Using minimum reserves and taxes on banks to tame the redistributive effect of ECB's interest rate hikes: a legal assessment

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Abstract

To fight off the inflationary wave that followed the Covid pandemic, the European Central Bank (ECB) has gradually increased the interests earned by banks on their excess liquidity. These interest rate hikes have resulted in temporary but consequential financial transfers from the public to the private sector. While commercial banks have, for a time, enjoyed high returns on their excess liquidity, central banks within the Eurosystem have made unprecedented losses that Member States' budgets must ultimately bear. This episode raises a question of institutional choice. Should the ECB, as some economists have argued, proactively mitigate these financial transfers by increasing the ratio of the unremunerated minimum reserves that commercial banks must maintain? Or should Member States—or possibly the EU institutions—intervene ex post and correct those transfers through taxation or regulatory interventions? To tackle these questions, this article investigates the extent to which the ECB's mandate and the principles governing the conduct of monetary policy both constrain and enable interventions by the ECB or the Member States to prevent or correct the redistributive effect of interest rate hikes.

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Keywords: European Central Bank, Monetary policy, Inflation. Excess liquidity, Minimum Reserves, Bank Taxes, Bank windfall

A. Introduction

In the aftermath of the Global Financial Crisis, the European Central Bank (ECB) increasingly relied on non-standard measures to conduct its monetary policy. With the post-pandemic inflationary shock that erupted in 2022, interest rates made a comeback as the central instrument of monetary policy. To absorb excess liquidity and tighten the money supply, between July 2022 and September 2023, the ECB Governing Council gradually increased its interest rates up to four percentage points.[1] This shift in monetary policy has come with a temporary side-effect: sizable transfers from the public to the private sector. Commercial banks have enjoyed high returns on their excess liquidity, increasing their profitability. At the same time, the Eurosystem's central banks have made record losses that ultimately fall on the Member States, as the Eurosystem's primary shareholders. While this side-effect is transient, it is very consequential. According to some estimates, they reached around EUR 140 billion in 2023, approximating the total yearly spending of the EU.[2]

In September 2023, to mitigate this side-effect marginally, the ECB stopped remunerating the minimum reserves that commercial banks must keep on accounts with the Eurosystem's central banks. *De Grauwe* and *Ji* have argued that the ECB should have gone further by increasing the ratio of unremunerated minimum reserves.[3] Between Autumn 2023 and the first half of 2024, there was a window of opportunity for such a move, which the ECB did not use. Member States, for their part, adopted or are considering adopting various measures to tax or limit commercial banks' windfall. This article investigates the extent to which the ECB's mandate and the principles governing its conduct enable and constrain these interventions by the ECB or the Member States to prevent or correct the redistributive effect generated by interest rate hikes. Section B highlights the origins of this redistributive effect. Section C discusses and assesses *De Grauwe* and *Ji*'s proposal to use the minimum reserve requirement more actively. This article argues that their proposal would have entailed a significant deviation from the principle of an open market economy, which is difficult to justify under the ECB's mandate. It would also have required making difficult trade-offs that would have carried significant reputational risks for the ECB at a time when its ability to tame inflation was being tested in

1 In July 2022, the ECB Governing Council increased the interest rate from the Deposit Facility from -0,5 to 0%. Over the following year, the rate was gradually increased, reaching 4% in September 2023. For the last decision of the ECB Governing Council that increased the interest rate, see *ECB*, Press Release – Monetary Policy Decisions – 14 September 2023, available at: https://www.ecb.europa.eu/press/pr/date/2023/html/ecb.mp230914~aab39f8c21.en.html (9/3/2025).

2 *De Grauwe/Ji*, Journal of International Money and Finance 2024/143, pp. 2 et seq.

3 *Ibid.*

an unprecedented manner. Perhaps, more crucially, raising the minimum reserve ratio beyond 2% would have unlawfully interfered with EU-wide prudential rules. Section D considers the tax and regulatory measures that Member States adopted or are considering adopting to correct the financial transfers produced by ECB's monetary policy.

B. The redistributive effect of ECB interest rate hikes: context

To implement its monetary policy, the ECB relies on an operational framework composed of two types of tools: (1) market-based instruments, which include the two Eurosystem standing facilities and open market operations (Art. 18 Statute of the European System of Central Banks and of the European Central Bank [Statute of the ESCB/ECB]) and (2) a regulatory instrument, the minimum reserve requirement (Art. 19 Statute of the ESCB/ECB).

The open-market and credit operations are the ECB's central tools of monetary policy implementation. They steer short-term money market rates in line with the ECB's monetary stance, guiding price developments in the broader economy. These market operations are conducted in a decentralized fashion by National Central Banks (NCBs) of the Eurosystem, based on guidelines issued by the ECB.[4] The minimum reserve requirement, for its part, is an instrument of liquidity control used by the ECB to complement open-market and credit operations.[5]

In accordance with Art. 19 of the Statute of the ESCB/ECB, the Council, by regulation, grants the ECB the power to require commercial banks to hold a minimum reserve of liquidity on account with Eurosystem central banks. The Council Regulation defines the scope of the ECB's regulatory power, including the basis for minimum reserves, their maximum permissible ratio, and the appropriate sanctions for non-compliance.[6] Within the room of maneuver granted by the Council, the ECB, by regulations, primarily determines two key features of the minimum reserve requirement: the level of remuneration and the reserve ratio, which is defined as a percentage of short-term deposits and securities on commercial banks' balance sheets.[7]

Before the Global Financial Crisis, in a financial system characterized by scarce liquidity, the ECB's operational framework followed a corridor system based on three policy rates. The two policy rates of the Eurosystem standing facilities – the Marginal Lending Facility and the Deposit Facility – defined the upper and

4 Guidelines (EU) No. 2015/510 of the European Central Bank, OJ L 91 of 2/4/2015, p. 3.
5 Art. 19 Statute of the ESCB/ECB; Regulation (EU) No. 2021/378 on the application of minimum reserve requirements, OJ L 73 of 3/3/2021, p. 1.
6 Council Regulation (EC) No. 2531/98 concerning the application of minimum reserves by the European Central Bank, OJ L 318 of 27/11/1998, p. 1.
7 Art. 4, Regulation (EC) No. 2818/98 of the European Central Bank on the application of minimum reserves, OJ L 356 of 30/12/98, p. 1. See then, subsequently, Art. 4, Regulation (EC) No. 1745/2003 of the European Central Bank on the application of minimum reserves OJ L 250 of 2/10/2003, p. 10.

lower bounds within which short-term money market rates fluctuated. The Deposit Facility's function is to absorb commercial banks' excess cash. Banks can access this facility at their discretion to deposit overnight their end-of-day surplus liquidity.[8] These deposits are remunerated at the deposit facility rate, which set the floor for the corridor within which money market rates fluctuated. Conversely, the Marginal Lending Facility's function is to lend cash to banks in liquidity shortage at a higher penalty rate, the marginal lending facility rate, which acted as the ceiling of the corridor system.[9] The ECB then used main refinancing operations to steer money market rates within the corridor set by the two standing facilities. Through those refinancing operations, the ECB periodically supplied liquidity to banks against collaterals based on a predefined estimate of their cash shortage. The interest rate on the main refinancing operations was set between the floor and the ceiling rates of the standing facilities and signaled the ECB's monetary policy stance.

Within this operational framework, the minimum reserve requirement fulfilled two supporting functions that enhanced the effectiveness of market-based instruments.[10] First, minimum reserves must be kept on average over a monthly maintenance period. Commercial banks can temporarily withdraw or add funds to their accounts held with NCBs in reaction to short-term changes in the money market. This helps smooth out the money market rate around the rate of the main refinancing operations. Second, minimum reserves created a structural liquidity shortage, enabling the ECB to more accurately predict how much liquidity to supply to commercial banks via its main refinancing operations. This allowed the ECB to retain greater control over money market rates through its periodic refinancing operations. In that framework, the ECB had set the minimum reserve ratio at 2% of commercial banks' short-term liabilities. To align it with money market conditions, the remuneration of banks' minimum reserves was set at the same level as its main refinancing operations.[11]

The ECB responded to the Global Financial Crisis and the resulting collapse of the money market activity by easing commercial banks' access to liquidity. Interest rates were lowered, and from June 2014 onwards, the deposit facility rate was negative, meaning that commercial banks had to pay the Eurosystem to deposit their excess liquidity. In addition, the Eurosystem turned to quantitative easing (QE) to ease financial conditions further and counter disinflation risks. With QE, the Eurosystem expanded its balance sheet by buying large amount of financial assets from market participants, including commercial banks, which became the holders of substantial excess liquidity. By 2014, as liquidity became increasingly abundant, the

8 Guidelines (EU) No. 2015/510 of the European Central Bank on the implementation of the Eurosystem monetary policy framework, OJ L 91 of 2/4/2015, p. 3.

9 *Ibid.*

10 *ECB*, The Single Monetary Policy in Stage Three – General Documentation on ESCB monetary policy instruments and procedures, available at: https://www.ecb.europa.eu/pub/pdf/other/gendoc98en.pdf?ce78c77a8dfd9f57408f0e3f628edefb (18/2/2025), p. 52.

11 Regulation (EC) No. 2818/98 of the European Central Bank on the application of minimum reserves, OJ L 356 of 30/12/98, p. 1.

money market rate gradually stabilized around the deposit facility rate, effectively transforming the ECB's corridor system into a de facto floor system.

Once inflation surged in 2022, the ECB raised interest rates, primarily using the deposit facility rate to signal its monetary policy stance. Between July 2020 and September 2023, the deposit facility rate was steadily increased from 0% to 4%. This move has resulted in significant financial transfers from the public to the private sector. Commercial banks have benefited from high remuneration on their abundant excess liquidity. As their net interest income has surged, banks have grown in profitability, likely leading to higher payouts to banks' equity shareholders.[12]

Meanwhile, the Eurosystem's central banks are facing significant losses. Through QE, the Eurosystem had bought low-yield financial assets while financing these purchases through short-term deposits of commercial banks' excess liquidity, which were then remunerated at negative rates. This strategy initially generated profits but carried substantial interest rate risks. In 2022, these risks started materializing. With interest rates rising, the Eurosystem had to pay commercial banks high interest for their excess liquidity while earning much less from the low-yield assets on their balance sheet. The resulting losses have been considerable. In 2024, the German and Belgian NCBs reported a loss of EUR 19.8 billion and 3.7 billion respectively.[13] The ECB itself reported a loss of EUR 7.9 billion.[14] Since Member States are the primary shareholders of the Eurosystem's central banks, they will have to bear the fiscal costs of these losses, mainly through reduced profit distributions, and if necessary, through a recapitalization, should an NCB fall into deep negative equity.

However, the redistributive effect of the ECB interest rate hikes is transitory. The surge in commercial banks' profitability is not lasting.[15] Banks recorded higher profits primarily because they were slow to raise the interest rates paid to their customers on their deposits while benefiting from higher interest earnings on the loans they supply. At the same time, the Eurosystem will return to profitability as quantitative tightening gradually reduces the size of its balance sheet. As the inflationary wave is fading, the ECB Governing Council has begun lowering interest rates. The ongoing decline of the deposit facility rate reduces the remunerations earned by banks on their excess liquidity.

12 *Couaillier* et al., ECB Economic Bulletin 2023/6, p. 88 (noting that the surge in net interest income earned by banks is likely to have contributed to higher payout to banks' equity shareholders).

13 *Bundesbank*, Annual accounts for 2024, available at: https://www.bundesbank.de/en/press/speeches/annual-accounts-for-2024-951884 (9/3/2025); *Banque national de Belgique*, Communiqué au marché de la Banque nationale de Belgique, available at: https://www.nbb.be/doc/ts/enterprise/press/2025/cp20250116_fr.pdf (9/3/2025).

14 *ECB*, Financial statements of the ECB for 2024, available at: https://www.ecb.europa.eu/press/pr/date/2025/html/ecb.pr250220~eca25e4e21.en.html (9/3/2025).

15 *Chen* et al., IMF Working Paper 2024/142, pp. 1 et seq.

C. Minimum reserves requirement as cost-saving device? Potential and constraints

In the Eurosystem's current floor system, the role of minimum reserves as money market stabilizer has diminished, as it is now the deposit facility rate that primarily defines the ECB's monetary stance.[16] In reaction to this evolution, the ECB has made only modest adjustments to the features of minimum reserves. Amid the Global Financial Crisis, the ECB decreased the reserve ratio from 2% to 1% to enhance liquidity provision to commercial banks, maintaining this level ever since.[17] In 2022, as the excess liquidity caused the money market to align more closely with the deposit facility rate, the ECB adjusted the remuneration of the minimum reserves, lowering it from the main refinancing rate to the deposit facility rate to align it with market conditions.[18]

In July 2023, the ECB Governing Council took the unprecedented step of stopping remunerating the minimum reserves.[19] This decision was deemed "a proportional response to some of the side effects that were arising from the rapid monetary policy tightening in an environment of high excess liquidity".[20] According to estimates, this measure saved the Eurosystem approximately EUR 6,6 billion.

De Grauwe and *Ji* contend that the ECB should have turned the minimum reserve requirement into an active monetary policy tool to counteract the redistributive effect of interest rate hikes. They pleaded for an expansion of the minimum reserve ratio to 10% – the limit set out in the Council Regulation – which, according to their estimates, would have reduced transfers to banks by roughly EUR 60 billion.[21] In their view, the ECB could have extended the cost-saving function of the minimum reserve requirement without altering the core feature of its operating procedure, as it could still rely on the deposit facility rate to signal its monetary policy stance. This proposal sparked speculation as to whether the ECB would follow this

16 On this point, see *Ceccacci* et al., Banca d'Italia-Mercati, infrastrutture, sistemi di pagamento 2024/46, pp. 7 et seq.

17 Regulation (EU) No. 1358/2011 of the European Central Bank, OJ L 338 of 21/12/2011, p. 51.

18 Regulation (EU) No. 2022/2419 of the European Central Bank, OJ L 317 of 12/12/2022, p.7.

19 Regulation (EU) No. 2023/1679 of the European Central Bank, OJ L 216 of 1/9/2023, p. 96.

20 *ECB*, Meeting of 26-27 July 2023: Account of the monetary policy meeting of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday and Thursday, 26-27 July 2023, available at: https://www.ecb.europa.eu/press/accounts/2023/html/ecb.mg230831~b04764f45f.en.html (5/1/2025).

21 *De Grauwe/Ji,* Journal of International Money and Finance 2024/143, pp. 2 et seq.; *De Grauwe/Ji*, The role of central bank reserves in monetary policy: Bundesbank Invited Speakers Series, available at: https://www.bundesbank.de/en/service/dates/the-role-of-central-bank-reserves-in-monetary-policy-913968 (5/1/2025); *De Grauwe/Ji*, Central banks can fight inflation without massive handouts to banks, available at: https://www.omfif.org/2023/09/central-banks-can-fight-inflation-without-massive-handouts-to-banks/ (9/3/2025).

approach, leading to concerns in the banking community.[22] While some members of the ECB Governing Council expressed openness to the idea, others voiced their opposition.[23] Meanwhile, discussions over *De Grauwe* and *Ji*'s proposal extended beyond the ECB, fueling discussions in the Monetary Dialogue, parliamentary questions by MEPs, and debate with NCB governors within national parliaments.[24]

Legally, the ECB enjoys broad discretion when conducting its policy. But, as discussed below, the ECB may only marginally account for the redistributive effect of its policy. Legal constraints remain as to what the ECB can do. The losses incurred by the Eurosystem and the interest income earned by commercial banks are the result of a market-based monetary policy. Increasing unremunerated minimum reserves, as suggested by de *De Grauwe* and *Ji*, by contrast, entails a significant deviation from the principle of an open market economy – one that is difficult to justify under the ECB's mandate.

I. Cost-efficiency in ECB monetary policy

At the press conference following the ECB's decision to stop remunerating minimum reserves, President *Christine Lagarde* justified the move by stating that the Governing Council has a public duty to make its monetary policy as efficient as possible.[25] This statement is hardly surprising; cost-efficiency has been a guiding principle of monetary policy design since the start of EMU.

Ahead of Stage Three of EMU, the European Monetary Institute (EMI) – the ECB predecessor – identified cost-efficiency as one of the key principles deriving from the provisions of the Treaties and the Statute of the ESCB/ECB, which should guide the design of the ECB's operational framework.[26] According to the EMI, "the

22 *Kosonen*, Increase in minimum reserves would hit bank liquidity at crucial moment, available at: https://www.omfif.org/2023/09/central-banks-can-fight-inflation-without-massive-handouts-to-banks/ (5/1/2025).

23 See *Canepa/Koranyi*, ECB to tackle excess liquidity in next stage of inflation fight -sources, available at: https://www.reuters.com/markets/europe/ecb-tackle-excess-liquidity-next-stage-inflation-fight-sources-2023-09-18/ (5/1/2025); *Koranyi*, No strong case for jacking up bank charges: ECB's Wunsch, available at: https://www.reuters.com/markets/rates-bonds/no-strong-case-jacking-up-bank-charges-ecbs-wunsch-2023-09-21/ (5/1/2025).

24 E.g., *Committee on Economic and Monetary Affairs*, Monetary Dialogue with Christine Lagarde, President of the European Central Bank (pursuant to Art. 284(3) TFEU), available at: https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230605_annex_2~5c31f6fb6a.en.pdf; see also, for example, the discussions in the Belgian Parliament, Rapport annuel 2022 de la Banque Nationale de Belgique (BNB), available at: https://www.lachambre.be/FLWB/PDF/55/3410/55K3410001.pdf (18/2/2025), p. 23.

25 *ECB*, Monetary Policy Statement, Frankfurt am Main, 27 July 2023, available at: https://www.bde.es/f/webbe/GAP/Secciones/SalaPrensa/ComunicadosBCE/DecisionesPoliticaMonetaria/23/2023-07-27-MonetaryPolicyStatement.en.pdf (18/2/2025).

26 *European Monetary Institute*, Progress towards Convergence, available at: https://www.ecb.europa.eu/pub/pdf/othemi/emiprogresstowardsconvergence199511en.pdf (18/2/2025), pp. 72–73; *ECB*, "Annual Report 1995, April 1996", available at: https://www.ecb.europa.eu/pub/pdf/annrep/ar1996en.pdf (18/2/2025), p. 52.

decision on the operational framework has to take into account budgetary considerations, of both the ESCB and its counterparties”.[27] The operational framework adopted in March 2024 reaffirmed cost efficiency as a guiding criterion and clarified its legal foundations: the principle of proportionality and the principle of central bank independence.

Under this reading, the principle of proportionality (Art. 5 para. 2 TFEU) requires the ECB, when choosing between monetary policy options equally effective to achieve price stability, to select the one that minimizes financial burdens for itself and for its counterparties. Art. 130 TFEU, which protects the financial independence of NCBs and the ECB, also provides normative guidance for the design of monetary policy. The financial independence of a central bank may be defined as the probability that it will have to request additional capital injection from the state to be able to carry out its monetary policy functions. If the probability is remote, the central bank does not depend on the government’s consent for additional funding and may carry out its monetary missions autonomously.[28] Monetary policy should be cost-effective to minimize losses, thereby sustaining the central bank’s financial independence by reducing the risk of political pressures.

II. The ECB’s price stability mandate as a constraint

Cost-effectiveness, however, is not a central consideration in the design of monetary policy – and rightly so. As the accounts of ECB Governing Council meetings reveal and as *Lagarde* has acknowledged, the side effects of the ECB’s monetary policy on banks’ profits and Eurosystem’s losses are secondary to the fight against inflation.[29] A central bank is not a for-profit undertaking, but a public institution with the primary objective to maintain price stability (Art. 127 para. 1 TFEU). The ECB has a duty to make its policy as cost-effective as possible, but only within the parameters of its mandate.

As the Court of Justice of the EU recognized in *Gauweiler* and *Weiss*, given its mission’s technical and complex nature, the ECB enjoys a broad discretion in assessing the suitability and proportionality of its action, but remains bound to provide adequate reasons for its decisions.[30] In the 2022 inflationary wave context, justifying a significant increase in unremunerated reserves would have been challenging. For three reasons, this measure may undermine the ECB’s ability to steer price developments. It may weaken the transmission of monetary policy (1), impede

27 *Ibid.*

28 See, e.g., *Nordström/Vredin*, Staff Memo 2022, p. 14; *Wessels/Broeders*, in: De Nederlandsche Bank (ed.), pp. 20 et seq.

29 See, e.g., *Christine Lagarde*, Monetary Dialogue – 5/6/2023, available at: https://multimedia.europarl.europa.eu/de/video/monetary-dialogue-with-christine-lagarde-president-of-the-european-central-bank-questions-answers-part-2_I242081 (9/3/2025).

30 ECJ Case C-62/14, *Gauweiler and others v. Deutscher Bundestag*, judgment of 16 June 2015, ECLI:EU:C:2015:400, paras. 68–69; ECJ, Case C-493/17, *Weiss and others*, judgment of 11 December 2018, ECLI:EU:C:2018:1000, paras. 30–32.

the effectiveness of future monetary policy (2) and affect the credibility of its action as a monetary authority (3).

First, banks serve as financial intermediaries in the transmission of ECB monetary policy. They act as a "pass-through", adjusting the interest rates on deposits and loans to the ECB policy rates. The effectiveness of this transmission mechanism is crucial for the ECB's ability to affect price developments. The Court held in *Gauweiler*, that safeguarding this mechanism is part of the ECB price stability mandate (Art. 127 para. 1 TFEU).[31] Yet, depending on how commercial banks react, increasing unremunerated minimum reserves may impede monetary policy transmission.

De Grauwe and *Ji* contend that during the peak inflation in 2022-2023, the high remuneration of excess liquidity set by the ECB incentivized banks to increase lending to firms and households, contradicting its monetary tightening efforts. In their view, raising unremunerated reserves would have curtailed this incentive and reinforced the contractionary effect of high policy rates.[32] But this assumption is debatable. To preserve profitability, banks might have responded by lowering the interest rates they offer on deposits – weakening the ECB's efforts to curb inflation by discouraging saving.[33] Alternatively, banks could have sought to evade the higher minimum reserve requirement, for example, by offering higher earning deposits through their English subsidiaries.[34] Such disintermediation would have weakened the monetary transmission mechanism, ultimately undermining the ECB's ability to curb inflation.

Second, according to some economists, increasing unremunerated reserves may pose risks to the effectiveness of the ECB's future monetary policy.[35] During the period of ECB balance sheet expansion, banks sold some of their assets to the Eurosystem in exchange for liquidity, under the assumption that they could always deposit this liquidity with the ECB's Deposit Facility and earn interests. Banks may perceive high unremunerated reserves as an unexpected policy shift that affects their risk calculations. If the ECB were to rely on QE again, banks would increase their liquidity buffers to factor in this risk when they sell their assets to the Eurosystem. This, in turn, could reduce the effectiveness of QE in easing financing conditions.

Third, another critical factor is the credibility of monetary policy. A central bank's credibility hinges on its ability to manage markets' inflationary expectations, which in turn influence actual inflation.[36] If the markets believe that a central bank cannot tame inflationary trends, prices will tend to rise in anticipation of future inflation, making the job of maintaining price stability harder. Credibility is primar-

31 ECJ, Case C-62/14, *Gauweiler and others v. Deutscher Bundestag*, judgment of 16 June 2015, ECLI:EU:C:2015:400, paras. 49–50.

32 *De Grauwe/Ji*, Journal of International Money and Finance 2024/143, pp. 12 et seq.

33 *McCauley/Pinter*, Unremunerated reserves in the Eurosystem, part 2: Tax incidence and deposit relocation risks, available at: https://cepr.org/voxeu/columns/unremunerated-reserves-eurosystem-part-2-tax-incidence-and-deposit-relocation-risks (5/1/2025).

34 *Ibid.*

35 *Ibid.*

36 *Mackiewicz-Lyziak*, Acta Oeconomica 2016/1, pp. 125 et seq.

ily built by a central bank through a track record of consistent and effective action to attain its inflation target.[37] In this regard, the 2022 inflationary shock, given its unexpected magnitude, represents a major test of public trust in the ECB's ability as an inflation-fighting institution – one that could have long-lasting effects on its credibility.[38]

At the onset of the inflationary surge, the ECB's credibility had already been somewhat undermined by its delayed response in raising policy rates. Like many other central banks, the ECB failed to consider the severity of the inflation to come.[39] This initial slow reaction made the ECB's subsequent action, as well as its consistency and its communication around it, even more critical to preserve markets' trust. The July 2023 decision to stop remunerating minimum reserves sparked debates within the ECB Governing Council, seemingly due to concerns about its impact on the ECB's credibility. This may help explain why the Governing Council refrained from increasing unremunerated reserves in the following months.

Increasing unremunerated reserves may have affected the ECB's credibility for three interrelated reasons. First, in March 2023, to enhance the predictability of its actions, the Governing Council decided to make public the three elements of its monetary reaction function – the factors guiding its monetary policy decisions to ensure a return to its target inflation rate.[40] These factors were the inflation outlook, the dynamics of underlying inflation and the strength of the monetary policy transmissions. Repeated adjustments to monetary policy driven by cost-efficiency concerns that are unrelated to these factors could signal inconsistency in the ECB's actions. This may suggest a growing preoccupation for the state of the Eurosystem's profits and losses, potentially distracting the ECB from its price stability mission. In other words, market participants might believe that the ECB uses its monetary policy operations to limit its losses rather than to combat inflation. Transparent and effective communication from the ECB on its policies may not entirely address these markets' concerns.

Second, markets' perception of the Eurosystem's financial independence may be affected. In principle, a cost-effective monetary policy strengthens a central bank's financial autonomy. But adjusting monetary policy to reduce losses – especially when some of those losses have already materialized – could suggest that the poor state of the Eurosystem's finances limit the ECB's room of maneuver. This could undermine the appearance of the ECB's independence in the eyes of market participants.

Finally, adjustments to the ECB monetary tools for cost-efficiency reasons may give the impression that the Euro area monetary system is entering an era of fiscal

37 *Blinder*, The American Economic Review 2000/90, pp. 1421 et seq.

38 On the inflation shock of 2021-22 as a test for the ECB's credibility and the public trust in the money it issues, see *Tuori*, Maastricht Journal of European and Comparative Law 2023/4, pp. 491 et seq.

39 *Ibid.*

40 *ECB*, Monetary policy decisions, Press Release, available at: https://www.ecb.europa.eu/press/pr/date/2023/html/ecb.mp230316~aad5249f30.en.html (18/2/2025).

dominance, a perception that ECB's representatives have sought to dispel in their communication.[41] Losses of the Eurosystem's central banks result in reduced profits distributions to Member States, which, in turn, strain their budget. Measures that mitigate the impact of monetary policy on national treasuries could reinforce the idea that fiscal concerns constrain Eurosystem's actions or that the budgetary deficits and debt levels of Member States partly drive the ECB's policy.

III. The principle of an open market economy as a constraint

In advocating for an increased use of minimum reserves, *De Grauwe* and *Ji* point to the historical practice of central banks.[42] In the 1970s and 1980s, many central banks in the Western world used minimum reserves requirements extensively to combat inflation, and few remunerated those reserves. However, by the late 1980s, the prevailing norm in central banking practice shifted. Transactional instruments became the primary tools for achieving price stability. Art. 127 para. 1 TFEU, which mandates the ECB to act in line with the principle of an open market economy, has partially entrenched this market-based approach in primary law. A return to greater reliance on regulatory instruments, in deviation from this provision, would require solid justifications from the ECB.

The Statute of the ESCB/ECB distinguishes between the remuneration of bank excess liquidity via the Deposit Facility, on one hand, and the requirement for commercial banks to hold minimum reserves. The Deposit Facility is part of the regular ECB's market-based instruments (Art. 18 Statute of the ESCB/ECB). Commercial banks may access at will to make overnight deposits, under terms they accept. The minimum reserve requirement, however, stands out among the ECB monetary policy instruments because it is regulatory in nature. Through this device, the ECB exerts coercive powers over commercial banks. While the Statute of the ESCB/ECB grants significant leeway to the ECB in using market-based instruments, its authority to impose minimum reserve is further constrained by secondary law.

The Treaty framers felt that more forceful interventions in the operation of the markets by regulations that may impose obligations on third parties require further

41 See, e.g., *ECB*, Is monetary policy dominated by fiscal policy? – Speech by Isabel Schnabel, Member of the Executive Board of the ECB, at a conference organised by Stiftung Geld und Währung on 25 years of the euro – Perspectives for monetary and fiscal policy in an unstable world, at a panel on "Inflation and public budget. Is monetary policy dominated by fiscal policy?", available at: https://www.ecb.europa.eu/press/key/date/2024/html/ecb.sp240607~c6ae070dc0.en.html (5/1/2025).

42 *De Grauwe/Ji*, The extraordinary generosity of central banks towards banks: Some reflections on its origin, available at: https://cepr.org/voxeu/columns/extraordinary-generosity-central-banks-towards-banks-some-reflexions-its-origin (9/3/2025).

backing from an EU institution with more solid democratic credentials.[43] For that reason, unlike market-oriented instruments, the Statute of the ESCB/ECB provides that it is for the Council to grant to the ECB the authority to introduce minimum reserves and to condition the exercise of that authority by defining the basis for minimum reserves, its maximum permissible ratio, and the applicable sanctions for non-compliance.[44] The Council Regulation adopted for that purpose grants broad discretion to the ECB. But Art. 19 para. 1 of the Statute of the ESCB/ECB further limits this discretion by requiring the ECB to follow the principle of an open market economy when defining the function and the features of the minimum reserve requirement.

Imposing high unremunerated minimum reserves on banks affects the operation of market forces, although the economic characterization of this impact remains debated. Most view unremunerated reserves as a hidden tax on banks' deposits.[45] *De Grauwe* and *Ji*, however, reject this traditional view. They argue that the regular operation of the market involves a trade-off between liquidity and profitability. Liquid assets tend to generate lower returns, while more profitable assets are generally less liquid.[46] From this perspective, a high remuneration of excess liquidity resulting from the ECB interest rate hikes would defy market logic. Regardless, imposing high unremunerated reserves generates opportunity costs for commercial banks, as it prevents them from allocating liquidity to more productive uses. In this way, it necessarily interferes with normal market dynamics.

The Court of Justice of the EU has never clarified the legal content of the principle of an open market economy. What is clear, however, is that this principle is not absolute and may be subject to justified deviations.[47] Despite the absence of judicial guidance, some core normative implications can be drawn from that principle.[48] First, it establishes a hierarchy among the ECB's monetary policy instruments: the ECB should prioritize a market-based approach before resorting to a regulatory tool like the minimum reserve requirement. The preparatory discussions that led to Stage Three of EMU make clear that minimum reserves should be a subsidiary

43 *Committee of Governors of the Central Banks of the Member States of the European Economic Community*, Draft Statute of the European System of Central Banks and of the European Central Bank, available at: https://www.ecb.europa.eu/ecb/access_to_documents/document/cog_pubaccess/shared/data/ecb.dr.parcg2019_0109draftstatutecommentary19910412.en.pdf (5/1/2025), p. 11 ("This instrument does not rely on the voluntary response of willing counterparties, but imposes an obligation on market participants. The conditions and terms under which minimum reserves can be applied will have to be established by the Council").

44 Council Regulation (EC) No. 2531/98 concerning the application of minimum reserves by the European Central Bank, OJ L 318 of 27/11/1998, p. 1.

45 See, e.g., *Hardy,* IMF Working Paper 1997/35, pp. 41–93.

46 *De Grauwe/Ji*, The extraordinary generosity of central banks towards banks: Some reflections on its origin, available at: https://cepr.org/voxeu/columns/extraordinary-generosity-central-banks-towards-banks-some-reflexions-its-origin (9/3/2025).

47 See, e.g., *Dietz*, Common Mkt. L. Rev. 2022/2, p. 405; *Weismann*, Eur. L. Rev. 2024/5, p. 555.

48 *Solana/Goldoni*, European Law Open 2024/1, p. 31.

instrument. The ECB should first consider "the extent to which these functions [of minimum reserves] can be fulfilled by alternative instruments".[49] In its practice, the ECB has adhered to this view, relying primarily on standing facilities and open market operations to steer the money market rate while using the minimum reserve requirement only as an accompanying measure. Second, the principle of an open market economy should be accounted for in the level of minimum reserves and their remuneration. Unless convincingly justified, minimum reserves should be remunerated at an interest rate that reflects market conditions.[50]

IV. Minimum reserves, prudential rules, and the ECB "financial stability" mandate

The minimum reserve requirement regulates the liquidity that commercial banks must keep. As such, it is partly a hybrid tool. Besides the monetary policy function it officially fulfills, it may also have an effect equivalent to that of prudential rules. Before 2011, there was no extensive liquidity regulation at the EU level. At that time, minimum reserves have, unofficially at least, filled part of that regulatory void.[51] But the rise of extensive prudential regulation has since then rendered that role obsolete.[52]

De Grauwe and *Ji* plead for reawakening the macroprudential function of minimum reserves. In their view, higher minimum reserves would address long-term financial stability concerns, in addition to saving costs.[53] There are flaws, they argue, in the rules on banks' liquidity agreed by the Union co-legislators as part of the EU Single Rulebook. The liquidity requirements that commercial banks must fulfil rely on a definition of liquid assets that *De Grauwe* and *Ji* view as too loose.[54] In crisis times, the value of assets classified as "highly liquid" may plummet, leaving troubled commercial banks unable to meet liquidity demands. Minimum reserves, for their part, do not count towards banks' liquidity requirements. They do not

49 *European Monetary Institute*, Annual Report 1995, April 1996, available at: https://www.ecb.europa.eu/pub/pdf/annrep/ar1996en.pdf (18/2/2025), p. 54.
50 *Smits*, p. 275; *Reinesch* et al., p. 281.
51 This seems to be the thinking of the ECB Governing Council. See *ECB*, Account of the monetary policy meeting of the Governing Council, Frankfurt am Main, 26-27 July 2023, available at: https://www.ecb.europa.eu/press/accounts/2023/html/ecb.mg230831~b04764f45f.en.html (10/3/2025) ("[...] it was mentioned that the very rationale for minimum reserve requirements was now less clear, in view of the prudential liquidity regulations for banks that had been introduced in response to the global financial crisis").
52 On the macroprudential function historically fulfilled by minimum reserves requirements, see *Gray*, IMF Working Paper 2011/36, pp. 1 et seq.
53 *De Grauwe/Ji*, The extraordinary generosity of central banks towards banks: Some reflections on its origin, available at: https://cepr.org/voxeu/columns/extraordinary-generosity-central-banks-towards-banks-some-reflexions-its-origin (5/1/2025).
54 For the definition of liquid assets under EU prudential rules, see Art. 416, Regulation (EU) No. 575/2013, OJ L 176 of 27/6/2013, p. 1.

qualify as "highly liquid assets" because banks cannot withdraw them at will.[55] For *De Grauwe* and *Ji*, the ECB should increase the ratio of minimum reserves to tighten the liquidity control to which banks are subject beyond current regulatory requirements. If a financial crisis hits, the ECB could lower minimum reserves to free up additional liquidity. In other words, minimum reserves would be used to compensate for the weaknesses of the EU prudential rules and increase the financial system's resilience.

However, using a monetary tool for macroprudential reasons in this way would run afoul of the founding Treaties. Primary law restricts the types of financial stability-related measures the ECB may adopt as part of its monetary policy.[56] Pursuant to Art. 127 para. 5 TFEU, the ECB shall "contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system". The primary responsibility for financial stability thus lies with national and European regulators and supervisors. The merely contributory role assigned by the Treaties to the ECB does not allow it to turn itself into a complementary financial regulator. The minimum reserve requirement remains a monetary policy instrument, not a prudential tool. The primary price stability mandate of the ECB laid down in Art. 127 para. 1 TFEU also allows the adoption of measures related to financial stability, if they aim at safeguarding the proper functioning of the monetary policy transmission mechanism.[57] But this provision may not be used to expand the ECB's powers in relation to financial stability beyond the scope of the contributory competence conferred by Art. 127 para. 5 TFEU.[58] In any case, there would also be serious democratic objections to an independent monetary authority, like the ECB, using its monetary toolbox to partly supplant or correct prudential rules agreed by the EU co-legislators.

More generally, the advent of unified EU prudential rules and the establishment of the Banking Union have de facto limited the ECB's freedom to increase the ratio of minimum reserves. In theory, as explained above, the Council Regulation adopted in 1998 set the upper limit of the minimum reserve ratio at 10%.[59] The co-legislators devised the EU-wide liquidity requirements at the time when the ECB had set the minimum reserve ratio around the 1% or 2% mark. Any increase beyond this 2% threshold may arguably interfere with – or at least affect – the operation of pru-

55 See Art. 10 para. 1 lit. b sublit. iii of the Commission Delegated Regulation (EU) 2015/61, OJ L 11 of 17.1.2015, p. 1; *ECB*, Treatment of central bank reserves with regard to the Liquidity Coverage Requirement (LCR): Common understanding between the ECB and National Authorities, available at: https://www.bankingsupervision.europa.eu/press/letterstobanks/shared/pdf/2015/150930communication_LCR_treatment_of_central_bank_reserves_for_LSIs.en.pdf (12/2/2025).

56 *ECB*, Financial stability and the ECB: Speech by Yves Mersch, Member of the Executive Board of the ECB, ESCB Legal Conference, Frankfurt, 6 September 2018, available at: https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180906.en.html (12/2/2025).

57 *ECB*, The ECB's monetary policy strategy statement, available at: https://www.ecb.europa.eu/home/search/review/html/ecb.strategyreview_monpol_strategy_statement.en.html (12/2/2025).

58 *Ioannidis* et al., ECB Occasional Paper Series 2021/276, pp. 1 et seq.

59 Art. 4 para. 1, Council Regulation (EC) No. 2531/98, OJ L 318 of 27.11.1998, p. 1.

dential rules. The principle of institutional balance (Art. 13 para. 2 TEU) requires the ECB to act "with due regard for" the policies devised by other EU institutions.[60] In light of this, the ECB should calibrate its monetary policy to minimize interference with prudential regulation and supervision. It should thus consider other viable ways of achieving price stability before considering an increase of minimum reserves beyond the 2% threshold.

In addition, the Baking Union's legal framework has erected a so-called "Chinese wall" between the ECB's tasks of banking supervision and its mission as a monetary authority. Under the SSM Regulation, the ECB must conduct its supervisory function "without prejudice to and separately from its tasks relating to monetary policy".[61] Given the interplay between financial stability and price stability, one may argue that the separation between supervisory and monetary functions does not have to be read strictly.[62] Whilst this may be true, monetary policy decisions that actively meddle with prudential regulation and supervision would, in any case, be the source of conflicts of interests that the decoupling of monetary policy and financial supervision is, by design, meant to prevent.

D. A corrective role for Member States or EU Institutions?

Member States have adopted or consider adopting various ex post interventions to limit commercial banks' windfall. These corrective measures have been piecemeal and do not follow a concerted pan-European strategy. This may be due partly to the fact that the redistributive effect of the ECB's interest rate hikes has been unequal across the Euro area. On the hand, the fiscal costs of ECB's monetary policy are unevenly distributed across the Euro area. Overall, Northern European NCBs shoulder more sizeable losses than their Southern counterparts. The reason is that some of the bond purchase programmes launched by the ECB were not organized under a loss-sharing scheme: NCBs primarily bought sovereign bonds issued by their own government. In comparison with Southern European NCBs, the bond portfolios of Northern European NCBs have much lower yields, reflecting the higher creditworthiness of their government.[63] On the other hand, despite the advent of the euro and the establishment of the Banking Union, banking markets remain organized along national borders.[64] As a result, the rise in banks' profitability has varied from Member State to Member State, depending on the prevailing practices in the local banking market and its competitiveness. Generally, banks would enjoy higher

60 See, e.g., ECJ, Case C-73/14, *Council v. Commission*, judgment of 6 October 2015, ECLI:EU:C:2015:663, para. 61; Case C-425/13, *Commission v. Council*, judgment of 16 July 2015, ECLI:EU:C:2015:483, para. 69.

61 Art. 25 para. 2, Council Regulation (EU) No. 1024/2013, OJ L 287 of 29.10.2013, p. 63.

62 *Goldmann*, European Constitutional Law Review 2018/2, pp. 283 et seq.

63 For statistics on interest rates on government bonds issued by Member States, see the *ECB*, Interest rates' statistics for convergence purposes, available at: https://data.ecb.europa.eu/data/data-categories#interest-rate-statistics-convergence-purposes (9/3/2025).

64 See, e.g., *Enria*, VIEWS 2023, pp. 56 et seq.

profitability in national markets where loans supplied to households and companies have variable interest rates. In many jurisdictions, banking markets in the retail sector are oligopolistic, leaving banks under little competitive pressure to swiftly adjust the interests earned by depositors to ECB's interest rate hikes.

In that context, some Member States are considering regulatory measures to improve the competitiveness of the retail banking sector, such as easing the formalities for transferring deposits from one bank to another.[65] The EMU legal framework constrains, to an extent, their freedom of action in that respect. The regulation of deposit and savings accounts should not interfere with the transmission of the ECB monetary policy. Belgian lawmakers, for example, envisaged tying interest rates on deposits to the ECB's deposit facility rate.[66] Such a measure would short-circuit the channelling of ECB monetary impulses.[67] It could even make inroads into the domain of monetary policy because it potentially falls within the category of dirigiste measures of monetary control that the ECB could hypothetically take, with the assent of the Council, in case of monetary emergency (Art. 20 Statute of the ESCB/ECB).

What most Member States have turned to, however, is taxation. In 2023 and 2024, around half of them introduced additional levies on banks, with differing characteristics, in terms of base, rate and duration.[68] Taxing banks' excess profits after they have been realized comes with downsides and raises policy dilemmas. To capture those excess earnings, taxation may have to be retroactive. How much would a retroactive tax affect banks' risk calculations and business strategies? How can one devise a tax scheme that specifically targets this windfall? How can this tax produce significant budgetary resources without endangering financial stability? Member States have taken different approaches with varying degrees of success. For example, via tax measures, Latvia recouped more than the losses incurred by the public sector because of interest rate hikes. An increase in corporate income tax combined with the levy of an additional mortgage borrower protection fee raised EUR 210 million in revenues. At the same time, *Latvijas Banka* – the Latvian NCB – made EUR 54 million in losses.[69] By contrast, Italy imposed a 40% tax on banks' increased interest

65 See, e.g., in Belgium and the Netherlands: *Autorité belge de la Concurrence*, Communiqué de presse: L'Autorité belge de la Concurrence publie son avis relatif aux services bancaires de detail, available at: https://www.abc-bma.be/sites/default/files/content/download/files/20231110_ComPres_52_ABC.pdf (18/2/2025); *Autoriteit Consument & Markt*, ACM: spaarrentes blijven achter door te weinig concurrentie, available at: https://www.acm.nl/nl/publicaties/acm-spaarrentes-blijven-achter-door-te-weinig-concurrentie (18/2/2025).

66 Proposition de loi relative au rattachement du taux d'intérêt de base minimal des comptes d'épargne réglementé au taux de la facilité de dépôt de la BCE, Ch., 2022-2023, n°3405, p. 1.

67 *ECB*, Opinion of 28 June 2023 on tying the minimum base interest rate on regulated savings accounts to the deposit facility rate and introducing a protected interest rate on savings deposits, CON/2023/18.

68 For an overview, see *Maneely/Ratnovski*, IMF Working Paper 2024/143, pp. 1 et seq.

69 *Ibid*.; *Latvijas Banka*, On the performance of Latvijas Banka in 2023, available at: https://www.bank.lv/en/news-and-events/news-and-articles/news/16918-on-the-performance-of-latvijas-banka-in-2023 (5/1/2025).

margins but allowed banks to avoid the levy if they allocated their excess earnings to non-distributable reserves.[70] All Italian banks chose the latter option.[71] Ultimately, while the measure enhanced the financial resilience of Italian banks by compelling them to expand their capital buffers, it failed to generate additional revenues for the Italian budget.

Beyond policy considerations, the EMU framework arguably imposes some – albeit loose – constraints on how Member States may tax their banks. In the absence of harmonization, Member States retain their competence on taxation but they must exercise this power in a manner consistent with Union law, including the principle of sincere cooperation (Art. 4 para. 3 TEU).[72] As such, Member States should refrain from enacting taxation measures that may undermine price stability. As the ECB has noted, taxation should not erode the capital base of commercial banks in a way that hampers their ability to transmit the ECB's monetary policy impulses to the broader economy.[73]

However, there is no clear legal benchmark to determine when bank taxation would unlawfully undermine ECB's policies. This is because it is difficult to ascertain the precise effect that taxing banks' excess profits may have on monetary policy transmission. This effect depends not only on the legal design of the tax but also on economic factors, the business cycle and the overall state of the relevant banking market. Depending on the circumstances, taxing banks' excess profits may, at the margin, enhance the interest rate pass-through, as credit institutions might opt to raise their deposit rates more quickly to attract additional deposits rather than incur higher tax costs.[74] But, as the ECB has noted, with higher interest rates, banks may face declining profitability in the medium term because their lending volume may diminish and their portfolio of non-performing loans may increase. In that scenario, a tax on excess profits may prevent commercial banks from building up the required capital buffers to cover those additional risks, potentially undermining their capital base in the long run.[75]

In the absence of a clear substantive legal benchmark, Member States arguably still have a procedural obligation under the principle of sincere cooperation to conduct an adequate impact assessment that considers the effect of projected taxes

70 Art. 26, decreto legge 10 agosto 2023, n. 104, G.U. n. 186, 10/8/2023; Legge 9 ottobre 2023, n. 136, di conversione in legge, con modificazioni, del decreto legge 10 agosto 2023, n. 104, G.U. n. 236, 9/9/2023.

71 *Greco*, Il paradosso delle tassa sugli extraprofiti, available at: https://www.repubblica.it/economia/2024/02/13/news/tassa_extraprofitti_banche_guadagni-422118883 (9/3/2025).

72 See, e.g., ECJ, Case C-80/94, *G.H.E.J. Wielockx v. Inspecteur der Direct Belastingen*, judgment of 11 August 1995, ECLI:EU:C:1995:271, para. 16. See also ECJ, Case 208/80, *The RT Hon. Lord Bruce of Donington v. Eric Gordon Aspden*, judgment of 15 September 1981, ECLI:EU:C:1981:194, para. 14.

73 See, e.g., *ECB*, Opinion of 4 April 2023 on the imposition of a temporary solidarity contribution, CON/2023/9, p. 4.

74 See *Maneely/Ratnovski*, IMF Working Paper WP 2024/143, pp. 1 et seq.

75 See, e.g., *ECB*, Opinion of 4 April 2023 on the imposition of a temporary solidarity contribution, CON/2023/9, p. 4.

on the stability of their banking market and the functioning of the monetary transmission mechanism.[76]

Ultimately, only dialogue between economic policymakers and the ECB can resolve potential tensions between bank taxes and monetary policy. The Treaties provide for two communication channels that facilitate this dialogue. Representatives of the ECB – most often its President and an Executive Board member – participate in Eurogroup meetings and, in this context, may raise concerns with finance ministers regarding potential interferences between fiscal and monetary policies.[77]

Furthermore, according to the founding Treaties and Council Decision 98/415/EC, Member States must consult the ECB on national draft laws that apply to financial institutions insofar as they affect financial stability.[78] The ECB opinions on draft tax measures adopted on that basis are the central medium through which a dialogue between national authorities and the ECB takes place regarding the suitability and legality of national interventions designed to mitigate the redistributive effects of monetary policy.[79]

Another downside of this heterogeneous set of taxation schemes is that it further fragments the European banking market and carries risks of discrimination and double taxation.[80] Some of these tax schemes may even run afoul of internal market law.[81] An EU-wide tax on banks' excess profits could have been considered to avoid such fragmentation. In 2022, the Council, based on Art. 122 TFEU, agreed on an EU solidarity contribution to be levied on the excess profits earned by energy companies due to a surge in energy prices.[82] An EU tax on banks' excess profits could have been modeled after the EU solidarity contribution. However, such a measure would have faced significant political and legal obstacles. First, it is unclear whether Art. 122 TFEU is a suitable legal basis for enacting tax measures. The EU solidarity contribution is currently being challenged before EU courts for this reason.[83] Second, under this Treaty provision, the Council acts on its own, by qualified majority voting, and without involving the European Parliament. It is questionable whether a

76 The ECB has at times called upon Member States to conduct impact assessment when they consider adopting tax on banks. See *ECB*, Opinion of 2 November 2022 on the imposition of temporary levies on certain credit institutions, CON/2022/36.
77 Art. 1, Protocol No. 14 on the Euro Group.
78 Art. 127 para. 4 TFEU, Art. 282 para. 5 TFEU, Art. 2 para. 1, sixth indent of Council Decision 98/415/EC, OJ L 189 of 3/7/1998, p. 42.
79 See *ECB*, Opinion of 2 November 2022 on the imposition of temporary levies on certain credit institutions, CON/2022/36; Opinion of 4 April 2023 on the imposition of a temporary solidarity contribution, CON/2023/9; Opinion of 2 November 2023 on the imposition of a temporary tax on banks, CON/2023/35; Opinion of 12 September 2023 on the imposition of an extraordinary tax on credit institutions, CON/2023/26; Opinion of 15 December 2023 on the imposition of a tax on credit institutions, CON/2023/45.
80 See, e.g., *ECB*, Opinion of 15 December 2023 on the imposition of a tax on credit institutions, CON/2023/45, p. 4.
81 For an analysis of the compatibility with EU law of the Spanish windfall tax, see *García* et al., Nordic Tax Journal 2024, pp. 1 et seq.
82 Council Regulation No. 2022/1854 on revenue cap and solidarity contribution as an emergency intervention to address high energy prices, OJ L 261 of 7/10/2022, p. 1.
83 See, e.g., (pending) Case T-802/22, *ExxonMobil v. Council*, OJ C 54 of 13/2/2023, p. 23.

procedure with such weak democratic credentials should be used for enacting tax measures. Third, some Member States, including Germany, were reportedly opposed to a tax on banks' excess profits and could have formed a blocking minority in the Council.[84]

Instead, what may be most needed at the EU level is the completion of the Banking Union, accompanied by additional regulatory interventions to dismantle persistent differences in the structure of banking markets across the Euro area. This would intensify competitive pressure on banks to adjust their deposit rates to ECB policy rates, thereby accelerating the transmission of monetary policy and mitigating the transfer that results from interest rate hikes.

E. Conclusion

Monetary policy operations inherently have distributional consequences. By nature, central banks' transactions may generate windfalls for the credit institutions that act as their counterparties. They also carry risks for the central banks, with potential fiscal consequences that impact state budgets. What is troubling in the current context is the sheer size of those distributional consequences, which some may argue raise democratic concerns. How can an independent monetary authority like the ECB, without any prior democratic deliberations, conduct a policy generating transfers from the public to the private sector that approach the total yearly spending of the EU?[85]

The ECB is ill-equipped and ill-positioned to significantly mitigate the side-effect of its own policy beyond the measure it has already implemented. Minimum reserves may only be used marginally for that purpose. It is true that, within the current operational framework, the function of this monetary tool is unclear, and the ECB has not fully elucidated it. But prudential rules, the open market principle and the scope of its price stability mandate seriously constrain how the ECB may mobilize this instrument to mitigate Eurosystem's losses and banks' excess profits.

At the core, the difficult-to-draw division between economic and monetary policies, on which the EMU framework relies, is to blame.[86] The sizeable financial transfers from the public to the private sector are an aftereffect of the ECB unconventional monetary policy, which has had far-reaching economic consequences and has left commercial banks with vast amounts of excess liquidity. But the separation between economic and monetary policy also guarantees the democratic legitimacy of the EMU framework: political authorities in control of economic policies, at the national and the EU level, retain several tools to offset the economic effects of monetary policy as long as they do not endanger the effectiveness of ECB's actions.

84 *Reuters*, "European countries differ over windfall taxes on banks", available at: https://www.reuters.com/markets/europe/european-countries-differ-over-windfall-taxes-banks-2023-09-13/ (13/2/2025).
85 *De Grauwe/Ji*, Journal of International Money and Finance 2024/143, p. 1.
86 On the difficult-to-draw distinction between economic and monetary policy, see *Waibel*, in: Govaere/Gaben (eds.), pp. 90 et seq.

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