbank and long-time foil of Trichet from before the 1988 Balladur memorandum, was undecided on the merits of Stage 3: "Tietmeyer was mulling over whether to express these questions out loud when his dilemma was resolved by a harsh riposte from Jean-Claude Trichet, governor of the Banque de France. Delay was a preposterous idea, he retorted, launching into a passionate defence of EMU (Marshall, 1999:8). While Trichet's conviction to complete EMU saved the project, it would be Duisenberg that became the first President of the ECB. After Duisenberg's 'voluntary' retirement, Trichet would lead the institution he had personally made, and that had, likewise, shaped his own concept of self and how credibility was earned in central banking.

Trichet's time as ECB president was much the same as his tenure at the Bank of France, but this time without any institutional or Ministerial-level resistance to overcome. His previous experience only further entrenched his stability-oriented nature as "Trichet had been engaged in a near-continuous struggle with French politicians over stewardship of the French economy" (Marsh, 2009: 213). Indeed, Trichet had become so wholly consumed by stability-oriented policies that "one German central banker speaks approvingly of Trichet as 'our convert'; another comments that, for Germany it is incomparably better to have a French ECB president carrying out a Bundesbank-style policy in Frankfurt than a German president carrying out a *Banque de France*-type policy in Paris" (Marsh, 2009: 226). By the time the European sovereign debt crisis began in earnest, Trichet had more experience in central banking than any member of the Executive Board, albeit all learned under his own dual mandate: a stability-oriented independent central banker combined with the 'perfect' civil servant building *construction europeene*.

5.3. Qualitative empirical evidence: Draghi

Looking at the present ECB President, the qualitative data support the *prima facie* quantitative results of Mario Draghi as *Signor Altrove* - Mr. Somewhere Else (Wall Street Journal, n.d. (a)). In contrast to Trichet, Draghi was trained as an economist under Robert Solow at MIT and remained as such, but in a variety of diverse institutional settings. It was not until 1991, that he began work in European public administration, which corresponded with his role as Director-General of the Italian Treasury negotiating EMU. However, his entry into public service came as his predecessor, Mario Sarcinelli, had resigned midway through EMU negotiations in protest over entrenched Italian *partitocrazia* at *Tesoro*. Draghi did have international experience, albeit in Washington, at the World Bank, "yet Draghi faced constraints. He had been thrown into the IGC [3rd Intergovernmental Conference] after it was already well under way, and the growing domestic problems of the public debt vied for his attention" (Dyson and Featherstone, 1999: 496-7). Draghi was primarily an academic economist in 1991 when he began work in public administration; an outsider to EMU.

His vital role as a negotiator for Italian accession to EMU was simply to ensure Italy was able to join with the other first-tier members of European integration, not institution-building. In the few instances where Draghi and the *Tesoro* attempted to influence the foundation of the ECB, it was soundly defeated (Ibid: 514). This was as much to do with Draghi's late entry as Italy's overall position in EMU: "Ultimately, the Italian position in relation to EMU appeared to be one of dependency amidst hegemony. Italy needed EMU, but EMU was defined by others" (Ibid: 532).

Even if Draghi's role in building the ECB was reduced, it is still possible to see parallels in his behaviour at the Treasury and later at the Bank of Italy. Internal institutional change, initiated by Draghi, can be seen both during negotiations and also at the Treasury: "Draghi would implement a number of internal reforms affecting the structure and quality of personnel in the *Tesoro*" (Dyson and Featherstone, 1999: 460). It would be internal domestic change, promoting privatization and financial market liberalization that would occupy Draghi's time at *Tesoro*. Indeed, technocrats like Draghi saw the process of EMU as an external, but beneficial force that could drive domestic change. EMU was a necessary *vincolo esterno* - external constraint - that was for technocrats a means of instigating domestic market-oriented reform, not a debate over the end constellation of emerging EMU institutions or the direction of integration (Dyson and Featherstone, 1996: 272).

In contrast to the Italian Treasury, the Bank of Italy has held an important function in Italian economic governance as a strong, credible institution: a strong bank in a weak state (Quaglia, 2009: 189). Even after Maastricht, throughout the transition period with the European Monetary Institute, and later as a member of the Eurosystem, "the Banca d'Italia has represented a 'credible interface' for Italy with the outside world - the 'power of credibility'" (Quaglia, 2009:190). This is of importance when looking at its former Governor Mario Draghi, as the institution he took over in 2006 was already a credible central bank. But this credibility derived from its research and technical capabilities. The Bank of Italy had much to lose with EMU, and that was no clearer than to Antonio Fazio, Draghi's predecessor at the Bank from 1993-2005. The institution that Draghi inherited was far different from the weak Bank of France that Trichet found. The institutional environment would shape their respective perception of central banking, as for each governor it was their first leadership experience with central banking. The Bank of Italy after Maastricht was shaped by Fazio. Of equal significance, Draghi would take over from Fazio under the same uncertain conditions that he began with at *Tesoro*: after his predecessor's resignation, and with a mandate for institutional change, however entrenched the mind-set.

Fazio is notable as he was the only European central banker who actively fought against EMU. Both during and after the signing of Maastricht he led Italian Eurosceptics against continued integration (Quaglia, 2009: 188). It was not a new position within the Bank of Italy, as "his stance echoed the views of former Banca d'Italia governor Paolo Baffi, who had opposed Italy's joining the

European Monetary System in 1979 on the grounds that, under the constraints of an unchanged exchange rate, Italian industry would quickly become uncompetitive against lower-cost European rivals such as Germany" (Marsh, 2009: 193). During Stage 2, Fazio consistently rejected measures that would increase centralization of the ECB (Marshall, 1999:290). The process repeated itself throughout Stage 2 and 3 of EMU, as even under centre-left Italian governments "the Banca d'Italia - or to be precise, Governor Fazio and some of his advisers - did not share the government's objective of joining EMU in the first wave" (Quaglia, 2008:87). As the Prime Minister of the period remarked: "To say that Fazio was doubtful about the Euro is an understatement. He was strongly against it. He did what he could do to stop it. His scepticism went beyond Baffi's" (Prodi, in Marshall, 2009:193). Fazio made it clear publicly as well that Italian accession to EMU was a mistake and while Italy had seen a 'virtuous circle' of reduced interest rates, the potential for a 'vicious circle' was just as likely (Blitz, 1998).

Fazio was also instrumental in shielding the Bank of Italy from the effects of centralization imposed by joining the European System of Central Banks (ESCB). It was Fazio that "considerably expanded its research staff in the period 1996-2003 as part of a deliberate strategy to strengthen the Bank's influence within the Eurosystem and in ECB decision-making" (Quaglia, 2009: 197). His discretion in reinforcing the Bank of Italy in spite of centralization attempts would also have important consequences for the institution that Draghi would be attempting to change. Fazio's euro-sceptic approach extended to liberalization of the financial market as well, never authorizing any foreign takeovers of domestic firms, and widely criticized because of it (Financial Times, 11 Feb 2005). His attempt to insulate the domestic Italian financial sector would eventually lead to Fazio's resignation mired in scandal. The circumstance was a familiar one for the incoming governor, and "from the outset, Draghi gave clear signals of change, albeit emphasizing the continuity of the prestigious tradition of the Bank of Italy" (Quaglia, 2009: 195). Draghi made clear that he would reverse the policies of Fazio and that "the priority was to regain 'credibility'" (Quaglia, 2009: 195).

It is relevant in the current discussion as Draghi was again placed in the position of restoring credibility through change. Furthermore, the institutional environment - that of scepticism to integration - would have been fully entrenched upon Draghi's arrival. This is in marked contrast to Trichet at the Bank of France who had begun in 1993 with a weak institution dependent first on *Tresor* and later the Eurosystem (Howarth, 2009: 127). More than any other consideration, Draghi's career is marked by *institutional diversity*. Within this diverse institutional mix, we find that he is responsible for initiating change in difficult circumstances, often requiring a complete reworking of previous policies in order to restore credibility. It goes without saying this was the situation he encountered upon becoming President of the European Central Bank.

6. Discussion and conclusion

The question of why Draghi acted differently than Trichet in some respects is the wrong question. Although it would appear that Draghi has an equal professional and ideological imperative to maintain price stability he nonetheless felt credibility could be gained through a change of course. Clearly, examining the empirical evidence, joining a new institution and initiating change runs throughout Draghi's career. The matter in question is why did Trichet not act more aggressively during the European crisis. Indeed, if Trichet was so committed to *construction européenne* and the process of building EMU, one would expect that it would fall to him to 'do whatever it takes' to save the Eurozone. The answer lies in the fact that Trichet was acting under two forces at all times. On the one hand, he was a dedicated civil servant pursuing Mitterrand's conception of a *construction européenne*; a vision he also shared. On the other, he learned his chosen vocation as a stability-oriented central banker who was profoundly shaped by his time before, during and after EMU negotiations. He was instrumental in creating the ECB, and likewise, his personality and personal conception of central banking is bound up with the institution.

Trichet is defined by institutional continuity with respect to ECB institution building. The institutional shift from the *Tresor* to the Bank of France is still within the sphere of public administration, but represents a calculated professional and personal change, with real consequences for his self-conception. It is a change from a civil servant to a central banker. Indeed, his time as a civil servant in France, and later as a central banker are nearly equal. For most of Trichet's time after Maastricht, these two professional identities were not in conflict: the 'perfect' European civil servant building Mitterrand's *construction européenne* and the independent Bundesbank central banker worked in concert or with little divergence in policy output. The European sovereign debt crisis, however, placed these two identities in opposition, and a hesitant, timid response is the outcome as the weight of maintaining credibility through stability came into real conflict with maintaining credibility in the system as a whole - the system he had built and that had likewise built him.

He could not allow either *construction européenne* to be dismantled, but nor could he permit - and maintain his own credibility and what he believed was essential for institutional credibility - any changes that could be deemed overly unorthodox. Trichet, therefore, moved conservatively: policy-making just sufficient to preserve EMU but incapable of resolving the crisis, constrained as he was by the institutional rules and legacy which he formed part and parcel.

While we have focused on the differences in personality between Trichet and Draghi as explanatory factors, we can of course not be absolutely confident that these are the only factors at work. A perfectly reasonable critique of the argument would be that the intensity of the European Sovereign Debt Crisis substantially worsened as Draghi took over the central bank. Undoubtedly, the time

frame plays an important role in any analysis, however it is difficult to analytically assess its impact or control for its effects. We also did not control for the impact of possible exogenous factors shaping the decision making of both personalities as the crisis progressed. Comparing other central banks that have undergone similar changes in leadership during periods of crisis would contribute to resolving this analytical inconsistency. Alternatively, as the ECB is still a young institution, observing its evolution may help to reveal further the underlying dynamics of central banking behaviour and future accidents of personality.

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