Co-funded by the
Europe for Citizens Programme
of the European Union

The European Central Bank

The ECB in Frankfurt Am Main, Germany

The European Central Bank has its roots in the European Monetary Institute (EMI). This institute was established as part of the Economic and Monetary Union (EMU), an idea that had floated around in Europe for a long time, but was finally taken up by the European Council in 1988. They gave then-President of the European Commission Jacques Delors, together with the heads of each national central bank, the assignment to come up with a plan for economic and monetary integration. This plan was formalized in the 1992 Maastricht Treaty, which eventually led to the introduction of the Euro and the European Central Bank in 1998.

Composition

There are four decision-making bodies of the ECB that are mandated to undertake the objectives of the institution. These bodies are the Governing Council, Executive Board, the General Council, and the Supervisory Board.

The Governing Council is composed by the six members of the executive board together with the Governors of the national central bank.

The Executive Board comprises the President, Vice-President, and four other executive members. They are appointed by the European Council, and serve for an 8-year non-renewable term.

The General Council is a transitional body that exists only until all the EU member states have adopted the Euro. It comprises the President, Vice-President, and Governors of the national central banks of the EU member states.

The Supervisory Board comprises the chair, vice-chair, four ECB representatives, and representatives of national supervisors.

Powers and functions

The primary function of the European Central Bank is to maintain price stability and safeguard the value of the Euro. The Governing Council does this by maintaining inflation around the 2% target which maintains stability. It reaches this goal by setting three key interest rates: the minimum bid rate, the marginal lending rate, and the deposit rate.

The minimum bid rate is the rate of interest set by the ECB for one-week loans. When it is lowered, it encourages commercial banks to borrow more money, and in turn to lower their own interest rate, reducing the cost of borrowing for businesses and consumers. This leads to increased inflation.

The marginal lending rate is the rate of interest set for overnight loans. Commercial banks use these types of loans to meet their reserve requirements. This rate is normally set just over the minimum bid rate, encouraging banks to loan excess cash to each other. If this rate is lowered, inflation increases.

The deposit rate is the interest rate paid on deposits. If this rate is high, it is more attractive for commercial banks to hold on to deposits. If the rate is low, it is more attractive to loan money to businesses and consumers.

Decision-making

The Governing Council is the main decision-making body of the ECB. It tries to take its decisions through unanimity or consensus. When this is not possible, a majority voting system is used. Over the years, this has become more common.