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A European Credit Council for Consistent and Informed Policymaking

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Abstract: In *Banque Providence* Eric Monnet draws on the history of central banking to investigate the problem of insufficient democratic anchoring of monetary policy. It is a very timely contribution, especially as the choices that the central bankers will face in the near future are bound to get ever more political. This article discusses Monnet's proposals to increase central bank legitimacy through common deliberation of monetary policy authorities and economic policymakers, in particular in relation to EU's credit policy. I draw on the rich literature on interinstitutional accountability to identify conditions for such an EU Credit Council to be fit for purpose. I further identify two specific EU contexts where further deliberation would be particularly called for: the differentiated monetary and internal market (credit) policies and the Green Deal. With regard to the first, I show how an EU Credit Council could help deepen our understanding of the mutual impact of advancing EU banking integration and continued existence of multiple currency regimes. With regard to the second, I discuss clarifications and adjustments needed in the EU legal framework to ensure that further policy coordination on financing the transition within such a Credit Council would facilitate the achievement of EU's sustainability goals.

Keywords: central banking, EU banking integration, European Central Bank, sustainable finance, foreign currency loans

JEL Classification: E5, O52, G18

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Toward a European Credit Council?

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1 *Banque Providence* and the Illusions of Central Banking

In the title of his 2014 book recounting the role of monetary policy during the Great Financial Crisis, Neil Irwin referred to central bankers as “The Alchemists”. The name was to suggest the potency of the Federal Reserve and the European Central Bank (ECB) in times of financial instability. Yet it also evokes an element of magic and trickery. There are indeed several magical tricks inherent in the design of modern central banking that remain magically forgotten: the illusion of neutral monetary policy in the context of pervasive inequality, the squaring of narrow mandates with sweeping emergency intervention powers or the neat separation between different functions that a central bank performs in an economy. Wide acceptance of such contradictions very often makes the discussion on modern central banking and its democratic anchoring confusing and largely detached from the daily practice of monetary policymaking.¹

In this context, Eric Monnet’s *Banque Providence* (“Welfare Bank”) elucidates how the modern-day magic tricks of central banking became accepted not on the

¹ Consider for example the viability of the idea of central banking as removed from politics in the context of the euro area crisis as discussed in van ’t Klooster and Fontan (2020).

basis of facts, but to fit the institutional design within prevailing economic dogmas. Such a perspective allows Monnet to broaden the discussion on the current challenges of central banking and the possible reforms. For example, he clearly explains the insurance function that central banks provide to modern welfare states and the shortcomings of the doctrine of limited delegation when applied to such institutions.² Cutting through some of the central banking illusions sheds new light on the question of what institutional design is best suited for the role that central banks actually play in modern financialised economies. The stakes of the discussion on how to reconnect monetary policymaking with political processes are high, especially given the importance of the former in shaping the financing (credit) dimension of industrial policies. The return of inflation in developed economies should not quieten the debates on central bank democratic anchoring. Rather, the ever more challenging environment, makes finding an answer to the question of how to achieve an honest and just monetary policy more urgent.

In this article I engage with the themes of *Banque Providence* from a legal-institutionalist perspective. In Section 2, I emphasise that recent economic developments only strengthen the case for reintroducing politics of central banking. The difficult trade-offs that the monetary policy authorities will face in the context of an economic downturn and inflation will test their legitimacy in the eyes of the broader public. The creation of new dedicated fora of deliberation offers a promising avenue in this respect. However, as the insights from the rich EU literature on deliberative and interinstitutional accountability suggest, such fora must satisfy several conditions relating to their composition and rules of procedure for such an arrangement to yield meaningful results (Section 3). I further discuss two specific ways in which an EU Credit Council could be particularly helpful in contributing to more consistent and informed monetary policymaking in the EU. First, as a body to fill in the gaps left by the differentiated scopes of monetary and internal market (credit) regulations in the EU (Section 4). Second, as a body ensuring that despite the troubled economic times we stay on the course of the sustainability ('net zero') transition (Section 5).

2 EU Central Bank Politics in an Age of Difficult Trade-Offs

With inflation across the developed world rising in the aftermath of the COVID-19 pandemic and Russia's invasion of Ukraine, the appetite for a deeper discussion on the democratic anchoring of central banks seems limited. In fact, as we enter a new

² See Monnet in this special issue, especially his discussion of Tucker (2018).

era of monetary tightening some economists are calling for anyone questioning existing independence dogmas or requesting greater coordination of monetary policy with the sustainability transition to essentially “back off.”³ This is a somewhat troublesome development as the trade-offs that the central banks will face in the context of socioeconomic, geopolitical and environmental instability will only get more political. Making such policy choices without explicitly recognising that ours is the time of goal-oriented transition, would risk creating another central bank illusion, namely of these institutions being removed from the broader socioeconomic and policy-guided transformations. In other words, environmental and climate change mitigation considerations and the sustainability transition affect – implicitly or explicitly – monetary policy calibration, which further strengthens the case for a rethinking of central bank democratic anchoring.

As Monnet reminds us, in the EU such discussion has already started largely as a result of the ever-expanding role of the ECB since the Great Financial Crisis of 2007–2008 as the guarantor of the “irreversibility of the euro” and of financial stability in times of panic and uncertainty (TLTRO, PEPP) as well as an agent of fiscal discipline in some euro area Member States (Greece, Portugal, Cyprus). These developments have created fertile ground for scholarship and policy advocacy arguing for greater accountability and coordination of monetary policy with other economic policies. Such coordination was seen as means of “reining in” the frigid politics of austerity and reinforcing the legitimacy of central bank policymaking by strengthening its anchoring in democratic politics.⁴ A series of high-profile court cases across the EU were brought to question whether the new policy instruments used by the ECB still fell within the scope of its mandate and whether they were correctly calibrated and balanced against other policy objectives (i.e. “proportionate”).⁵ With the Maastricht Treaty economic dogmas dominating in the minds of the judges, however, the exploration of the institutional design of central banking from the perspective of justice and legitimacy continued to be limited. In this context, the legal features of central banking – such as independence – acted as a shield and a boundary demarcating the line between the legal and the economic aspects of EMU’s institutional design.⁶ EU judges’ deference to the technicalities of economic assessment led them to largely rubber stamp, rather than meaningfully engage with, the ECB’s decision-making.

³ Rajan (2022).

⁴ Massoc (2022), Braun and Hoffmann-Axthelm (2017), de Boer and van ’t Klooster (2020), Amtenbrink (2019), Zillioli (2016).

⁵ Smoleńska and Tokarski (2022), Goldmann (2014), de Boer and van ’t Klooster (2020), Steinbach (2017), van der Sluis (2019) more generally on the legal transformation of the ECB see: Beukers et al. (2022).

⁶ See esp. Feichtner (2016) questioning the naturalised conception of money in EU law from a legal perspective.

In this context, *Banque Providence* sheds a new light on the factors which continue to insulate central banking from more incisive accountability: that is it shows these to be historically contingent.⁷ As Monnet explains, central banking played a central role in the emergence of the modern welfare state and the separation between monetary policy and credit policy is meant to align institutional design with the prevailing economic dogmas. Distributional and broader socioeconomic concerns are meanwhile part and parcel of central banking. This perspective brings monetary policy back within the terrain much more familiar to lawyers, namely that of justice and public interest regulation. In the EU context specifically, which is the focus of this contribution, such a broader view on central banking makes it possible to see some further illusions specific to the EU's economic constitutions, such as the differentiation in the scopes of financial and monetary policies as well as the "Chinese wall" between banking supervision and monetary policy of the ECB.

3 Politicising Central Banking Through Interinstitutional Accountability

Monnet proposes addressing the legitimacy deficit of central banking by ensuring that monetary policy authorities are better embedded in broader socioeconomic policies of the EU and Member States by creating a European Credit Council. Such a Council would serve as a bridge between the narrowly construed monetary policy of the ECB and broader "credit policy" shaped by financial regulation and industrial policy more broadly. The body would enjoy no specific powers, serving mainly as a platform for strengthening ownership and learning through reflexive discussion on the policymaking process. Such arrangements fall squarely within the notions of interinstitutional accountability developed in EU scholarship. In fact, thinking of fora for reason-giving and deliberation has been central to EU legal scholars' efforts to strengthen the legitimacy of technical decision-making in the complex and multi-level polity.⁸ To meaningfully strengthen policy making's democratic anchoring, any deliberative and bargaining interaction must take place between institutions having clearly articulated policy mandates and the composition of the deliberative body must be sufficiently diverse to ensure meaningful deliberation.⁹ The discussion must

⁷ See also on this point and the central banks as boundary organisations between the state and the economy Coombs and Thiemann (2022).

⁸ Smoleńska (2020), Everson and Vos (2016), Gerstendberg and Sabel (2002); On notions of inter-institutional accountability within regulatory networks see Monti (2016), Dawson et al. (2019), on politicisation of administration and inter-institutional accountability see Everson and Vos (2016).

⁹ Joerges and Neyer (2006).

be sufficiently well structured: exchange and reflexivity can be facilitated through rules of procedure, e.g. regarding any votes on common positions. Only when such conditions are fulfilled can we speak of new forms of throughput legitimacy as defined by Vivien Schmidt.¹⁰ Such legitimating techniques are naturally no substitutes for more direct democratic participation and politics. They also may breed inter-institutional tensions¹¹ and power struggles.¹² But there are several reasons why the deliberative supranationalism and interinstitutional accountability approaches are valuable in the EU context, and central banking and credit policy in particular. First, they recognise the trade-offs between the different perspectives which must be brought together for a policy process to be legitimate and ultimately just. Second, they recognise the complexity of policymaking: the point of deliberation is not to create another institutional layer, but to overcome the silos which may exist if particular highly specialised agencies do not talk to each other. Third, and connectedly, open deliberation may also allow the identification of gaps in policy structures. This rich EU governance literature offers a number of insights for the institutional design of a European Credit Council, left open in Monnet's proposal, relating to its composition and deliberative process in particular.

As regards the EU Credit Council composition, Monnet provides few details in *Banque Provenance*, apart from the fact it could be administratively located in the European Parliament (EP). With the theme of deliberation defined around issues of credit policy, at first overview, a broad spectrum of parties would have to be involved. Institutions dealing with credit policy issues in the EU are many: European Commission, the Member States, the European Parliament, the EU's financial institutions (the European Investment Bank, the European Stability Mechanism), the relevant EU agencies (the European Banking Agency, the European Securities and Markets Agency) as well as the national parliaments, in addition to the EU's central banks. One risk of including so many groups is that the Credit Council would be a reflection of the complexity of the EU's financial and economic policy institutional design, rather than a forum for meaningful exchange. Two design principles would have to be considered: variable composition and diversity requirements. First, different formats could be centred around a particular policy problem defined by the EU Council, European Parliament or the ECB. Such dedicated fora could be dedicated for example to financing the sustainability transition and closing the gap created by the differentiation in internal market and monetary policy integration in the EU (see on these points below). Second, sufficient diversity of the Credit Council members is crucial. While Monnet suggests that central banks should be challenged on

¹⁰ Schmidt (2013).

¹¹ Moloney (2020).

¹² Busuoic (2016).

their own turf (economic expertise), the interinstitutional accountability literature emphasises that deliberation achieves best results when the parties involved are “sufficiently distinct.” This means that even largely technocratic deliberation should ensure that the economic policy take on credit policy is challenged from the perspective of other fields such as climate science or other social sciences. For example, with regard to deliberations on the role of credit policy in the sustainability transformation, a role for the EU’s Platform for Sustainable Finance and the European Environmental Agency should be considered. In the EU context, ensuring diversity of epistemological perspectives, e.g. with respect to time horizons or scopes of differentiated policies, will further allow policymakers to spot institutional design gaps and improve policy outcomes.

As regards the EU Credit Council’s deliberation process, it is important to recognise that even if its final recommendations would have little binding force, it is how the exchange takes place that is really the *raison d’être* of any deliberative body. Deliberation should therefore be designed in a way creating “arenas of justification” and inter-institutional accountability through heavier burden of proof and reasoning requirements imposed on the decisionmaker. Structuring the exchange and setting out the relevant requirements *ex ante*, e.g. regarding transparency of information or organisation of discussions, is critical to align the expectations of participants. Varying the level of abstraction of discussions – from definitions to the fine details of policy calibration – would be one way to semi-structure the discussion.

Transparency in central bank policymaking is a further precondition for a meaningful deliberation within a Credit Council such as that suggested by Monnet. In this context, the light-touch judicial review of ECB policymaking is a missed opportunity to open-up the central banks’ black boxes. As Paweł Tokarski and I have argued, the proportionality test offers a useful avenue for creating greater transparency in central bank action and ensuring its alignment with EU economic policy goals formulated by conventional political bodies (EU Council).¹³ Proportionality serves here not as means to undermine the ECB, as has been occasionally suggested in the aftermath of the *Weiss* jurisprudence,¹⁴ but rather as means of upholding the rule of law and providing an avenue for dialogue (deliberation) on ECB policy choices. For example, in the context of developing an EU law-compliant “green” monetary policy, proportionality requires a clear formulation of the aims pursued, appropriate calibration of the instruments deployed as well as evidence that the central bank has assessed the possible negative effects on other (non-monetary) policy objectives of its decisions. Such a framework allows for transparency in the ECB’s choices when calibrating specific policies (collateral rules, asset purchases) to

¹³ Smoleńska and Tokarski (2022).

¹⁴ Baquero Cruz (2022), Amtenbrink (2019).

support the green transition. Only if the reasoning deployed by the central bank is laid out in such a way can “outsiders” meaningfully assess whether these decisions are right (the ethical perspective)¹⁵ or legal (the rule of law perspective).¹⁶

4 European Credit Council for “One Market, Many Monies”

As proposed by Monnet, a European Credit Council would allow for better coordination between monetary policy and credit policy, to the extent that the latter is effectively formulated at the junction between central bank concerns and financial regulation. Monnet reminds us in this respect that interest rate policy is inherently a credit allocation tool. Financial regulations, such as microprudential requirements or mortgage rules, in shaping the availability of credit, have a far-reaching impact on money supply.¹⁷ Recognising this interrelationship between banking regulation and monetary policy brings to the fore a particular feature of the EU’s institutional design, namely the differentiated scopes of monetary and credit policies. Rather than “one money, one market” in the EU we have “one market, many monies.” Whereas the EU banking regulations apply to Union as a whole, there continue to be several monetary policy authorities in the EU (that of euro area plus those of the eight – soon seven – other currencies used in the EU, such as Swedish *krona* or Polish *złoty*). As far as banking supervision is concerned, the level of integration is more advanced in the euro area since the creation of the European Banking Union (EBU).¹⁸ Nevertheless, the laws applied by the ECB in this context are largely either EU regulations (e.g. Capital Requirements Regulation) or directives implemented by individual Member States (as in the case of the Capital Requirements Directive). And yet there is no dedicated forum in the EU to discuss the implications of this banking regulation-currency differentiation, except a high-level and vague function which the European Systemic Risk Board (ESRB) may have in this respect as far macroprudential policy is concerned. A dedicated configuration of a European Credit Council could be useful to identify positive and negative spillovers across the scopes of monetary and banking market policies. Their differentiation equally carries distributional consequences that create problems of inadequate legitimization, which begs to be addressed.

Foreign currency loans are perhaps the most visible recent problem providing evidence that currency and banking regulation matters cannot be neatly confined

¹⁵ van ’t Klooster (2021).

¹⁶ See notes 5–8.

¹⁷ Murau and van ’t Klooster (2022).

¹⁸ Busca (2020).

within borders in the context of liberalised financial markets. Across non-euro Central and Eastern Europe (but also some euro area countries) borrowing in foreign currency (especially Swiss Francs but also euro) was popular during the late 2000s because it offered more favourable conditions than borrowing in domestic currency. Due to the inherent currency risk which subsequently materialised, these loans became the source of financial and social instability, leaving the policymakers with a difficult choice: should the banks be made to cushion the blow (e.g. case of Hungary) or should it be the gullible (or perhaps overly risk-prone) borrowers? The matter was subsequently put before the CJEU judges who found that the loan contract clauses which placed the currency risk on the borrower contravened EU's consumer protection law. Foreign currency mortgages have been largely restricted in the EU under the 2014 Mortgage Credit Directive. Nevertheless, individuals and companies may still receive loans in foreign currencies where they receive income in it. A not-insignificant number of borrowers falls into this category, especially the firms integrated within pan-European value chains.¹⁹ In the context of significant currency fluctuations and an economic downturn, the cross-currency links may yet become problematic from both the perspective of financial stability and socioeconomic impact. Where European central banks are preparing for such an eventuality by establishing multiple new swap lines, understanding the impact on access to finance (credit) across the internal market could be deepened through a Credit Council as proposed by Monnet. Furthermore, where this matter has been addressed only indirectly in EU law via the CJEU and EU consumer law, legitimacy issues are evident.

Another area where coordination across monetary and financial regulation authorities would be valuable is the sustainability transition. Since the 2018 Sustainable Finance Action Plan, the EU has played an ever-increasing role in shaping investment available for the deployment of green technologies. New micro-prudential and market rules seek to ensure that it becomes cheaper and easier to access capital for firms wanting to decarbonise or implement sustainable solutions (i.e. that they benefit from a “greenium”). Whereas in the past, few examples of gentle suasion of financial institutions are to be found, e.g. with regard to supporting SME credit or long-term infrastructural projects, it is only with this recent policy turn that we witness the emergence of systemic efforts at directly shaping credit at EU level. The EU's sustainable finance rules are further largely implemented through generally applicable regulations across the internal market, suggesting that “sustainable credit” is becoming a largely harmonised area in the EU. Evidently, however, the actual availability of such credit is shaped by the place of a given currency in the currency hierarchy and the extent to which the central bank includes

¹⁹ For example, in Poland in the first half of 2022 the amount of new Euro-denominated credit to firm rose by 128%.

climate change and environmental considerations in its monetary policy decisions.²⁰ Implementing sustainable credit regulation should therefore be coordinated with monetary policy authorities since coherent signalling of commitment to the sustainability transition would facilitate timely adjustment by the financial sector. More practically, incorporation by central banks of the new regulations regarding climate and environmental risk in their own operations is necessary to ensure effective implementation (and enforcement) of the new rules. Nevertheless, the capacity of central banks to incorporate sustainability issues in their policymaking differs across the EU. This poses a risk to both the internal market as far as the uniform application of the new sustainable finance regulations is concerned, and consequently also to the achievement of EU's Green Deal goals.

So far, the interlinkage between credit policy (especially banking regulation) and monetary policy has been explored largely only in the context of macro-prudential policy as institutionalised in the European Union since 2010. Macro-prudential policy is intended to instil safeguards against systemic financial instability and specifically risks arising in the context of free capital flows in a currency area. With a few exceptions within the context of European Banking Union (EBU), macroprudential policy in the EU has remained a national competence. Consequently, as Monnet also points out, the effective role of the new EU agency designed as a coordination forum – the European Systemic Risk Board (ESRB) is largely limited to exchange of information and increasing transparency of policies implemented at national level. A European Credit Council would help to broaden the scope of coordination efforts by looking not just at the risk from “one market, many monies” differentiation, but also at the positive feedback loops which may be achieved, for example by facilitating coordination of approaches to sustainable finance across the EU's different monetary regimes.²¹

5 European Credit Council for the Green Deal

Monnet's call for improved policy coordination as regards monetary policy's impact on credit policy is particularly important these days when the spectre of high inflation and economic downturn is creating significant risks for the success of the sustainability transition. The evidently higher cost of capital associated with raising rates as monetary tightening is being implemented by EU central banks is difficult

²⁰ Murau and van 't Klooster (2022).

²¹ Further on the obligations of all EU central banks as regards the sustainability transition as well as the visible accountability gap in that respect see: Smoleńska et al. (forthcoming), Goodhart and Lastra (2018).

to square with a policy of accelerating the green transformation through private investment.²² At the same time, the legal obligation to consider sustainability politics in monetary policy is now broadly accepted in the EU given the provisions of the EU Treaty, such as Art. 11 TFEU, which requires EU institutions to make their policies in a way aligned with environmental policy goals and Art. 3 TEU, which articulates the common objectives of the Treaty, including peace, values and the well-being of Europeans – which is now also understood to encompass environmental preservation.²³ To give effect to these articles, a European Credit Council for the Green Deal should bring together monetary policy authorities with bodies responsible for implementing and monitoring the sustainability transition (the European Commission, EU and national environmental agencies), with a view to ensuring policy coherence and timely implementation. Such an institutional innovation requires however several clarifications and adjustments in the EU legal framework.

For the potential of a Green Credit Council to be truly harnessed, there can be no doubt about the role which the ECB and other central banks across the EU play in transition. Concretely, once the hybrid nature of credit policy is acknowledged there can be no doubt that EU's central banks must take into account the effects (positive and negative) of their monetary policy on the sustainability transition. This may require that, even as a policy of monetary tightening is being implemented, favourable conditions are being introduced for "greening" collateral²⁴ or that any tightening is "looser" for assets which meet specific green criteria.²⁵ In any case central banks are evidently obliged to follow EU law, as well as secondary law such as regulations or directives, in operationalising monetary policy, including to determine climate and environmental risk associated with banks' activities.²⁶

At the same time, the doctrine of "Chinese walls" between different areas of financial policy – monetary, supervisory and resolution – needs to be modified. This requirement – found across EU's banking regulation – seeks to prevent conflicts of interests in the pursuit of different policy objectives, such as financial stability, protecting depositors or critical functions of banking (i.e. lending). While such a siloed approach evidently has benefits, e.g. from the perspective of externalising conflicts between different policy goals in terms of their impact or time horizon, few would argue that such a separation is water-tight in practice in the case of the ECB. Arguably, such "Chinese walls" revered in the EU context are another illusion to be scrapped, replaced by greater transparency and accountability as to how the

22 Greene (2022).

23 Solana (2019).

24 De Boer and van 't Klooster (2020), Mayer and Schürger (2022), Dafermos et al. (2021).

25 van 't Klooster (2022).

26 Smoleńska and Beukers (2022).

different objectives are to be balanced in the policymaking. This will also help to ensure that adequate safeguards are in place should the monetary policy tightening have negative financial stability effects potentially threatening the availability of financing for the sustainability transition.

6 Conclusion

With the increasing financialisation of modern economies, the significance of adequate coordination of monetary policy and credit will be ever more important and relevant not just for large economic actors, but also for individuals buying a house or saving for their pension. Monnet's contribution helps us to see this coordination problem not as a new one, but one which has been relevant for central banking since its creation. Dispensing with the illusions of central bank neutrality, begs the question of how to design adequate democratic anchoring for such hybrid and boundary institutions. Deliberation has long been one of the avenues proposed by EU scholars reconstructing the complexities of the EU as a feature of strength rather than weakness. A European Credit Council, if designed in a way that allows for adequate diversity of views and a structured exchange, could at the very least allow for transparency and mutual learning (improving policy outcomes). Such a deliberative forum could also help tackle two important challenges at the interface of narrowly construed monetary policy and credit policy. One of them is “one market, many moneys”, that is the differentiation of scopes of the monetary and banking regulation policy. Deepening our understanding of the mutual impact of banking integration and multiple currency regimes occupying different positions in global monetary hierarchy is very much needed, and a European Credit Council – as envisaged by Monnet – could be the right forum to achieve this. While the EU's macroprudential policy framework has captured some financial stability-related issues arising from free capital flows in a multi-currency context, it has fallen significantly short as a forum to address existing legitimacy issues and accountability gaps. The second challenge is ensuring adequate availability of the financing needed to accelerate the sustainability transition – an EU Credit Council for the Green Deal. That further policy guidance for the financial sector as to the pace of transition, policy trajectories and commitments, is necessary is evident. Transparent deliberation of these issues between EU and national actors, both specialised in the financial sector and those responsible for environmental and societal matters, could help address the accountability gaps that are emerging rather quickly in the sustainable finance policy space.

Neither the terms of the sustainability transition nor the availability of credit are abstract technicalities, but factors very tangible to individual Europeans, shaping their quality of life and expectations of the future. Ensuring greater transparency and accountability from the policymakers shaping them is therefore not only useful

in terms of output-oriented legitimacy focused on pursuing public interest and efficiency. It could also serve to strengthen citizens' trust at a time when output-oriented benchmarks are increasingly insufficient to create a sense of public ownership of expert policymaking. *Banque Providence*'s unique contribution is therefore that by exposing the features of central bank institutional design which insulate monetary policy authorities from politics, it directs our attention back to the direct connection between monetary policy and individual citizens in the modern European welfare states.

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