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EUROPEAN CENTRAL BANK ACCOUNTABILITY: HOW THE MONETARY DIALOGUE COULD EVOLVE

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Highlights

- According to the European Union Treaties, the European Central Bank (ECB) is accountable to the European Parliament. In practice, this accountability takes mainly the form of a quarterly Monetary Dialogue between the president of the ECB and the European Parliament Economic and Monetary Affairs committee.
- We assess the impact of the Monetary Dialogue. We describe the ECB's accountability practices, compare them to those of other major central banks and provide an assessment of the dialogue in the last five years. The Monetary Dialogue could be improved and we make recommendations on this.
- We also consider what role the Monetary Dialogue could play in the current context of the ECB's evolving role. We discuss in particular forward guidance and quantitative easing. We review the main features and the way in which those policies have been implemented by other central banks. We then suggest the appropriate role for the Monetary Dialogue in relation to each of those policies. We conclude with some observations on the function of the Monetary Dialogue after the establishment of a banking union in Europe.

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EXECUTIVE SUMMARY

- First, we describe the legal and actual procedure of the Monetary Dialogue and also the relationship between the European Central Bank (ECB) and the European Parliament more generally. We judge the Monetary Dialogue procedure in a positive light overall: the fixed schedule of quarterly meetings allows the ECB and the Parliament to have a general discussion on economic policy. The ECB complies with all its obligations under the Treaties and appears to cooperate fully with the Parliament during the Dialogue.
- Second, we compare the practices of the ECB with the procedures of the Bank of England and the Federal Reserve (Fed). The structure of the Monetary Dialogue is quite similar to its equivalents in the United Kingdom and the United States in terms of hearings and reports. However, because of some key differences, the ECB is less accountable or transparent than the Bank of England or the Fed: the European Parliament cannot sanction the ECB if it fails to fulfil its mandate, the European Parliament's has only a consultative role in the appointment of ECB executive board members, and the ECB does not publish the minutes and the votes of the Governing Council meetings.
- Third, we assess the dialogue in the last five years. The introductory statements made by the ECB president appear to never reveal important news or new policy measures, which tends to make the event less interesting for the media and the general public. However, the president is invited to give a view on some topics decided in advance by the European Parliament economic and monetary affairs committee (ECON). External monetary experts also write briefings on those topics in preparation for the hearing. We think that it could lead to a very fruitful discussion if members of the Parliament would focus on those topics, but this does not often happen. We also think that MEPs should put some emphasis on the successes or failures of the ECB in fulfilling its mandate: they should formally review its performance relative to its primary objective, and its secondary objective of supporting the goals of the European Union. To do that more effectively we recommend that the ECON committee chairman plays a greater role and asks the same series of very specific questions about the ECB's fulfilment of its mandates to the president of the ECB at the beginning of each hearing's Q&A session.
- Fourth, we assess the visibility of the Monetary Dialogue in the media. It appears that Monetary Dialogues are much less reported in the press than ECB monthly press conferences. Given that the accountability of the ECB to the European Parliament is only based on the information exchange with the ECB and not on the enforcement of its mandate, reporting of the event in the media should be important for the European Parliament. A publicised and well-functioning live stream, and a quickly available transcript of the hearing would enhance the transparency of this exercise and increase its visibility.
- Fifth, we consider what role the Dialogue could play in the current context of the evolving role of the ECB. We discuss in particular forward guidance and quantitative easing (QE). We review the main features and how those policies have been implemented by other central banks, and we suggest the appropriate role for the Monetary Dialogue in relation to each of those policies. On forward guidance, we believe that a discussion about the future course of monetary policy before the European Parliament, and the inevitable political discussions that come with the testimony both within Parliament and in the press as part of the Monetary Dialogue, might contribute to more effective forward guidance. Such discussions should therefore be encouraged for reasons of

accountability and transparency and because the discussions might make the policy more effective.

- Sixth, if the ECB decides to implement a quantitative easing policy, the purchase of government bonds in different euro-area countries would have some distributional consequences. The Monetary Dialogue would be an ideal platform for the European Parliament to evaluate any such programme under the ECB's remit.
- Finally, we conclude with some observations on the function of the Monetary Dialogue after the establishment of a banking union in Europe. Regardless of how effectively the European Parliament holds the ECB accountable for its function as banking supervisor, concerns about whether decisions taken as supervisor affect monetary policy should be part of the remit of the Monetary Dialogue.

INTRODUCTION

In the wake of widespread inflation in developed countries in the 1970s, and subsequent seminal research by Kydland and Prescott (1977) and Barro and Gordon (1983), one solution put forward to prevent political interference in monetary policy and its effects on inflation was to delegate its management to individuals who were insulated from the government and averse to inflation (Rogoff, 1985). Since then, operational independence has become an integral part of modern central banking.

However, because non-elected officials manage money and monetary policy, independent central banks should be accountable to an elected body. To whom they are accountable is different in different countries: some are accountable directly to the government, to the parliament or to both. According to the EU Treaty and the Statute of the European System of Central Banks (ESCB), in the euro area, the European Central Bank (ECB) is accountable to the only directly elected European Union (EU) institution, the European Parliament.

What accountability means in this context is not really spelled out, but according to Schedler (1999) accountability should be two-dimensional. Accountable central banks should be obliged to inform representatives of the people about their policy decisions and they should be able to justify them. Parliaments (or governments depending on the case) should be able to impose sanctions on central banks in case they fail to fulfil their mandates.

However, the ECB's situation is peculiar compared to other independent central banks. It is one of the most independent central banks in the world: it has full operational independence, financial independence and it even has target independence. The treaty establishes price stability as the EB's primary objective, but it does not give a precise definition of what is meant by price stability. The ECB Governing Council has therefore announced it intends to maintain inflation rates below, but close to, two percent over the medium term. Given this degree of independence, one should expect a high level of accountability. But the ECB only satisfies one part of Schedler's definition of accountability. It is true that the ECB explains regularly its actions to the European Parliament, but there is no way for the Parliament to take action if the ECB fails to fulfil its mandate. This is different to the situation facing the Fed, for example. A simple majority in Congress plus a presidential signature can change the Fed's statutes. The Monetary Dialogue is therefore essential to provide democratic oversight of the ECB. Because it is the only real instrument to make the ECB accountable for its policy, it should be a key meeting of the ECB and, in our opinion, it should become more visible, especially in the current context of the evolving role of the ECB with the recent introduction of forward guidance, the Outright Monetary Transactions (OMT) Programme and the Single Supervisory Mechanism (SSM).

In this brief, we first assess the exchange of information between the European Parliament and the ECB (especially during the last five years) and

'Given the degree of independence given to the European Central Bank, one should expect a high level of accountability. The ECB explains regularly its actions to the European Parliament, but there is no way for the Parliament to take action if the ECB fails to fulfil its mandate.'

compare it to other central bank practices around the world. We propose ways in which the Monetary Dialogue can be improved, and how its role in the ECB's communication strategy can be enhanced. It is important to note that we mainly restrict the discussion to recommendations to improve the Monetary Dialogue that could be easily and immediately implementable and that do not require a revision of the European Treaties. Given that a Treaty change would require EU member state unanimity, the probability of such a revision on this topic would be very low. Finally, we consider what role the Monetary Dialogue could play in the context of an evolving monetary policy with an emphasis on forward guidance, quantitative easing (QE) and bank supervision.

1 THE MONETARY DIALOGUE IN PRACTICE

In this section we analyse the relationship between the European Parliament and the European Central Bank. We describe the legal and actual procedure of the dialogue, compare the accountability practices of the ECB to those of the Bank of England and the Fed and provide an assessment of the dialogue in the last five years.

1.1 The relationship between the European Parliament and the ECB

The Legal Basis for the Monetary Dialogue is laid down in the Treaty on the Functioning of the European Union (TFEU) Article 284.3. The framework is given in Article 232, which gives the European Parliament the right to adopt its own Rules of Procedure. The Rules of Procedure, in turn, give a framework for the meetings between the European Parliament and the ECB.

Rule 113 regulates 'Statements by the European Central bank'. According to 113.3, the ECB President shall appear at least four times a year before the responsible committee. These meetings are informally called the Monetary Dialogue and are held with the Committee of Economic and Monetary Affairs (ECON). Before every meeting, the Parliament asks a monetary expert panel to submit briefing papers on one or two specific topics. These papers are published on the Parliament website shortly before the quarterly meetings. It is common practice that the ECB President incorporates the respective topics into his introductory statement to the Committee. After his statement, the ECB President has to answer questions from committee members. The committee chair leads the debate, which usually lasts about two hours including the introductory statement. On the Parliament's request, members of the ECB Executive Board can be invited to additional meetings. Unlike the four meetings with ECON, these meetings may or may not be confidential. After the public meetings, a report is prepared in the official languages and an audio recording of the meetings should be available on the European Parliament website.

Additionally, the ECB President shall present once a year the Annual Report to the European Parliament plenary, followed by a general debate, according to Article 284.3 TFEU. Even though it is not legally regulated, it is common practice that the ECB Vice-President presents the Annual Report to ECON on the day of its publication. This usually takes place around April and leaves the Parliament some months to draft a resolution that provides its opinion on the Annual Report, before the President appears before the plenary. In his introductory statement to plenary, the President addresses critical points raised in the resolution. Since 2011, the ECB's Annual Report has contained a section on external communication and accountability that describes the ECB's accountability to the European Parliament. It takes into account the dialogue held between the ECB and the European Parliament and characterises the main discussion topics. It refers, however, only to a short selection of topics discussed during the year. As Figure 1 on the next page shows, the Monetary Dialogue usually includes about eight topics each year, while the ECB's Annual Report comes back to only three of them. We think that the inclusion of this chapter is a positive development for the dialogue as a whole. A higher degree of completeness in order to inform the public about the meetings would be, however, desirable.

In addition to the debate during the meetings, any MEP can submit questions for written answer to the ECON Chair, who shall forward them to the ECB, as stated in Rule 118 of the Rules of Procedure. A record of written questions and answers shall be available in the *Official Journal of the European Union*. Questions not answered within the dead-

Figure 1: Monetary Dialogue briefing paper topics vs. ECB Annual Report topics in 2012

Topics of briefing papers

1 Macroeconomic imbalances and a single monetary policy in the euro area
2 Non-standard policy measures: a first assessment
3 Role of the ECB in financial assistance programmes
4 Crisis response by central banks
5 Banking union and a single banking supervisory mechanism
6 ECB intervention in the euro area sovereign debt markets
7 Towards a genuine economic and monetary union
8 Monetary policy and banking supervision

ECB Annual Report – Dialogue Focus

The single supervisory mechanism
Outright Monetary Transactions
The long-term vision for EMU

Source: Bruegel.

line can be included in the next Monetary Dialogue meeting at the request of the questioner.

The European Parliament also has a role in the appointment of ECB Board Members, though this is not part of the Monetary Dialogue. According to Rule 109 of the Rules of Procedure and Article 283.2 of the TFEU, any candidate nominated by the Council as President, Vice-President and Executive Board Member shall appear before ECON to make a statement and answer questions. The Committee in turn makes a recommendation to the Parliament on the approval of the candidate. The Parliament has only a consultative role in relation to the European Council, which approves the appointment. In case the Parliament does not agree with the Council's nomination, its President can ask the Council to nominate another candidate, but the Council can still decide to maintain the appointment of its nominee.

Overall, we judge the procedure of the Monetary Dialogue positively: the fixed schedule and predetermined course of events of the quarterly meetings allows both the ECB and the Parliament to build expectations about how information is exchanged between the two bodies. Nevertheless, we believe that some elements could be improved and this is what we focus on in section 1.3.

1.2 Practices of other major central banks

In this section, we compare the practices of the ECB with the procedures of the Bank of England and the Fed.

Similar to the Monetary Dialogue held between the European Parliament and the ECB, the Bank of England holds a dialogue between the Members of the Monetary Policy Committee (MPC) and Financial Policy Committee (FPC) and the House of Commons' Treasury Select Committee. These hearings take place on a regular basis. Bank officials also hold occasional meetings with the House of Lords Economic Affairs Committee. Unlike the Bank of England but similarly to the President of the ECB, there is a fixed schedule of meetings for the Chairman of the Fed. He appears, however, only twice a year before the US Congress: once in front of the Committee on Banking and Financial Services of the House of Representatives, and once in front of the Committee on Banking, Housing, and Urban Affairs of the Senate. Additionally, he or other Fed officials have to appear before either of the Committees on request. In addition, an Annual Report prepared by the Fed Board of Governors describing the Fed's activities is submitted to the Congress.

While the European Parliament takes at least an advisory role in the appointment of ECB Executive Board Members before an appointment is made, the UK Parliament plays no role in the procedure. The Crown appoints members of the MPC, after the prime minister and the Chancellor of the Exchequer have been consulted. Hearings of new MPC Members by the House of Commons' Treasury Select Committee are held only after the appointment has been made to assess the independence and the competence of the new appointee. In contrast, the US Senate has more power. Any appointment to the Fed Board of Governors made by the President of the United States has to be confirmed by the US Senate before it becomes effective.

In terms of reporting, we note that both the Bank of England and the Fed are more transparent than the ECB. Both the Bank of England and the Fed publish minutes after meetings of the MPC and the

Federal Open Market Committee (FOMC). The ECB is the only bank among the three that does not publish minutes. Since its creation, the ECB has been afraid that, if votes or discussions were public, there could be political pressure on members of the Governing Council in their countries of origin – especially if there is a conflict between a country's immediate economic interest and that of the euro area as a whole – and that this would reduce the independence of Governing Council members[1]. However, the ECB could find a solution to that problem by publishing minutes that would not reveal individual votes or names in the discussion.

Most importantly, the ECB differs from the Fed and the Bank of England because it cannot be sanctioned by the European Parliament if it fails to fulfil its mandate. By contrast, in the US for instance, a simple majority of Congress plus a presidential signature can amend the Federal Reserve Act and change the bank's statutes. There is no such possibility in the euro area. Table 1 summarises the main differences in the transparency and accountability of the three central banks.

1.3 Assessment of the last five years of the Monetary Dialogue

In this section, we focus mainly on the quarterly hearing of the ECB President that takes place in front of the European Parliament Economic and Monetary Affairs (ECON) committee, and on the plenary parliamentary sessions to which the president is invited. In both cases, the procedure is similar: the ECB president reads a statement and

Table 1: Comparison of the ECB, the Bank of England and the Fed

	European Central Bank	Bank of England	Fed Reserve Board
Legal basis	TEU, TFEU, Statute of the ESCB; international law, can only be changed with unanimity of EU countries	1998 Bank of England Act	Federal Reserve Act, can be altered by Congress
Appointment of Board Members	President, the vice president and the other members of the Executive Board shall be appointed by the European Council, on a recommendation from the Council after it has consulted the European Parliament and the Governing Council.	The Court is appointed by the Crown on the advice of the prime minister and the chancellor of the exchequer. Treasury committee holds appointment hearings for new Monetary Policy Committee (MPC) and Financial Policy Committee (FPC) members.	US president appoints members of the Board of Governors. Appointment has to be confirmed by the US senate.
Accountability to	European Parliament	House of Commons' Treasury Select Committee and government	US Congress
Testimony frequency	ECB president appears four times a year before the ECON committee. At Parliament's request, the president, vice president and other members of the Executive Board shall be invited to attend additional meetings.	Members of the MPC and FPC give evidence on a regular basis at hearings.	Chairman of the Board shall appear before the Congress in semi-annual hearings.
Reports	President presents Annual Report to the plenary. Vice president presents it to ECON. ECB replies in writing to written questions put by MEPs.	MPC members produce an annual report ahead of Treasury Committee hearings. After each meeting of the Monetary Policy Committee, the Bank publishes minutes of the meeting.	With each semi-annual hearing, submit a written report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking and Financial Services of the House of Representatives.
Sanctions	On application by the Governing Council or the Executive Board, the Court of Justice may compulsorily retire a member of the Executive Board.	An Member of the Court can be removed by the Oversight Committee with the consent of the Chancellor of the Exchequer.	Board Members can be removed for cause by the President of the USA.

Source: Bruegel based on TEU, TFEU, Statutes of the ESCB, European Parliament Rules of Procedure, Protocol No.4 on the Statue of the European System of Central Banks and of the European Central Bank, 1998 Bank of England Act, Federal Reserve Act

1. Duisenberg (2003): *"those who vote and whose votes could be identified and recognised would come under pressure from their national governments or parliaments to vote differently in future, for purely national reasons and considerations. One of the Governing Council's greatest assets is that it has always taken a euro-area-wide point of view, and I would hate to lose that".*

this is followed by a Q&A session between him and MEPs.

Concerning the introductory statement by the ECB president, our careful study of the speeches given in the last five years reveals that the first part is always quite similar to the economic and monetary analysis given in the ECB monthly press conference preceding the hearing. Therefore, no important news or new policy measures are ever revealed during the hearings. In a way, it makes sense that the ECB Governing Council makes announcements of new policies immediately after decisions are taken, ie during the press conference following the meeting, and it is also reassuring that its views on the economic situation expressed in front of the European Parliament are consistent with those expressed during the previous months, but this repetition at the hearing also gives the impression that the ECB considers that its own press conferences make the hearing redundant. By contrast, the Fed often uses the semi-annual testimonies of its chairman to make important public announcements about its policy. For instance, current Fed Chair Janet Yellen used her testimony in front of congress on 11 February to clarify the Fed's forward guidance strategy and announce that it may *"be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6.5 percent, especially if projected inflation continues to run below the two percent goal"*.

The second parts of the ECB introductory speeches are in general much more interesting, in our view, because they deal with topics on which the ECB president is invited to give his views. Topics are chosen by the ECON committee and a background on the topics is provided by the briefing papers prepared by monetary experts before each meeting. However, we regret that MEPs do not focus at all on those topics in their questions following the ECB president's statement, as this would give a focal point to the discussion.

Indeed, the Q&A session following the ECB president's introductory statement is unstructured with questions covering a wide range of topics, supposedly reflecting the monetary and economic concerns of European citizens. Of course, it is a good thing that MEPs are free to ask whatever question they want to the ECB president. Moreover, it seems that the Monetary Dialogue between the ECB and the Parliament has matured over time. The parliamentary discussion has shifted from the central bank's ability to maintain price stability and discomfort with the level of transparency of its decision making process, to more general discussions about economic policy.

However, again, we think that the dialogue would gain from focusing on some particular topics. More precisely, we have serious doubts about the extent to which the Monetary Dialogue actually amounts to an effective assessment of the performance of the ECB. We believe that committee members should focus on the successes or failures of the ECB as it works to fulfil its mandate: they should review its performance towards its primary objective, and also towards its secondary objective of supporting the goals of the EU (ie growth and high employment). Even though the European Parliament's instruments to discipline the ECB are non-existent, a more careful assessment of the ECB's performance could give more weight to the monetary dialogue.

One option would be for the ECON committee chairman to play a more prominent role and ask the same series of very specific questions at the beginning of each hearing's Q&A session about the ECB's fulfilment of its mandate. One question, if observed (or even predicted) inflation is too low or too high compared to the target, could be: *"why have you missed your inflation target since our last meeting?"*, in the same way that in the UK the Governor of the Bank of England is required to send an open letter to the Chancellor every time inflation moves away from the target by more than 1 percentage point in either direction, to explain why the Bank of England failed to achieve its man-

'The ECB president's introductory statement to the ECON committee is always similar to the economic and monetary analysis given in the ECB press conference preceding the hearing. Therefore, no important news or new policy measures are ever revealed during the hearings.'

date. In the opposite case, when the inflation target is met, the Chairman could also ask the ECB president why the ECB is not doing everything it can to fulfil its secondary objective and support EU policy objectives, if the ECON committee considers there are shortcomings in this respect.

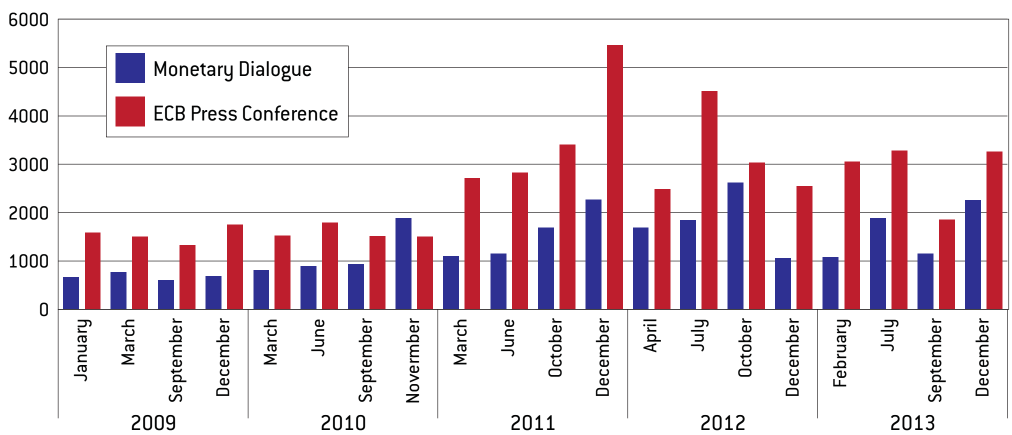
Finally, we assess the visibility of the Monetary Dialogue in the media. Given that the accountability of the ECB to the European Parliament is only based on the information exchange with the ECB and not on any enforcement powers, reporting of the event in the media should be important for the European Parliament. However, as Figure 2 clearly shows, it seems that the Dialogues are much less reported in the press than the ECB monthly press conference. Figure 2 also confirms our idea that MEPs should focus on one particular topic at each hearing. The monetary dialogue of October 2012, during which some MEPs were determined to talk about gender inequality, seems to have been the most cited dialogue in the media in the last five years. We do not say that coverage in the media should be the objective of this democratic exercise, but that it would help to put the ECB under democratic scrutiny.

The fact that the dialogue appears to be less important to the media or ECB watchers than the ECB monthly press conferences could even give the wrong impression that the ECB is more accountable to the financial markets than to the European Parliament. We also think that other elements would increase the media visibility and enhance the transparency of the Monetary Dialogue: a publicised and well-functioning live stream of the event (comparable to that available for ECB press conferences) is paramount, as are rapidly available transcripts of the hearings (for some reason the transcripts of the December 2013 and December 2012 hearings are missing on the dedicated webpage, and it is impossible to find the transcripts from before 2009). We encourage the European Parliament to highlight this event, because as long as the event is not sufficiently publicised, the ECB will be reluctant to make important announcements during the Monetary Dialogue, and reciprocally the event will not be visible if the ECB does not make important announcements, so the Monetary Dialogue could remain stuck in this bad equilibrium.

2 FUTURE ECB POLICY OPTIONS AND THE ROLE OF THE MONETARY DIALOGUE

This section reviews possible future policy choices the European Central Bank might face. A clear challenge for the euro area is deflation. The price level is below one percent, and a drop below zero could damage the European economy. Moreover, the ECB's most prominent conventional monetary tool, namely the interest rate, is already near zero, which means that the ECB has limited scope to use this instrument to address low inflation. Should the European Central Bank looks to what other banks have done, it will find two types of policies. The first is forward guidance. The second is quantitative easing. We review the main fea-

Figure 2: Mentions of the ECB in online media



Source: Bruegel based on Factiva. Note: 'mentions' refers to references to the 'ECB', 'EZB' or 'BCE' in English, German and French language online media on the day of, and the day after, each Monetary Dialogue or press conference in the respective month. Not every mention is checked for its relevance. The upward bias is, however, the same for both time series.

tures of each and then suggest the appropriate role for the Monetary Dialogue in the context of the two types of policy. We conclude with some observations on the function of the Monetary Dialogue after banking union.

2.1 The role of the Monetary Dialogue in the forward guidance strategy of the ECB

Forward guidance refers to a monetary strategy meant to guide consumers, markets and politicians about the medium term actions of a central bank. The version that the Fed and the Bank of England introduced respectively in December 2012 and August 2013 has two components. The first indicates that a possible increase in short-term interest rates will not happen before a specific macro-economic target is met. This was initially an unemployment rate of 6.5 percent in the United States and seven percent in the United Kingdom[2]. The goal of the policy is to influence not just short-term but also long-term interest rates. If markets are more confident that short-term interest rates will remain the same, long-term interest rates will fall towards the short-term rates. This should then encourage investment in capital goods as well as in housing. It should be noted that both institutions made clear that they would maintain this policy only while it did not mean that they would significantly overshot their inflation targets. As the banks note in their explanations, it is also a policy that they have introduced when interest rates were already very low and when there was little scope for further interest rate cuts[3].

In February 2014, both banks modified their frameworks as official unemployment rates fell close to the pre-announced targets. The Fed decided to widen its definition of what it counts on the job market to include other indicators, such as the long-term unemployed, but it basically kept a form of unemployment target in place. In the Bank of England's case, Governor Mark Carney announced that the Bank of England would increase the number of indicators it would use to assess when it would be appropriate to raise rates, including several indicators not related directly to employment, such as productivity, hours worked and household consumption. Neither central bank ended its forward guidance programme.

The second component of forward guidance is an active communication strategy about the targets. The banks want to influence market, and consumer, expectations about future monetary policy. There is a growing literature on how central bank communication affects expectations, which in turn affect individual behaviour[4]. For example, if consumers expect that prices will drop next year, they might wait to make their purchases. This type of deflationary scenario in Japan meant prices and economic output dropped even more than if households had expected stable or increasing prices.

These central banks have several platforms via which to announce, and to reinforce, their forward guidance policies. Former Fed Chairman Ben Bernanke first announced the most recent version of forward guidance in a press conference following a meeting of the FOMC. This is where the legislature might play a role. Current Fed Chair Janet Yellen announced the change in the US version of forward guidance in her testimony before the US Congress.

There is a further relevant point. The ECB is not the only institution that sets out future expectations on the health of the economy or the level of inflation. Some recent research suggests that increases in political contestation lead to more precise discussions among politicians about the economic future (Baerg, 2013), and this in turn provides a better hook for households on which to set their expectations. Discussion of the future course of monetary policy in front of the European Parliament, and the inevitable political discussions that come with the testimony both within Parliament and in the press as part of the Monetary Dialogue, represent a move towards greater contestation and might contribute to more effective forward guidance. In this case, such discussions should be encouraged for reasons of

'Discussion of the future course of monetary policy in front of the European Parliament, and the inevitable political discussions that come with the testimony, represent a move towards greater contestation and might contribute to more effective forward guidance.'

2. Note that the Federal Reserve Bank first introduced the concept of 'forward guidance' in August 2003, when it feared that deflation was a risk, and again in December 2008 at the height of the global financial crisis. In these early cases, there was a calendar date set rather than a specific macro-economic target that the Fed expected to reach before changing short-term interest rates. See Plosser (2013).

3. See Federal Reserve Bank (2014), and Bank of England (2013). For both banks, the statistical overshoot would be a rate more than 0.5 percent above each bank's explicit target of two percent. For the theoretical justification for why this policy is especially effective under very low interest rates, see Eggertson and Woodford (2003).

4. For example Blinder *et al* (2008).

accountability and transparency and because those discussions might make the policy more effective.

2.2 The role of the Monetary Dialogue if the ECB were to decide to implement a quantitative easing policy

Quantitative easing (QE) means that the central bank purchases assets, which boosts the money supply. There is a series of expected effects. QE provides a signal to households that monetary policy will remain expansionary in the future and that interest rates will remain low, which is the same function that forward guidance is meant to provide. QE has a similar goal to forward guidance, namely to push down long-term interest rates, but the central bank takes immediate action through its purchases. This action makes the asset class more expensive, and owners of assets are then expected to rebalance their portfolios, meaning that they purchase other assets. To the extent that commercial banks are the sellers of the bonds, they have more money on their balance sheets they can loan to customers, which may address a credit squeeze faced by businesses[5].

The US programme began in November 2008 and is on-going. The Fed has purchased mortgage-backed securities in addition to the purchase of US Treasury bonds. It asserts that QE has contributed directly to the economic recovery and to lower mortgage rates. In total, it has expanded its balance sheet almost $3 trillion since 2007[6]. The Fed has announced a 'tapering' of its programme, and it first reduced its purchases from $85 billion to $75 billion per month in December 2013.

The Bank of England began its QE in January 2009 at the height of the global financial crisis and it purchased £200 billion worth of mostly medium- and long-term government debt by January 2010. It made further purchases in 2011 and 2012, which took the total amount to £375 billion. It is no longer actively buying government bonds.

The Bank of Japan introduced what it calls quantitative and qualitative easing (QQE) in April 2013. The main purpose of the policy is to maintain price stability, which in practice means raising inflation towards its target of two percent, and it is done by trying to double the country's monetary base. Like the Fed, it purchases its government's bonds, and this is its main tool, with purchases of about 50 trillion yen per year as of 2013. It also buys exchange-traded funds (1 trillion yen) and Japan real estate investment trusts (50 billion yen)[7].

Each of these programmes therefore purchases government bonds. The ECB has announced a so-far unused policy to do the same, namely Outright Monetary Transactions (OMT), which allows the ECB to purchase essentially unlimited amounts of government bonds of member states that are already subject to a European Stability Mechanism programme, as long as the member states in question respect the conditions of the ESM programme. The ECB contends that this policy could be necessary on monetary policy grounds, namely to safeguard *"an appropriate monetary policy transmission and the singleness of the monetary policy"*[8]. Yet OMT is not strictly conceived as a direct monetary tool meant to push down interest rates across the euro area (Mody, 2014)[9].

For the ECB, a quantitative easing programme would probably mean the purchase of bonds of euro-area countries. The purchase of such assets would have distributional consequences. Governments would gain by paying less interest on their debt, while some households would lose by earning less interest on their savings[10]. Any government intervention in the economy that leads to profits for some groups in society should be subject to parliamentary oversight, with parliament holding the central bank directly accountable for such decisions. This is common practice where other central banks have initiated quantitative easing — the Fed has to defend its QE programme before Congress, while the UK Parliament created a Select Committee to take evidence on the Bank of England's programme[11]. Should the ECB adopt this policy, the Monetary Dialogue would be an ideal platform for the European Parliament to evaluate any such programme under the ECB's remit.

2.3 Should the Monetary Dialogue evolve to take into account the new role of the ECB as financial supervisor?

The Single Supervisory Mechanism (SSM) foresees the European Central Bank as the supervisor

5. A good summary appears in Joyce *et al* (2011).

6. *The Economist*, 14 January 2014.

7. See the explanation on the Bank of Japan website, and Bank of Japan (2013).

8. European Central Bank (2012).

9. There is an ongoing court case against OMT that began in the German Constitutional Court and is now pending at the EU Court of Justice. Whether OMT constitutes 'monetary policy' is one of the issues in contention.

10. In a recent report on the distributional consequences of quantitative easing from 2007 to 2012, the McKinsey Global Institute (2013) estimates that governments collectively saved $1.6 trillion, non-financial corporations saved $710 billion, while private household savers lost $610 billion. Our point is not that these figures are necessarily correct, but that they are significant and should be subject to parliamentary review.

11. Further information on the testimony is available at http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news/committee-to-take-evidence-on-qe/.

of 'significant' banks in the euro area. National supervisors will be most important for the remaining banks, although the ECB will cooperate with national authorities and can take responsibility for any bank in the euro area if it so chooses.

A concern is that the ECB's monetary policy objectives could conflict in the future with its banking supervision responsibilities. An increase in interest rates, for example, could be useful to maintain the ECB's inflation target, but it also might put pressure on the balance sheets of banks that have significant levels of short-term debt. It could also lead to an increase in non-performing loans if customers who took out short-term loans cannot afford higher interest rates. The central bank decision to address price stability would also affect bank profitability and (perhaps) financial stability. There is evidence that countries in which the monetary authority and banking supervisor are united in one institution have higher inflation rates than those in which these authorities are separate (eg Copelovitch and Singer, 2008).

Some steps have been taken to avoid this conflict. According to the regulation that establishes the supervisor, the ECB's Governing Council appoints four individuals to the Supervisory Board, all of whom should not perform duties directly related to monetary policy[12]. There are also arguments that there are important synergies between the two roles. Darvas and Merler (2013) suggest that liquidity assistance that only a central bank can provide is crucial to a banking supervisor. They also suggest that the ECB drop co-decision on various types of financial assistance programmes because such policies might represent a true conflict of interest.

Given that the decision has been taken that the ECB will add banking supervision to its pre-existing mandate to set monetary policy, how could, and should, the role of the Monetary Dialogue change to ensure democratic accountability? We have some concerns about the democratic accountability of the ECB as a supervisor under banking union. The European Parliament does have the right to approve the Chair and Vice-Chair of the SSM Supervisory Board, but the ECB selects the candidates[13]. There is an agreement between the European Parliament and the ECB that the Chair of the Supervisory Board will appear twice a year before the relevant European Parliament committee. The ECB will also submit an annual report to Parliament on its activities as a Supervisor, and the Chair is expected to present the report in an open hearing. There are also provisions for making specific hearings confidential[14]. Regardless of how well the European Parliament holds the ECB accountable for its function as banking supervisor, one would expect that concerns about whether decisions taken as supervisor affect monetary policy to be part of the remit of the Monetary Dialogue.

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12. See Article 26(5) of Regulation 024/2013.

13. See Howarth and Quaglia (2013) on the role of the European Parliament in the SSM.

14. European Central Bank and European Parliament (2013). For concerns about whether this procedure will be transparent enough about the state of the banking system, see Gandrud and Hallerberg (2014).

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