LSE Ideas

The Future of the
European Central Bank

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INTRODUCTION

The European Central Bank (ECB) is more important than ever to the European economy. Can governments control it? This report explores the need to make the ECB more transparent and democratically accountable to prevent the next Eurozone crisis.

The (ECB) needs to be looked at in the context of its past record. It has strayed from its mandate into economic and fiscal policy, and there has been an element of mission creep.

The ECB can justly claim to have held together a poorly-designed system in difficult circumstances. But the mission creep is its own responsibility. Not only is the ECB shielded from politicians, the ECB's statutes have also placed the ECB beyond the reach of democratic rules that sanction bad behaviour. What does this mean for the countries, companies, and banks that have grown to depend so much on the ECB?

Meanwhile, the European interest rate cycle is turning. The days of low interest rates are not quite over yet, but borrowing costs look set to start rising. Interest rates have remained lower for longer than we might have expected, but it is good to remember that a zero base rate and a central bank pumping money into the economy through purchasing bonds is not the norm.

ECB policymaking has become problematically controversial and politicised. At the very least, the reinforcement of democratic scrutiny over ECB policymaking is more urgent than ever. The evidence points to the ECB as both a technocratic and a political Leviathan within the Eurozone.

The ECB's independence, and the lack of accountability that comes with this independence, are only legitimate to the extent that the ECB has a narrow mandate, and follows this mandate. The expansion of the ECB's responsibilities for the survival of the single currency adds a dimension of institutional loneliness, as opposed to independence, to the ECB's role in the euro's governance.

In a recognition of the ECB's ever-more political roles – policies with redistributive effects, participation in the Troika, and the political implications of administering Emergency Liquidity Assistance – this report recommends the creation of a mechanism to ensure 'political buy-in' from the European Parliament and the Eurogroup for ECB actions that go beyond its mandate. The report explores the ECB's internal mechanisms to manage potential conflicts of interest, and highlights obvious areas of concern. These shortcomings in the integrity of the ECB warrant urgent improvements in particular in light of the ECB's unparalleled independence, which precludes proper external checks.

Following the euro's prolonged crisis, a consensus has emerged that in the absence of a more active fiscal policy, there has been an overreliance on monetary policy. This came in addition to the ECB's new role in the design and oversight of conditionality attached to macroeconomic adjustment programmes or 'bailouts', as well as ECB oversight of the euro area's largest banks as part of the Banking Union. This report explores these examples of the ECB's overlapping roles and potential conflicts of interest. ■

IS THE EUROPEAN CENTRAL BANK 'TOO BIG TO SUCCEED'?

John Ryan

At the moment, the European Central Bank (ECB) is both politicised and free from external political control. In principle, it is hard to see how this is sustainable over the long term. But it is equally hard to see how things can change, given Germany's principled attachment to central bank independence, and its entirely practical attraction to an arrangement under which the EU's more troublesome states will be disciplined without Germany getting all the blame.

> "European Monetary Union (EMU) has been a considerable achievement. Yet it also remains fragile because of a flaw in its governance."

If the history of Europe is any guide, then such apparently irrational arrangements can persist for a very long time indeed.[1] What it means is more of the same sub optimal performance that has plagued Europe since the Eurozone crisis began, including persistent high unemployment and financial instability. The Eurozone will endure, but it will not prosper.[2]

European Monetary Union (EMU) has been a considerable achievement. Yet it also remains fragile because of a flaw in its governance. This flaw is linked to the fact that there is no European government with the power to tax and spend independently from national governments, which means there cannot be even limited integration of government budgets and political oversight.[3]

If mutualisation of at least a part of member states' debt (sharing the responsibility for that debt across the Eurozone) was to happen, the Eurozone would take a big stride towards a large, integrated, and liquid (busy and stable) bond or debt market. This would make the European bond market more like that of the United States, which makes the dollar such an attractive currency. It would partly address the complaint that the euro is a currency without a state and so by definition lacks the independent fiscal capacity that is a fundamental characteristic of a reserve currency.[4] So far, Germany has downplayed the grand plan of French President Emmanuel Macron for Eurozone reform, refusing to concede any substantive step towards fiscal union or a federal EU crisis machinery.

THE TECHNOCRATIC EUROPEAN CENTRAL BANK RULES THE DEMOCRATIC VOID

In 2015 Mario Draghi, the head of the ECB, decided to extend European Quantitative Easing (creating new money to buy financial assets, including bonds – known as Euro-QE) until March 2017. Then he extended Euro-QE to December 2017, with a promise to do more if necessary. When 2017 arrived there was talk of tapering, or reducing the programme. But in October 2017, the ECB announced that starting in January 2018 it would make monthly purchases of €30 billion until the end of September 2018, "or beyond, if necessary."[5] The ECB will halve its monthly purchases of bonds to €15 billion between October and December and stop them at the end of 2018, and sees no prospect of an increase in the ECB's key lending rate – currently 0.0% – until the summer 2019 at the earliest.[6] But what would that mean for the countries, companies, and banks that have grown to depend so much on the ECB?

It is, however, not just the vast power with which the ECB holds sway over Europe's economies that is cause for mounting concern, it is the complete lack of transparency and accountability with which it wields that power.[7] The ECB is far more independent than the US Federal Reserve, whose legal status is far weaker and which is directly accountable to Congress and the US government. The ECB was supposed to be like the German central bank, the Bundesbank. It has, however, failed to emulate the distinctive attributes that made the Bundesbank successful, such as accountability and interdependence with other democratic institutions.[8]

The Maastricht Treaty, which defines the role of the ECB, says that the ECB has a primary mandate to maintain stable prices. It also says that, "where it is possible without compromising the mandate to maintain price stability", the ECB will also support the "general economic policy of the EU". This includes, among others, "steady, non-inflationary and environmentally friendly growth'" and "a high level of employment". However, the emphasis is explicitly on price stability. The ECB can therefore justly claim to have held together a poorly designed system in difficult circumstances. But its mission creep is its own responsibility.

Not only is the ECB shielded from politicians, ECB statutes have also placed it beyond the reach of democratic rules on bad behaviour.[9] The ultimate control politicians have over a central bank is the power to change its rules or statutes and the power to appoint governors. For example, in the case of Germany, a simple majority in the Bundestag could change Bundesbank law. This procedure is absent in the Eurozone. The statutes of the ECB can only be changed by revising the Maastricht Treaty, which requires unanimity of all member states – an unachievable political goal.

The ECB today argues that the only institution that has the right to limit its power is the European Court of Justice. But the court itself is not controlled directly by elected politicians, and it is consistently displaying an activist 'Europhile' interpretation of European treaties.[10]

The Eurozone crisis has given the ECB governing council such an increase of power that no national government or national institution can match it. The Governing Council can at any time, with a majority vote, decide the fate of at least half a dozen governments, supporting them or bringing them down – and that number is increasing.

The ECB's buying of sovereign and corporate bonds has spawned a mass culture of financial dependence across Europe, while merely serving to paper over the cracks that began forming in some Eurozone economies during the sovereign debt crisis. In many places the cracks are even bigger now than they were back then. This is the elephant in the ECB's room, and by now it is too big to ignore.

WAS KARL OTTO PÖHL RIGHT ABOUT THE SUSTAINABILITY OF THE EUROZONE?

The Euro, although 'a currency without a state', is backed by significant political and even state-like commitments. That the Euro must be saved at all costs is a core belief of both technocrats such as Draghi and politicians such as German chancellor Angela Merkel. Political elites, particularly in Germany, have staked their legacy on its success.[11]

But there is a growing mismatch between the monetary and fiscal sides of the Eurozone governance system and this has led to a number of problems. The main problem is that, while we may not find it easy to live with the ECB, we cannot live without it. Yet, when we look at the Greek bailout programmes, it is easy to conclude that they have failed.[12] The troika has imposed austerity, which has led to a severe contraction of output and highly adverse welfare effects. This was intended, in a way, to punish Greece for its perceived profligacy rather than serve as a way out of the crisis.[13]

With almost prophetic insight German economist and former president of the Bundesbank Karl Otto Pöhl wrote in 1988:

> "In a monetary union with irreversibly fixed exchange rates the weak would become ever weaker and the strong ever stronger. We would thus experience great tensions in the real economy of Europe ... In order to create a European currency, the governments and parliaments of Europe would have to be prepared to transfer sovereign rights to a supranational institution."[14]

In the early stages of the crisis, the ECB exercised its influence through secret letters to troubled member states such as Ireland and Italy, laying down conditions and implicitly threatening to withdraw support if they were not met. Now, the bank exercises its power directly and in public.[15]

THE POLITICISATION OF ECB POLICYMAKING

In November 2010, in a letter to the Irish Finance Minister, the ECB threatened to cut off liquidity support for Irish banks unless the government agreed to a financial assistance programme with the EU and the IMF (known as the 'troika', or set of three).[16] The letter also made demands for fiscal austerity and structural reform that were not only beyond the ECB's remit but were also wrong for Ireland's circumstances. (In 2013 the ECB, now under Draghi's leadership, similarly sought to impose a troika programme on Cyprus.)

> “The main problem is that, while we may not find it easy to live with the ECB, we cannot live without it.”

It is unclear whether the ECB’s role in designing and monitoring conditions on spending and structural reforms for financial assistance packages is consistent with its legal mandate.

The history of ECB involvement in Ireland and Greece during the Eurozone crisis showed that as long as its ‘lender of last resort’ role remains as confused as it currently is, questions about whether the ECB is acting beyond its legal mandate and becoming overly involved in political and economic policy will in turn provoke questions about its legitimacy and accountability. [17]

The ECB’s irresponsible actions in this case call into question their respect for the IMF attempts to resolve Greece’s debt crisis in a sustainable way. The ECB may or may not have had good reasons to cut off Greece – depending on your point of view – but it is clear that such a move is political. A central bank that is supposed to be the lender of last resort and guardian of financial stability was taking a deliberate and calculated decision to damage the Greek banking system. There was reputational damage, with the ECB seen in some quarters as arrogant, unaccountable, and authoritarian.[18]

Meanwhile, the European interest rate cycle is turning. The days of super-low interest rates are not quite over yet, but borrowing costs look set to start rising. The ECB will have to start preparing the way over the next 12 months. We need to remember that a zero base interest rate and a central bank pumping money into the economy through purchasing bonds is not the norm. In one country alone, the cracks are so large that they could end up fracturing the entire Eurozone project. That country is Italy.[19]

The government of Italy is saddled with one of the biggest public debt mountains in the world. The ECB now holds €341 billion of Italian bonds, an amount that far exceeds the €246 billion increase in Italy’s gross national debt since the ECB’s purchase programme started in 2012. The Five Star Movement and the Northern League who recently agreed to form a government following the 2018 election, were – according to a draft version of their coalition agreement leaked on 15 May 2018 – considering asking the ECB to forgive €250 billion of the country’s debt. They denied the leak was accurate, but Italian government bond prices dipped sharply the following day in reaction. The new Italian government may face serious problems from the markets and the European Union. Italian bonds will begin to soar, driving up the costs of funding for the Italian government. This is a major problem for Italy whose economy is still 6% smaller than it was before the global financial crisis of 2008.[20]

Italy’s new anti-establishment government gives the ECB some tough choices as it tries to tread a line between containing market turmoil and sticking to plans to end its crisis-era monetary support. The Italian government indicated that they had worries about whether — and how — the ECB was affecting markets. “The spread has spiked: it would be useful to know how much debt the Bank of Italy and the ECB have bought compared to the norm?

Have purchases gone down?”[21] At the same time, it was quick to reiterate its commitment to the Euro.

Italian finance minister Giovanni Tria stated in an interview with Corriere della Sera:

> “The position of the government is clear and unanimous. There is no discussion about leaving the euro. The government is determined to prevent any emergence of market conditions that would lead to leaving the euro. It’s not just that we don’t want to leave it: we will act in such a way that conditions that could call into question our presence in the euro area don’t start to emerge”.[22]

Tria was asked about Italy’s position with regards to France’s calls for common bank deposit insurance and a Eurozone investment budget and Germany’s calls for monitoring on member states by a European monetary fund and debt restructuring procedures:

> “We agree with what France proposes. We want to move forward on many aspects of euro area governance and the Banking Union. I just say that: as for the monitoring, the EU commission has done a very good job, I don’t see why we should create an overlap with the intervention of a European monetary fund. More in general, we are not going to accept measures which, albeit unintentionally, may cause financial instability. Let’s avoid unintended consequences. Let’s be careful to avoid self-fulfilling prophecies. Italy is committed to reduce its debt, but for this process to go on we can’t accept proposals undermining confidence in our debt sustainability.”[23]

Unless Tria’s actions depart markedly from his words, the populist reform agenda in Italy is pretty much dead on arrival. He has decided to placate the markets, ECB, and the EU for now while playing a longer and stealthier game of loosening Eurozone austerity.

ECB LEVIATHAN LACKS ACCOUNTABILITY

Now the European project is in real trouble with out-of-touch domestic and European political elites and an establishment unable to address the concerns of public opinion. Many people no longer trust mainstream politicians, EU technocrats, and elites in general.[24] They seem captured by vested interests and incapable of improving the life of ordinary people, let alone setting out a compelling vision of a brighter future. Politics is turning nasty, fractious and inward-looking – with unpredictable consequences.[25]

Perception matters. ECB President Mario Draghi has been reprimanded in public by the EU’s Ombudsman, Emily O‘Reilly, whose job it is to arbitrate public complaints about EU institutions. The complaint against Draghi was that he had compromised his public role by regularly attending the Group of 30 (G 30), a private club of corporate and central bankers. In her response to the complaint, O‘Reilly recommended that Draghi should suspend his membership of the group for the remaining duration of his term:

> “The implied closeness of the relationship through membership – particularly between a supervising bank and those it supervises – is not compatible with the independence obligation of an institution such as the ECB.”[26]

While O'Reilly said there was no evidence of sensitive information being shared at the G30, there could still be "a perception that, through the participation of members of the ECB's decision-making bodies, the ECB could be open to influence in the shaping of new regulatory practices."[27]

And it is not as if the ECB has not already got into hot water over sharing sensitive information with market players in other settings.[28] In 2015, a member of the ECB's highly influential Governing Council, Benoît Cœuré, was caught sharing confidential, privileged information about the ECB's imminent bond purchases at a meeting of academics, bankers, and hedge funders to allow them to front-run the programme (trading with advance knowledge).[29]

The ECB is already home to hundreds of billions of Euros worth of artificially low-yielding sovereign bonds and on the back of this is becoming a dumping ground for risky corporate debt that is paying low yields. Under Draghi's leadership, the ECB is now the world's biggest 'bad bank'.

Quantitative easing constitutes a monetary policy experiment, the social, financial, and macroeconomic consequences of which vastly exceed conventional monetary policy. In September 2017, the ECB had a total balance sheet of €4.5 trillion.[30] Something of this scale needs accountability.

CONCLUSION

The Eurozone, in its relatively short time of existence, has successfully overcome a number of crisis periods. As the political landscape is changing, it will be more difficult to develop more constructive and proactive solutions for the Eurozone crisis, such as debt restructuring, than was the case with the 'muddling-through' approach that has characterised the Eurozone crisis strategy to date.

The Eurozone is regarded as an elite-driven project which is losing democratic legitimacy with European citizens and is facing populist opposition in several countries. The ECB epitomises that perceived 'democratic deficit' - run by an unaccountable bureaucracy which poses serious problems for the future of the Euro and ultimately the European Union.

In light of the political salience of ECB policies and their impact, it is questionable whether the independence of the ECB remains democratically viable. The evidence points to the ECB as both a technocratic and a political Leviathan within the Eurozone. ECB policymaking has become unaccountable, controversial and politicised. The reinforcement of democratic scrutiny over ECB policymaking is more urgent than ever. ■

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INSTITUTIONAL LONELINESS: HOW TO FIX CONFLICTS OF INTEREST AT THE ECB

Leo Hoffmann-Axthelm

"The ECB is being attacked from North and South, from left and right, and has in the process become a very defensive institution."

The European Central Bank (ECB) has acquired new and at times conflicting responsibilities – but its unrivaled independence limits accountability. It should urgently adopt better internal policies to deal with inevitable conflicts of interest, while broader reforms to deepen the Eurozone are needed to lighten the burden on the Bank.

Since the global financial crisis, a number of certainties of monetary policy and economics have been called into question. Along with them, the relatively recent consensus in favour of central bank independence is under threat.

In arguing for preventing conflicts of interest and improving accountability, I do not intend to weaken central bank independence. In fact, I believe proper accountability is required precisely to protect and justify bank independence.

ECB INDEPENDENCE AND ACCOUNTABILITY

In a democracy, institutions should be legally accountable for their actions, and this accountability needs to be organised at the level at which decisions are taken. It would not make sense to hold national central banks (NCBs) or their governors accountable for the actions of the European Central Bank. As the only fully supranational institution in the Eurozone, the ECB is accountable at the European level.

Yet the ECB's near-total independence makes proper accountability almost impossible.[1] The ECB may be answerable to the European Parliament and European Council, but if they are unsatisfied with the ECB's actions, there is nothing they can do to hold it to account. For example, the ECB's President and Executive Board members may only be removed by the Court of Justice of the EU, upon an application from the ECB's own Governing Council, if they manifestly no longer fulfil the required conditions or are guilty of "serious misconduct".[2]

The Court has also largely relinquished judicial review for the admissibility of ECB policies; they have taken a very broad interpretation of what policies can be defined as within the ECB's "monetary" remit and declined to second-guess the ECB on whether fiscal implications of asset buying programmes risked breaching the monetary financing prohibition laid down in the EU's treaties. [3]

In contrast to the understandably broad interpretation the ECB has taken of its own treaty-based mandate and of what type of unconventional policies pass as 'monetary' in nature, the Bank has taken a very narrow interpretation of the treaties when it comes to its obligations towards other institutions, jealously defending its independence. This is understandable. Central banks have to constantly guard against political institutions encroaching on their independence, especially when they are relatively new. Attacks on its independence are often quite opportunistic. While Germany played a key role in making the ECB the most independent central bank ever, this did not keep German politicians from making public demands on the ECB or even blaming it for the rise of anti-European parties.[4] The accusation is particularly interesting given that more often than not, it was Germany that opposed Eurozone reforms that would have allowed the ECB to reduce its exposure and play a less proactive role in crisis mitigation (For example: a more counter-cyclical fiscal policy, instruments to pool risk in debt issuance, or more decisive steps to break the sovereign-bank doom loop – the cycle of both banks and governments in debt destabilising each other.)

More generally, the ECB is being attacked from North and South, from left and right, and has in the process become a very defensive institution. There are several examples of this:

- The ECB claims that it does not take any political decisions whatsoever, claiming to be a purely "technical" institution[5] – hiding distributive effects and political considerations (e.g. on the 'moral hazard' effects of buying up government bonds) behind a cloud of technical jargon.

- The ECB claims that it is not lobbied, even while Banking federations set up shop in Frankfurt with the explicit aim of lobbying it (and its own Ethics Framework specifies cooling off periods during which former staff may not lobby their ex-colleagues). At the same time, the ECB has lobbied other European institutions with regard to key financial policy issues, such as the financial transaction tax and the regulation of securitisation.[6] This role as a de-facto policymaker arguably exceeds the ECB's mandate.

- The ECB insists that Emergency Liquidity Assistance (ELA) is a national prerogative,[7] even while almost all notable cases of ELA have to be discussed at ECB-level due to their structural, monetary implications (though President Draghi has in late 2017 acknowledged that ELA should indeed be made an ECB competence, if national central banks agree to give up the relic of monetary sovereignty).

- The ECB claims that not mutualising risk from quantitative easing purchases was a technical necessity, but meeting minutes published later show that the

Governing Council had a substantive debate about the merits of pooling risk, ultimately opting not to.

- The ECB uses its independence to limit what documents it makes accessible to the European Court of Auditors,[8] and to shield national central bank offices from local prosecution.[9]

All of this does not contribute to trust in an institution that combines unrivalled independence with unprecedented powers. The common belief inside the ECB is that the institution is politically under siege, especially in Germany. The type of defensiveness produced by this idea can also directly impact its accountability to the European Parliament. Due to the Parliament's lack of legal levers, it may be more appropriate to speak of answerability rather than accountability. Parliament can only compel the ECB President to show up once a year to present its annual report; his quarterly appearances for the "Monetary Dialogue" are voluntary, turning the notion of accountability on its head.

The ECB's answerability to Parliament was further weakened in 2016. In a resolution on the ECB's annual report, Parliament asked the ECB to further increase transparency. In response, the ECB argued that the call for transparency "appears to have been met", based on positive language elsewhere in the resolution.[10]

To be clear: We are not saying that ECB staff and management have more, or less, conflicts of interest than other EU institutions. But in public administrations, it is normal for integrity risks to arise – that is why we are less interested in how this or that case or even scandal has been dealt with. Rather, we want to see clear safeguards and procedures that will restore the public's trust that the inevitable conflicts of interest can be spotted as they arise, and are adequately dealt with.

When it comes to scrutinising the ECB and making sure it abides by its mandate, EU law, and properly polices internal conflicts of interest, we depend entirely on the ECB itself.

"All of this does not contribute to trust in an institution that combines unrivalled independence with unprecedented powers."

INTERNAL CHECKS AND BALANCES

So how are the ECB doing? The state of internal mechanisms to deal with potential conflicts of interest leaves a lot to be desired. This is surprising for an institution that receives so much attention, wields such power over our money and financial system, and acts with near-total independence. It appears that the myriad of academics and experts analysing all ECB policies in great detail do not usually focus on the governance of integrity.

As of yet, the ECB does not have a Whistleblowing Policy, in spite of the January 2014 recommendation from the European Ombudsman based on the EU Staff Regulation.[11] If staff notice that colleagues or superiors or their respective spouses have conflicts of interest, holdings in affected financial products, fail to pass on relevant information, or are outright corrupt, there is no proper channel for staff to report this. They may approach the internal audit function or the governance office, but in view of generally low levels of trust and satisfaction at the overworked ECB (whistleblowers occasionally contact us or the ECB's staff union directly instead), it is clear that a proper channel for whistleblowing should be created.

In view of Transparency International's best practice guide for whistleblowing,[12] this should include the option to do so anonymously, as staff may have well-grounded reason to fear retaliation, in particular when reports concern senior management. Currently, such reports are regulated in a non-public "administrative circular" from 2006, which is not recognisable as a whistleblowing policy, nor does it offer guarantees, protections or even a predictable process by which reports will be followed up.

Speaking of potential conflicts of interest, it is surprising to say the least that ECB Governing Council members do not have to file public declarations of financial interests and assets. While Members of the European Parliament, European Commission, and European Investment Bank Management Committee usually have to make such disclosures, as well as most think tank directors and journalists, the people in charge of our money do not. It should go without saying that these people wield enormous powers and responsibilities and have a heightened risk for potential conflicts of interest. Every national central bank governor could enrich themselves enormously with the insider information they hold. To ensure that everything is clean, we need to see their assets and incomes.

The Code of Conduct for members of the ECB Governing Council should be amended accordingly, also extending the Executive Board's policy of disclosing external meetings to all Governing Council members. The ECB should furthermore join the EU's Joint Transparency Register, which would require senior management to meet only registered interest representatives, and to publish those meetings. All banks that seek to influence the ECB should have to disclose basic information about their lobby activities and funding on the EU lobby register.

It is furthermore interesting that the ECB has no way to suspend or expel members of their own council. This is governed by national law as they are appointed by national central banks not the ECB. It is therefore not clear what can be done when there is alleged wrongdoing, as in the recent case of the Latvian Governor.[13]

In this case, he was barred by the national anti-corruption authority from leaving the country. The ECB did not immediately appeal this, unlike in previous cases where it invoked its independence against police raids of central bank offices in Slovenia. However, the ECB is checking with the Court of Justice of the EU whether the Latvian authorities' measures against the Governor accused of bribe-taking were legal.[14]

The alleged money-laundering involved Latvian bank ABLV, and caused some soul searching on whether there should be a European authority investigating money-laundering,[15] given that it took US authorities to indict ABLV and thus bring the bank to its knees. The outgoing Europol chief went as far as to say that 99% of wealthy criminals' dirty money appears to transit the European financial system effortlessly.[16] The incident also showed once again the limitations of Emergency Liquidity Assistance (ELA), given that ELA was granted to ABLV on Wednesday and the bank was declared failing or likely to fail by Friday.[17]

As shown in the Transparency International case study on ELA in Greece,[18] it seems clear that transparency concerning ELA is so insufficient that it is used as a way to put the banking system of a Member State under pressure, squeezing the Greek Government into further concessions as part of its negotiations on conditionality for the third European Stability Mechanism (ESM) 'bail-out' in 2015.

The ECB's market contact groups[19] are a good example of creating transparency and trust. The process inevitably involves the ECB meeting banks with very particular sets of incentives that do not reflect those of society as a whole. But the publication of agendas, participant lists, and summaries of meetings creates transparency.

Unfortunately, this laudable effort is undermined by ECB President Draghi's membership of and attendance at the so-called G30 Group, where central bankers, bank regulators and executives of banking giants meet to discuss global financial politics. It is hard to imagine Mr Draghi entertaining the finer points of the ECB's banking supervision there, but it seems equally clear that the necessary information exchange can happen at the technical level in aforementioned market contact groups. Contact between the ECB and the banking sector does not require the President to participate in elite clubs in which the world's global banks will promote policies favourable to themselves, rather than to the 'real economy'. The optics are not good and are liable to reduce trust, warranting the European Ombudswoman's recommendation that Mr Draghi's membership cease[20]

Finally, the ECB's Ethics Committee is presided over by its former President, Jean-Claude Trichet. Naturally, the former President has very limited incentives to find wrongdoing at the Bank. Imagine the outcry had former Commission President Jose Manuel Barroso been in charge of the Commission's ad-hoc ethics committee, which recently had to assess Mr Barroso's new job as Chairman of global investment bank Goldman Sachs International.[21]

"Contact between the ECB and the banking sector does not require the President to participate in elite clubs in which the world's global banks will promote policies favourable to themselves."

RECENT REFORMS

While much of the above sounds pretty bleak, there have been recent improvements. In terms of transparency the ECB does not live up to the standards of the US Federal Reserve, but in 2015 it has started publishing meaningful summaries of Governing Council meetings, the so-called accounts (non-attributable, shortened minutes), usually within a delay of one month. In terms of integrity of its leadership, it has started publishing all external meetings of Executive Board members (President, VP, and four regular members), with a delay of three months – a reasonable delay given that a flurry of activity could indicate financial stability concerns that will move markets.

As mandated by new EU banking union regulation establishing the ECB as the Single Supervisory Mechanism (SSM) for banks, the ECB has also updated its Ethics Framework,[22] introducing and extending cooling-off periods, and strengthening some conflict of interest provisions specific to the business of supervising banks. This makes sense in view of the sweeping sanctioning powers acquired by the ECB over supervised banks – from hefty fines up to 10% of annual turnover to the revocation of banking licenses. That legislation also introduced new legally binding mechanisms through which the parts of the ECB acting as SSM have their own lines of accountable to the European Parliament and Council. The ECB has also established a new Compliance and Governance Office, creating an internal hub for transparency and integrity issues.

> "The ECB is a part of the troika...where it has to participate in the negotiation and supervision of structural reforms and fiscal policy – both areas go far beyond the ECB's monetary policy mandate."

Finally, the Bank has made some adjustments following the publication of Transparency International's study of its transparency, integrity, and accountability: The ECB committed to the introduction of a proper Whistleblowing Policy, which should happen before the end of 2019. It began publishing information on the corporate bonds it is buying as part of its "quantitative easing" programme (which is relevant given that by buying corporate bonds the ECB may favour multinational corporations over smaller businesses, and by buying specific bonds but not others, the ECB could distort competition e.g. in favour, or against, multinationals that make their money with renewables as opposed to fossil fuels). It made minor yet insufficient tweaks to its ELA-policy, and more significantly started stating in public that ELA should indeed become an ECB competence.[23] Last but not least, it has amended the mandate of its Audit Committee.[24] This was vital given that Transparency International had uncovered that 100% of the Audit Committee were or had been members of the Governing Council, which is legally and politically responsible for any and all ECB actions, significantly limiting its ability to act as an independent check.

OUTLOOK: WELCOME FIRST STEPS, BUT MORE REFORMS NEEDED

All of these improvements are more than welcome, but more needs to be done. Transparency International counts on the European Parliament to keep pushing the ECB, and to overhaul its own Monetary Dialogue in order to more effectively hold the ECB to account with the limited tools available.[25]

The ECB is a part of the troika (the ECB, European Commission, and International Monetary Fund), where it has to participate in the negotiation and supervision of structural reforms and fiscal policy – both areas go far

> "The fact that the ECB was largely left alone in picking up the pieces of the Eurozone crisis... goes some way in explaining its over-exposure and stretched mandate."

beyond the ECB's monetary policy mandate – while still being responsible for the country's monetary policy. These are areas of economic governance that are painstakingly kept separate in non-bailout circumstances. The ECB is also responsible for the supervision of that country's systemically important banks, their provisioning with (emergency) liquidity, and by extension for the health of the financial sector overall – presenting risks that undue financial stability considerations could impact monetary policy choices. And the ECB is a creditor of that same country, meaning that it has an interest in having its holdings of sovereign bonds repaid, which can only happen if it green-lights bailout disbursements as part of the troika.[26]

In its efforts to save the single currency, ECB Presidents Trichet and Draghi both sent letters with specific demands of a non-monetary nature to Prime Ministers or Finance Ministers of Eurozone Member States. Unsurprisingly, the ECB assured us that this would never happen again. And yet, the structural incentives for the ECB did not change, which is why such grave misjudgements could occur again. This is why Transparency International recommended the ECB establish a process by which the Presidents of the Eurogroup and European Parliament can be petitioned to lend political buy-in and legitimacy to actions the ECB deems necessary, but which may indeed go beyond its mandate – a concept developed from Paul Tucker.[27]

The ECB's independence can only be justified with a view to its narrow mandate, and to the extent that the ECB sticks to this mandate in practice. The fact that the ECB was largely left alone in picking up the pieces of the Eurozone crisis when Member State governments did not converge on a broader reform of the euro's institutional architecture, goes some way in explaining its over-exposure and stretched mandate. It also shows that accountability is insufficient for the ECB's current powers. The ECB's is not just a case of independence: it is a case of institutional loneliness.[28]

Member States should come together to decisively deepen European Monetary Union to relieve the ECB of some of its responsibilities, notably within the troika and ESM-Treaty, and better separate out banking supervision from monetary policy.

Furthermore, the ECB should get a proper fiscal counterpart – institutionalising the Eurogroup as an EU body, itself accountable both at national level (with finance ministers reporting to their parliaments) and at the European level for those decisions which the Eurogroup has taken jointly.[29] Some thought could be given to ways to better integrate the ELA and efforts to prevent money laundering, and how to introduce legal mechanisms to suspend Governing Council members in case of irregular conduct.

In the meantime, the ECB must do more to restore the public's trust in its internal checks and balances. ■

NOTES

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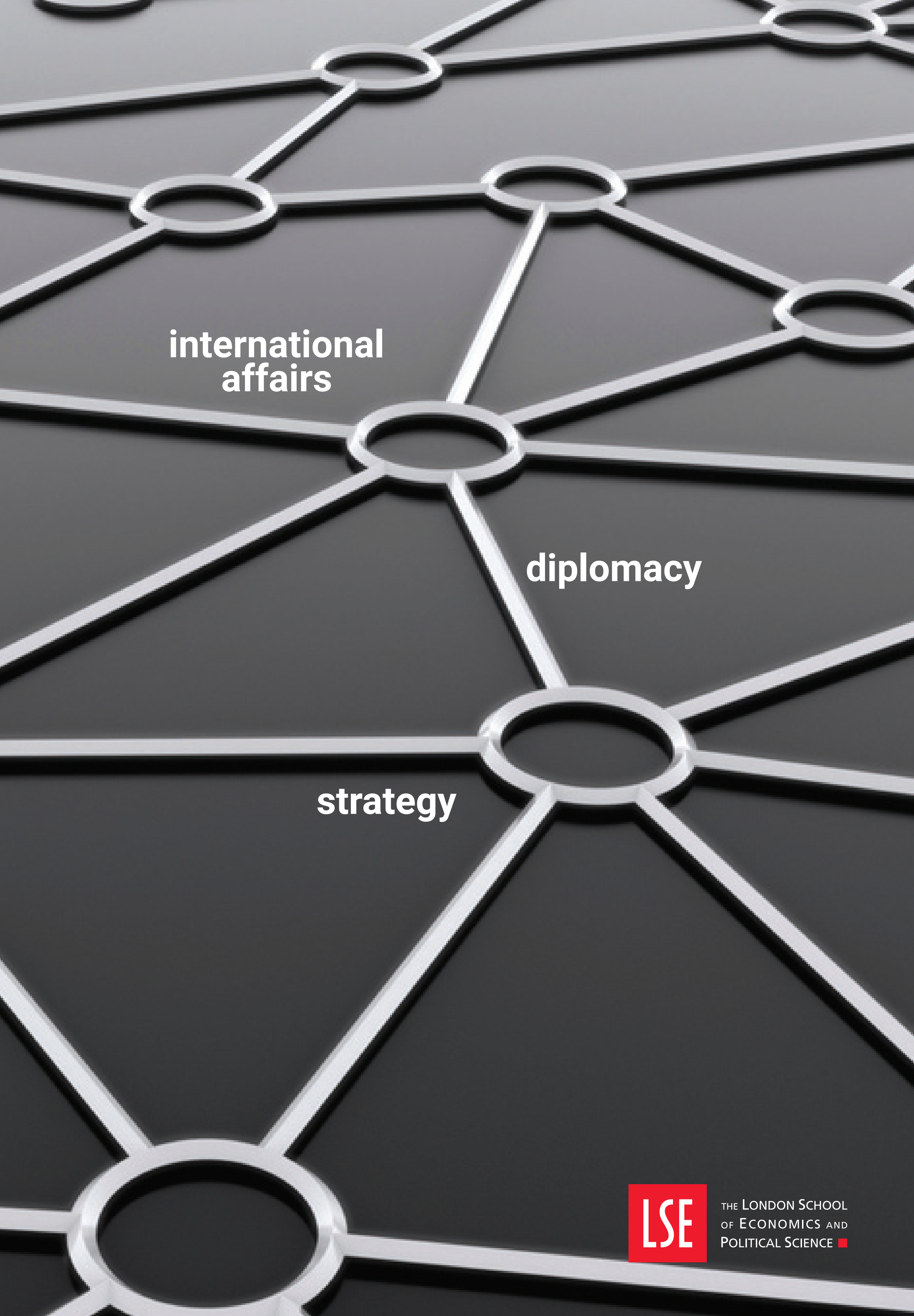

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