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The ECB Mandate: Perspectives on Sustainability and Solidarity

Policy Department for Economic, Scientific and Quality of Life Policies
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The ECB Mandate: Perspectives on Sustainability and Solidarity

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Abstract

This report analyses the ECB mandate in light of its primary objective of price stability along with its secondary objective to support the general economic policies in the Union (Article 127 TFEU), which include employment, growth, climate change, and the quality of the environment, bearing in mind the broader goals of sustainability and solidarity (Article 3 TEU). The pursuit of financial stability directly interacts with the price stability mandate.

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LIST OF ABBREVIATIONS

CJEU	Court of Justice of the European Union
COVID-19	Coronavirus crisis
ECB	European Central Bank
EMU	Economic and Monetary Union
EP	European Parliament
ESCB	European System of Central Banks
GFC	Great Financial Crisis
IMF	International Monetary Fund
LoLR	Lender of Last Resort
LTRO	Long-Term Refinancing Operations
MEP	Member of European Parliament
NGFS	Network for Greening the Financial System
NCBs	National Central Banks
PELTRO	Pandemic Emergency Long-term Refinancing Operation
PEPP	Pandemic Emergency Purchase Programme
PSPP	Public Sector Purchase Programme
QE	Quantitative Easing
SSM	Single Supervisory Mechanism
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TLTRO	Targeted Long-term Refinancing Operations

EXECUTIVE SUMMARY

- **As part of its monetary policy strategy review**, the European Central Bank (ECB) is reassessing how its monetary policy tools to achieve its primary objective of price stability should take account of "other considerations, such as financial stability, employment, environmental sustainability" in accordance with Article 127 TFEU and Article 3 TEU.

- **This paper considers the ECB's legal mandate and whether it is adequate to manage the economic and financial risks associated with unsustainable activity**, including climate change, financial crises and pandemics like COVID-19. It argues that the potential consequences of these risks – for the economy and for the financial sector in particular – fall squarely within the ECB's mandate to support the economic policies in the EU and that they interact with the primary objective of price stability.

- **Regarding monetary stability, we recommend that the ECB focus on low and stable inflation as a priority, but also support a sustainable growth rate that is defined as such over the long-term**. The ECB should support national governments in considering how monetary measures can be used to help provide credit to support climate adaptation and mitigation strategies and to address the economic damage caused by the COVID-19 crisis, in line with the principle of solidarity, but within the confines of the Article 123 (1) Court of Justice of the European Union (CJEU) jurisprudence.

- **Financial stability considerations suggest that central banks should go further than this, to positively promote a transition to a sustainable and hence lower carbon economy, as part of their primary objectives**. The full recognition of the ECB's secondary objectives, to support the EU's wider economic policies, can be invoked as necessary, including deciding what tools can be used to stabilise the banking sector in response to the COVID-19 crisis.

- **The ECB's role as a bank supervisor will be important for ensuring that authorised firms are identifying and managing environmental and social risks**. For instance, the ECB can help banks build stress tests based on forward scenarios that will help the industry judge what its capital and liquidity requirements should be in the face of future threats to stability caused by environmental or social phenomena.

- **The paper concludes, however, that EU institutions and Member State fiscal authorities have the primary role to play managing economic policy to address these risks because of their control over taxation, expenditure, legislation and regulation**. **Nevertheless, the ECB must take environmental, social and economic sustainability into account to the extent that these secondary objectives impact upon the primary price stability mandate.** The ECB can facilitate a growing role for EU institutions and Member States to fill the governance gap in fiscal policy at the EU level by providing more economic backing to address environmental and social sustainability risks, particularly regarding the urgent need to adopt substantial measures to address the COVID-19 crisis.

1. INTRODUCTION

This report considers how the European Central Bank can play an important role in reducing the economic and financial risks arising from unsustainable activity, in light of climate change, financial crises and pandemics like COVID-19. We argue that the potential consequences of these risks – for the economy in general and for the financial sector in particular – fall squarely within the ECB's mandate, which includes its secondary objective to support the economic policies in the European Union, and that they interact with the primary objective of price stability.

Although the ECB has an important role in addressing these risks, we claim that EU institutions and Member State fiscal authorities have the primary role to play managing economic policy to address these risks because of their control over taxation, expenditure, legislation and regulation. Nevertheless, it is submitted that the ECB must take environmental, social and economic sustainability risks into account, both as part of its secondary objective and because they can impact upon the price stability mandate.

Also, of particular relevance in the context of the ECB's operations is the contribution to financial stability (Article 127.5 TFEU). As the great financial crisis (GFC) and subsequent sovereign debt crisis in the euro area evidenced, financial instability impairs the normal transmission mechanism of monetary policy. Actions to combat systemic risk in financial markets are an integral part of the central bank's armoury to achieve price stability.

The evolving nature of central banking helps us frame the questions posed to us by the European Parliament (ECON Committee), namely: (1) how the ECB's primary price stability objective interacts with the secondary objectives, namely the general economic policies of the Union, in accordance with Article 127.1 TFEU and (2) how the ECB should fulfil its broad mandate as defined by Article 3 TEU, in particular with regard to climate change.

The European Parliament requested this assignment on 6 March 2020, before the World Health Organization declared COVID-19 to be a pandemic on 11 March and before many of the unprecedented measures of economic and monetary support in the EU and around the world were announced.[1] While pre-COVID-19, the emphasis on climate change and sustainability was part of the monetary policy strategy review launched by President Lagarde, the unprecedented nature of the pandemic has brought a new dimension to the role of the ECB.

The COVID-19 crisis provides a vivid example of the challenges that the ECB and other central banks (as well as public authorities) confront when dealing with unforeseen circumstances of such magnitude: an unprecedented public health crisis which constitutes both a demand shock and a supply shock to the economic system of gargantuan proportions and, in the case of the EU responses, questions the very commitment by Member States to deeper monetary and economic integration and evidences the need for solidarity. After all, the support of the general economic policies of the Union also includes solidarity in accordance to Article 3 TEU.[2]

The effectiveness of the ECB's response to the COVID-19 will depend on the economic leadership of EU institutions and Member States in providing financing and related resources to the countries most affected by the crisis. On 23 April 2020, the European Council approved the Eurogroup's EUR 540 billion

1 We would like to thank Annina Melliger for assistance in production and style formatting of the report.

2 Further to Aricle 3 TEU, the solidarity clause of Article 222 (1)(b) TFEU states that:

"The Union and its Member States shall act jointly in a spirit of solidarity if a Member State is the object of a terrorist attack or the victim of a natural or man-made disaster. The Union shall mobilise all the instruments at its disposal, including the military resources made available by the Member States, to:

(b) assist a Member State in its territory, at the request of its political authorities, in the event of a natural or man-made disaster. "

rescue package consisting of European Stability Mechanism credit lines, investment capital from the European Investment Bank and the European Commission's temporary Support to mitigate Unemployment Risks in an Emergency (SURE). They also agreed to create a Recovery Fund and mandated the Commission to spell out the details and the amount and sources of funding.

The COVID-19 public health crisis brings again to the fore the contours of monetary policy, exposing the asymmetry between a centralised monetary policy and decentralised fiscal policies in the euro area. We contend that any future EU economic recovery programme will necessitate significant support and involvement of the ECB, within the boundaries of the Treaty provisions.

The overarching purpose of our report is thus to analyse how the ECB's mandate can be interpreted in light of its primary objective of price stability along with its secondary objective to support the general economic policies of the Union, including employment, growth, climate change and the quality of the environment, bearing in mind the broader goals of sustainability and solidarity and the importance of financial stability. In short, how can we reconcile the pursuit of secondary objectives while not sacrificing price stability?

Understanding the ECB's mandate is a very important question which is being increasingly raised, not just by campaigners, but by the central banks themselves.[3]

[3] Draghi, 2020; Lagarde, 2019; Prudential Regulation Authority, 2018; Cœré, 2018; Debelle, 2019.

2. HISTORY OF CENTRAL BANK OBJECTIVES

While the *raison d'être* for establishing the first central banks (Swedish Riksbank in 1668 and Bank of England in 1694) was government finance, the objectives of central banks have changed over time.[4] The Federal Reserve System was founded in 1913 in response to the damaging banking crises at the beginning of the twentieth century in the US, and it was entrusted with powers to act as lender of last resort - discount window - and to supervise banks. The main rationale for the creation of the Bundesbank in 1957 in Germany was price stability, a mandate which was 'inherited' by the ECB in 1999. Following the GFC of 2008, the rediscovery of financial stability as a key central bank objective (as well as being an objective for the government and for financial regulatory and supervisory agencies) has inspired legislative reforms around the world.

In the UK, financial stability is a statutory objective of the Bank of England on a par with price stability (twin mandate) while in the case of the ECB, given the hierarchy of objectives established in Article 127 TFEU (with price stability as the primary objective), the establishment of the Single Supervisory Mechanism and the responses to the dual financial and sovereign debt crisis in the euro area have been adopted within that Treaty framework (Article 127.5 refers to financial stability and Article 127.6 is the enabling clause for prudential supervision) and, despite its importance, financial stability is subordinate to price stability according to the Treaty. As explained below, the very wording of Article 127 of the Treaty is much more precise when it comes to the objective of price stability than when it comes to the other objectives.

In the US, the history of the Federal Reserve System illustrates the vicissitudes of monetary and financial developments. While during the Great Depression and its immediate aftermath the emphasis was on growth and employment, not on controlling inflation (not dissimilar to the economic situation in the aftermath of the GFC), the 'oil shock' in the 1970s destroyed the post-war pattern where governments had tried to buy a little more growth with a little more inflation (Philips curve), instead entrenching price stability as their primary concern.

Empirical evidence and theory suggest that independent central banks do a better job than politicians at controlling inflation.[5] Governments needed a brake to avoid taking destructive actions when the siren of inflationary temptation appeared, and like Ulysses at the mast, central banks around the World were granted independence to achieve inflation control. One goal: price stability, one instrument: monetary policy was the recipe adopted almost universally.

Up until the GFC, the solution adopted by the political authorities in many countries was to pursue growth and employment directly through fiscal policy and other instruments of economic policy—typically under political instruction—and to delegate the mandate of price stability and the conduct of monetary policy to an independent central bank. This model relied upon the pursuit of one goal: monetary stability; using one instrument: monetary policy. In the eyes of many central banking experts, since monetary policy was essentially a single instrument, it could not simultaneously be assigned to more than one objective. This is known as the **Tinbergen Rule** (named after Nobel Laureate Dutch economist, Jan Tinbergen),[6] which states that for each and every policy target there must be at least one policy tool. If there are fewer tools than targets, then some policy goals will not be achieved. If a monetary tool is assigned two objectives, for example, it is unlikely to achieve both and may end up achieving neither because of the related compromises necessarily involved. According to this line of thought, monetary tools are best suited to achieving price stability, while other policies and mechanisms should be applied to other objectives.

[4] See generally Lastra, 2015, ch 2 and 7 and Goodhart, 1985.

[5] See Lastra, 1996, pp 13–24, for a broader explanation of the arguments for and against central bank independence, and Lastra, 1992, 476–82.

[6] Tinbergen, 1952.

Tinbergen's (1952) rule that the number of achievable policy goals cannot exceed the number of policy instruments suggests that a mechanical monetary policy rule targeting price stability can fail to achieve the objectives of full employment and price stability.

But, as with any economic theory, it had some fault lines. The first one refers to the primacy of the goal of controlling inflation in all circumstances. The second fault line refers to the measurement of inflation. Following Goodhart's law, any observed statistical regularity will tend to collapse once pressure is placed upon it for control purposes,[7] the measurement of inflation based on the Consumer Price Index (CPI) largely ignored asset prices, in particular house prices, thus being unable to identify and combat the 'elephant in the room', that is a large asset price bubble that eventually burst in August 2007.[8]

The emphasis on price stability is a development that needs to be understood in a historical context: that provided by the country experiences, economic policies, and economic thinking which prevailed in the second half of the twentieth century. This development has had important legal implications nationally and internationally, particularly in the 1990s, as a substantial number of domestic laws as well as some international treaties (most notably the Maastricht Treaty on European Union) made this objective the primary goal of central banks and monetary agencies just as a number of provisions have been elaborated to hold those institutions accountable for their success (or failure) in pursuing this goal.

In the twenty-first century we need a rebalanced framework of macroeconomic policy, with fiscal policy regaining part of its earlier role.

[7] Goodhart, 1985.

[8] Goodhart, 2016.

3. THE ECB'S MANDATE

As discussed above, since the GFC, central bank mandates with a primary objective of price stability have either been explicitly expanded by new legislation to incorporate financial stability as the 'twin mandate' and with it a range of supervisory functions. The EU Member States voted in 2012 unanimously in Council, based on Article 127 (6) TFEU, to grant the European Central Bank supervisory powers for credit institutions (banking groups). The ECB's responsibilities under the Treaty also extend to overseeing payment and settlement system, which is also a basic task of the ECB in accordance with Article 127(2) TFEU. The ECB's wide-ranging competences raise the important issue to what extent its powers can support the general economic policies of the Union.

The GFC changed the traditional understanding of the instruments of monetary policy, adapting the conventional tools, namely, open market operations, discount policies and reserve requirements, and adding a range of unconventional measures[9] - all using instruments foreseen by the Treaty and the Statute of the ESCB but never used in this way, or to this extent in the past - including credit support, credit easing (long-term refinancing operations, LTROs), interventions in foreign exchange and securities markets, provision of liquidity in foreign currency (swaps), negative interest rates and forward guidance and, most significantly, quantitative easing (QE). Resorting to 'central bank balance sheet policy' has brought monetary policy into uncharted territory.

3.1. The ECB's primary objective: price stability

Monetary stability has an internal dimension (stability of prices within a given jurisdiction) and an external dimension (the value of the currency vis-à-vis other currencies). Monetary stability can be defined in positive terms or in negative terms. In positive terms, monetary stability refers to the maintenance of the internal value of money (ie, price stability) as well as of the external value of the currency (i.e., the stability of the currency vis-à-vis other currencies, which is, in turn, influenced by the choice of exchange rate regime).[10] In negative terms, monetary stability refers broadly to the absence of instability (erratic or unanticipated movements) in the level of prices. When it comes to price stability (internal dimension of monetary stability), the phenomenon of deflation can cause as much 'instability' as inflation.

Price stability became the prime responsibility of a modern central bank with the generalised acceptance of central bank independence as an instrument in the pursuit of such objective. In developed countries it usually involves targeting it directly.[11] The primary objective of the ECB is price stability (internal dimension of monetary stability). This mandate is set forth in clear terms in Article 127 (1) of the Treaty on the Functioning of the European Union (TFEU):

> *"The primary objective of the European System of Central Banks (hereinafter referred to as 'ESCB') shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union."*

[9] Lastra 2015, chapter 7.

[10] Lastra 2015, chapter 2. The stability of exchange rates and the issue of which is the best exchange rate arrangement for a given country (fixed, floating, or some version of managed float) remain a matter of great controversy in the economic literature. Since monetary laws tend to reflect the prevailing economic theories of any given time (path dependency) and since the pendulum has shifted from fixed to floating and back to fixed with all sorts of variations in between (managed float, dirty floating, fixed but adjustable), the law tends to refer to the external dimension of monetary stability (the stability of the currency) in rather ambiguous terms.

[11] IMF 2019.

Whilst Article 127(1) establishes the primacy of the price stability mandate, it does not give a precise definition of what is meant by price stability. The ECB's Governing Council announced a quantitative definition of price stability: "Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%" and clarified that, in the pursuit of price stability, it aims to maintain inflation rates "below, but close to, 2% over the medium term."[12] Though movements (measured in percentage rate of change) in consumer price indices or retail price indices have generally been used as a measurement of inflation, in recent years there has also been a debate about the importance of other economic indicators to measure inflation (such as a nominal gross domestic product target). Some economists have expressed concerns about the limitations of using as measures of inflation price indices of currently provided consumer goods and services. Goodhart, for instance, suggested some time ago that an analytically correct measure of inflation should take account of asset price changes, in particular of housing prices and of changes in financial asset prices.[13] In any case, price stability refers both to inflation (rising prices) and to deflation (falling prices).

The basic economic thinking behind setting price stability as the primary objective of the ESCB's monetary policy is that it is the task of other economic actors to deal with the growth potential of the economy, and that assigning to monetary policy an objective for real income or employment is problematic. Stable prices are a pre-requisite for longer term economic prosperity.

The wording of Article 127(1) TFEU is heavily influenced by Article 12 of the 1957 Bundesbank Law, which was the subject of academic controversy in Germany, with one author referring to it as the 'squaring of the circle'.[14]

Price stability is not only the primary objective of the ESCB. It is also one of the objectives of the Union, according to Article 119(2) TFEU and to Article 119(3) which states that stable prices shall be one of the 'guiding principles' of the Union. It is interesting to observe that Article 119(2) TFEU refers to price stability as being the primary objective both for the 'single monetary policy' and for 'exchange rate policy'. But, as stated above, the price stability mandate refers to the single monetary policy.

The Treaty establishes a clear hierarchy of objectives and assigns overriding importance to the objective of price stability, reflecting the consensus that stable prices are essential to achieve a favorable economic environment and a high level of employment. This is in line with the Tinbergen Rule[15], mentioned above, which states that for each and every policy target there must be at least one policy tool.

3.2. ECB's Secondary Objectives

Article 127 TFEU makes clear reference to Article 3 (paragraph 3) of the TEU that defines broadly the ESCB's secondary objectives to support the economic policies of the Union as follows:

> *"The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of*

[12] http://www.ecb.europa.eu/mopo/strategy/pricestab/html/index.en.html

In the *Weiss* case [*Weiss and others v ECB*, Case C- 493/17], the CJEU agreed that the 2% interpretation was fine, saying it is for the ECB to the decide and that 2% does not appear manifestly erroneous.

[13] See Goodhart, 1999. Few economists have contributed as much to the history and understanding of central banking in theory and practice as Charles Goodhart has. For long relegated to the abstruse universe of the specialist, central banking has now come to the front of economic policy debate. This process has been facilitated in no small way by the writings, teachings, and policy advice of Charles Goodhart.

[14] See Stern, 1980,

[15] Tinbergen, 1952.

protection and improvement of the quality of the environment. It shall promote scientific and technological advance.

It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child.

It shall promote economic, social and territorial cohesion, and solidarity among Member States.

It shall respect its rich cultural and linguistic diversity, and shall ensure that Europe's cultural heritage is safeguarded and enhanced."

The Treaty provisions are less clear in defining the ECB's role in supporting the broad general economic policies of the Union – also known as the ECB's 'secondary objectives.' While the GFC evidenced the importance of financial stability, attention during the COVID-19 crisis has turned to the objectives of growth and employment as well as the principle of solidarity.

Financial stability was not considered at the time the Maastricht Treaty was signed as relevant as the 'primary' goal of price stability.[16] Indeed, while the wording of the latter is crystal clear: "The primary objective of the European System of Central Banks shall be to maintain price stability", the language of Article 127(5) is much less forceful: "The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system". Of course, the law simply reflected the division of responsibilities at that time.

The 'basic' task conferred onto the ECB was monetary policy (one goal: price stability, one instrument: monetary policy) while prudential supervision remained decentralised at the level of the Member States.

However, there is now a consensus that the neglect of financial stability considerations in the years leading up to the crisis was one of its causes. But the ECB's role in financial stability (recognised in Articles 127(5) TFEU and 3.3 of the ESCB Statute) is not an exclusive role. Other Member State authorities and European committees and bodies as well as national authorities also have responsibility for financial stability. The pursuit of financial stability transcends geographic boundaries and institutional mandates. It is a fundamental public good for the euro area and also for the single market in financial services.

The other condition mentioned in Article 127(1) TFEU, namely to act in accordance with the principles of an open market economy with free competition and favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119 TFEU is a generic statement of respect for market economics in the workings of the ESCB.[17] Because of this 'generic' nature it is difficult to hold the ECB accountable for its performance in the pursuit of this goal. Accountability is facilitated when there is one goal, rather than multiple goals and when that goal is narrowly defined rather than formulated in broad terms.

In the euro area, the different jurisdictional domains make it difficult to reconcile the pursuit of the primary and the secondary objectives. As we have already noted, whilst price stability in the euro area is a Union objective pursued by a single centralised monetary policy, the pursuit of the secondary objectives relies upon decentralised fiscal policies (subject to coordination) and upon some (limited) common mechanisms and funds whose adequacy to confront the COVID-19 crisis is currently being tested. In contrast, in countries such as the UK, where the jurisdictional domain of monetary and fiscal policy is aligned, the support of the economic policy of Her Majesty's Government, including its objectives for

[16] See Lastra, p 1265.

[17] As it is for the Union and the Member States under Arts 119 and 120 TFEU.

growth and employment, is aligned with the price stability mandate or primary objective of the Bank of England in terms of jurisdiction.[18]

[18] Teneyro (2020) p. 5.

4. WHAT CAN THE ECB DO TO ADDRESS SUSTAINABILITY RISKS?

Based on the experience of previous crisis episodes, and the COVID-19 pandemic, it can be observed in the presence of instability, that the resources of governments and central banks alike become devoted to short-term crisis management. That is probably the easiest way to lose sight and control of any longer-term sustainability agenda. Indeed, one of the main motivations for low and stable inflation is precisely that it enables economic agents to concentrate on matters related to real outcomes and long-term planning without being distracted by the costs of inflation or short-term volatility in the economic cycle. Central banks must not compromise on their core objective of monetary stability. Sound monetary and financial control is a pre-requisite for a long-term sustainable economy.

4.1. The ECB as a bank supervisor

The European Banking Union is arguably one of the most significant EU projects since the creation of the euro. The Banking Union was designed to restore the financial health and stability of the European banking system and to sever the link between weak euro area banking systems and fragile sovereign debt finances.[19] The Banking Union consists of three pillars: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM), and the European Deposit Insurance System (EDIS). The SSM forms the supervisory pillar for credit institutions of the European Banking Union and empowers the ECB to carry out prudential supervision of credit institutions and certain financial holding companies that are established in participating Member States.[20]

Broadly speaking, regulation consists of the setting of principles, rules and standards, whilst supervision involves monitoring and surveillance of institution compliance along with investigations and enforcement.[21] Both have a role to play in identifying sustainability risks that affect banking sector stability. Under the SSM, the ECB is a bank supervisor responsible for oversight and surveillance of individual credit institutions but does not promulgate the regulatory and technical implementing standards adopted by the European Banking Authority. The European Commission adopted a Sustainable Finance Action Plan in 2018,[22] which proposed amendments to the Capital Requirements Directive V that delegate authority to the EBA to undertake assessments of the materiality of sustainability risks and to recommend how they should be included in prudential regulatory requirements (such as exposure limits) and for the EBA to report back to the Commission regarding several categories of risks between 2021 and 2025.[23] This could potentially lead to amendments to the EU bank regulatory rulebook that the ECB is required to apply as bank supervisor.

These developments at the EU level will have implications for how the ECB carries out its supervisory responsibilities under the SSM, particularly how it plans to carry out changes to incorporate climate and

[19] Council Regulation (EU) 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L287/63 (SSM Regulation); European Parliament and Council Regulation (EU) 806/2014 of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) 1093/2010 [2014] OJ L225/1 (SRM Regulation).

[20] Alexander (2020) pp 28-31, and Lastra (2015) Chap 10.

[21] See Lastra (1996) chap 2 and Lastra (2015) chap 3 for the difference between supervision and regulation.

[22] European Commission, 2018. See also, Alexander and Fisher, 2019, pp 17-19, arguing that the EU prudential rulebook should remain risk based if and when it includes sustainability risk measures to calculate regulatory capital.

[23] The CRD V instructs to the EBA to report - by 28 June 2021 on inclusion of ESG risks in the SREP (Article 98 (8) CRD V) [and] - by 28 June 2025 “whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives would be justified”, ‘if appropriate’ followed by a legislative proposal from the Commission ... (Article 501 c CRR 2). The CRR 2124 provides for - disclosure of ESG risks, as defined by the EBA report, by large institutions as of 28 June 2022 “on an annual basis for the first year and biannually thereafter” (Article 449a CRR 2). See also, Smits (2020).

other sustainability risks into its supervisory review enhancement programme and what its input is likely to be in the forthcoming EBA Reports that will assess the materiality of these risks. Indeed, the ECB's expectations for banks regarding how they manage the financial risks associated with sustainability are evolving. The ECB is a member of the Network for Greening the Financial Sector (NGFS) and its contribution to that forum should be monitored by the European Parliament in order to gauge how it might fulfil its supervisory responsibilities in this area and to assess the scope of its mandate as a European institution bound to provisions such as Articles 11 and 13 TFEU, and to its very own secondary objective which refers to Article 3 TEU. In this regard, the chairman of the NGFS, Frank Elderson, stated in the NGFS Annual Report 2019 that:

> *"Currently, the Coronavirus and its consequences seem to overshadow everything else and, no doubt, they require coordinated action. However, even in this crisis, we should not lose sight of the fact that climate change stays an urgent and vital issue. Hence, the NGFS members' strong response to continue their collective contribution to the greening of the financial system is key. The greener the recovery from the current crisis is, the better."*[24]

4.2. Article 123 – prohibition on monetary financing and the ECB's independence

Member State governments are primarily responsible for setting and implementing economic policy to achieve environmental and social sustainability objectives. The economic costs of the GFC and the Eurozone sovereign debt crisis in 2012, however, burdened many euro area governments with high national debt levels which increasingly limit their capacity to pursue general economic policies, including measures to mitigate climate change and pandemic-induced health and economic risks.

The Eurosystem's exclusive responsibility for monetary policy in the euro area is backed by a strong declaration of independence. Central bank independence enhances the credibility that is necessary for the effectiveness of monetary policy operations. Article 130 TFEU clearly indicates that the ECB and the NCBs in the performance of the tasks conferred upon them by the Treaty and the Statute are independent from both national instruction and from the instruction of other EU institutions.[25] The ECB is answerable to the European Parliament and to the Court of Justice of the European Union. Article 263 TFEU and Article 35 of the Statute of the ESCB give exclusive jurisdiction to the CJEU to review the legality of the ECB's actions and decisions. Therefore, the ECB is not bound by the judgments of any national court (including the recent judgment of the German Constitutional Court that we further discuss below).

As part of its monetary policy responsibilities, the ECB has embarked on a number of asset purchase programmes in the post-crisis period involving the purchase of bank, sovereign and corporate bonds with the objective to stimulate bank lending and prevent deflation and a generalised economic downturn in the euro area. Some asset purchase programmes (i.e., the Public Sector Purchase Programme [PSPP] scheme) have faced legal challenges on the grounds that they violate Article 123 (1) TFEU's prohibition on monetary financing. Also the German constitutional court confirmed in its decision of 5 May 2020 (discussed below) that the PSPP does not violate Article 123 TFEU.

[24] NGFS (2020) 2.

[25] The Treaty protects the independence of the ECB in strong terms vis-à-vis other EU institutions and national governments and bodies. Article 130 TFEU states: *"When exercised 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 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."*

Article 123 (1) TFEU prohibits the ECB and the Eurosystem national central banks from financing a government obligation or task. It reads as follows:

> "*Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as "national central banks") in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.*"

Article 123 (1) TFEU – together with Article 21.1 of the Statute of the European System Central Banks (ESCB) – thus prohibits the ECB from creating overdraft facilities or credit facilities directly in favour of EU institutions, agencies, bodies or member states and regional public bodies, and prohibits the direct purchase by the ECB from Member States of debt instruments.

The prohibition of monetary financing in Article 123(1) TFEU is a cornerstone of EMU and is linked also to the principle of financial independence. While the ECB/ESCB's primary objective is to ensure price stability, the basis assumption of this objective is that state fiscal discipline be maintained. Because the financial obligations of the state can often jeopardise the financial independence of the central bank, the prohibition on monetary financing in Article 123 (1) contributes to the protection of ECB independence.

According to recent CJEU jurisprudence,[26] the ECB can purchase Member State bonds as *indirect* measures to support the effective functioning of its monetary policy framework, but the CJEU made clear in the *Weiss* case that its use of such indirect measures are constrained by the principle of proportionality and that indirect measures involving the purchase of Member State bonds on the secondary markets cannot undermine the Member States' pursuit of a sound budgetary policy.[27] In *Weiss*, the CJEU considered the legal validity of the ECB's Public Sector Purchase Programme (PSPP) by interpreting Article 123 (1) to mean that it prohibited all financial assistance from national central banks that are members of the ESCB to a Member State; but this prohibition does not preclude, generally, the possibility of ESCB members purchasing from the creditors of such state bonds previously issued by that State.[28] In approving the ECB's PSPP programme, involving the purchase of Member State bonds on the secondary market, the CJEU approved the ECB's practice of purchasing the bonds in a flexible manner by "allowing

[26] *Weiss and others v ECB* (Case C- 493/17). See also, Judgment of 16 June 2015, *Gauweiler and Others,* C- 62/14, EU:C:2015:400. See discussion in Grund, 2020.

[27] The wisdom of asset purchases and quantitative easing (QE) programs and the fiscal consequences of such purchases has been questioned by a number of voices. For a recent discussion in the US see Selgin, 2020, and in the UK see Bateman, 2020.

The circumstances in the UK and US are however very different from those in the EU/euro area and not only because of the different jurisdictional domain (discussed above) but also because the prohibition of monetary financing impedes the ECB to act as direct or indirect fiscal arm of EU institutions/Member States. In contrast, under US law, Congress and the Treasury can direct the Fed - in times of crises - to buy US Government bonds and to provide indirect fiscal support, like the loan guarantees in the SBA programme, and under UK law, the so-called Way and Means facility can also be extended.

In considering the role of central bank asset purchases and other forms of QE that further increase the total amount of liabilities held by central banks, some economists point out that there should be a degree of caution regarding the eventual need to offload the debt that is currently being accumulated on central bank balance sheets.

See De Larosière, SUERF Policy Note 148, 2020: *"The idea that states can compensate for everything by exposing their balance sheets is unfortunately, in part an illusion. Indeed, most States have fragile balance sheets with monumental debts and the extension – which some would like to see unlimited – of these financial capacities obviously raises the essential issue of the sustainability of deficits – except if one agreed that all incremental expenses were to end up for ever on central banks' balance sheets. However, such an approach would ultimately lead to the systematic monetisation of all deficits"*. https://www.suerf.org/policynotes/11613/reflections-on-the-health-and-financial-crisis

[28] *Weiss and others v ECB* (Case C- 493/17).

for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions”.[29]

The CJEU, however, held that Article 123(1) TFEU imposes two limits on the national central banks when it adopts a programme that may involve indirect financing of public authorities and bodies of the Union and the Member States. First, according to *Gauweiler*, the NCB cannot validly engage in indirect financing of a public authority or body of the Union or Member States if it would mean, in practice, that its intervention has an effect equivalent to that of a direct financing of public authorities and bodies of the Member States. Second, the NCB must build sufficient safeguards into its intervention to ensure that the latter does not fall foul of the prohibition of monetary financing in Article 123 TFEU, by satisfying itself that the programme comforms with the proportionality principle in that the measures in question are necessary to support the effective functioning of the ECB’s monetary policy and that the measures are not such as to reduce the impetus which Article 123 (1) creates for Member States to follow a sound budgetary policy.[30]

According to this reasoning, as long as the ECB acts within these limits, it can adopt other indirect measures involving, for instance, the purchase of ‘green’ bonds issued by corporates or the purchase of sovereign bonds on the secondary market which were issued by EU Member States to combat the economic and social damage of the COVID-19 crisis. But the proportionality principle suggests that the ECB should conduct an analysis that the particular measures it undertakes to promote a more effective monetary policy are suitable to those ends, and that they are necessary – that is, there are no less onerous measures available that do not possibly contravene Treaty prohibitions (eg., Article 123 (1) TFEU) – to achieve those ends, and that the measures’ disadvantages (or costs) do not manifestly outweigh its advantages (proportionality *stricto sensu*).

In what appears to be a seminal decision on 5 May 2020, the German Constitutional Court,[31] while rejecting the CJEU’s decision upholding the PSPP programme in *Weiss* as *ultra vires* on the grounds that the CJEU failed to engage in a ‘comprehensive’ analysis of the economic effects and risks of the ECB’s PSPB programme and whether it was necessary to achieve an effective monetary policy that supports price stability, it confirms that there is no violation of Art 123 TFEU in the PSPP. The press release of the German Constitutional Court clearly states that “the decision does not apply to PEPP” discussed below.

In a rare statement in response to the German Constitutional Court (press release No. 58/20 of 8 May 2020) the CJEU clarified that it “has jurisdiction to rule that an act of an EU institution is contrary to EU law. Divergences between courts of the Member States as to the validity of such acts would indeed be liable to place in jeopardy the unity of the EU legal order and to detract from legal certainty. Like other authorities of the Member States, national courts are required to ensure that EU law takes full effect”.

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[29] *Weiss and others v ECB* (Case C- 493/17), para 133.

[30] See Judgment of 16 June 2015, *Gauweiler and Others,* C- 62/14, EU:C:2015:400, Judgment of 16 June 2015, paragraphs 95 and 97, paragraphs 100 to 102 and 109.

The very definition of *monetary finance* in the legal literature is the subject of some controversy. In an illuminating *forthcoming* contribution Bateman (2020) explains the difference between direct and indirect varieties of monetary finance and links the legal and economic debate that surrounds the importance of sound budgetary policy.

[31] The Bundesverfassungsgericht or BVerfG released its controversial judgement on 5 May 202 https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2020/bvg20-032.html at a very sensitive political and economic time in Europe given the COVID-19 crisis. In any case, regarding Article 123 that the German Constitutional Court grudgingly accepts that PSPP might be in conformity with Article 123 TFEU, or rather, that it does not manifestly violate Article 123 TFEU. In this respect they emphasize the purchase limits and delays established by the PSPP to allow price discovery.

4.3. The ECB's response to the COVID-19 crisis: legal implications

The scale of the COVID-19 crisis was highlighted by former ECB President Mario Draghi in a letter to the *Financial Times* in which he stated that the economic shock from coronavirus required "a significant increase in public debt" similar to that undertaken "in times of war". The ECB has responded to the economic fallout of the pandemic by adopting on 12 March 2020 an asset purchase programme of EUR 120 billion until the end of 2020.[32] The ECB followed this up by announcing on 18 March 2020 an additional asset purchase programme entitled the Pandemic Emergency Purchase Programme (PEPP) and further measures on 30 April 2020.

The PEPP significantly loosens the restrictions the ECB has previously imposed on its asset purchase programmes, given the dimensions of the challenge and that this is a very temporary and specific programme. On 30 April 2020, the ECB Governing Council announced forward guidance that it is "fully prepared to increase the size of the PEPP and adjust its composition, by as much as necessary and for as long as needed', and '[i]n any case it stands ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry."[33] Prior to the PEPP, ECB bond purchases were limited by its self-imposed rule that required them to be made in proportion to the relative size of each country's economy and its contribution to ECB capital, and the issue and issuer limit. Under PEPP, the ECB has a high degree of flexibility to purchase up to EUR 750 billion of additional bonds, including euro area sovereign bonds.

The PEPP is a proportionate monetary policy instrument established in response to the specific, extraordinary and acute COVID-19 crisis which is necessary for implementing the ECB's monetary policy following the government lockdown measures which are leading to a considerable contraction in economic activity. As stated in Recital 4 of the PEPP Decision: "This situation hampers the transmission of monetary policy impulses and adds severe downside risks to the relevant inflation outlook". Responding to critics who argue that this expansive bond buying programme might undermine the price stability objective, Mr Draghi wrote in the *Financial Times* that "given the present and probable future levels of interest rates, such an increase in government debt will not add to its servicing costs".

In addition, the ECB announced on 30 April that two ECB bank lending programmes would be utilised to combat the economic downturn. First, beginning in June 2020 and until June 2021, the ECB will lend to euro area banks at rates as low as minus 1 percent through its previously available targeted long-term refinancing operations (TLTROs). The minus 1 percent interest rate only applies until June 2021, regardless of the maturity of the operation. The TLTRO loans work by requiring banks to achieve certain targets in the volume of lending before they qualify to borrow at the minus 1 percent rate from the ECB. Second, the ECB announced a new series of non-targeted pandemic emergency longer-term refinancing operations (PELTROs) for banks that would become available in May until 2021. The PELTRO loans are designed to provide banks with "an effective liquidity backstop" by allowing them to borrow from the ECB at very low rates.

The ECB justifies the adoption of these indirect measures to ease credit conditions for euro area banks as promoting the effective functioning of its monetary policy (normal transmission mechanism) and to

[32] On 12 March 2020, the ECB agreed to 13 additional Long-term Refinancing Operations (LTROs) programmes that will purchase bank assets in return for the very low deposit facility rate of ??. For a legal commentary of the PEPP see Sebastian Grund at https://www.delorscentre.eu/en/publications/detail/publication/legal-compliant-and-suitable-the-ecbs-pandemic-emergency-purchase-programme-pepp/

[33] The PEPP decision was published in the Official Journal on 25 March 2020

See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2020:091:TOC. See also EP (2020) https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/648787/IPOL_BRI(2020)648787_EN.pdf

respond to the price deflation caused by government lockdown measures in response to the COVID-19 crisis. They are designed to incentivise banks to lend more to businesses and individuals with the hope that this additional lending will create economic activity that will increase prices to the target level of about 2% retail price inflation.

Nevertheless, the ECB's adoption of these new programmes - the PEPP (involving indirect purchase of Member State bonds) and the TLTRO and PELTRO (involving negative interest rate loans for banks) – that ostensibly support the price stability objective may attract legal and policy criticism on the grounds that price stability is being used as a 'legal fig leaf' that obscures the underlying reality that the ECB is simply providing subsidies and credit support in a way that a EU fiscal authority would do if one were to exist at the EU level. It can be argued that the CJEU finally put an end to the use of wide-ranging indirect measures with its ruling in the *Weiss* case by holding that the proportionality principle should apply to determine the legal limits on the use of such tools and that proportionality requires that such tools are 'necessary' to achieve the price stability objective.

The ECB may be called to justify the PEPP, PELTRO and TLTRO programmes in light of the proportionality principle and the necessity test that must be met to show that these measures are *necessary* to ensure the effective functioning of its monetary policy and to meet the price stability objective. In favour of the legality of the PEPP, the logic of the *Weiss* case suggests that a decision of the ECB may be necessary (and valid) to achieve that objective from a monetary policy perspective while also having a beneficial impact on the Member States' fiscal objectives, such as lowering sovereign borrowing costs. The legal limitations with the ECB's use of wide-ranging indirect measures to achieve its price stability objective illustrates clearly the gap in EU fiscal policy governance and the need for bolder moves by EU political/fiscal authorities, particularly regarding how EU institutions decide to use the European Stability Mechanism and European Investment Bank to capitalise and manage an EU investment fund to support Europe's economic recovery from the COVID-19 crisis.

However, it is unclear whether EU institutions and Member States have the political will to meet the challenge. This is why the corona bond proposal has been sidelined by the Commission in its ongoing work for a Recovery Fund. If Germany, and other similar-minded Member States, does not want mutualisation of risk in policies, such as a cross-border deposit insurance scheme and in other areas of economic and social policy that involve the recycling of economic surpluses from more prosperous Member States to less prosperous (more directly impacted by COVID-19) Member States to address cross-border risks, then the whole euro area/ECB monetary and financial governance framework will never work efficiently or effectively because it will always 'bump-up' against legal constraints under the Treaty. A Treaty revision will be the best long-term solution. But in the short run we must confront the devastating economic consequences of the pandemic.

Parallel with the monetary policy measures adopted by the ECB in March and April, the Council of Ministers agreed on 23 April 2020 a series of economic measures to be operational by 1 June 2020.[34]

[34] See https://www.consilium.europa.eu/en/press/press-releases/2020/04/23/conclusions-by-president-charles-michel-following-the-video-conference-with-members-of-the-european-council-on-23-april-2020/

Though the ESM Precautionary Credit Line (PCCL) can open the way for the operation of the OMT (Outright Monetary Transactions programme), there is controversy surrounding its conditionality and its efficacy, with different views amongst different Member States. Some economists have advocated a dedicated COVID-19 credit line within the ESM at https://voxeu.org/content/covid-credit-line-europe. As regards the European Investment Bank it has great potential to aid recovery through a focus on equity capital. (For a commentary see Gnan (2020), https://www.suerf.org/policynotes/11391/aeuropean-capitalization-and-development-fund-ecdf-to-facilitate-europes-post-corona-recovery)

Though this is beyond the scope of this paper it is important to note that funding via lending is not the best solution. Funding should come in the form of equity and be done by a dedicated public instrumentality. In the US, Saule Omarova and Robert Hockett have advocated a National Investment Authority. See Saule Omarova (2020) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3566462.

According to this political agreement, Member States can use an enhanced ‘pandemic’ credit line with the European Stability Mechanism so that Member States can borrow up to 2 per cent of their gross domestic product on “direct and indirect” costs relating to the health crisis without any conditions attached regarding post-crisis macroeconomic reforms. The agreement also provides for increased capital of EUR 25 billion for the European Investment Bank that can be leveraged for additional lending of up to EUR 200 billion for the real economy. The ‘pandemic’ credit line and investment fund represent an important step by EU Member States and EU institutions to provide economic support for the crisis-hit European economy.

4.4. Financing a sustainable recovery fund

EU institutions and Member State policymakers should take the lead in adopting fiscal measures to mitigate the impact of the COVID-19 crisis and to rebuild the European economy by establishing a sustainable Recovery Fund. At its meeting of 23 April 2020 the Council also tasked the Commission to come up with proposals for such a Fund, and agreed that it should be financed as part of the EU’s Multi-annual Financial Framework (MFF) in which the EU budget should increase from 1.2 to 2 per cent of the bloc’s gross national income. In establishing such a Fund, account must be given to the prohibition in Article 125 (1) TFEU, the so-called no bail-out clause, that provides:

> “*The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a joint project. A Member shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.”*

Article 125 (1) essentially prohibits the Union or Member States from assuming financial commitments of a Member State, including central governments, regional, local or public authorities, unless for a joint project. The CJEU analysed the scope of Article 125(1) in the *Pringle* case,[35] where it held that Member States can provide some financial assistance or share liabilities of a Member State as long as the assistance is attached to a commitment by the Member State to adhere to a sound budgetary policy. The CJEU ruled that Article 125 does not “prohibit the granting of financial assistance by one or more Member States to a Member State which remains responsible for its commitments to its creditors provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy.’[36] This means that any agreement to share commitments of liabilities of a Member State(s) by Union institutions or other Member States is permissible if the assistance is accompanied by conditions that are such ‘as to prompt the Member State to implement a sound budgetary policy”.

Conditionality in the EU is a novel legal concept, that has found its way into the jurisprudence of the CJEU and into the ESM Treaty (an intergovernmental agreement). It is a concept borrowed from the IMF.[37]

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35 Judgment of 27 November 2012, *Pringle*, C- 370/12, EU:C:2012:756. The *Pringle* judgement, distinguishes between monetary and economic policy measures. See Lastra 2015, chapter 8.

36 Case C-370/12 *Pringle*, para 132.

37 See Lastra, 2015, chapter 13. IMF conditionality is not a simple concept. There is hard conditionality and there is soft conditionality. And some facilities come with no conditionality. Likewise, in the EU there appear to be different interpretations of conditionality, with the Netherlands favouring a harder conditionality than France (lighter) or Italy (no) conditionality.

There is room in the Treaty to adequately respond to Covid-19.[38] The so-called 'emergency rule', Article 122 TFEU (which has been used as the legal basis for SURE, Support to mitigate Unemployment Risks in an Emergency) confers on the Union the power to grant *ad hoc* financial assistance to a Member State threatened by exceptional circumstances or natural disasters.

Article 122 (2) TFEU reads as follows:

> *"Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken."*

It is clear in our opinion that COVID-19 falls under the scope of those 'exceptional occurrences' beyond the control of a Member State and that therefore, assistance can be provided on the basis of this emergency rule. In interpreting Article 122(2) TFEU in *Pringle*, the CJEU reasoned that if the aim of Article 125(1) was to prohibit all forms of financial assistance, then Article 122(2) which allows the Union to grant *ad hoc* financial assistance, would have to state that it derogated from Article 125 (1) TFEU.[39] Under these conditions, the Court concluded that Article 125 "prohibits the Union and the Member State from granting financial assistance as a result of which the incentive of the recipient Member State to conduct a sound budgetary policy is diminished".[40]

In addition, the CJEU refers to the preparatory work of the Maastricht Treaty that states "the aim of Article 125 TFEU is to ensure that Member States follow a sound budgetary policy"[41] and that the prohibition laid down in Article 125 ensures that Member States remain subject to the logic of the market when they incur debt, since that ought to prompt them to maintain budgetary discipline. "Compliance with such discipline contributes at Union level to the attainment of a higher objective, namely maintaining the financial stability of the Union".

The challenge in the response to the COVID-19 health and economic crisis is to stop a cascade of debt defaults bringing down healthy businesses and exacerbating job losses across Member States in the EU.[42] Some of the countries most affected by the pandemic - like Spain and Italy - need fiscal space in their responses to the crisis. The tax base will diminish as government expenditure increases, thus leading to both higher deficits and higher public debt, which will increase the cost of government borrowing. A number of concomitant monetary and fiscal measures are needed to stop a downward spiral. (Economic damage of course will be magnified if there is a second outbreak in the fall). The solution to excessive debt is not more debt.

Another alternative that attempts to address the unsustainable debt issue has been suggested by a group of economists who argue that the EU can avoid increasing debt to an unsustainable level for companies and businesses by creating a European pandemic equity fund that takes stakes in unquoted small and

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[38] The flexibility clause (Article 353 TFEU) also provides room for manoeuvre. The interpretation of Article 125(2)TFEU with regard to Article 123 and 124 and the possibility of expanding the ECB functions according to Article 127(6)TFEU following the simplified revision foreseen in Article 48(6) TEU is another enabling provision.

[39] Case C-370/12 Pringle para 130.

[40] Case C-370/12 Pringle, para 136.

[41] Draft Treaty amending the EEC Treaty with a view to achieving economic and monetary union, Bulletin of the European Communities, Supplement 2/91, p. 24 and p.54.

[42] As the IMF Managing Director, Kristalina Georgieava stated in April 2020, this is a "crisis like no other". It is more complex, more uncertain and truly global. The IMF World Economic Outlook forecasts a decline in output of USD 9 trillion in 2020-2021, not seen since the Great Depression. https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020

medium-sized companies.[43] The fund would invest in equity issued by European companies and be entitled to a share of future earnings. Such an investment would improve the strength of corporate balance sheets, while shifting the focus of the EU's recovery efforts away from the politically intractable debate of credit-versus-grants to an equity capital investment plan that is neither credit (debt) or grants. The problem with the Commission plan is that it primarily relies on leveraged investment based on debt. However, equity is a more appropriate instrument to counter an incipient corporate debt crisis. It avoids a potential widespread corporate default on guarantees from Member State governments or on EU loans that could spread and become a sovereign debt and financial crisis.

This is the time for the EU to show the solidarity that is needed to come out of this crisis. But solidarity must be balanced with responsibility.[44] The project of European integration has benefitted during its history from the effects of solidarity: from German reunification and opening the doors of EU membership to Central and Eastern Europe, to the use of structural funds to even out economic disparities amongst the Euro regions.[45] The COVID-19 crisis tests yet again the "weak E" of EMU. The coordination between monetary and economic/structural measures is of paramount importance.

[43] Boot et al., 2020.

[44] For an interesting reflection on solidarity in the context of EMU see paragraphs 142-150 of the Opinion of the Advocate General Kokkot in the *Pringle* Case, http://curia.europa.eu/juris/document/document.jsf?docid=130561&doclang=EN

[45] All cohesion policy funds have been redirected to fight the COVID-19 emergency. All uncommitted money from the three Cohesion Policy funds – the European Regional Development Fund, the European Social Fund and the Cohesion Fund - will be mobilised to address the effects of the public health crisis. To make sure that funds can be re-directed to where they are most urgently needed, transfers between funds as well as between categories of regions and between policy objectives will be made possible. Moreover, co-financing requirements will be abandoned, as Member States are already using all their means to fight the crisis. Administration will be simplified. The EU is proposing to use all available remaining funds from this year's EU budget to help to respond to the needs of European health systems. https://ec.europa.eu/commission/presscorner/detail/en/IP_20_5

5. CONCLUSIONS

In this paper, we have set out an analysis of why and how the ECB can and should be involved in addressing the risks to its price stability objective by considering other considerations such as environmental sustainability, financial stability and crisis management, consistent with its pursuit of the primary objective.[46]

Environmental sustainability risks affect central bank primary objectives through monetary conditions and financial stability risks. Regarding monetary stability, we recommend that the ECB focus on low and stable inflation as a priority, but also support a sustainable growth rate that is defined as such over the long-term. ECB monetary measures can be used to help provide credit to support climate adaptation and mitigation strategies and to address the economic damage caused by the COVID-19 crisis, but within the confines of the Article 123 (1) CJEU jurisprudence and in accordance with the principle of central bank independence.

Financial stability considerations suggest that central banks should go further than this, to positively promote a transition to a sustainable and hence lower carbon economy, as part of their primary objectives. The full recognition of secondary objectives, to support the government's wider economic policies, can be invoked as necessary.

In addition, the ECB as bank supervisor should have an important role to play in ensuring that authorised firms are identifying and managing adequately the risks from climate change. They can help banks build stress tests based on forward scenarios that will help the industry judge what its capital and liquidity requirements should be in the face of future threats to stability caused by environmental or social phenomenon.

Finally, it should be emphasised that although there are important tools that the ECB can utilise to support increased financing for environmental and socially sustainable economic activity, nevertheless the lead authority for mitigating environmental and social sustainability risks should always be EU institutions and Member State governments which, unlike the ECB, control legislation, taxation and expenditure programmes, and have overall responsibility for regulatory frameworks and make direct economic interventions. And not to be excluded are private sector market participant who are the main agents for implementing governmental policies – and who are the source of most of the risks and have the greatest potential for managing risks and steering the economy to a more sustainable path.

[46] It should be noted that while some economists warn about deflation - see inter alia Davies (2020) - some others, such as Goodhart and Pradhan (2020) caution about inflation in the post-COVID-19 world, "Future imperfect after coronavirus".

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ANNEX

This report analyses the ECB's mandate in light of its primary objective of price stability along with its secondary objective to support the general economic policies in the Union (Article 127 TFEU), which include employment, growth, climate change, and the quality of the environment, bearing in mind the broader goals of sustainability and solidarity (Article 3 TEU). The pursuit of financial stability directly interacts with the price stability mandate.

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