Dealing with the ECB's triple mandate

By Christophe Blot, Jérôme Creel, Paul Hubert and Fabien Labondance

The financial crisis has sparked debate about the role of the central banks and monetary policy before, during and after the economic crisis. The prevailing consensus on the role of the central banks is eroding. Having price stability as the sole objective is giving way to the conception of a triple mandate that includes inflation, growth and financial stability. This is *de facto* the orientation that is being set for the ECB. We delve into this situation in one of the articles of the OFCE issue entitled *Reforming Europe* [1], in which we discuss the implementation of these three objectives.

The exclusive pursuit of the goal of price stability is now insufficient to ensure macroeconomic and financial stability. [2] A new paradigm is emerging in which the central banks need to simultaneously ensure price stability, growth and financial stability. This has been the orientation of recent institutional changes in the ECB, including its new responsibility for micro-prudential supervision. [3] Furthermore, the conduct of the euro zone's monetary policy shows that the ECB has also remained attentive to trends in growth[4]. But if the ECB is indeed pursuing a triple mandate, what then is the proper relationship between these missions?

The crucial need for coordination between the different actors in charge of monetary policy, financial regulation and fiscal policy is lacking in the current architecture. Furthermore, certain practices need to be clarified. The ECB has played the role of lender of last resort (with banks and to a lesser extent States) even though it has not specifically been assigned this role. Finally, in a new framework in which the

ECB plays a greater role in determining the euro zone's macroeconomic and financial balance, we believe it is necessary to strengthen the democratic accountability of the Bank. The definition of its objectives in the Maastricht Treaty in fact gives it strong autonomy in interpretation (see in particular the discussion by Christophe Blot, here). Moreover, while the ECB regularly reports on its work to the European Parliament, the latter does not have any way to direct this [5].

Based on these observations, we discuss several proposals for coordinating the ECB's three objectives more effectively henceforth:

1 – Even without modifying the treaties in force, it is important that the heads of the ECB be more explicit about the different objectives being pursued [6]. The declared priority of price stability no longer corresponds to the practice of monetary policy: growth seems to be an essential objective, as is financial stability. More transparency would make monetary policy more credible and certainly more effective in preventing another financial and banking crisis in particular. The use of exchange rate policy [7] should not be overlooked, as it can play a role in reducing macroeconomic imbalances within the euro zone.

2 – In the absence of such clarification, the ECB's extensive independence needs to be challenged so that it comes up to international standards in this area. Central banks rarely have independence in deciding their objectives: for example, the US Federal Reserve pursues an explicit dual mandate, while the Bank of England's actions target institutionalized inflation. An explicit triple mandate could be imposed on the ECB by the governments, with the heads of the ECB then needing to make effective tradeoffs between these objectives.

3 – The increase in the number of objectives pursued has made it more difficult to deal with tradeoffs between them. This is

particularly so given that the ECB has *de facto* embarked on a policy of managing the public debt, which now exposes it to the problem of the sustainability of Europe’s public finances. The ECB’s mandate should therefore explicitly spell out its role as lender of last resort, a normal task of central banks, which would clarify the need for closer coordination between governments and the ECB.

4 – Rather than calling the ECB’s independence completely into question, which would never win unanimity among the Member States, we call for the creation *ex nihilo* of a body to supervise the ECB. This could emanate from the European Parliament, which is responsible for discussing and analyzing the relevance of the monetary policy established with respect to the ECB’s expanded objectives: price stability, growth, financial stability and the sustainability of the public finances. The ECB would then not only be invited to report on its policy – as it is already doing to Parliament and through public debate – but it could also see its objectives occasionally redefined. This “supervisory body” could for example propose quantified inflation targets or unemployment targets.

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[1] *Reforming Europe*, edited by Christophe Blot, Olivier Rozenberg, Francesco Saraceno and Imola Streho, *Revue de l’OFCE*, no. 134, May 2014. This issue is available in French and English and has been the subject of a post on the OFCE blog.

[2] This link is examined in “Assessing the Link between Price and Financial Stability“ (2014), Christophe Blot, Jérôme Creel, Paul Hubert, Fabien Labondance and Francesco Saraceno, *Document de travail de l’OFCE,* 2014-2.

[3] The implementation of the banking union gives the ECB a role in financial regulation (Decision of the Council of the

European Union of 15 October 2013). It is henceforth in charge of banking supervision (particularly credit institutions considered "significant") in the Single supervisory mechanism (SSM). As of autumn 2014, the ECB will be responsible for micro-prudential policy, in close cooperation with national organizations and institutions. See the article by Jean-Paul Pollin, "Beyond the banking union", in *Revue de l'OFCE, Reforming Europe* .

[4] Castro (2011), "Can central banks' monetary policy be described by a linear (augmented) Taylor rule or by a nonlinear rule?", *Journal of Financial Stability* vol.7(4), p. 228-246. This paper uses an estimation of Taylor rules between 1991:1 and 2007:12 to show that the ECB reacted significantly to inflation and to the output gap.

[5] In the United States, the mandate of the Federal Reserve is set by Congress, which then has a right of supervision and can therefore amend the Fed's articles and mandate.

[6] Beyond clarifying objectives in terms of inflation and growth, the central bank's fundamental objective is to ensure confidence in the currency.

[7] This issue is considered in part in a recent OFCE post.