



26-17 Principled Pragmatism: Fourteen Years on the European Central Bank's Governing Council

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INTRODUCTION

I started my career as a young economist, trained in a rather classical tradition. My PhD, for instance, focused on fiscal policy and interest rate spreads within the European Exchange Rate Mechanism, and I have been intellectually and professionally engulfed in Europe's economic and monetary integration ever since.

In 1995 I first joined the Dutch central bank (DNB) to help prepare for the upcoming euro adoption. Three years later, I helped set up the Euro Area desk at the International Monetary Fund. Upon my return to DNB at the end of 1999, I spent the better part of the next decade working on financial regulation.

The 2008–2009 global financial crisis transformed me from a diligent financial regulator into a crisis manager in charge of some of the most complex bank rescue operations of my career. I then moved from DNB to the Dutch Treasury where the focus shifted

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from managing the crisis itself, think about bank rescue, asset disposal, bank recapitalization and the like, to the rebuilding of the institutional architecture that would make the system more resilient to avoid a repeat of such a cataclysm.

In 2011, I was appointed president of DNB, a position I was privileged to hold for 14 years. Over that period, I attended over a hundred European Central Bank (ECB) Governing Council meetings and worked with three different ECB presidents. Simultaneously, from December 2021 until the end of my term, I chaired the Financial Stability Board, which offered me a unique vantage point across both monetary and global financial stability policy and allowed me to take a role in global policy coordination beyond the European realm.

Stepping down from the ECB a bit more than a year ago has given me the opportunity to look back and think about this period, how policy has changed and how my views have been tested and refined by events. In this Policy Brief, I reflect on that intellectual journey over these 14 years across three interlocking themes in the monetary policy domain: asset purchases and the de facto lender-of-last-resort role in a fragmented monetary union; fiscal policy and the question of common European borrowing; and the international role of the euro in a shifting geopolitical order.

I believe the evolution of my thinking on these issues mirrors, in many respects, the evolution of the monetary union and its architecture. I continue to believe that Europe's sui generis integration creates unique challenges for economic policy and for monetary policy, creates a distinct responsibility for central bankers, and demands that the ECB's policy be bound by laws, conditionality, and be anchored to the price stability mandate. But Europe's integration also calls for pragmatism in updating this policy framework in order to protect its original principles.

1. ASSET PURCHASES AND THE LENDER-OF-LAST-RESORT FUNCTION IN A FRAGMENTED MONETARY UNION

1.1 Skepticism about unconventional tools

When I took office in the summer of 2011, the ECB was navigating the first tremors of what would become a full-blown sovereign debt cum banking crisis. The intellectual framework I brought to Frankfurt was rooted in a traditional conception of the central

bank's role: price stability should be achieved through the interest rate, with unconventional measures reserved for genuine emergencies such as the 2008–2009 global financial crisis. My initial orientation placed me among the more skeptical voices on the ECB Governing Council regarding the scope of monetary expansion and asset purchases.

This skepticism reflected my economic upbringing, but not ideological rigidity. It rested on genuine concerns about the effectiveness and side-effects of unconventional tools. As new evidence came in and the state of our monetary union evolved, however, I have always been updating these beliefs. Even though I had been rather reserved about the effectiveness of the Securities Market Program (SMP) agreed under President Jean-Claude Trichet, for example, I wholeheartedly agreed to the Outright Monetary Transactions (OMT) announcement by Mario Draghi in the summer of 2012.

But while acknowledging the effectiveness of asset purchases to repair monetary policy transmission, I was more skeptical about the effectiveness of our quantitative easing (QE) program to bring inflation back to target. Here too, my views have evolved. The incoming evidence on the effects of QE has offered important lessons for supporters and skeptics alike. Asset purchases are an integral part of the monetary policy toolkit; they help shape the matrix of interest rates (across time and across asset classes) to maximize the effect of policy when the short-term policy rate reaches the lower bound.

That being said, I do believe that the effectiveness of QE depends both on the economic context and the stance of fiscal policy. In a liquidity trap where monetary policy loses much of its power, fiscal multipliers are typically maximized. If the euro area were ever to end up in such a situation again, I would therefore be a strong proponent of euro-area-wide coordination of the appropriate aggregate fiscal stance.

1.2 The ECB as a lender of last resort

The pivotal moment in my thinking came in 2012, when the fragmentation of sovereign bond markets threatened the very integrity of monetary union. Yield spreads on Italian and Spanish

debt spiraled to unsustainable levels, breaking the homogeneity of monetary transmission that is a precondition for the effective single monetary policy. From 2011 onwards, the euro crisis was no longer simply a crisis of sovereign debt or a banking crisis like in Ireland or Spain. With contagion spreading, it became evident that markets were doubting the political integrity of the monetary union and the euro's irreversibility and with that the singleness of money in the euro area. The emergence of convertibility risk and the associated breakdown of our monetary policy transmission made clear that our analytical framework and policy toolkit needed to take a leap forward.

As a central banker in an incomplete economic and monetary union, I came to accept that homogeneity of monetary transmission cannot be separated from some sort of lender-of-last-resort role. This is why I publicly supported the OMT program in 2012, a position that wasn't always understood in northern European circles. My endorsement was, however, conditional: the OMT had to be subject to strict fiscal and structural conditionality. I had quickly recognized the brilliance of the comments that Mario Draghi had made in London in July of 2012 and, with appropriate safeguards in place, I was in full support. The OMT was never actually activated, yet it permanently reordered markets' understanding of the ECB's backstop capacity, a canonical demonstration of how central bank credibility can work through deterrence rather than deployment.

In January 2025,¹ I described OMT as "*a quantum leap*" because it was the moment the ECB promised to engage in potentially unlimited asset purchases if needed, thereby eradicating redenomination risk and acting de facto as a lender of last resort. It revealed what I now hold to be a fundamental truth about the architecture of the eurozone: a currency union with nationally fragmented fiscal policies, debt markets, and banking systems cannot function without some form of central bank backstop, however conditional.

1 See Klaas Knot, "From Frankfurt with love—14 years on the ECB's Governing Council," University of Groningen, January 31, 2025.

1.3 From APP to PEPP

In 2015, the ECB launched its first QE program aimed directly at loosening the monetary stance and boosting inflation. The launch of this Asset Purchase Program (APP) brought me into a more explicit tension with the majority of my colleagues in the Governing Council. While I fully accepted the necessity of unconventional measures to anchor expectations in the deflationary environment of the mid-2010s, I consistently pressed for discipline in the program's application, including clear criteria for both its expansion and its eventual normalization because I continued to have reservations about its ultimate effectiveness in pushing inflation to below but closer to 2 percent.

Over time, I've come to see QE as a way of signaling our commitment to our target and as an extension of conventional short-term interest rate policy to the entire yield curve and matrix of interest rates. By compressing term and risk premia across asset classes and lowering longer-term borrowing costs, asset purchases provided meaningful accommodation when the short end of the curve had reached its lower bound. This channel was strongest when there still was substantial scope for longer-term rates to fall. As the yield curve became progressively flatter, however, the marginal effectiveness of additional purchases declined, while the side-effects and the challenges associated with an eventual exit accumulated over time. In this environment, monetary policy without fiscal support loses much of its effectiveness.²

With hindsight I think the ECB on the whole was too slow to develop QE in 2014, and I take my share of responsibility for this. But then I also think it probably carried on with QE for too long and in a way that could have been more targeted. The lesson I draw from this experience is that it is probably better to start QE earlier and stronger than we have but also to be more flexible and end it sooner. After all, "shock and awe" will likely maximize the announcement effect on inflation expectations, while incremental purchases will be unlikely to generate a more structural shift in the underlying rate of inflation.

2 See Klaas Knot, "The case for fiscal stabilization in a low interest rate environment," Witteveen lecture, Erasmus University of Rotterdam, June 11, 2021.

The pandemic allowed this new doctrine to be tested. The Pandemic Emergency Purchase Program (PEPP) launched in March 2020 departed from the capital key constraint that governed earlier asset purchases, explicitly allowing more flexibility across asset classes and jurisdictions to prevent a fragmentation of financial conditions during a symmetric shock. I supported the PEPP wholeheartedly, recognizing that the health emergency had created an unprecedented form of demand destruction that warranted an equally unprecedented fiscal and monetary response. The PEPP's design (flexible, large, and clearly temporary) also aligned with my preference for instruments whose scope was flexible, but its duration explicitly bounded. Over time, we've been able to conduct PEPP purchases more efficiently. We focused on preserving favorable financing conditions, rather than buying a preset amount of bonds. In periods of favorable conditions, this allowed us to buy less, while stepping up when conditions demanded so. I believe this is one of the ways in which we can ensure the proportionality of purchase programs.

Speaking at the London School of Economics in early 2026 after leaving office,³ my retrospective on the QE experiment distinguished clearly between asset purchases

- i. as a mechanism for financial market stabilization and monetary policy transmission repair where I believe they had worked,
- ii. as a tool to stave off deflation risk where their announcement and initiation contributed to halting the decline in inflation expectations, and
- iii. as a tool for nudging inflation higher, where the empirical evidence is rather mixed.

Our experience with QE has also taught me that while central bank independence is indispensable, monetary and fiscal policy cannot always be seen in isolation. It is a mistaken belief that monetary policy can fully stabilize the economy in all circumstances irrespective of the fiscal stance and the broader institutional context. QE, in particular, benefits from an aligned fiscal stance. This

3 See Klaas Knot, "[Remarks at the London School of Economics](#)," February 5, 2026.

has important institutional consequences and implies that while independence is critical, it should not prevent policy coordination.

1.4 The TPI and the institutionalization of the backstop

The creation of the Transmission Protection Instrument (TPI) in July 2022, as the ECB pivoted to monetary tightening for the first time in 11 years, completed the circle. The TPI represented the institutionalization of some of these lessons on asset purchases.

Our Economic and Monetary Union (EMU), characterized by nationally segmented sovereign debt markets, needed a backstop facility to prevent self-fulfilling fragmentation crises from impairing the transmission of monetary policy. The TPI could be activated against any member state facing unwarranted spread widening, subject to compliance with the EU fiscal framework—an architecture that was consistent with my earlier insistence on conditionality for central bank intervention in sovereign markets. It facilitated a forceful interest rate tightening to counter the rapidly accelerating inflation, without fears of triggering turmoil in financial markets. It thereby further cemented the credibility of the ECB as inflation fighter, while the conditionality embedded in the TPI served to limit moral hazard. In this context, it is important to note that it did not stop sovereign spreads in the euro area from continuing to respond to domestic fiscal and structural developments.

Taken together, my trajectory on asset purchases and the lender-of-last-resort function traces a coherent arc: from skeptical to principled pragmatist. I accepted each new instrument not out of enthusiasm for monetary activism but out of recognition that allowing fragmentation to undermine monetary policy transmission or fracture the singleness of money was incompatible with the ECB's price stability mandate and the ECB's role in safeguarding the integrity of the monetary union.

2. COMMON BORROWING AND EUROPEAN PUBLIC GOODS

2.1 The initial framework: Fiscal discipline and national responsibility

My initial position on the fiscal architecture of the monetary union was firmly grounded in the Dutch tradition of fiscal prudence as also reflected in the Maastricht framework: independent national fiscal

policies subject to common rules without fiscal solidarity. I regarded this architecture as both economically sound to avoid fiscal dominance and politically necessary to maintain democratic accountability for the single currency. Common borrowing, in my view, risked diluting incentives for member states to maintain sustainable public finances and introducing moral hazard, which is why I long resisted it.

Successive crises, in particular the euro crisis but then also the COVID crisis, made me accept, however, that the Maastricht architecture was incomplete and needed repair. The policy response to the global financial crisis and the euro crisis effectively already established the contours of a new architecture that included some level of risk-sharing and common borrowing by way of conditional lending programs like the European Financial Stability Facility (EFSF), European Financial Stabilization Mechanism (EFSM), and European Stability Mechanism (ESM), backed by appropriate legal and political safeguards.

But this was not enough. The policy mix achievable after the euro crisis was inadequate because the common belief that national fiscal policy should focus on national stabilization while ECB monetary policy would take care of euro-area-wide stabilization failed to anticipate possible liquidity traps, an effective lower bound to policy interest rates, safe-haven flows, and limited fiscal space.⁴ The postcrisis deflationary environment, therefore, reinforced the case both for fiscal coordination at the European level and for a monetary policy backstop very much in the way that it was delivered during the COVID crisis through a combination of fiscal and monetary expansion. Another example where pragmatism was called for in order to protect the EMU's original principles and safeguard the monetary union.

2.2 The pandemic as turning point: NGEU and the new paradigm

The pandemic was a decisive inflection point in that regard. The monetary/fiscal policy mix had worked far better in 2020 than during the sovereign debt crisis. The crucial difference, as I

4 See Klaas Knot, "The case for fiscal stabilization in a low interest rate environment," Witteveen lecture, Erasmus University of Rotterdam, June 11, 2021.

argued at the time, was that the pandemic hit all member states simultaneously, making coordinated fiscal expansion both politically feasible and economically sensible. The activation of the general escape clause of the Stability and Growth Pact, combined with the ECB's accommodative stance, prevented an economic collapse. More significantly, the introduction of NextGenerationEU (NGEU), funded through common EU debt issuance, represented a structural innovation for risk sharing, fiscal expansion, and fiscal policy coordination.⁵

Together, PEPP, the relaxation of national fiscal rules as well as NGEU stabilized the economy, had a calming effect on financial markets, and prevented spreads from widening.⁶ Conditionality, in the form of reform commitments attached to recovery fund disbursements in order to lift productivity growth, made the instrument both politically acceptable and economically more robust.

2.3 Common defense spending as a tool for strategic autonomy

Russia's invasion of Ukraine and the recent reorientation of transatlantic defense cooperation have given rise to the need for Europe to rearm. The new geopolitical imperative also creates new realities for European financial policymakers, including for central bankers. Indeed, greater defense spending needs will stretch national budgets. More common defense spending would achieve a triple purpose: a political signal of European integration and resilience, a potentially more effective and efficient provision of this essential public good, and thereby enhanced international attractiveness of the euro.

But I retain my instinct for conditionality and sound incentives. Common debt issuance as one of the funding alternatives for the greater defense effort cannot serve as a backdoor bypass of fiscal rules or as a vehicle for disjointed and ineffective national defense

5 See Klaas Knot, "Emerging from the crisis stronger together," HJ Schoo lezing, Elsevier, September 1, 2020.

6 See also Klaas Knot, "Free trade and financial stability, containing the effects of geopolitical fragmentation," Eurofi High Level Seminar, Ghent, February 23, 2024.

spending. In the medium term, any higher EU debt should go hand in hand with lower national debt: the servicing costs of EU bonds are ultimately borne by the same taxpayers as those of national debt. Common issuance may reduce funding costs, but it cannot ignore fiscal sustainability considerations.

2.4 The safe asset nexus: Completing the architecture of the euro

I have consistently connected the eurobond argument to the broader question of the eurozone's institutional completeness. The absence of a genuine euro-denominated safe asset at scale as liquid and structurally embedded as US Treasuries was both a symptom and a cause of the eurozone's vulnerability to fragmentation. Triple or double A-rated national bonds like German Bunds, while safe, were not issued in sufficient volume to anchor the euro area's financial system. EU-labeled supranational bonds like those issued by the European Investment Bank (EIB), ESM, or under NGEU had the potential to partially fill this gap, but only if issuance was consistent, predictable, and of sufficient scale to generate the liquidity premia that make sovereign safe assets self-reinforcing.

This analysis places my own thinking in dialogue with a broader literature on safe assets and the euro area's design flaws, a literature to which scholars such as Markus Brunnermeier and Ricardo Caballero have contributed. While I continue to believe that the proposals to bundle and somehow mutualize existing national debts are politically less feasible as they decouple liability from control, going forward I do recognize a legitimate case for more European public goods that could generate a gradually growing supply of euro-denominated safe assets.

3. A STRATEGY FOR A GLOBAL ROLE OF THE EURO

3.1 The ECB's traditional agnostic stance

For most of my tenure, I shared the ECB's traditional stance on the euro's international role: deliberate agnosticism. The ECB's mandate is domestic price stability. The euro's external attractiveness was understood as a by-product of sound monetary policy rather than a policy objective in its own right. The Governing Council did not seek to promote the euro as a reserve currency or invoicing currency

for international trade; its international role would reflect the underlying strength of the European economy and institutions.⁷

This stance was analytically defensible. The dollar's dominance as the world's reserve and invoicing currency reflects decades of institutional depth, legal predictability, and market liquidity that cannot be manufactured by policy decree. In a 2021 panel discussion on the comparative roles of the dollar, the euro, and the renminbi, I articulated the standard view that the euro's external position would evolve with the quality of European institutions rather than through deliberate promotion campaigns.

3.2 The case for a larger role

The geopolitical disruptions of 2022–2025, which started with Russia's invasion of Ukraine, the sanctioning of Russian central bank reserves, and subsequently the trade and institutional frictions with the United States under the Trump administration, created conditions in which the traditional agnostic posture became intellectually insufficient. I traced this evolution explicitly in my Peterson Institute speech of April 2025.⁸

The euro's external use, I noted, had initially developed well after the currency's introduction in 1999, rising above the combined share of predecessor currencies including the Deutschmark. But the 2008–2009 global financial crisis, followed swiftly by the euro crisis, had exposed the monetary union's design flaws and substantially depressed the euro's international appeal. The post-2020 context, however, offered a natural moment for reassessment.

I described my own intellectual journey from agnostic to that of a cautious believer. I don't believe it's realistic or desirable to replace the dollar's global role, understanding the network effects and self-reinforcing dynamics of reserve currency status and recognizing that dethroning a world currency typically requires a major crisis rather than simply a deliberate policy.

7 See Klaas Knot, "International spillovers and the ECB's monetary policy," CF40/Euro50/PIIE Conference, March 27, 2021.

8 See Klaas Knot, "Agnostic or preaching the gospel—what the state of the world implies for ECB monetary policy and the role of the euro," Peterson Institute for International Economics, Washington DC, April 23, 2025.

But I have come to believe that a bigger international role of the euro would be desirable and achievable. The main driver of this shift is strategic: European payment systems and financial market infrastructure were highly dependent on foreign service providers, creating vulnerabilities that had become politically unacceptable in an era of weaponized financial interdependence. In addition, the expansion of private digital currencies and the digital euro project make it necessary to think more strategically about sovereign infrastructure for our digital payments.

3.3 The conditions for a larger international role

External strength is a reflection of internal cohesion and coherence. The euro's international role could be bolstered by policies that strengthened and deepened the European economy and its financial markets. I see four priorities.

First, the integration and deepening of the European internal market, with the euro's international attractiveness as a welcome by-product. Second, the creation of a more secure and sovereign payment infrastructure. The ECB's efforts to expand the use of the TARGET instant payment settlement (TIPS) service and to deploy the digital euro to retail and wholesale use are important steps in that direction. Third, the creation of a genuine single capital market: as long as a US investor wishing to invest across the EU faces potentially 27 distinct regulatory frameworks for corporate law and insolvency, European capital markets will remain fragmented and unattractive. Fourth and final, more structural issuance of common EU bonds, which would deepen the euro-denominated safe asset market and increase its liquidity for foreign investors.

But with greater powers come greater responsibilities. A larger international role will lead international agents to look increasingly to the ECB in times of market distress, as the Federal Reserve has always been central to the international monetary system. The ECB's evolution over 14 years, the development of the OMT, PEPP, TPI, EUREP, and an expanded toolkit for financial stability has, I would argue, prepared it for that expanded role, even if the mandate remains formally unchanged and if the swap and EUREP framework remains somewhat conservative.

CONCLUSION: PRINCIPLED PRAGMATISM

My 14-year tenure at the intersection of European monetary policy and global financial regulation defies the usual hawk/dove divide and taxonomy. Events repeatedly tested my convictions. While keeping a keen interest in academic and theoretical work, I want to believe that I have always kept an open and flexible mind to be able to adapt to events and articulate policy responses that were rooted in strong theoretical and empirical precedent without being dogmatic.

As the facts changed, I've updated my views on important areas of monetary and financial policy, without letting go of the fundamental principles underlying our monetary union. I hope that by applying this form of "*principled pragmatism*," I have contributed to shifting the European consensus on these issues.

I believe the intellectual arc I have travelled remains coherent and bends towards a more perfect and safer monetary union. I have also learned from my peers over these years, some of the best thinkers and policymakers in Europe, quite a few important lessons. Mario Draghi has demonstrated the value of decisive leadership at a time when the euro area needed it most. He demonstrated that the trust and confidence built by institutions and norms in peacetime enabled decisive action in crisis, and this has likely saved the euro area. I have also learned from Jean-Claude Trichet and, in particular, Christine Lagarde that dialogue, cohesion, and consensus were never an obvious thing but the result of patient, deliberate steps and that leading from the back could often be the best possible form of leadership.

I am still learning today that while Europe is blessed with Treaties and statutes that protect the independence of the central bank, this independence must always be protected and cherished. But independence is not a one-way street. It requires us to stay open to challenge and contestation so as to avoid groupthink and the comfortable refuge of our ivory towers. Independence should never prevent us from engaging in constructive dialogue and cooperation with other branches of government, without prejudice to our mandate. I believe that in today's world rife with geopolitical threats, the call on the central bank to act in pursuit

of the general policies of the EU will be an obligation that we should approach with an open mind, as long as price stability is not compromised. Finally, independence cannot allow us to evade or avoid accountability. I believe that great strides have been made but still more can be done so that the European public feels that the ECB responds to its people.

Finally, in a world of greater and more radical uncertainty, we must be more open to the contributions of others to our daily work. The work of historians, political economists, other social scientists and physicists must become a bigger input in our work. Greater uncertainty and wider sets of risks and shocks imply that we must be prepared to listen to the epidemiologists, the energy specialists, the biologists, and perhaps even the philosophers. Our responsibility indeed is better understood as one that doesn't only attempt to control prices but, by virtue of setting the cost of borrowing for our economy and the discount rate of our future, as one that directly connects the present we endure to the future we aspire to.

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