

**THE ECB'S CONUNDRUM AND 21ST-CENTURY
MONETARY POLICY: HOW EUROPEAN MONETARY
POLICY CAN BE GREEN, SOCIAL, AND DEMOCRATIC**

by Jens van 't Klooster



The ECB's conundrum and 21st-century monetary policy: How European monetary policy can be green, social, and democratic

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Abbreviations

APP	Asset Purchase Programme
CSPP	Corporate Securities Purchase Programme
ECB	European Central Bank
ESCB	European System of Central Banks
ESM	European Stability Mechanism
EU	European Union
LTRO	Long-Term Refinancing Operation
MRO	Main Refinancing Operation
OMT	Outright Monetary Transactions
PEPP	Pandemic Emergency Purchase Programme
PSPP	Public Sector Purchase Programme
QE	Quantitative Easing
SMP	Securities Market Programme
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TLTRO	Targeted Longer-Term Refinancing Operations

Preface

by Michael Peters, Finanzwende

This paper is an important contribution to the debate around the increased role of central banks on the one hand and the adherence to their mandate on the other hand. This is not only the cause for heated debates of lawmakers and academics, but has also been subject to important court rulings. Central banks have become crucial actors for the stabilisation of our economic system, while at the same time they have come under attack from the conservative political spectrum.

The ECB's mandate was drafted thirty years ago with a narrow focus on the prevention of inflation. The 21st century confronts the ECB with many new challenges. In order to address them, the ECB had to increasingly broaden the interpretation of its price stability objective. Under its price stability mandate, the ECB embarked on activities such as crisis interventions with bond purchase programmes and today even considers joining the fight against climate change. However, the ECB lacks a clear democratic guidance for such interventions.

This lack of a script undermines the legitimacy of the ECB's choices and the effectiveness of its programmes. It should not lead us to the conclusion that the ECB should go back to narrowly focussing on inflation prevention only. On the contrary: The EU's political institutions can solve the ECB's conundrum by providing it with renewed democratic authorisation. In the EU treaties, there are several tools available to give the ECB legitimacy for environmental and social policies.

This paper's conclusion is good news for those looking for a constructive solution to the ECB's conundrum. The ECB needs a clearer mandate, but not to limit its actions. On the contrary, a more concise mandate is needed to enable the ECB to live up to its new role as the single most important economic policy actor in Europe. The EU Parliament would be the right institution to provide the ECB with the necessary legitimacy for this endeavour.

Introduction¹

- The ECB's mandate was drafted 30 years ago and focuses narrowly on preventing inflation
- The 21st century confronts the ECB with many new challenges, for which it lacks clear democratic guidance
- This lack of guidance undermines the legitimacy of its choices and the effectiveness of its programmes
- The EU's political institutions can solve the ECB's conundrum by providing it with renewed democratic authorisation

The European Central Bank (ECB) faces a conundrum. Since monetary policy is the most important economic competence entirely delegated to the EU level, new crises have time and again forced the ECB to act. At the same time, the central bank remains bound by a 30-year-old mandate, which assigns it the narrow objective of price stability. This balancing act has led the ECB to increasingly broaden the interpretation of its price stability objective – recently also analysing climate change as a potential threat. That strategy has considerable downsides, as it has insulated the ECB from the democratic debate needed to design fair and legitimate policies. To meet the social and environmental challenges of the 21st century, the ECB needs renewed democratic guidance from the EU's political institutions.

The past years saw the ECB forced to the very edges of its mandate. Its 2012 Outright Monetary Transactions (OMT) programme ended the Eurozone crisis, but was also held to break EU law. In 2015, 35,000 Germans filed a court case asking the German Constitutional Court to prohibit the German central bank from taking part in the programme. The years that followed saw the ECB move from one contested programme to the next.

¹ I want to thank Benjamin Braun, Nik de Boer, Daniela Gabor, Ben Folit-Weinberg and the Transformative Responses to the Crisis team for helpful comments on an earlier draft. The report draws extensively on the argument developed in more detail in Nik de Boer and Jens van 't Klooster "The ECB, the Courts and the Issue of Democratic Legitimacy after Weiss", *Common Market Law Review* 57, no. 6 (2020): 1689–1724. It also incorporates material from Jens van 't Klooster, "The ECB, the Climate and the Interpretation of 'Price Stability'", *Just Money Roundtable: Monetary Policy in the EU*, <https://justmoney.org/the-ecb-the-climate-and-the-interpretation-of-price-stability/> and "The ECB's Financial Risk-Management: Historical Insights for the Review of the Monetary Policy Strategy", which is to appear in *The "New" European Central Bank: Taking Stock and Looking Ahead*, eds. Thomas Beukers, Diane Fromage, and Giorgio Monti (Oxford: Oxford University Press).

The Eurozone crisis and the accompanying deep recession led the ECB to initiate a multi-trillion government bond Public Sector Purchase Programme (PSPP), which again landed the ECB in the German Court – in its shock May 2020 Weiss ruling, the Court came out in favour of the litigants. Just a few weeks earlier, the ECB had again broken new taboos with its 2020 Pandemic Emergency Purchase Programme (PEPP).

A decade of crises saw the ECB face many choices about which its mandate had little to say. Although critics often asserted that it broke the law, such critiques usually represent a particular, equally political view on what the ECB should do.² As Benjamin Braun and Daniela Gabor both show in their policy briefs, every monetary policy decision impacts the allocation of capital and creates winners and losers. Anything the ECB does is unavoidably political.³

How then should we understand the ECB's conundrum? In a recent article, Nik de Boer and I answer that question in terms of what we call „authorisation gaps“: The ECB faces choices with far-reaching consequences for which its mandate provides no clear course of action.⁴ The ECB often has multiple options, which are all legally permissible but will also all be political and controversial.

One crucial area where the ECB faces significant authorisation gaps is its effort towards greening the economy of the European Union (EU). Already, the ECB could have done much more to improve the environmental impact of the EU's financial system, starting with its own monetary policy. In the past years, billions of newly minted euros went to the economy's most polluting sectors. These choices, again, reflect a mandate drafted in the 1980s that is in dire need of revisions. Until such an update occurs, its weak democratic legitimacy will hinder the ECB from contributing to the EU's broader economic, environmental, and social policy objectives.

The diagnosis that the ECB faces authorisation gaps suggests a simple fix. If the ECB's real problem is a lack of democratic authorisation, then the easiest solution is for the EU's elected representatives to provide just such authorisation. I conclude this report by showing that there are many tools available within existing EU treaties to give the ECB democratic authorisation for effective environmental and social policies. Rather than politicising the ECB or limiting its independence, renewed democratic guidance is itself the best bet for ending widespread discontent about central bank overreach.

² See Adam Tooze, “The Death of the Central Bank Myth”, *Foreign Policy*, 13 May 2020; Katharina Pistor, “Germany's Constitutional Court Goes Rogue”, *Project Syndicate*, 8 May 2020; Antoine de Cabanes and Clement Fontan, “Why Germany's Far Right Wants Judges to Rule Europe's Monetary Policy”, *Jacobin*, 24 May 2020.

³ Benjamin Braun, “Central banking beyond inflation”, *Transformative Responses Policy Brief*, Daniela Gabor, “Revolution without revolutionaries: Interrogating the return of monetary financing”, *Transformative Responses Policy Brief*

⁴ De Boer and van 't Klooster, “The ECB, the Courts and the Issue of Democratic Legitimacy after Weiss” (see note 1).

The rest of the report is structured as follows. Section 1 explains the monetarist ideas that informed the drafting of the ECB mandate in the 1980s and how they used to provide its operations with democratic legitimacy. Section 2 discusses how the Eurozone crisis and the recent pandemic led the ECB to move far beyond the role originally envisaged for it. Section 3 turns to how very similar gaps in its mandate hinder it from effectively contributing to fighting climate change. Section 4 proposes actionable democratic solutions for the EU's political institutions, the Member States, and the ECB itself to give its new programmes an adequate democratic basis.

1. The Maastricht Treaty and the ECB today

In the historically influential monetarist conception of central banking, the overriding objective of monetary policy is price stability, which central banks pursue as a technical task of setting interest rates. That conception is the core of the ECB's mandate, as formulated in the 1992 Maastricht Treaty. However, that mandate stopped serving its democratic role when the Eurozone crisis led the ECB far beyond this narrow self-understanding.

When the European Community initiated the process of monetary unification, the task of the central bank was meant to be simple.⁵ At the time occasionally referred to as "Eurofed", it was meant to pursue price stability. In the background of that simple objective were a set of ideas about money and the economy, popularised by Milton Friedman, that deny that monetary policy can make a lasting contribution to the economy's productive capacity. Reflecting this pessimistic view of what monetary policy can do, the ECB was meant to achieve the well-defined objective of price stability by using one simple tool: setting interest rates. Setting interest rates is understood as a technical exercise, whereby the central bank prevents inflation by raising interest rates.

These monetarist ideas are also the basis for a historically influential democratic justification of central bank independence.⁶ This justification assumes that central bankers are bound by a legal mandate, which is the outcome of the democratic process. The central bank's role is to implement that mandate in light of considerations of efficiency and technical feasibility. Democratic legitimacy, on this account, results from the legal mandate, which authorises the central bank to use a well-defined set of powers subject to clearly specified conditions for their use. Political choices are made in drafting the mandate, not in implementing it. As a result, this authorisation provides the ECB's operations with legitimacy. To this day, central bankers confidently assert that the choices made in designing ECB programmes have a firm foundation in their mandate.⁷

⁵ Kathleen McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (New York, NY: Cornell University Press, 1998); Harold James, *Making the European Monetary Union* (Cambridge, MA: Harvard University Press, 2013).

⁶ Robert Elgie, "The Politics of the European Central Bank: Principal-Agent Theory and the Democratic Deficit", *Journal of European Public Policy* 9, no. 2 (1 January 2002): 186–200, <https://doi.org/10.1080/13501760110120219>; Paul Tucker, *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State* (Cambridge, MA: Harvard University Press, 2018); Jens van 't Klooster, "The Ethics of Delegating Monetary Policy", *Journal of Politics* 82, no. 2 (2020) <https://doi.org/10.1086/706765>: 587–99; Leah Downey, "Delegation in Democracy: A Temporal Analysis", *Journal of Political Philosophy*, 2020, <https://doi.org/10.1111/jopp.12234>.

⁷ Yves Mersch, "Central Bank Risk Management in Times of Monetary Policy Normalisation" (International Risk Management Conference, 8 June 2018, Paris), <https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180608.en.html>; Jens Weidmann, "Climate Change and Central Banks" (Bundesbank Financial Market Conference, Frankfurt, 29 October 2019), <https://www.bundesbank.de/en/press/speeches/climate-change-and-central-banks-812618>.

It was never entirely true that the ECB's mandate was so strict. Recognising that the mandate was likely to remain as it was agreed for a long time, and considering "the evolutionary nature of financial markets" the provisions covering its instruments provide almost no constraints on the ECB's operations.⁸ The absence of fine-grained instructions in its mandate was meant to allow the ECB to respond flexibly to new circumstances – legal space it would amply need in the years that followed the 2007–2008 global financial crisis. The final version of the Maastricht Treaty also leaves considerable room for a more activist monetary policy and objectives that go beyond price stability. As the Dutch central banker André Szász laments in his history of the Euro:

For France, in particular, accepting the Bundesbank model was a major concession, deviating as it did from French centralist tradition, and even raising doubts on the purpose of monetary integration, which for France was to ensure more influence on monetary decision-making. Thus having in principle made the concession at the European Council Meeting in Rome in October 1990, it fought a rearguard action when the European Central Bank's statutes were drafted. Though the principle of independence of the ECB and its priority for price stability was clearly established in the Treaty, sufficient ambiguity was incorporated in it to make sure that the issue could be raised again at a later stage.⁹

So, what sort of discretion did the drafters leave to the ECB? For one, the central bank can make important choices in how it understands its objectives. The Treaty explicitly states that the ECB should not merely "implement", but also "define" its monetary policy. Beyond price stability, the ECB's secondary mandate requires it to "support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union" where that is compatible with the objective of price stability. The secondary mandate refers to the broader economic policy objectives of the EU as outlined in Article 3 of the Treaty on European Union (TEU), which include "full employment and social progress" as well as referencing "the quality of the environment" (See Box 1 below for key passages from the ECB mandate). It is left open how to rank these objectives.

⁸ Committee of Governors, "Draft Statutes of the European System of Central Banks and the European Central Bank with an Introductory Report and a Commentary" (Brussels: Europe Agency, December 1990), 16.

⁹ André Szász, *The Road to European Monetary Union* (London: Palgrave Macmillan, 1999), 147.

Like concerning its objectives, the ECB mandate is also general where it comes to instruments. Article 18 of its Statute permits the ECB to engage in a broad range of vaguely defined financial market transactions. Article 20 also permits the ECB “the use of such other operational methods of monetary control as it sees fit”, conditional on a two-thirds majority in its Governing Council. Beyond these provisions there is also not much that constrains what the ECB can do. Article 123 of the Treaty on the Functioning of the European Union (TFEU), which prohibits the direct purchase of public debt, is explicitly meant to allow for the purchase of government bonds in financial markets.¹⁰ This generality is unlike many of its European predecessors, which often had detailed provisions for permissible instruments.¹¹ The Bundesbank, for example, was subject to very detailed risk management provisions.¹²

In what sense was the ECB’s monetary policy ever founded upon a clear basis of democratic authorisation? Although the Maastricht Treaty does not define its instruments and goals, the ECB’s monetary policy operations fitted a widely accepted interpretation of that mandate. As long as there was agreement that the ECB should pursue price stability by setting short-term interest rates, that interpretation provided it with democratic legitimacy.

¹⁰ Delors Committee, “Report on Economic and Monetary Union in the European Community”, Committee for the Study of Economic and Monetary Union (Brussels, 17 April 1989), 22, http://aei.pitt.edu/1007/1/monetary_delors.pdf.

¹¹ EMI, “Eligible Instruments for Mobilisation and Pledging during Stage 3 of EMU”, Monetary Policy Sub-Committee Task Force on Eligible Debt Instruments for Mobilization and Pledging (Frankfurt: European Monetary Institute, November 1995), 3.

¹² Law concerning the Deutsche Bundesbank of 1957, Articles 19 to 25.

Box 1: Key passages from the ECB mandate

Article 127(1), TFEU:

“The primary objective of the European System of Central Banks (hereinafter referred to as ‘the ESCB’) shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources [...]”

Article 3(3), TEU:

“The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance. [...]”

Article 18, ECB and ESCB Statutes:

“In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may:

- operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in euro or other currencies, as well as precious metals;
- conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral.”

2. The ECB's conundrum, the Eurozone crisis and the pandemic

In response to the Eurozone crisis, the ECB has considerably broadened its task, which led it to redefine its understanding of price stability. Once it moved away from the earlier monetary interpretation of its mandate, the Treaty stopped being a source of clear guidance for the ECB.

In the 2010–2012 Eurozone crisis, the price stability objective became the rationale for buying the sovereign bonds of individual Member States – most notoriously in the ECB's OMT programme. Up until then, buying sovereign bonds had been widely considered going beyond the ECB mandate, which prohibits buying bonds directly from governments. Since that does not preclude buying them indirectly, the ECB committed to purchasing government debt in financial markets. This is what Mario Draghi meant when he announced in July 2012: “Within our mandate, the ECB is ready to do whatever it takes to preserve the euro.”

To justify its 2012 OMT programme, the ECB conceptualised the sovereign debt crisis as a threat to price stability. It argued that large divergences between bond markets for individual Member States undermined its ability to set financial market conditions across the euro area. Buying bonds was, therefore, required to maintain price stability. However, the stakes were clearly much higher. Had the ECB not acted, the crisis would not only have impaired its ability to achieve price stability. In 2012, doing nothing could easily have ended the euro.

That argument did not convince everyone. The German lawyers who sued the ECB in the 2015 Gauweiler case argued that the OMT programme constituted a “suspension of the market mechanisms which violates the Treaties”; a view also supported by Bundesbank President Jens Weidmann.¹³ Although the letter of the law may not rule out indirect purchases of government bonds, such purchases are counter to its original spirit.

Despite all the sound and fury, neither the ECB nor the German litigants have a clear-cut case. The ECB mandate simply does not contain provisions for whether – and if so, how – the ECB should deal with sovereign bond prices. Hence, both sides can readily cite passages in the ECB mandate to support their preferred interpretation. The legality of the central bank's actions became an endless source of academic disagreement.

¹³ BVerfG OMT reference. par. 4–5; 13–15; Jens Weidmann, “Eingangserklärung anlässlich der mündlichen Verhandlung im Hauptsacheverfahren ESM/EZB”, 11 June 2013, <https://www.bundesbank.de/de/presse/stellungnahmen/eingangserklaerung-anlaesslich-der-muendlichen-verhandlung-im-hauptsacheverfahren-esm-ezb-662878>.

The legal status of the OMT programme is best understood as an example of an authorisation gap. In deciding whether or not to intervene in sovereign bond markets, the ECB faces choices with far-reaching consequences for which there is no clear basis in its mandate.¹⁴ The absence of clear authorisation undermines not only the ECB's legitimacy, but also its effectiveness. After bond yields started diverging sharply already in 2009, it took the ECB years to agree on the OMT programme. Meanwhile, a debt sustainability issue in one Member State, Greece, caused years of crisis and almost brought the Eurozone to its end. From the perspective of its mandate, there are still no binding reasons for the ECB to support government borrowing.

Table 1. Gaps in the mandate and ECB choices after 2008

Gaps	ECB decisions	Alternative	ECB programmes
Sovereign bond market panic	Buying government bonds to stabilise markets	Disruption of the transmission mechanism and possible end of the euro	<i>SMP, OMT, PEPP</i>
Existing instruments no longer work	Designing new tools that allow the ECB to achieve the price stability objective	Lowering the inflation target	<i>APP, PEPP</i>
Environmental impact of operations	Implementing market-neutral monetary policy	Incorporating green objectives in the design of monetary policy operations	<i>CSPP, collateral requirements on MROs and LTROs, PEPP</i>

Since the OMT programme, authorisation gaps have popped up left and right, leading the ECB to ever broaden its understanding of price stability (see Table 1). After the bond market panic ended in 2012, European economies remained in a deep recession.

¹⁴ See de Boer and van 't Klooster, "The ECB, the Courts and the Issue of Democratic Legitimacy after Weiss" (see note 1).

Youth unemployment topped 40% in Greece and Spain. With its short-term interest rates already at zero, the ECB decided to embark on a quantitative easing (QE) bond buying programme – the ECB’s Asset Purchase Programme (APP). By far the largest sub-programme, the multi-trillion euro Public Sector Purchase Programme (PSPP) is a program for buying government and EU debt. By buying debt, the ECB seeks to boost consumption and investment, thereby “ultimately contributing to a return of inflation rates to levels below but close to 2% over the medium term”.¹⁵

The ECB’s bond purchase programmes have had a pervasive economic impact, but their effectiveness remains contested. The side-effects of the programmes are by now well documented. Companies have used low interest rates to invest, but also to buy their own shares and pay dividends.¹⁶ By driving up the price of financial assets and real estate, Europe’s asset owners have been the biggest beneficiaries of these programmes.¹⁷ Exactly how much employment and economic growth the ECB’s programmes have in fact created remains contested. Central banks that support QE find much larger benefits than researchers at the Bundesbank, which opposes QE.¹⁸ Because the PSPP’s benefits are so unclear, the question regularly comes up whether the true objective of the PSPP is not simply to fund individual governments.¹⁹

¹⁵ Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10).

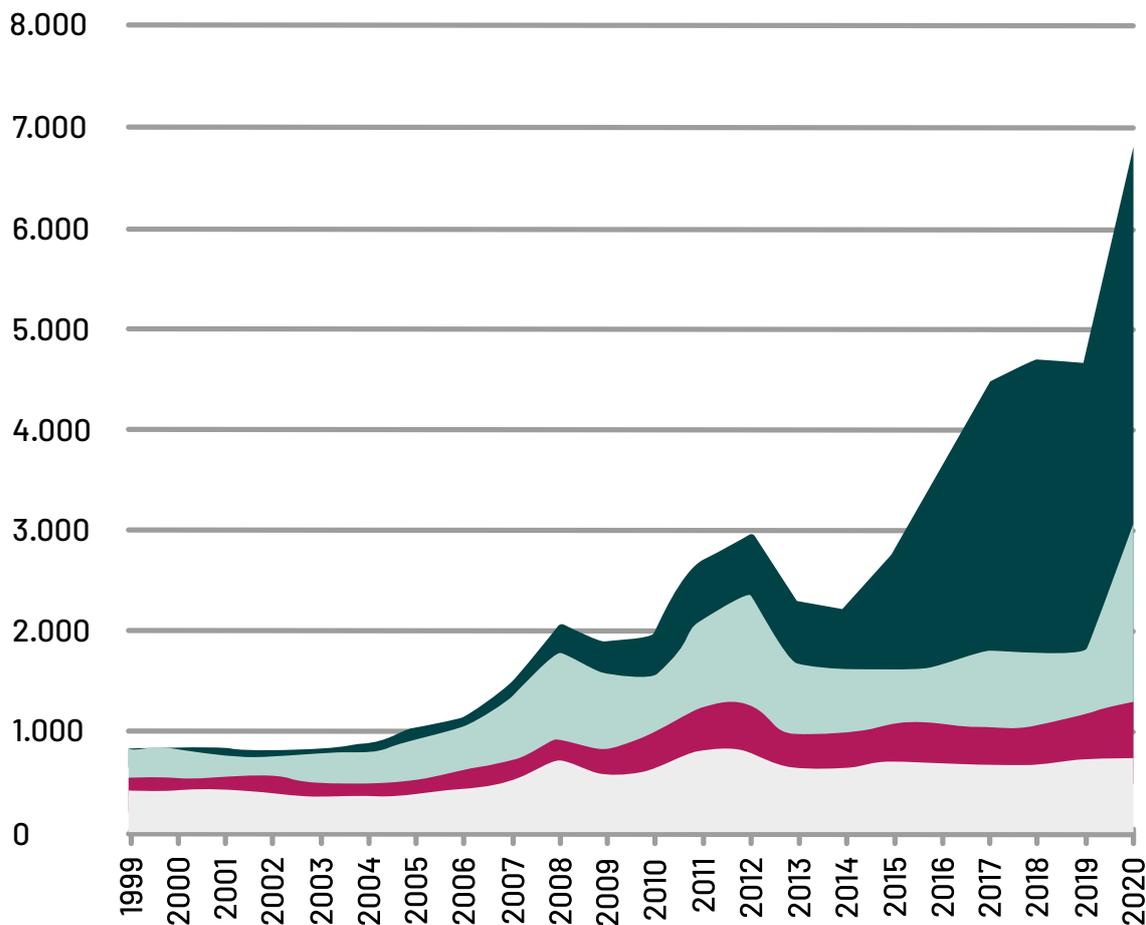
¹⁶ Lior Cohen, Marta Gómez-Puig, and Simón Sosvilla-Rivero, “Has the ECB’s Monetary Policy Prompted Companies to Invest, or Pay Dividends?”, *Applied Economics* 51, no. 45 (26 September 2019): 4920–38, <https://doi.org/10.1080/00036846.2019.1602715>; Karamfil Todorov, “Quantify the Quantitative Easing: Impact on Bonds and Corporate Debt Issuance”, *Journal of Financial Economics* 135, no. 2 (1 February 2020): 340–58, <https://doi.org/10.1016/j.jfineco.2019.08.003>.

¹⁷ Dietrich Domanski, Michela Scatigna, and Anna Zabai, “Wealth Inequality and Monetary Policy”, 6 March 2016, https://www.bis.org/publ/qtrpdf/r_qt1603f.htm.

¹⁸ Brian Fabo et al., “Fifty Shades of QE: Conflicts of Interest in Economic Research” (Cambridge, MA: National Bureau of Economic Research, 28 September 2020), <https://doi.org/10.3386/w27849>.

¹⁹ Recently, Will Bateman “Quantitative Easing, Quasi-Fiscal Power and Constitutionalism” in Just Money Roundtable: Monetary Policy in the EU, 28 December 2020, <https://justmoney.org/will-bateman-quantitative-easing-quasi-fiscal-power-and-constitutionalism/>.

Figure 1. ECB assets in billions of euros (Source: ECB)



- Governments bonds and other securities (PSPP, CSPP, PEPP etc.)
- Monetary policy credit (MROs, LTROs, TLTROs, etc.)
- Gold and gold receivables
- Other assets

The ECB argues that the PSPP's side-effects can be ignored in the pursuit of its price stability mandate, which raises an obvious question: Should the ECB pursue its inflation target, come what may? In the 1990s and early 2000s, the ECB set out a simple and quantitative definition of price stability: consumer price inflation of below, but close to, 2% over a two- to five-year horizon. However, the ECB's 2% target is not in the mandate, but rather self-imposed. Accordingly, there is a clear gap in the PSPP's authorisation.

The ECB could have changed its objectives, rather than introduce new instruments to achieve it. The mandate itself does not settle that choice.

The authorisation gaps in the ECB mandate are likely to become only larger over time. The ECB has already gone beyond the tasks that are clearly defined in its mandate and moved on to a much wider range of issues, including emergency lending to banks, supporting the profitability of banks, and participation in sovereign debt restructurings. The Pandemic Emergency Purchase Programme (PEPP) introduced in March 2020 combines elements of the OMT and the PSPP, in ways that are difficult to disentangle.²⁰ Like the OMT, the PEPP serves to stabilise spreads in sovereign bond markets and prevent a repeat of the 2010-12 panic. Like the PSPP, the PEPP serves to fight an economic downturn and stage an economic recovery. At €1,350 billion, it is hard to accept that the objectives of this programme are so opaque; compare this to the minute requirements that govern the €750 billion Next Generation EU recovery fund.²¹ As the size of the ECB's balance sheet approaches 60% of Eurozone GDP, European citizens will want to know what ECB all this newly created money is for.

²⁰ Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17).

²¹ Special meeting of the European Council (17, 18, 19, 20 and 21 July 2020) – Conclusions, <https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf>. See also Gabor, "Revolution without revolutionaries: Interrogating the return of monetary financing" and Bateman "Quantitative Easing, Quasi-Fiscal Power and Constitutionalism".

3. The ECB's conundrum and the climate crisis

The ECB is a pivotal player in European economic policy, but for now it lacks the democratic guidance that is appropriate for the current economic environment. An important area where the ECB could do more concerns its environmental impact. Monetary policy is all but sure to have some role in managing the climate transition. The major political questions today focus on what shape their tasks should take, how much is left to financial markets, and where the public gets a say over the actions of central banks.

The current review of the ECB's monetary policy strategy is likely to result in climate change being conceptualised as a threat to price stability. Indeed, economically, climate change merits consideration even from a narrow focus on consumer prices. Decarbonising the economy will require ditching carbon-intensive infrastructure, productive capacity, and even whole sectors of the economy.²² Extreme weather events threaten coastal real estate and can damage the economy's productive capacity. Droughts and biodiversity loss threaten agriculture. Climate change, accordingly, will have consequences for the central bank's ability to achieve its medium-term inflation target. As Christine Lagarde explained already this summer:

*I contend that price stability can be significantly affected by climate change, and that as a result of that, if we want to deliver on our mandate, we have to be not only mindful but also take action in order to prevent climate change from affecting that price stability that is our mandate.*²³

Should the ECB indeed conceptualise climate change as a threat to price stability? Again, there is no clear answer in the ECB mandate, which only lists the "quality of the environment" amongst its secondary objectives.

²² Sandra Batten, "Climate Change and the Macro-Economy: A Critical Review", Bank of England Working Papers (Bank of England, 12 January 2018); Malin Andersson, Julian Morgan, and Claudio Baccianti, "Climate Change and the Macro Economy", Occasional Paper Series (Frankfurt: European Central Bank, 1 June 2020); Yannis Dafermos, Maria Nikolaidi, and Giorgos Galanis, "Climate Change, Financial Stability and Monetary Policy", *Ecological Economics* 152 (1 October 2018): 219–34, <https://doi.org/10.1016/j.ecolecon.2018.05.011>.

²³ ECB, "Interview with The Washington Post 22 July 2020", European Central Bank, 23 July 2020, <https://www.ecb.europa.eu/press/inter/date/2020/html/ecb.in200723~0606f514ed.en.html>; Isabel Schnabel, "Never Waste a Crisis: COVID-19, Climate Change and Monetary Policy", <https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200717~1556b0f988.en.html>; Isabel Schnabel, "When Markets Fail – the Need for Collective Action in Tackling Climate Change" (European Sustainable Finance Summit, Frankfurt, 28 September 2020), https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200928_1~268b0b672f.en.html; Christine Lagarde, "Climate Change and the Financial Sector" (COP 26 Private Finance Agenda, London, 2 March 2020), <https://www.bis.org/review/r200302c.htm>.

That objective provides no guidance for how to integrate climate-related and environmental concerns into the ECB's monetary policy.²⁴ It would be a mistake to infer from the absence of legal clarity that the ECB should do nothing. The same was true, as we saw, for the ECB's crisis OMT programme and the PSPP. Today, few people think that the ECB should have done nothing instead. Similarly, simply following the market is not a wise policy now.

Defining price stability in a way that focuses on long-term economic stability will enable the ECB to do away with the carbon bias of its existing programmes. As a consequence of its policy of "market neutrality", the ECB's Corporate Securities Purchase Programme (CSPP) benefits carbon-intensive firms such as utilities, companies engaged in fossil fuel extraction, and car manufacturers, which are overrepresented in bond markets.²⁵ The market neutrality policy, however, has only a shallow basis in the ECB mandate, which merely contains the generic requirement that the ECB should operate "in accordance with the principle of an open market economy".²⁶

The ECB now provides banks with cheap funding, which they may use to fund fuel extraction and energy production and to enable the construction of energy inefficient buildings. With the COVID-19 emergency lending programmes, billions in cheap recovery lending will again go to projects whose economic viability is likely to be short-lived. If so, their contribution to growth and price stability would be transient. That may be in line with the ECB's current definition of price stability, which focuses on year-on-year consumer prices over the medium term. However, as we saw, that definition is not itself in the Treaty, and is due for revision.

Although taking a more active approach to climate change is clearly a step in the right direction, there are again concerns about both the legitimacy and the effectiveness of pursuing climate action as part of the price stability mandate.

²⁴ See for some recent proposals: Simon Dikau, Nick Robins, and Ulrich Volz, "A Toolbox of Sustainable Crisis Response Measures for Central Banks and Supervisors – Second Edition", INSPIRE Briefing Paper (London, 2020); Jens van 't Klooster and Rens van Tilburg, "Targeting a Sustainable Recovery with Green TLTROs" (Positive Money Europe & Sustainable Finance Lab, 2020), <http://www.positivemoney.eu/wp-content/uploads/2020/09/Green-TLTROs.pdf>; Pierre Monnin, "Shifting Gears: Integrating Climate Risks in Monetary Policy Operations", CEP Policy Brief (Berlin, 2020); NGFS, "Climate Change and Monetary Policy Initial Takeaways", Technical Document (Paris: Network for Greening the Financial System, 2020), https://www.ngfs.net/sites/default/files/medias/documents/climate_change_and_monetary_policy_final.pdf; Yannis Dafermos et al., "Decarbonising Is Easy" (London: New Economics Foundation, 2020), <https://neweconomics.org/2020/10/decarbonising-is-easy>.

²⁵ Sini Matikainen, Emanuele Campiglio, and Dimitri Zenghelis, "The Climate Impact of Quantitative Easing" (London: Grantham Research Institute on Climate Change and the Environment, 2017); Stefano Battiston and Irene Monasterolo, "How Could the ECB's Monetary Policy Support the Sustainable Finance Transition?" (Zurich: FINEXUS: Center for Financial Networks and Sustainability, 2019); Dafermos et al., "Decarbonising Is Easy" (see note 23).

²⁶ Jens van 't Klooster and Clément Fontan, "The Myth of Market Neutrality: A Comparative Study of the European Central Bank's and the Swiss National Bank's Corporate Security Purchases", *New Political Economy* 25, no. 6 (2020): 865–79, <https://doi.org/10.1080/13563467.2019.1657077>.

The ECB can justify an activist trajectory in terms of the price stability objective, but many other things could be justified as well. This is the key problem with the ECB's authorisation gaps; the law has lost much of its role in guiding monetary policy. Authorisation gaps make the democratic basis of any actions – activist or not – thin. Acting to green the financial system would arguably be less political than doing nothing, but that in itself does not legitimise any particular ECB policy.

Justifying activist policies on price stability grounds could also once again land the ECB in the courts. In June 2020, the German Constitutional Court dismissed a case against the CSPP, but it signalled that a programme like the CSPP could qualify as economic policy rather than monetary policy if it amounted to state aid or a substantial distortion of competition.²⁷ Meanwhile, Member States and NGOs are likely to consider litigation on the question of whether the ECB's CSPP investments in Ryanair and Shell are really a proportionate way to pursue the monetary policy objectives.

²⁷ 2 BvR 71/20, 2 BvR 72/20 CSPP, Decision of 15 June 2020.

4. Democratising the ECB

The ECB's conundrum is clear. For issue after issue, its mandate simply does not say what the ECB should do. That is not surprising, since it was written decades ago and has remained unchanged since then. The absence of explicit democratic authorisation for its policies undermines the ECB's ability to contribute effectively to the EU's broader economic, environmental, and social policy objectives. But if the ECB's conundrum is the result of insufficient democratic authorisation, then the solution is straightforward: Revisit the democratic basis for ECB operations. This is possible without limiting the ECB's independence.

There are four ways to provide the ECB with renewed democratic authorisation.²⁸

I. The mandate of the ECB can be amended through Treaty change

The Member States can, of course, revise the legal provisions that govern the ECB, as spelt out in the EU treaties. New provisions can clarify how the ECB should take into account the effects of its choices on government budgets, environmental sustainability, financial stability, and other issues. It is true that the ratification of amended provisions is a laborious process – it involves an intergovernmental conference, queens, kings, dukes, and dozens of other political figures and bodies. By itself, however, this should not stop a set of amendments targeted on the structure of the Economic and Monetary Union. Trade agreements are also regularly successfully ratified.

II. The interpretation of key passages in the ECB mandate can be specified through fiscal-monetary coordination on the EU level

Key passages in the ECB mandate are general and open to interpretation. However, they do not specify who should put forward that interpretation. This is one of the crucial ambiguities left by the drafters of the mandate in defining the ECB's independence. Independence prohibits governments from instructing the ECB what to do, but legal acts that apply to it do not fall under that article. As the European Court of Justice ruled in the landmark Olaf-case:

²⁸ For more detail, see de Boer and van 't Klooster, "The ECB, the Courts and the Issue of Democratic Legitimacy after Weiss" (see note 1).

*there are no grounds which prima facie preclude the Community legislature from adopting, by virtue of the powers conferred on it by the EC Treaty and under the conditions laid down therein, legislative measures capable of applying to the ECB.*²⁹

One way in which the political institutions of the EU can help the ECB interpret its mandate is by ranking the many distinct objectives of economic policy referenced in its secondary mandate (listed in Article 3 TEU). To this end, Article 121(2) TFEU already allows the EU Council to formulate “the broad guidelines of the economic policies of [...] the Union”. The European Parliament could also issue a motion on the ranking, which would also help give weight to existing accountability structures.³⁰ Since the secondary mandate asks the ECB to support the EU’s “general economic policies”, it only makes sense for the EU’s legislature to weigh in on what these policies are. Providing democratic guidance on how to rank the secondary objectives would not undermine the ECB’s independence, nor, since they are secondary objectives, its price stability mandate. Article 125(2) TFEU permits the Council to specify the definition of the ECB’s monetary financing prohibition outlined in Article 123 TFEU.³¹ These definitions have not been revised since 1993, which should be done to set out under what conditions it is permissible for the ECB to purchase government bonds.

III. Other passages in the ECB mandate can be amended through the EU’s ordinary legislative procedure

The Treaty also leaves scope for amendments to some passages in the ECB’s legal mandate. Article 129(3) TFEU allows the Council and the European Parliament to make changes to key articles from the ECB Statutes.³³ Article 18 could be amended to specify eligibility criteria for the ECB’s Asset Purchase Programmes and collateral requirements.

²⁹ Case C-11/00, *Commission v. ECB*, EU:C:2003:395, at 136.

³⁰ See also Grégory Claeys and Marta Domínguez-Jiménez, “How Can the European Parliament Better Oversee the European Central Bank?”, *Monetary Dialogue Papers*, September (Brussels: European Parliament, 2020).

³¹ The Council currently does so in Council Regulation 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Arts. 104 and 104b(1) of the Treaty, O.J. 1993, L 332/1.

³² Council Regulation (EC) No 3603/ 93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b (1) of the Treaty [1993] OJ L332/ 1.

³³ This includes Article 17 (on ECB deposit facilities), Article 18 (on open market and credit operations), Article 22 (on clearing and payment systems; think central bank digital currencies), Article 23 (on external operations; think swap lines), and a range of articles at the end of the statutes on central bank accounting and the distribution of profits.

Amendments could be used to link ECB instruments to the EU's Taxonomy Regulations, which clarifies in detail which economic activities contribute to the EU's environmental objectives.³⁴ Article 17 could be amended to provide criteria for the ECB's current practice of deposit tiering, whereby banks receive a top-up on interest they receive on deposits at the ECB. That subsidy is estimated to amount to €200 million for Deutsche Bank alone.³⁵ A revision to the accounting framework could provide a sound legal basis for helicopter money and other loss-making programmes that side-step the financial system.

IV. The ECB can couple its operations to existing EU policies and objectives

The ECB can have an important role in requesting more clear guidance on how to navigate authorization gaps from EU institutions. If it does not receive such guidance, the ECB can still strengthen its democratic legitimacy by coupling its programmes to existing politically sanctioned legal instruments. An example of where the ECB has already done this is its OMT programme, which is only open to Member States that are in an EU emergency funding programme such as the European Stability Mechanism (ESM).³⁶ This makes OMT lending conditional on the approval of the other Member States.³⁷ Without going into the substantive merits of the ESM, linking the OMT programme to the ESM was a clear improvement on the prior Securities Market Programme (SMP), in which the ECB bought governments bonds at its own discretion. This provided the ECB with undue political leverage – in 2011 ECB President Jean-Claude Trichet and Italian Central Bank Governor Draghi sent letters to individual Member States requesting structural economic reforms. Coupling its monetary operations to EU greening initiatives could similarly serve to green ECB monetary policy. A Green TLTRO programme could make the interest rates paid to banks conditional on their lending in accordance with the EU's green taxonomy.³⁸ The European Investment Bank could receive a more prominent role in allocating the ECB's investment portfolio.

³⁴ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, O.J. 2020, L 198/13. TEG, "Taxonomy Report: Technical Annex" (Brussels: Technical Expert Group on Sustainable Finance, March 2020).

³⁵ Bloomberg, "Deutsche Bank Gets Biggest Boost from Tiering, JPMorgan Says", <https://www.bloomberg.com/news/articles/2019-09-13/deutsche-bank-gets-biggest-boost-from-ecb-tiering-jpmorgan-says>.

³⁶ ECB, "Technical Features of Outright Monetary Transactions", http://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html.

³⁷ See Article 13 of the ESM Treaty.

³⁸ See van 't Klooster and van Tilburg, "Targeting a Sustainable Recovery with Green TLTROs" (see note 23).

Conclusion

The ECB is a key actor in the EU's economic policy, but its democratic legitimacy derives from a decades-old mandate. It does not address many of the choices it faces today. This leads the ECB to subsume new tasks time and again under its price stability objective.

The Member States and the EU's political institutions are first and foremost to blame for this conundrum. The task of setting out the objectives and instruments of the ECB was always meant to be the responsibility of democratic institutions, but, as we have seen, they have neglected that task. Instead, important choices are left to the ECB itself. This hands-off approach makes the position of the ECB precarious, since it cannot point to anything like an explicit democratic authorisation for its post-crisis choices.

Going forward, it is unlikely that the ECB will be able to contribute effectively to the EU's climate-related and environmental objectives without more formal backing, setting it up for new legal challenges. By denying the ECB adequate democratic guidance, the EU's political institutions weaken the ECB as an institution. However, there are tools within the existing EU treaties to provide ECB operations with a formal legal basis. This is the only way to solve the ECB's conundrum.