AN EP-ECB INTERINSTITUTIONAL AGREEMENT
ON MONETARY POLICY

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EXECUTIVE SUMMARY

This report asks two questions: **How should the European Parliament (EP) and the European Central Bank (ECB) improve the accountability relationship within the framework of existing primary law and the ECB's monetary policy role? And what function can a formalized Interinstitutional Agreement (IIA) have in achieving that end?**

To prepare the ground for answering these questions, **the report traces the history of the ECB's accountability relationship to the EP, documenting that the self-understanding that long informed the ECB's strategy has become outdated.** The ECB was to use one tool to achieve one objective: by steering interest rates in money markets it aimed to keep inflation close to but below 2%. Its analytical framework was narrowly focused on predicting consumer price inflation over a medium term horizon. Reflecting the technical nature of its task, democratic accountability would focus on how the central banks used its one instrument to achieve the price stability objective.

Since 2008, the ECB's tasks have become much more complex. The concept of price stability has been broadened to encompass not only medium-term (2-5 year inflation as measured by the Harmonized Index of Consumer Prices), but also the more nebulous notion of long-term price stability. The ECB has also come to pursue a range of objectives such as financial stability, supporting government bond markets and, more recently, mitigating climate change.

The 2021 review formalizes a new, more political role for the ECB. The review introduces a new analytical framework, which covers the transmission mechanism of monetary policy, long-term risks to price stability and financial stability. The ECB will also assesses the proportionality of its programmes and monitors undesirable side-effects. Although some of the objectives it pursues are distinct from the inflation objective, the ECB for now treats them as broad economic pre-conditions of keeping inflation to the new target of 2%.

Despite these dramatic changes, the objectives and instruments of its accountability framework have remained almost unchanged. This asymmetry is due to assumptions that no longer hold. Rather than returning to its old simple role, the ECB needs new accountability mechanisms.

To accommodate the ECB's more complex and political role, the EP-ECB accountability relationship should be strengthened along two axes.

The first axis concerns enhanced democratic justification. For now, the ECB's relationship with the EP revolves around explaining how it sought to pursue low inflation on a 2-5 year time horizon. This provides little insight into the inherently political choices made by the ECB. New instruments and information channels should ensure that MEPs can accurately assess the new considerations that inform the ECB's deliberation. In addition to the current accountability practices, we make the following main proposals to improve the justification of ECB decisions:

- Enhanced self-evaluation by the ECB through the conduct of Impact Assessments of different policy options (along the lines of the Impact Assessments the Commission conducts for certain legislative and non-legislative proposals) in the annual report and potentially more frequent monetary policy reports to the EP.
- Enhanced evaluation by the EP through the conduct of ex post investigations into the decisions, actions and omissions of the ECB during an exceptional or large-impact event or period (e.g., the COVID-19 shock).
- Independent evaluations of monetary policy measures through a dedicated office at the ECB.
- Better involvement of the EP in Governing Council meetings, either through attendance of the ECON chair as an observer or through dedicated meetings of ECON members with ECB experts shortly after Governing Council meetings to explain the decisions taken.
- An EP-specific disclosure regime to improve access of MEPs to non-public information, such as internal memos on the practical implementation, design or legal feasibility of specific monetary policy measures that inform the decisions of the Governing Council, if necessary using a secure reading room.

The second axis along which the ECB accountability framework needs to be strengthened concerns supplementary democratic authorization. The 1992 Maastricht Treaty provides the ECB with a mandate to pursue a narrow objective of price stability. Today, however, the central bank faces many new choices that simply have no answers in its current Treaty framework. The ECB justifies its policies as if they were narrowly focused on price stability, but in practice it intervenes in bond markets and acts on climate change how it sees fit. We point to an important role for democratic guidance issued by the EP (and the Council) concerning the pursuit of specific secondary objectives and concern for side-effects where the ECB's mandate is indeterminate. We make three main proposals to overcome its democratic deficit and improve the authorization of ECB monetary policy:

- The EP should put forward its interpretation of the "the general economic policies in the Union" referenced in the ECB secondary objectives. This could be done in its annual resolution on the ECB's annual report.
- The ECB should consult the EP regarding its interpretation of the secondary objectives and their relevance for the ECB whenever the ECB contemplates strategy changes.
- The EP should also push for incorporating references to the ECB's secondary objectives into legislation that is relevant for the implementation of monetary policy. Examples of such acts include the Taxonomy Regulation (2020/852) and the Sustainable Finance Disclosure Regulation (2019/2088).

Turning to the role of formalizing the IIA between the ECB and EP in achieving these objectives, there are both advantages and disadvantages. Although none of our proposals requires a formal IIA to be effective, and formalization may reduce flexibility, it also implies a stronger commitment and is in line with the constitutional importance of EP-ECB relations.

INTRODUCTION

There is a striking asymmetry in the European Central Bank (ECB)'s current approach to democratic accountability. **Although the post-2008 era saw the ECB move dramatically beyond its narrow monetarist interpretation of the legal mandate outlined in the 1992 Maastricht Treaty, the central bank has continued to hew closely to its scarce accountability provisions.** In basic outline, the ECB's relationship with the European Parliament (EP) has not changed much since the late 1990s. Meanwhile, its spate of unconventional operations and new policy priorities saw the ECB's role change beyond recognition.

The EP is currently taking the lead in addressing this glaring gap in the democratic structures of the European Union. In the February 2021 EP resolution on the ECB's Annual Report for 2020, the parliament called for the negotiation of a formal Interinstitutional Agreement (IIA) to "formalise and go beyond the existing accountability practices regarding monetary functions". A conversation between the ECB and the ECON Committee of the EP started at the beginning of 2022, mostly covering the scope of the agreement and possible avenues to expand the current accountability practices, but with no discussion on the form of the agreement. The Russian invasion of the Ukraine in February temporarily halted the conversation, which is scheduled to restart once the situation has stabilized.

To inform the deliberations of the EP facing the ECB, this reports provides a legal and political analysis of existing accountability practices, while outlining scope for improvement, both by means of an IIA as well as through non-formal changes to ECB-EP interactions. In doing so, the report answers two questions: **How should the EP and the ECB improve the accountability relationship? And what function can a formalized IIA contribute?**

The report is structured as follows.

Chapter 1 develops a detailed analysis of the evolving ECB strategy to highlight how **the nature of ECB monetary policy has shifted. The new 2021 strategy formalizes a much more complex and political role for the ECB, which now faces many new choices, while assessing proportionality of its choices and monitoring side-effects.** Today, de facto secondary objective, such as financial stability and climate change, have become crucial determinants of monetary policy.

Chapter 2 shows that **despite incremental steps forward, accountability practices still broadly follow the 2003 structure.** Accordingly, existing accountability practices are no longer adequate. We argue for improvements along two axes: i) **enhanced democratic justification** to the EP and the broader public; and ii) **supplementary democratic authorization** by the EP (and other political institutions) of the EU.

Chapter 3 **outlines concrete proposals for improving both axes of ECB accountability.** To enhance **democratic justification** we propose

- enhanced ECB self-evaluation;
- ex post EP investigations of big events;
- an ECB Independent Evaluation Office;
- EP involvement in Governing Council meetings; and
- an EP-specific disclosure regime.

We also proposed **supplementary democratic authorization**, through

- EP interpretations of the secondary mandate provisions;
- EP consultation on strategy changes; and
- references to ECB secondary objectives in legislation that is relevant for the implementation of monetary policy.

We conclude by outlining distinct advantages and disadvantages of a formal IIA. As we suggest, **the choice of new accountability instruments and the formalization provided by an IIA should be approached holistically and with an eye to strengthening the two axes of the ECB's accountability structures.**

1
ECB DELIBERATION AND ACCOUNTABILITY[1]

The ECB's mandate provides a clear democratic authorization for pursuing the price stability objective by setting interest rates. As long as this was the only task of the ECB, parliamentary accountability practices could have a narrow focus. Indeed, its 1998 and 2003 reviews saw the monetary policy strategy focus on the identification of shocks and resulting threats to price stability. However, since 2008 the ECB's role has undeniably become more complex.

Under the 2021 strategy, the nature of ECB monetary policy has shifted and it faces many new choices, must assess the proportionality of these choices and monitors undesirable side-effects. This raises new political questions. Under the monetary-financial pillar of the ECB's new strategy, financial stability and climate change have also become crucial determinants of monetary policy.

Despite taking on a much more complex task, ECB accountability practices still broadly follow the 2003 structure. The ECB explains how it has used its instruments to achieve its medium-term price stability objective. A look at the new decision structure of the ECB lays, however, bare that these practices have become inadequate. To prepare the ground for reviewing the existing accountability structures, this chapter first reviews the ECB's 1998 and 2003 strategies (1.1). We then turn to the 2021 strategy to analyse the many new choices that the ECB faces (1.2).

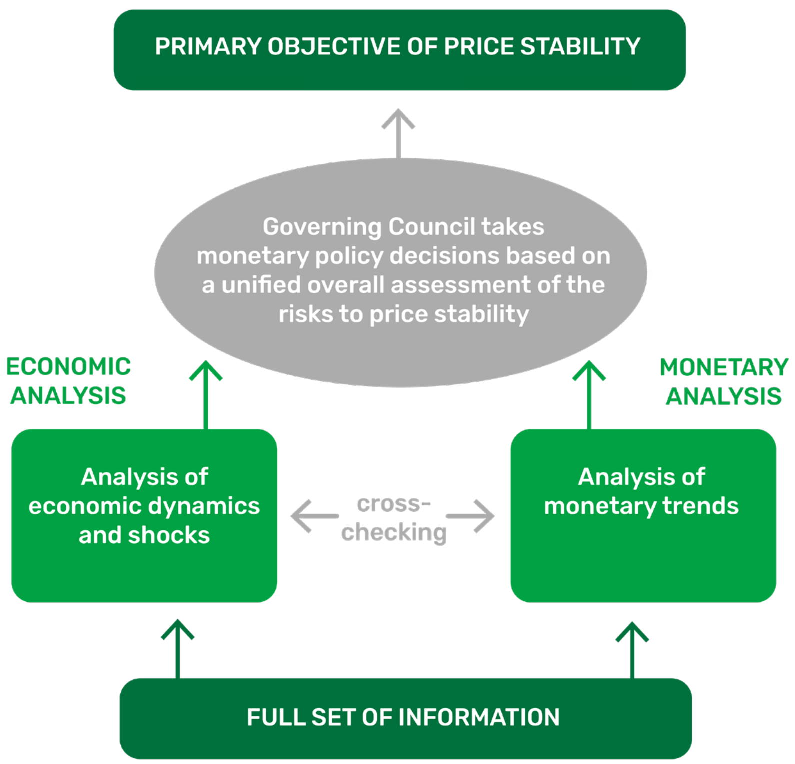
1 This chapter draws on Van 't Klooster & De Boer (2021) and Van 't Klooster (2021a).

1.1 THE OLD ECB AND ITS FOCUS ON PRICE STABILITY

The democratic legitimacy of the ECB's monetary policy rests predominantly on its legal mandate. Drafted in 1990, the mandate was meant to provide the ECB with a well-defined set of powers and conditions for their use. Although the legal text itself allows for many interpretations, the 1998 and 2003 strategies of the ECB rely on an interpretation that specifies both its objectives and instruments. The ECB's accountability to the European Parliament and the people of Europe consisted first and foremost in explaining how it had implemented the legal mandate assigned to it.

In its early strategies, the ECB saw itself as using one instrument to pursue one well-defined objective (ECB 1998; 2003)**.** As a consequence its discretion in exercising powers was limited. The ECB held itself to pursue one objective, namely "price stability" as spelled out in Article 127(1) TFEU. Before 2008, the ECB also used a narrowly defined toolbox to achieve that objective. Its operations sought to steer interest rates in short term money markets, which were to feed into the economy via bank lending. The ECB saw itself in the role of Ulysses' rowers: steering beyond the sirens of excessive money creation, using well defined instruments to achieve a clear goal. Figure 1 reproduces the decision structure from the 2003 monetary policy strategy.

Figure 1: The 2003 decision structure of the ECB (Source: ECB 2003)



As visible in Figure 1, **the ECB's early strategies involved a relatively simple decision-making procedure.** The role of the Governing Council was to interpret the evidence from the economic and monetary analyses and decide what monetary policy measures were justified to act on them. If the economy operated below its potential output, the ECB would do nothing or seek to stimulate the economy by lowering rates. If it was seen to be at risk of operating above potential, the ECB would pull the brake by raising interest rates. Establishing how to set interest rates was understood by the central bank to be a technical, not a political challenge. Since there is only one value of the instrument that is compatible with achieving the long-term potential of the economy, the discretion of the central bank is limited.

The ECB's self-conception always rested on a particular interpretation of the ECB's role rather than the letter of the law. The Treaty explicitly states that the ECB should not merely "implement", but also "define" its monetary policy. Moreover, the ECB has more objectives than just price stability. Just in the sentence after outlining that objective, its mandate states that "without prejudice to the objective of price stability, the [ECB] shall support the general economic policies in the Union". The sentence continues to specify that the ECB should support those broader economic policies to contribute to the objectives of the EU as outlined in Article 3 TEU.

Article 127 TFEU

(1) The primary objective of the [ECB] shall be to maintain price stability. Without prejudice to the objective of price stability, the [ECB] 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 [ECB] shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119.

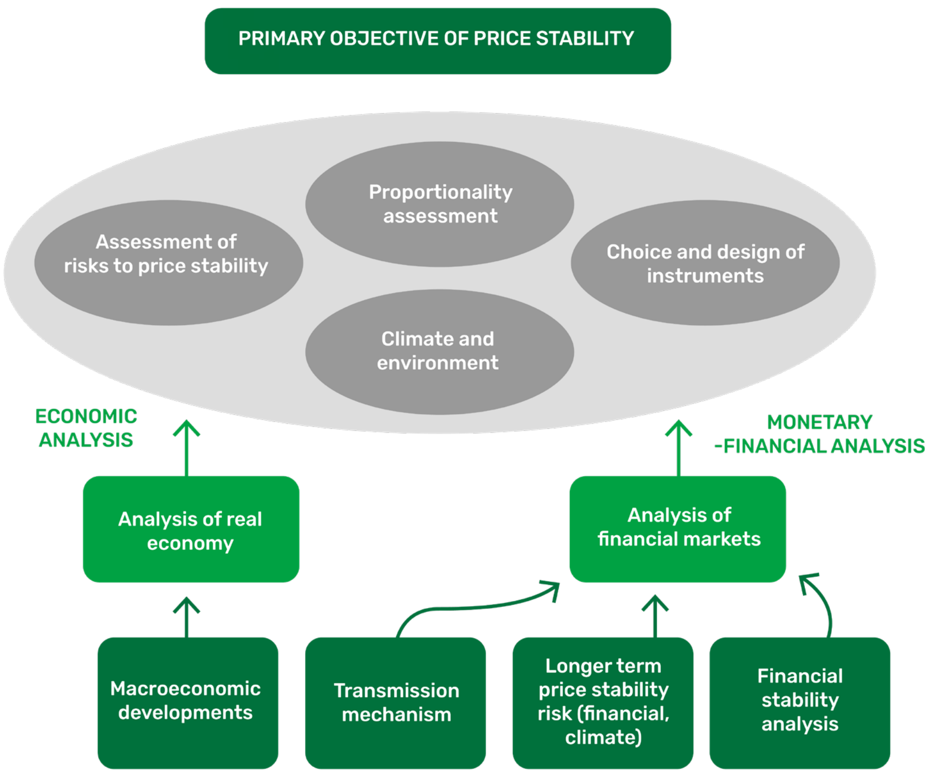
The provisions covering the ECB's instruments similarly provide almost no guidance on its use of instruments. Article 18 of its Statute permits the ECB to engage in a broad range of vaguely defined financial market transactions. Article 20 also permits the ECB "the use of such other operational methods of monetary control as it sees fit", conditional on a two-thirds majority in the Governing Council. Article 123 TFEU, which prohibits the direct purchase of public debt, is explicitly meant to allow for the purchase of government bonds in financial markets (van den Berg 2004). Article 127(1) also contains the general provision that the ECB should act "in accordance with the principle of an open market economy".

Despite the overriding importance of price stability, the ECB has always held that it should not "mechanically" pursue it at any cost. In the face of a supply shock, its medium-term orientation is meant to allow for accepting inflation above target because the costs of aggressive pursuit of price stability would be large. As it explained in the 2003 strategy review,monetary policy needs to be tailored to the nature of the shocks hitting the economy, and their size, source and potential for propagation. On this basis, the key ECB interest rates must evolve in such a way that the path of future inflation remains in line with the ECB's objective of price stability over the medium term (ECB 2003, 88).

Within the monetarist ideas that shaped the ECB at its creation, the central bank is meant to achieve the well-defined objective of price stability by using one simple tool: setting interest rates. Setting interest rates is seen as a technical exercise whereby the central bank seeks to steer the economy towards its potential output, where potential output is understood as the level of economic output compatible with long-term price stability. Higher rates reduce demand by constraining funding to the economy, which imposes an economic cost in terms of lost output. That cost, however, was held to be transilient as it would serve to maintain the economy on its long-term growth trajectory as determined by supply-side forces. In the long run, money should be "neutral". However, the time horizon over which the ECB pursues price stability can be adjusted to support broader economic priorities beyond price stability. Despite the focus on price stability, discretion and trade-offs were always part of the ECB's monetary policy strategy.

Reflecting its two-pillar structure, the Governing Council took into account two types of analysis that were both thought to be of importance for the future inflation developments (see Figure 1)**.** First, an *economic analysis* that focused on the business cycle and economic output. To determine potential output, the ECB focused its analytical efforts on determining to what extent changes of (actual) economic output are a consequence of long-term supply-side factors such as structural and frictional unemployment, and changing technology, and what deviations are merely the result from short-term fluctuations in nominal demand and commodity prices. Over time, this became by far the most important element in the analyses. Reflecting its first chief economist's conviction that monetary aggregates were crucial to price developments, the ECB also conducted a *monetary analysis*. This analysis saw private sector money creation by banks and other financial institutions primarily as an indicator of future price developments for consumer goods. The analytical framework accordingly reflected the belief that developments in financial markets were only relevant for a central bank from a price stability perspective. It was this attitude that led the ECB to miss the dramatic build-up of instability in the financial system preceding 2008 and act much too late on the doom loop in sovereign debt market during the 2010-12 Eurozone crisis.

Figure 2: The 2021 decision structure of the ECB (Source: authors)



1.2 THE ECB'S NEW STRATEGY

The 2021 strategy review formalizes the dramatic changes in the role of the ECB with an explicit role for what we refer to as de facto secondary objectives. Despite superficial continuity, the era that followed the Great Financial Crisis saw the role of the ECB change dramatically, confronting it with choices far beyond medium term-price developments (de Boer and van 't Klooster 2020). With secondary objectives, we mean considerations that the ECB pursues without prejudice to price stability, but that are to some extent independent of price stability.

The new decision structure has transformed both with regard to the elements feeding into Governing Council decision-making and with regard to the underlying analytical framework. To compare the nature of deliberation in the Governing Council under the 2003 and the 2021 strategies, we have mapped key changes onto the 2003 flow chart (Figure 2).

Governing Council decision-making on instruments, proportionality and the environment

The first thing to note when considering Figure 2 is that decision-making in the Governing Council now encompasses at least four different types of decisions. The ECB still decides on its general monetary policy stance with an eye to achieving its medium-term price stability objective. However**, three new elements have become pivotal to deliberation: instruments, proportionality and the environment.**

The first type of new choices that the ECB faces concern the many different instruments at its disposal. The ECB's main refinancing rate has been below 1% since 2012 and stuck at 0% since 2016. For that reason, the ECB has relied extensively on three types of additional instruments: (i) forward guidance; (ii) asset purchases; and (iii) longer-term refinancing operations (LTROs and TLTROs). Because it has a range of instrument at its disposal, it faces a choice in terms of which combination of instruments to use to pursue price stability. Each of these instruments, in turn, raises complex choices in the design of the instrument: how to communicate, what assets to include in the purchase programme and how to set the conditions of the targeted LTROs, amongst others. The ECB also faces entirely new questions concerning the monetary objects it issues, such as whether it could and should issue a digital form of central bank money available to the public and what design features such digital euro would have (S. Grünewald, Zellweger-Gutknecht, and Geva 2021).

A second type of new choices emerge in the context of the ECB's new proportionality assessment. Because its choice and design of instruments may have further economic policy effects, the ECB assesses whether these side-effects are outweighed by their benefits in achieving price stability. As the ECB explains:

> the Governing Council recognises the need to limit possible side effects of the new policy instruments and therefore remains committed to continuing to perform careful proportionality assessments and to adapting the design of measures related to these instruments with a view to minimising side effects, without compromising price stability (ECB 2021, 9).

Low interest rates have had a range of undesirable economic side-effects. Rather than just promoting investment, they have boosted the value of existing financial asset and real estate prices (Domanski, Scatigna, and Zabai 2016). Where the money did reach firms, these have often used it to buy their own shares and boost dividends (Cohen, Gómez-Puig, and Sosvilla-Rivero 2019; Todorov 2020). The benefits of these measures have landed disproportionately with Europe's wealthiest citizens.

Should the ECB turn to raising interest rates, potential side-effects could be even worse (Albertazzi et al. 2021). Higher rates reduce the value of fixed-income instruments and thereby impact the volume of collateral available within the financial system. It can also set off a crash in housing markets. In the worst case, high rates could lead to a financial market panic. Raising rates, moreover, is only warranted when it is effective in bringing down inflation. Today's high prices are driven by supply chain disruption and energy prices, which makes the interest rate tool less effective (Shin 2021). Higher rates can do little to bring down oil and gas prices. Similarly, they do not address limited supply in the face of shifting post-pandemic consumer demand. Higher rates would discourage producers from investing in additional capacity to relieve bottlenecks while making millions unemployed.

Doing a proportionality assessment means that the ECB will seek to design operations that are most effective, while minimizing side-effects. The ECB has already made new choices in how to deal with the side-effects of its monetary policy. For one, the ECB's TLTROs make low refinancing costs of banks conditional on sufficient "real economy" lending. This is meant to channel money directly to the real economy, while reducing the financial market effect. Second, the ECB has introduced a programme of deposit tiering, which provides banks with a rebate on the negative interest rates. This serves to offset losses to banks resulting from its deposit facility, which would negatively impact bank lending.

Third, with the 2021 strategy, the ECB has announced that it will henceforth take an active role in monitoring the effects of its policy on climate and the environment. In the past years, the EU's environmental agenda has become a major source of new challenges for the ECB. In its 2021 strategy review, the ECB has proposed new ways to reduce unintended side-effects of it policies. For example, the ECB's corporate bond purchases have been linked to boosting investment in the most polluting sectors of the European economy (Matikainen, Campiglio, and Zenghelis 2017; Greenpeace 2020; van 't Klooster and Fontan 2020). However, environmental concerns are not limited to unconventional policies: High interest rates might hinder governments and firms from making the investments needed for the EU's environmental transition. The ECB is now looking to revise the rules of its corporate sector purchase programme (CSPP) because it disproportionately benefits unsustainable sectors of the economy (ECB 2021). Going forward, nature-related economic stability is a precondition for long-term price stability, even if it has only limited impact on the 2-year time horizon that the ECB typically focuses on. The ECB also mentions climate change as an objective relevant to the design of monetary policy, although its statements fall short of identifying it as a secondary objective that the ECB pursues "without prejudice" to price stability.

The new analytical framework

The second major change to the ECB's decision structure concerns the analytical framework. While deciding how to pursue price stability, the ECB now reflects extensively on a range of new economic and financial market effects of its policy. Compared to the 2003 strategy review, the medium-term orientation of the 2021 review is a lot more cryptic. The ECB will not only consider "the appropriate monetary policy response to a deviation of inflation from the target" but also "cater for other considerations relevant to the pursuit of price stability." (ECB 2021). Although hidden behind technical economic vocabulary, it is here that we find the clearest account of the ECB's de facto secondary objectives.

Although its analytical framework looks superficially continuous with the two-pillar structure that preceded it, the two could not be more distinct. For one, while in 2003 the two pillars were both focused on predicting price stability within the medium-term time horizon, this is now relegated to the first pillar of economic analysis. This is where the ECB considers what used to be the whole of its strategy: risks to medium-term price stability. Complementing this macroeconomic economy focus, the new monetary-financial pillar treats financial market dynamics as of interest in their own right. By giving these considerations a role in decision-making, they now inform deliberation independently of medium-term price stability.

The ECB's new analytical framework takes into account three entirely distinct ways in which conditions in financial markets may shape its policy. First, financial markets are of importance because they serve to transmit the monetary policy interventions to the real economy. Disturbances in markets and spreads between the bonds of individual Member States can hamper the effects of interventions. The Governing Council now takes those effects on monetary transmission into account in how it pursues the price stability objective. Second, the ECB looks at longer-term financial market dynamics as a potential factor impacting price developments. Investment in financial assets, housing and sectors exposed to climate risk can create bubbles that impact longer-term price stability. Accordingly, these developments are now monitored more closely and discussed in the Governing Council. And third, the ECB also looks into financial stability as a consideration of interest in its own right, entirely distinct from price stability. As ECB board member Isabel Schnabel recently explained, the ECB refrained from raising rates in December 2020 because this would have "further fuelled emerging overvaluations in parts of euro area financial and real estate markets". As she went onto explain the trade-off the ECB made:

> By tolerating a potential lengthening of the medium-term horizon, we effectively mitigated risks to financial stability which could have arisen from a more intense use of our policy instruments. (Schnabel 2021)

The contrast with the 2003 strategy is striking: the ECB analyses and takes into account the monetary and financial impact of its operations in ways that are not merely instrumental towards achieving the medium-term inflation objective. Formally, financial market transmission, long-term price stability and financial stability are not designated as secondary objectives of the ECB. However, they are secondary objectives in all but name, since they are objectives that the ECB pursues along-side its medium term inflation objective. This means that the EP should be well-informed about their role in deliberation and the way they are balanced against each other.

1.3 CONCLUSION

The comparative analysis of the 2003 and 2021 strategy brings out major changes in the type of deliberation that occurs in the ECB's Governing Council. If we look at Figure 2, the axis that leads from the economic analysis to the general stance still fits the old story of pursuing a narrow objective by means of monetary policy rates. However, the addition of three new topics of deliberation in Governing Council decision-making as well as the revised monetary-financial analysis document deliberation of a much more complex nature.

Many choices that the ECB faces today cannot be (solely) subsumed under the imperative of price stability on a two to five year time horizon. They concern objectives that the ECB already takes into account without prejudice to price stability, hence fitting naturally under the legal tasks conferred onto it by its secondary mandate. With the 2021 strategy review, these de facto secondary objectives have become visible in the analytical framework. However, it remains genuinely unclear from the ECB's public statements and justification to the European Parliament how these de facto secondary objectives factor into its deliberations.

BOX 1:
THE ECB AND SOVEREIGN DEBT

The ECB's attitude to government finances remains opaque. In March 2020, the ECB took up a crucial role in backstopping bond markets, buying Member State debt equal to 92% of expected deficits in that year. Had it not done so the record issuances of public debt would have destabilized debt markets. It would also have been impossible for governments to effectively fight the pandemic. Accordingly, the question regularly comes up whether the true objective of the PEPP is not simply to fund individual governments (Bateman 2021; Gabor 2021).

The ECB's account of what the PEPP does is opaque (van 't Klooster 2021b). In the formal act describing the programme it is narrowly justified as a response to an 'extraordinary and acute economic crisis, which could jeopardise the objective of price stability and the proper functioning of the monetary policy transmission mechanism'. In its communications, however, the programme is presented as staging an economic recovery, but also as aimed towards stabilising government bond markets. Christine Lagarde has gone so far as to concede that the objective of the PEPP is to ensure 'supportive financing conditions for all sectors in the economy. This applies equally to individuals, families, firms, banks and governments.' (Lagarde 2020).

This opacity reflects the ECB's long and complex relationship to government bond markets. Before 2005 there was no ECB policy against buying sovereign debt, and the central bank was widely expected to backstop markets. There were good reasons for this. In drafting the EMU's historically unprecedented monetary financing prohibition, careful attention was paid to allow for secondary market purchases – not just with an eye to "securing the transmission mechanism of monetary policy", but rather reflecting decades of central bank experience: If governments issue large volumes of debt, in a crisis or a war, only the central bank will absorb the debt (cf Draghi 2020; Gabor 2021). In 2005, the ECB introduced a minimum credit rating requirement for sovereign debt, barring the ECB from buying debt or lending against debt with a lower credit rating.

During the Eurozone crisis rating agencies downgraded member states, resulting in a bond market panic. Until 2012, the ECB deferred to credit rating agencies in its treatment of sovereign bonds. The ECB's 2012 Outright Monetary Transactions (OMT) programme ended the crisis in European bond markets, but its legality remains contested. In 2020 there was no debt crisis despite again record deficits. The credit rating requirements for sovereigns, however, remain in flux. Before March 2020 Greece was excluded from the ECB's 2014 Public Sector Purchase Programme (PSPP), but today it is part of the PEPP. Even after net purchases end, the PEPP will continue to be re-invested in a "flexible" way, meaning that it will operate as a quasi-OMT programme from now on. Throughout all these dramatic changes the ECB justified its treatment of sovereign debt with reference to interest rate setting and the price stability objective.

In justifying these programmes to the European Parliament as geared towards price stability, the ECB provides very little insight into the considerations that shape its thinking. Explaining a multi-trillion bond purchase programme in terms of pursuing price stability raises more questions than it addresses.

2
PARLIAMENTARY ACCOUNTABILITY

There is a striking asymmetry between the ECB's new role and its accountability framework. After 2008, the ECB has moved far beyond the narrow inflation fighting role envisaged at its creation, introducing de facto secondary objectives and a host of new instruments. Meanwhile, the objectives and instruments of its accountability framework have remained almost unchanged. This asymmetry is due to assumptions that no longer hold: that setting monetary policy is fundamentally a technical task, which pursues the sole objective of price stability.

To reflect today's much more political ECB, the accountability framework should be improved along two axes: (i) **enhanced democratic justification** of the actual choices it makes; and (ii) **supplementary democratic authorization** for the ECB's pursuit of secondary objectives.

2.1 ACCOUNTABLE INDEPENDENCE

For the ECB, accountability has historically been understood to require primarily giving a justification.[2] In 2002, the ECB defined accountability as "being held responsible for one's decisions and being required to justify and explain them" (ECB 2002, 48; Fraccaroli, Giovannini, and Jamet 2018). As the ECB explained,

> a measurement of the central bank's performance always requires a balanced and differentiated assessment. While the use of formal sanction mechanisms would be too blunt and would have potentially negative implications for the efficient fulfilment of the central bank's mandate, constant scrutiny of the central bank's actions by the parliament and the public at large seems the appropriate method for holding an independent central bank accountable. (ECB 2002, 47)

The ECB's definition of accountability reflects its historical self-understanding as pursuing a well-defined price stability objective. Theorised as "accountable independence" (Lastra 1992; Magnette 2000), the ECB's accountability framework primarily served to demonstrate that the central bank's actions as a matter of fact realise its democratic mandate. To this end, the ECB set itself a simple and quantitative inflation target of "below, but close to, 2% over the medium term" (ECB 2003, 79). This metric constituted a clear standard by which to evaluate the ECB's actions. The EP's task could be limited to verifying whether the ECB has succeeded in achieving that goal and asking how it has sought to use its instruments to achieve its objectives. If it had met its target, the EP could ask in more detail how it has done so. If not, the ECB could be asked to explain how it will improve.

Recent improvements to the ECB-EP accountability framework have stayed within the accountable independence frame (see Table 1)**.** ECB Parliamentary accountability takes place through three broad instruments. First, the ECB publishes an annual report that sets out its tasks, the activities of the ESCB and the Eurosystem's monetary policy. Second, the ECB's President and other Executive Board members participate in public hearings before the EP plenary and ECON committee, respectively ("monetary dialogue"). And third, the ECB answers written questions from MEPs and responds to the EP's annual resolution on the ECB annual report. Across these three instruments, the emphasis is on the ECB explaining how it has used its instruments to achieve the inflation target.

2 On Parliamentary accountability of the ECB, see Amtenbrink & Van Duin (2009), Beukers (2013) Collignon & Diessner (2016), Braun (2017), Curtin (2017), Chang & Hodson (2019), Lastra (2015; 2020), Diessner & Jourdan (2019) Fromage et al (2019), Petit (2019) and Dawson, Maricut-Akbik & Bobić (2019), Claeys & Domínguez-Jiménez (2020), de Boer & van 't Klooster (2021). On the accountability framework for the Banking Union, see Fromage & Ibrido (2018), Amtenbrink & Markakis (2019), Maricut-Akbik (2020).

TABLE 1: ECB-EP ACCOUNTABILITY FRAMEWORK		
Accountability instrument	**Description**	**Legal basis**
Annual Report	ECB submits an annual report on its tasks, the activities of the ESCB and the Eurosystem's monetary policy to the EP, Council, Commission, European Council.	Article 284(3) TFEU, Article 15.3 ESCB Statute
	The ECB President presents the Annual Report on the occasion of the plenary debate on the EP resolution on the ECB.	Article 284(3) TFEU, Article 15.3 ESCB Statute The legal basis for EP resolutions (own-initiative reports) is Article 54 RoP[3]
	Members of Executive Board may be heard by competent committees of the EP.	Article 284(3) TFEU
	ECB Vice-President presents the Annual Report to the EP's ECON committee in a dedicated session.	Conventional practice
"Monetary Dialogue"	ECB President participates in the public quarterly hearings before the ECON committee, where she delivers a statement and answers questions from MEPs (since January 1999).[4,5]	Article 284(3) TFEU, Article 15.3 ESCB Statute, Article 135(3) and (5) RoP
	ECB Executive Board members participate in hearings of the ECON committee to explain the ECB's reasoning and decisions on specific topics.[6]	Article 284(3) TFEU, Article 15.3 ESCB Statute, Article 135(4) and (5) RoP
Other communications with the EP	MEPs can address written questions to the ECB.[7]	Conventional practice since early 2000 Article 140 and Annex III RoP
	ECB responds to EP resolution on its Annual Report ('feedback').	Conventional practice since 2016 (2014 Annual Report)

The accountability framework is supported by information on its operations that the ECB makes available to the public via different information channels, including its own publications and the media (Table 2).

3 Rules of Procedure – 9th parliamentary term – July 2019, OJ L *302, 22.11.2019, p. 1.*

4 Hearings are livestreamed, text of the statement and a verbatim report of the Q&A sessions are published on the websites of both institutions.

5 Before each meeting, the EP assembles a panel of external experts to prepare and present reports on relevant monetary policy topics, published on the EP's website.

6 Publication of a verbatim report of the meeting.

7 Answers are signed by the ECB President and published on the ECB's and EP's websites.

TABLE 2: INFORMATION TO THE PUBLIC		
Information channel	**Description**	**Legal basis**
Press conference after each monetary policy meeting	Every 6 weeks	Conventional practice
Publication of Economic Bulletin	8 times a year Contains the economic and monetary analysis that informed the Governing Council's policy decisions.	Article 284(3) TFEU, Article 15.1 ESCB Statute
Publication of weekly financial statement of the Eurosystem	Provides information on monetary policy and foreign exchange operations as well as investment activities.	Article 15.2 ESCB Statute
Publication of accounts of monetary policy meetings	Since February 2015, 4 weeks after each meeting. *No publication of detailed minutes nor of the votes of the Governing Council members. Viewpoints are kept impersonal.*	Article 132(2) TFEU, Article 10.4 ESCB Statute
Occasional papers, interviews, speeches and other academic communications	Published on the ECB's website.	Conventional practice
ECB blog	Since March 2020 Blog posts by members of the Governing Council provide insights on recent policy decisions and specific timely topics relating to the euro area economy.	Conventional practice

The ECB's understanding of accountable independence puts the emphasis on the ECB's role in explaining its choices. The ideal of accountable independence assumes that the instruments and objectives are well-defined such that the main topic of accountability should be how the central bank has gone about pursuing this task. The ECB could offset its obligations of accountability merely by showing that it had achieved its inflation target.

However, because this understanding of accountability is limited, the pressure on the ECB to provide a genuine justification was always relatively low (Amtenbrink and Van Duin 2009; Dawson, Maricut-Akbik, and Bobić 2019). The central bank needed to explain what it had done to achieve its self-imposed inflation target. Even if it failed to meet the target, the task of the EP was limited to pointing that out. This, the hope was, would contribute to ensuring better performance in the future.

2.2 ACCOUNTABILITY TODAY

The ECB's historical framework of independent accountability was premised on two assumptions that are no longer tenable. Rather than returning to its old simple role, the ECB needs new accountability mechanisms.

First, independent accountability assumed that the choices that the ECB made were of largely technical nature, so that its parliamentary justification could focus on how the ECB used one instrument to achieve its objective. However, as part of its proportionality analysis, the choice of instruments and its climate action plan the ECB makes choices as to which its objectives prioritizes and how it pursues them. Consider the example of the ECB contracting its policy stance. In the coming months, the ECB could do so by adapting its asset purchase programmes, but it could also change the refinancing conditions for banks. Changes to asset purchase programmes could either involve its older Public Sector Purchase Programme (PSPP), its Corporate Sector Purchase Programme (CSPP) or its Pandemic Emergency Purchase Programme (PEPP), or a combination thereof. All these programmes have design parameters that can be tweaked, which have a range of further financial market effects. Similarly, when it comes to the ECB's refinancing operations, existing TLTRO programmes allow for considerable differentiation with regard to the forms of lending that the ECB wants to reduce. Because monetary policy decisions are often made in a context of uncertainty there can be sizable factual disagreement on what the potential effects of any of the operational choices are. Accordingly, even where the Governing Council's concerns are focused on the medium-term development of prices, its task is far from narrowly technical.

The second assumption that informed the choice for independent accountability was that the ECB would pursue a simple price stability objective, which the ECB specified in 1998 and 2003 by choosing its inflation metric. In the past years, the ECB has dramatically broadened its understanding of price stability to (just to name a few concerns) cover interventions in sovereign bond markets and supporting the EU's climate agenda. While official ECB language still insists that all its policies ultimately pursue price stability, it is undeniable that the ECB today faces (and routinely makes!) much more complex trade-offs. Accountable independence is, however, incompatible with the pursuit of de facto secondary objectives.

The ECB's 2003 self-understanding rested on a dubious interpretation of Article 127(1), which obfuscates the legal requirements that apply to it. Article 127(1) assigns to the ECB the role of defining its monetary policy with an overriding concern for price stability but contains a secondary mandate to support "the general economic policies in the Union" to be pursued by the ECB "without prejudice" to price stability. The provision further specifies that the ECB should support those broader economic policies in order to contribute to the EU's objectives as outlined in Article 3 TEU. The secondary mandate is just as legally binding as the ECB's primary objective of price stability. Complementing these provisions, the ECB also has the task of contributing to the "smooth operation of payment systems" (Article 127(2) TFEU), "contribute to […] the stability of the financial system" (Article 127(6) TFEU) and is required to integrate "environmental protection requirements […] into the definition and implementation" its monetary policy (Article 11 TFEU). These passages go almost unmentioned in the 2003 review, which is hard to reconcile with faithful implementation of the ECB's legal mandate.

Some might think that rather than adapting independent accountability, the way to improve the ECB's accountability framework is to once again make its deliberation and decision-making conform with the "old ideal".[8] According to this view, the ECB should revoke its unconventional policies and go back to the 2003 strategy, when its deliberation and decision-making had a more narrow focus. That would involve discontinuing its asset purchase and TLTRO programmes, revoking the OMT announcement and, thereby, allowing sovereign debt markets to once again drive member states into bankruptcy. It would also end any concern about inefficiencies building up on the financial system as a consequence of asset price inflation and the failure of companies to adequately disclose climate and environment related risks. This, critics sometimes suggest, is not just desirable, but in fact required by the ECB's legal mandate.

That nostalgic view is neither realistic, nor is it convincing in terms of its legal interpretation of the ECB mandate. First, the ECB's new political role emerged from over a decade of difficult deliberation within the Governing Council itself. That role also reflects a broader shift in the ideational paradigm that inform European economic policy. Low consumer price inflation was a priority of the 1980s, which accordingly came to acquire prominent position in the early interpretation of the Maastricht Treaty. Today, financial stability, stable government finance conditions and environmental sustainability are not only key priorities of EU economic policy, but also widely recognized to be important preconditions of price stability. The Governing Council arrived at the new strategy to reflect lesson learned in the past 15 years. In the context of the 2021 strategy review, the ECB wrote eighteen (often book-length) background papers to outline its evolving thinking. Without relitigating all these debates, we do want to suggest that discarding these lessons merely to improve ECB accountability would be irresponsible.

A second, and more straightforward objection is that **insisting on the ECB's narrow price stability objective is also hard to reconcile with its mandate provisions** (Grünewald 2020; Elderson 2021; de Boer and van 't Klooster 2021; Ioannidis, Hlásková Murphy, and Zilioli 2021). As a matter of EU law, the ECB must support general economic policies in the EU, as long as this does not run counter to the objective of price stability. In the words of ECB Executive Board member Frank Elderson: the secondary objective "stipulates a duty, not an option" (Elderson 2021). In sum, **rather than clinging to the ECB's older role, the European Parliament needs to push for new accountability mechanisms for monetary policy.**

8 See for example Paul Tucker's statements to the European Parliament at the ECON Monetary Dialogue Preparatory Meeting of 02 February 2022.

2.3 IMPROVING ECB ACCOUNTABILITY

The ECB's accountability justification of policy is still that for explaining a simple, technical choice: how to use its interest rate setting to achieve medium term price stability. So what would be required to update the ECB's accountability to the EP where it concerns its new choices? We suggest it needs to be strengthened along two axes: (i) **enhanced democratic justification** of the actual choices it makes and (ii) **supplementary democratic authorization** for its pursuit secondary objectives.

Enhanced democratic justification

The European Parliament and the public should have a better account of why the ECB makes decisions that reflect the three major changes to Governing Council deliberation under the 2021 Strategy Review. These are minimal conditions to ensure that the justification that the ECB provides to European Parliament conforms to the motivation for those choices within the Governing Council.

For one, reflecting the new analytical framework, the EP needs to have better access to economic and financial analysis that inform deliberation in the Governing Council (Curtin 2017)**.** The ECB's analytical framework has been dramatically extended, but much of the documents that inform decision-making remain confidential. The EP needs much better access to the information that informs deliberation and the ECB should provide more insight in what assumptions have guided their internal debate.

Second, the EP needs to know how the ECB makes choices concerning the proportionality assessment and the choice of instruments (Dawson, Maricut-Akbik, and Bobić 2019). Where it concerns the pursuit of price stability, the ECB should say more about the choices and trade-offs it makes. For any monetary policy decision, the Governing Council faces a range of alternative courses of action. An adequate justification must not just explain why one particular set of policy were chosen to pursue price stability. It should also explain why alternative options were *not* taken.

Finally, the ECB should provide the EP with more insight into its choice of objectives. The ECB's reluctance to explicitly endorse its pursue of secondary objectives has led it to take a complex intermediate position. It now pursues a range of new priorities while presenting these as ways to pursue price stability. The ECB should put more effort in explaining how it chooses and weighs its many de facto secondary objectives. For now some potential secondary objectives are mentioned as part of the 2021 Strategy, but how they factor into deliberation and how the ECB navigates trade-offs must be much clearer.

Supplementary democratic authorization

Beyond these minimal conditions for ensuring adequate democratic justification, we also think a more fundamental rethinking of the relation between the ECB and the EU's political institutions is in order (Claeys and Domínguez-Jiménez 2020; Ioannidis, Hlásková Murphy, and Zilioli 2021; de Boer and van 't Klooster 2021). For choices that involve trade-offs in the pace of pursuing price stability, we think the European Parliament and the Council should develop new accountability practices to address the ECB's choice of secondary objectives head on.

For now, the ECB has come to pursue its new priorities largely by subsuming them under the price stability mandate. By linking these objectives to price stability, the ECB can broaden its tasks. However, there are clear democratic objections to the ECB self-imposing secondary objectives. The ECB's legal mandate contains clear authorization gaps where the narrow objective of "price stability" is indeterminate.

The democratic decision to delegate monetary policy to it does not cover many of the new choices that the ECB today faces (de Boer and van 't Klooster 2020; 2021). One clear example is the introduction of a digital euro, which would raise new political questions, for example concerning citizens privacy and state anti-money laundering priorities. Most importantly, the mandate leaves the content of the secondary objectives open. At the same time, it requires the ECB to "support" the broader economic policies, rather than making policy itself. Since the ECB is not a banking or environmental regulator it should not act by itself. The secondary mandate does not give the ECB the competence to develop economic policy itself, for example, to make housing policy or design its own energy policy. The result is a paradox: the ECB's secondary mandate is legally binding, yet indeterminate, while it only gives the ECB the power to support economic policies developed by other institutions and the Member States.

The reason that the ECB has so far preferred to focus on its price stability mandate is that the legal text leaves unclear how to navigate its secondary mandate. There are many relevant secondary objectives, which in turn can all be supported in different ways. Accordingly, any policy for pursuing secondary objectives involves prioritizing objectives and adapting relevant instruments Yet, the ECB lacks the legal competence to develop its own policies for non-monetary topics. As an unelected actor, whose legitimacy derives from a narrow legal mandate, it is not suitably empowered to navigate these topics by itself.

A contribution to the recent review of the ECB's monetary policy strategy by members of the ECB Legal Services affirms our view that coordination on the interpretation of the secondary objectives is not only legally permissible, but also desirable (Ioannidis, Hlásková, and Zilioli 2021). The study cautions against cherry picking by the ECB from amongst the many economic policies that it could support: "given that the role of the ECB in this context is to support the policies of other institutions, deferring to these policies would be warranted not only with regard to their content but also to the hierarchisation of priorities." (Ioannidis, Hlásková Murphy, and Zilioli 2021, 17). Consequently, the ECB must orient itself to the broad outlines of economic policy set by other competent institutions. Acting on the secondary objectives requires the ECB to "support general economic policies but not autonomously make them." (Ioannidis, Hlásková Murphy, and Zilioli 2021, 16).

Where its mandate leaves important choices open, high-level coordination can play an important role in ensuring the legality and legitimacy of monetary policy. There is no legal reason why the specification of the secondary objectives should be left entirely to the ECB itself. Indeed, the supportive nature of these objectives suggest that would be the wrong way to navigate the secondary mandate. Rather than leaving the interpretation of the secondary objectives to the ECB,

> [t]he institutions responsible for indicating priorities for the purpose of Article 127(1) TFEU are primarily the European Council, the Council of the European Union (the "Council"), and *the European Parliament* [our italics]. (Ioannidis, Hlásková Murphy, and Zilioli 2021, 18).

3
PROPOSALS TO ENHANCE ECB-EP ACCOUNTABILITY RELATIONS

This chapter identifies areas in which current accountability practices could and should be enhanced, making concrete proposals on how to do so. All proposed enhancements seek to strengthen ECB accountability in light of the many new choices the ECB faces. They are not necessarily alternatives, but – if introduced as a package – have mutually reinforcing effect.

Updates to the ECB-EP accountability practices are both appropriate and possible within the confines of the Treaties. Our proposals are subject to three key constraints: (i) compliance with EU primary law; (ii) flexibility towards the future; and (iii) the need to avoid market disturbances.

The chapter covers both (i) enhancements to the existing framework of democratic justification by the ECB of its policies taken (3.1) as well as (ii) the introduction of an element of democratic authorization through guidance given by the EP (3.2)**.** The former rely on the existing framework under which the ECB explains and justifies its policies to the EP *ex post*, but revise that framework in light of the ECB's increasing exercise of discretion in the pursuit of monetary policy. The latter would apply with a view to the ECB's secondary objectives and would allow the EP to provide guidance on the substance of the economic policies of the Union, the political priorities in their further development and the hierarchy between the different objectives pursued by these policies. In section 3.3, we reflect on the advantages and disadvantages of a formal IIA for achieving these objectives.

3.1 BROAD SCOPE FOR ENHANCED DEMOCRATIC JUSTIFICATION AND AUTHORIZATION

In light of the ongoing negotiations of the ECB and EP on a potential future IIA, it is necessary to shed light on the scope for enhancements to the existing accountability framework. First of all, **constraints derive from the legal framework that applies to the ECB and its accountability to the EP.** Since our proposals do not assume any Treaty amendment, they must be in compliance with primary law, in particular the far-reaching independence granted to the ECB by Article 130 TFEU. **Further constraints arise from the need to cater for future developments in the design of ECB-EP accountability and to avoid market disturbances.** While our proposals are ambitious, they stay within these constraints.

Compliance with primary law

> ***Article 130 TFEU***
>
> *When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks.*

Accountability of a kind that involves influence by other institutions is clearly anticipated by the Treaty and, accordingly, meant to be compatible with ECB independence. The ECB's independence is firmly enshrined in the Treaty. It prohibits Member States' governments, Union institutions or any other body from seeking to influence the ECB's decision-making. It also prohibits the ECB from seeking instructions from these actors (Article 130 TFEU). However, these passages should not be read as conflicting with the EP's role. Article 284(1) TFEU gives the Presidents of the Council and the Commission the right to participate as observers in the ECB's Governing Council meetings. The President of the Council is also allowed to submit motions for deliberation (Article 284 (2) TFEU). Moreover, the EP can hear the ECB's President and can hold a general debate on the ECB's annual report. All these provisions would lose their meaning were Article 130 TFEU to exclude all influence by political authorities on the ECB's monetary policy (Beukers 2013, 1581–88; Smits 1997, 170–74; Bini Smaghi and Casini 2000, 381–84). This was confirmed by Advocate-General Jacobs in the OLAF-case, who stated that:

[T]he principle of independence does not imply a total isolation from, or a complete absence of cooperation with the institutions and bodies of the Community. The Treaty prohibits only influence which is liable to undermine the ability of the ECB to carry out its tasks effectively with a view to price stability, and which must therefore be regarded as undue.[9]

With the significantly broadened interpretation of the ECB's mandate, confirmed in the 2021 Strategy Review, the independence-accountability relationship needs readjustment as well. The ECB's independence is and has always been linked to its mandate. Far-reaching independence with limited accountability arrangements may have been justified under the ECB's narrow monetarist understanding of its mandate at the time the Maastricht Treaty was drafted. However, with a changing interpretation of the role that the Treaty assigns to the ECB, the existing legal provisions on ECB accountability should also be re-considered. What is crucial is to maintain the core of the ECB's independence. A strengthening of ECB accountability should not hinder the ECB "to carry out its tasks effectively with a view to price stability", but rather enhance the legitimacy of ECB actions and decisions in light of the substantially increased discretion associated with monetary policy-making today.

The ECB's pursuance of secondary objectives requires a different form of accountability, as that new role creates risks of blurred responsibilities between different authorities and incoherence of the policies adopted by them. Both would undermine ECB independence. The Treaty assigns a supporting role to the ECB with a view to its secondary objectives, leaving their interpretation and prioritization in the hands of other, democratically accountable authorities, amongst others the EP. Independence in the context of the ECB's secondary objectives must be understood against the background of this distribution of tasks and the institutional balance it implies. Guidance from and cooperation with other EU institutions, including the EP, are necessary for the ECB to fulfill its secondary mandate, to respect the mandates of other authorities and to ensure policy consistency (Article 7 TFEU).

Flexibility to cater for future developments and avoidance of market disturbances

The proposals outlined in this report meet the need to confine the risk of market disturbances while also allowing the EP to hold the ECB accountable for its monetary policy decisions to the citizens of the Union.

The ECB-EP accountability framework needs to remain flexible to cater for future developments. The inter-institutional cooperation between the EP and the ECB has a long history. Some conventional practices have evolved beyond what is strictly required by the Treaties to accommodate, to some extent, changed market circumstances and a changing institutional self-understanding of the ECB (see Table 1). The 2021 Strategy Review acknowledges these developments, providing a key moment to enhance accountability arrangements accordingly. As explained earlier in section 2.3, we do not think it is desirable, or even possible, for the ECB to retreat to its pre-2008 monetarist role. However, history proves that central banks are (and have to be) adaptive to change – and the same goes for their accountability frameworks.

9 Opinion of Advocate General Jacobs of 3 October 2022, case C-11/00, Commission of the European Communities v European Central Bank, ECLI:EU:C:2002:556, para. 151, with reference to J.-V. Louis, A legal and institutional approach for building a monetary union, Common Market Law Review 1998, p. 33, at p. 44.

Any changes to the accountability framework should also keep expectations and market dynamics in mind. Monetary policy effectiveness and the prevention of market disturbances are often-cited arguments against disclosure of information by central banks. These concerns are most relevant for interest rate decisions, whereas most of the accountability issues we raise affect rates at best indirectly. Accordingly, the ECB has a long way to go before transparency and accountability would conflict with stability. For now, the Bank of England and the U.S. Federal Reserve are much more transparent about diverging views within their decision-making bodies, even for interest rate decisions. Fear of political pressure imposed on Governors from within their Member States may explain these differences. The reasons why the ECB is reluctant to share information are thus more political than economic.

Better accountability may in fact pre-empt market panics. An area in which we identify a need for more disclosure are the ECB's secondary objectives. Lack of information on how they feed into Governing Council deliberations leads to speculation detrimental to monetary policy effectiveness and ultimately the ECB's independence. More guidance from the democratically accountable EP on the secondary objectives may reduce existing "authorization gaps" and enable the ECB to be more transparent on how it factors these objectives in.

While we plead for maximum transparency, our recommendations acknowledge that not all information can be public. Where this is the case, we have looked for effective institutional arrangements. For some information, the EP should resort to in-chamber meetings and secret reading rooms, with full disclosure only after an appropriate time has passed. In-chamber meetings and secret reading rooms have been put in place in the context of ECB banking supervision accountability arrangements and could equally be used for purposes of monetary policy accountability. We also suggest an Independent Evaluation Office as an effective conduit for information to flow from the ECB to the EP, and back.

3.2 ENHANCING ECB DEMOCRATIC JUSTIFICATION

We make five concrete proposals to strengthen democratic justification by the ECB compared to the current accountability framework. These are: (i) enhanced self-evaluation on the part of the ECB through the publication of impact assessments; (ii) enhanced evaluation of ECB policies by the EP through *ex post* investigations of big events; (iii) establishment of an Independent Evaluation Office to provide independent evaluations of ECB policies; (iv) involvement of the ECON committee in Governing Council meetings; and (v) introduction of an EP-specific disclosure regime using secure reading rooms, if necessary.

I. Enhanced ECB self-evaluation through impact assessments

A meaningful dialogue between the ECB and the EP could be greatly facilitated if the ECB provided an assessment of expected impacts of different policy options, along the lines of the impact assessments that the Commission conducts for certain legislative and non-legislative proposals (EC 2021a). Under the current accountability arrangements, the ECB provides justification for the monetary policy measures it has adopted but not for measures (or designs of measures) it decided not to adopt. Given that there are many different ways in which the ECB could pursue its medium-term inflation objective, this is a big omission of the existing accountability framework and significantly limits the EP's ability to scrutinize ECB choices. Not only has the 2021 strategy introduced much more discretion for the ECB in making these choices, holding the ECB accountable for adopting proportional monetary policy measures has also become a much more complex exercise for the EP.

ECB impact assessments would give an overview of different policy options with their estimated (positive and negative) impacts on price stability and relevant secondary objectives. They would also discuss potential undesired side effects and how these could be offset or mitigated. If necessary, an impact assessment could be conducted for a combination of policy measures to take into account their mutually reinforcing impact.

Impact assessments collect evidence to assess whether measures are warranted "and, if so, how they can best be designed to achieve relevant policy objectives." (EC 2021a, 10) Accordingly, they include a number of key steps the precise design of which may depend on the individual measure at stake: (1) problem identification; (2) identification of relevant secondary policy objectives; (3) identification of options for achieving the primary and relevant secondary objectives; (4) identification of impacts and potential side-effects of each policy option; (5) comparison of the options (EC 2021a, 31–33; 2021b, chap. 2).

The ECB's new decision structure (see Figure 2) **already constitutes a form of impact assessment to conduct analyses and help structure internal reflection on policy design.** What is lacking is external reporting on these internal processes and their key findings in a structured, comprehensive and yet comprehensible manner. Complexity involved in monetary policy decision-making may render this a challenging task. Often, the precise workings of measures are not entirely clear and cannot be substantiated with unambiguous analysis. The U.K. House of Lords investigation into the Bank of England's conducting of quantitative easing revealed, for example, that significant "knowledge gaps" continue to exist with a view to the effectiveness of quantitative easing and its distributional consequences (HoL 2021).

Making ambiguities or "knowledge gaps" transparent, the House of Lords report concludes, will likely stimulate a learning process:

> *We recognize that the quality of data on the effects of quantitative easing is limited but we believe that greater transparency will lead to improvements over time. (HoL 2021, para. 90)*

Knowledge of what the ECB's expectations or assumptions are regarding the effects and side-effects of measures it has implemented as well as their estimated success in supporting the economic policies in the Union is a necessary precondition for the EP to hold the ECB accountable. In Table 3, we provide an idea of what a summary of such impact assessment could look like.

Table 3: Example of an impact assessment summary regarding the design of the CSPP (Source: authors)

	Option 1: status quo (baseline)	Option 2: 'tilting' approach to align with carbon footprint of EU economy	Option 3: 'tilting' approach to align with Paris climate goals
Estimated success in achieving primary objective	Description + evaluation[10]	Description + evaluation	Description + evaluation
Estimated success in offsetting undesired side effects	Description + evaluation	Description + evaluation	Description + evaluation
Estimated success in achieving secondary objective of environmental protection	Description + evaluation	Description + evaluation	Description + evaluation
Estimated impact on other secondary objectives[11]	Description (with or without evaluation)	Description (with or without evaluation)	Description (with or without evaluation)

Such impact assessments should inform the introduction of new monetary policy measures and form the basis of regular reassessments of existing measures, which may or may not lead to adjustments of these measures.

10 The assessment may or may not be accompanied by a simple evaluation system to facilitate comparability: -- (very negative); - (negative); 0 (neutral); + (positive); ++ (very positive).

11 The ECB were to specify which secondary objectives it specifically looked into.

II. Enhanced EP evaluation through ex post investigations

The EP should conduct *ex post* investigations into the decisions, actions and omissions of the ECB during an exceptional or large-impact event or period such as the Great Financial Crisis, the Eurozone crisis or the COVID-19 shock. Examples of *ex post* investigations of central bank actions include the inquiry into the causes of the financial and economic crisis in the United States and the recent inquiry by the UK's House of Lords into quantitative easing (FCIC 2011; HoL 2021). In 2013/2014, the EP's ECON committee conducted an inquiry into the impact of Troika measures, including on the role of the ECB as a member of the Troika, leading to the EP resolution of 13 March 2014.[12] The ECB contributed to the investigations by responding to a questionnaire addressed to it by the ECON committee.[13] Also, former ECB president Jean-Claude Trichet agreed to participate in a special hearing on the matter on 14 January 2014. The ECB did not disclose, however, internal minutes and other relevant documents to facilitate more in-depth scrutiny of ECB decision-making.

***Ex post* investigations should take place with an appropriate time lag**, i.e. when market conditions have normalized and there is limited risk of creating turbulences through disclosure of details on the reasons that drove the ECB to adopt a certain policy (mix). Such investigations may include requests addressed to the ECB for additional documentation and/or for additional explanation through the use of written questionnaires or invitations of members of the Executive Board to special hearings.[14] The ECB would be expected to contribute to the investigations in line with the principle of sincere cooperation between EU institutions,[15] as it has partially done in the past, following the requests of the EP and the ECON Committee, respectively. A future EP-ECB accountability framework could contain a more formal process to that end.

As *ex post* investigations by definition take place after the investigated event has taken place, risks of creating market tensions or reactions will be limited. Communication between the ECB and the EP in the course of the investigation should thus remain as transparent and open as possible. However, if compelling public interests demand it, the ECON committee and the ECB may mutually agree on more confidential ways of communication (e.g., through in-chamber hearings) on certain sensitive aspects of the investigation.

III. Independent evaluations by an ECB Independent Evaluation Office

An Independent Evaluation Office (IEO) at the ECB, modeled after similar offices at the International Monetary Fund (IMF) and the Bank of England, would provide an additional pillar of evaluation and accountability. The Bank of England was the first of the major central banks to establish an IEO as an independent unit operating at arm's length from other units within the Bank. Since its inception in 2014, the IEO has produced several reports on the Bank of England's workings across all of its functions (not just monetary policy), including on forecasting (in 2015) and on quantitative easing (in 2021). The IEO of the Bank

12 Role and operations of the Troika with regard to the euro area programme countries, European Parliament resolution of 13 March 2014 on the enquiry on the role and operations of the Troika (ECB, Commission and IMF) with regard to the euro area programme countries (2013/2277(INI)), OJ C 378, 9.11.2017, p. 182.

13 See https://www.ecb.europa.eu/pub/pdf/other/140110_ecb_response_troika_questionnaireen.pdf

14 Depending on the subject of investigation at hand, they may rely on public calls for written evidence to gather as many views on the subject as possible. For the practice of the UK Parliament's Economic Affairs committee see, e.g., <https://committees.parliament.uk/call-for-evidence/381/

15 Article 13(2), second sentence, TEU.

of England is modelled after that of the IMF, established in 2001. Both existing IEOs were launched to increase public trust in their respective institutions and improve their learning culture as well as public accountability.

The IMF IEO's terms of reference stipulate the following purpose of the IEO (IMF 2015):

The Independent Evaluation Office (IEO) has been established to systematically conduct objective and independent evaluations on issues, and on the basis of criteria, of relevance to the mandate of the Fund. It is intended to serve as a means to enhance the learning culture within the Fund, strengthen the Fund's external credibility, and support the Executive Board's institutional governance and oversight responsibilities. IEO has been designed to complement the review and evaluation work within the Fund and should, therefore, improve the institution's ability to draw lessons from its experience and more quickly integrate improvements into its future work.

An IEO would complement existing ECB self-evaluations. Self-evaluation by the ECB have increased in quantity and quality over the last years. For example, a set of occasional papers published after the conclusion of the ECB's Strategy Review and the announcement of its outcome gives the public insight into the internal discussions that informed the ECB's renewed strategy. However, lack of independence of such ECB internal review creates a risk of reinforcing institutional biases, while asymmetries in terms of information and expertise unavoidably limit the effectiveness of external evaluation by the EP. An IEO would effectively overcome these limitations by providing objective and independent analysis of the ECB's monetary policy on the basis of internal information and with highly-skilled staff.

As IEOs are independent of the decision-making bodies and staff of their respective institutions, they provide objective evaluation on issues related to the workings of their institutions. To conduct their assessments, they have access to the records that they consider necessary to conduct their work and are free to engage with relevant staff members at their institutions. The Bank of England's Chair of Court determines the IEO's remit and work programme. The Bank of England's IEO is expected to conduct two in-depth evaluation of the Bank's work per year. In the case of the IMF, the work programme of the IEO is prepared by its director.

An ECB IEO will produce reports that are extremely valuable also for the EP to hold the central bank accountable. In 2019, the Bank of England's Court had commissioned its IEO to conduct an evaluation of the Bank of England's approach to quantitative easing. The report, published in January 2021, provides a critical assessment of the Bank of England's Asset Purchase Programme accessible to the interested public (Bank of England Independent Evaluation Office 2021). It directly fed into the U.K. House of Lords investigation on the conducting of quantitative easing by the Bank of England (U.K. House of Lords 2021). The House of Lords cites the IEO report several times and also questioned Melissa Davey, Director of the IEO, as a witness on the matter.

In light of these benefits for the ECB's democratic accountability, the establishment of an IEO is of more than purely ECB-internal concern. An IEO would help the ECB draw lessons from past experience and improve the effectiveness of its work. Providing the EP with objective and independent insight into the ECB's workings, it would also improve – at least indirectly – the effectiveness of ECB-EP accountability arrangements. The EP has thus a natural interest in the establishment of an IEO at the ECB. Its inter-institutional relevance could also be reflected in the IEO's institutional design.

Different levels of EP involvement are possible. The EP could, for example, be consulted on the IEO's work programme or the appointment of its chair or other staff members. The stronger the involvement of the EP the more the IEO would become a formal instrument of accountability.

IV. Involvement of the ECON committee in Governing Council meetings

Although the Treaty does not explicitly provide for an observer status for a member of the EP, EP involvement in Governing and General Council meetings would be both legally permissible and desirable. The President of the Council and a member of the Commission may participate as observers in meetings of the ECB's Governing Council (Article 284(1) TFEU).[16] That does not, however, necessarily exclude that such observer status could be granted to a member of the EP on the basis of institutional practice. Participation as an observer in Governing Council meetings, for example represented through the chair of the ECON committee, could happen upon invitation by the ECB and be governed by the ECB's confidentiality regime (Jourdan and Diessner 2019).[17] A similar arrangement could allow involvement of the ECON committee in General Council meetings.[18]

Alternatively, the **members of the ECON committee could meet informally with ECB experts after each monetary policy meeting** of the Governing Council and each meeting of the General Council to discuss the reasons for the outcome of the deliberations.

V. EP-specific disclosure regime

Better access to key documents would not only provide MEPs with a more complete picture to scrutinize ECB decisions, it would also allow them to pressure the ECB to make these documents accessible to the public. In this way, the EP would be better placed to keep the ECB's vast discretion in terms of its disclosure policy under some democratic check.

Under current accountability practices, MEPs do not possess any additional information beyond what is known to the public at large. The EP discharges its scrutiny of ECB policies and decisions (e.g., asking questions at the quarterly hearings or written questions) on the basis of information that the ECB makes publicly available. Besides the annual report presented to the EP, the ECB publicly disseminates information through press conferences after monetary policy meetings, the accounts of these meetings and further publication channels (see Table 2). The ECB has also improved communication on internal scientific background work over the past years (e.g. the background papers of the 2021 Strategy Review). However, the sharing of such background information remains occasional and there is continuing need to improve at least the ECON committee's access to key information.

16 The President of the Council may even submit a motion for deliberation to the Governing Council (Article 284(1), second paragraph, TFEU).

17 Article 3.5 Decision of the European Central Bank of 19 February 2004 adopting the Rules of Procedure of the European Central Bank (ECB/2004/2) allows the Governing Council to invite "other persons (...) if it deems it appropriate to do so."

18 Article 3.5 Decision of the European Central Bank of 17 June 2004 adopting the Rules of Procedure of the General Council of the European Central Bank (ECB/2004/12).

Today, the ECB Governing Council enjoys almost unlimited discretion as to which information is made public or not and in which form. While the ECB has undoubtedly become more transparent over the last years, it still observes a restrictive disclose regime, with the vast majority of ECB internal documents classified as ECB-RESTRICTED, ECB-CONFIDENTIAL or ECB-SECRET (Curtin 2017). Moreover, public access to ECB documents is governed by an ECB Decision[19] as the EU's access to documents regime does not apply to the ECB in its capacity as monetary policy maker.[20]

Several public interests may warrant secrecy, but not all arguments currently put forward are convincing.[21] The ECB has always held that confidentiality protects the members of the Governing Council from undue pressure from their respective member states.[22] The Treaties provide for the possibility of greater transparency regarding Governing Council deliberations (e.g., the publication of verbatim minutes and/or votes of individual members after five years) but leave the decision to the ECB.[23] More problematic from the point of view of Parliamentary accountability is secrecy with the aim of protecting the "financial, monetary or economic policy of the [Union] or a Member State".[24] Withholding certain information from the market and public at large may be warranted in some instances to ensure the effectiveness of monetary policy and – in the worst case – trigger market turbulences. However, it is often precisely that information that the EP would need to properly assess the reasons and proportionality of the ECB's decisions and actions. Examples include internal memos by the ECB's Legal Services and other Departments on the practical implementation, design or legal feasibility of specific monetary policy measures that inform the decisions of the Governing Council.

If documents are disclosed with an appropriate time lag, there will often be no weighty public interest in favor of secrecy. If strictly necessary, however, they could be made available to MEPs on a confidential basis or even within secret reading rooms. This practice already applies with a view to ECB Banking Supervision and would require the establishment of new classification categories by the ECB (i.e., ECB-EP-RESTRICTED, ECB-EP-CONFIDENTIAL and ECB-EP-SECRET).

19 Decision of the European Central Bank of 4 March 2004 on public access to European Central Bank documents (ECB/2004/3), OJ L 80, 18.3.2004, p. 42. See also Article 23.2 Decision of the European Central Bank of 19 February 2004 adopting the Rules of Procedure of the European Central Bank (ECB/2004/2), OJ L 18.3.2004, p. 33 (as amended).

20 Article 15(3), fourth subparagraph, TFEU.

21 See Article 4(1)(a) Decision of the European Central Bank of 4 March 2004 on public access to European Central Bank documents (ECB/2004/3), OJ L 80, 18.3.2004, p. 42.

22 This argument is quite controversial (e.g., Buiter (2014), amongst many others).

23 Article 132(2) TFEU ('The European Central Bank may decide to publish its decisions, recommendations and opinions'); Article 10.4 ESCB Statute ('The proceedings of the meetings shall be confidential. The Governing Council may decide to make the outcome of its deliberations public').

24 See Article 4(1)(a), second indent, Decision of the European Central Bank of 4 March 2004 on public access to European Central Bank documents (ECB/2004/3), OJ L 80, 18.3.2004, p. 42.

3.3 INTRODUCING SUPPLEMENTARY DEMOCRATIC AUTHORIZATION

A second prong of enhancements relates to the introduction of democratic authorization, enabling the EP to weigh in on the ECB's pursuit of secondary objectives (Article 127(1) TFEU and Article 3(3) TEU)**.** While the ECB finds itself in a supporting role when it comes to the "economic policies in the Union", the EP is one of the institutions that actually *makes* these policies. It is natural to assume a role for the EP in giving guidance to the ECB on the substance of the economic policies in the Union, the political priorities in their further development and the hierarchy between the different objectives pursued by these policies. Such guidance would help fill the "authorization gaps" the ECB is increasingly confronted with and enable it to act on the basis of input from the democratically accountable EP, thereby reducing concerns regarding democratic legitimacy and litigation risk.[25]

The EP can only give meaningful guidance if it has sufficient and adequate information on the ECB's choices in juggling the secondary objectives. Impact assessments published by the ECB, as proposed earlier in this report, would provide a meaningful source of information to that end. They would also allow the EP to scrutinize whether the ECB followed the guidance given on its secondary objectives, and if not, why.

We make three concrete proposals to supplement democratic justification with elements of democratic authorization:

I. EP gives its interpretation of secondary objectives. The EP could in the future devote a special section of its resolutions on the ECB's annual report to its interpretation and prioritization of the ECB's secondary objectives. This could include forward-looking input regarding pending legislative proceedings, Parliamentary initiatives and the priorities of MEPs in terms of these objectives. The guidance could identify current and future legislation that might be relevant for the implementation of monetary policy and outline – in broad terms – ways in which the legislation may affect the ECB's supporting role. It could involve a further element of accountability in evaluating whether the ECB has succeeded in maintaining priorities as set out in earlier resolutions.

In its feedback on the EP's resolution, the ECB could engage with the guidance given. It could explain how and which secondary objectives were taken into account with a view to a specific measure or decision and how their prioritization is in line (or not) with the guidance received from the EP.

II. EP incorporates reference to the ECB's supporting role in legislation. The EP could incorporate reference to the ECB's supporting role in the recitals of legislation that it

25 This report focuses on the role of the EP in providing guidance on the ECB's secondary objectives. Potential roles of the Commission and the Council in that respect fall outside the scope of this report.

identifies as relevant and high-priority for the ECB's secondary mandate. Examples of relevant and high-priority legal acts may include the Taxonomy Regulation[26] and the Sustainable Finance Disclosure Regulation.[27] Building on such Parliamentary guidance, the ECB could adjust the design of asset purchase programmes and the pricing of refinancing operations to support the EU's environmental agenda (van 't Klooster and van Tilburg 2020).

III. ECB consults EP on evolving strategy. The ECB should consult the EP regarding its interpretation of the secondary objectives and their relevance for the ECB whenever the ECB contemplates strategy changes. Consultations should take place in the context of regular reviews every five years, but also with a view to *ad hoc* reorientations within the strategy considered by the Governing Council. A stronger involvement of the EP in Governing Council meetings, as suggested earlier in this report, may prove essential to facilitate dialogue between the two institutions on the secondary objectives.

26 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, OJ L 198, 22.6.2020, p. 13.

27 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019, p. 1.

3.4 FORMALIZING CURRENT AND FUTURE CONVENTIONAL PRACTICE? ADVANTAGES AND DISADVANTAGES

Turning the current approach of evolving constitutional practice on the basis of informal unwritten agreement between the EP and the ECB into a formalized written IIA has advantages and disadvantages. An IIA would be a new step in EP-ECB interactions. Over the past decades, the EP-ECB accountability practices have evolved over time to go beyond what is strictly required by the Treaties. The conventional practices established constitute a form of interinstitutional agreement between the ECB and the EP. They are neither put in writing nor the result of any formal negotiation process. However, the existing accountability arrangements are implemented on the basis of a shared understanding by the two institutions that these practices are both necessary and appropriate to establish effective dialogue and eventually ensure that the ECB is accountable for its monetary policy to the citizens of the Union. Hence, the EP should ask itself: Should a future accountability framework be formalized? Or should it build upon existing conventional practices?

To aid the EP in navigating these questions, we put forward four main considerations.

I. Improvements in substance are possible without formalization. Enhancements to the existing accountability arrangements, in terms of both democratic justification and democratic authorization, as proposed in this report, do not depend on the conclusion of a formal IIA between the ECB and EP. They could continue to be part of interinstitutional conventional practice.

II. Formalization implies a stronger commitment. A formal IIA increases the level of commitment on the part of the ECB to comply with the agreed framework, even if not designed as a binding agreement in a strictly legal sense (Beukers 2011). A formalized IIA on monetary policy would be perceived as morally or politically binding and may exhibit certain indirect legal effects. The duty of sincere cooperation[28] and the principle of legitimate expectations imply that the parties to an inter-institutional agreement are prohibited from unilateral or arbitrary termination (Jacqué 1987, p. 400). Both the ECB and the EP would be expected to renegotiate the contents of a formal IIA before terminating the agreed accountability arrangements and to give justification to the other party for doing so.

III. Formalization is in line with the importance of EP-ECB relations. EP-ECB relations have intensified and evolved substantially over the past years. A formal IIA would give the appropriate weight to these relations and to the EP as the ECB's accountability forum for monetary policy. Formalization makes the role of the EP more visible and ultimately strengthens accountability.

28 Article 4(3) TEU.

IV. Formalization reduces flexibility. A formalized IIA could reduce the flexibility of the ECB and EP to adapt *ad hoc* to future developments. Enhancements of the formalized accountability arrangements would require a renegotiation of the IIA or would otherwise remain outside the framework of the IIA. Formal negotiations are resource-intense for both institutions and may increase resistance to further enhancements, in particular of the ECB. A formal commitment to renegotiate in good faith upon the request of one party may mitigate these concerns. Flexibility could also be improved if the IIA were subject to regular joint reviews regarding its effectiveness and appropriateness, for example in the context of monetary dialogue.

CONCLUSION: HOW TO NEGOTIATE THE IIA ON MONETARY POLICY

This report asked two questions: How should the EP and the ECB improve the accountability relationship? And what function can a formalized IIA have in contributing to doing this? To conclude we outline how our answers to these questions should inform the ongoing negotiations between the EP and the ECB.

The arguments we put forward in Chapters 1 and 2 show that **the EP has a strong claim in pushing the ECB to improve the existing accountability structures.** Current accountability practices lag behind the dramatic evolution of monetary policy since 2008, placing the onus on the ECB to update its understanding of the relevant Treaty provisions. It is not consistent to launch a Pandemic Emergency Purchase Programme, legal but much against the grain of the 1992 EMU, while insisting that accountability practices should remain as close to the EU Treaty texts as possible.

The ECB's new political role requires accountability structures that are up to scratch. To accommodate the ECB's new role, **the EP should push for** improvements along two axes: i) **enhanced democratic justification** to the EP and the broader public; and ii) **supplementary democratic authorization** by the EP (and other political institutions) of the EU.

From a perspective of negotiation, we note an important asymmetry between these two axes. **While any improvements to democratic justification require the ECB to move, the EP can itself initiate a practice of supplementary democratic guidance**, for example in its annual resolution on the ECB's annual report. Once an EP practice along these lines develops, the Council and Commission may also be willing to develop similar practices.

In chapter 3, **we outlined concrete proposals for improving both axes of ECB accountability.** To enhance the ECB's democratic justification we proposed enhanced ECB self-evaluation through the publication of impact assessments of monetary policy measures, EP *ex post* investigations of big events, an ECB Independent Evaluation Office, EP involvement in

Governing Council meetings and an EP-specific disclosure regime. We also proposed supplementary democratic authorization through EP interpretations of the secondary mandate provisions, EP consultation on strategy changes and references to ECB secondary objectives in legislation that is relevant for the implementation of monetary policy. Turning to the role of a formal IIA, we highlight advantages and disadvantages that should be kept in mind. Since our proposals all take **into account primary EU law and the need to ensure effectiveness of the ECB's monetary policy, none of them should be** ***a priori*** **off the table.**

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