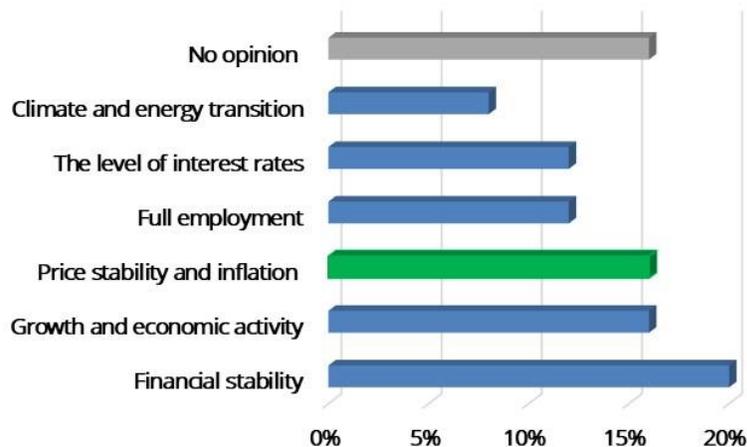


The ECB mandate through the lens of the new monetary strategy

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People's views diverge as to which economic priorities the ECB should focus on. After recalling the economic rationale of the ECB mandate, as well as the legal framework, this posts gives some insights into the reasons why its new strategy takes account of other considerations, such as climate change, in the way in which the ECB fulfils its mandate.

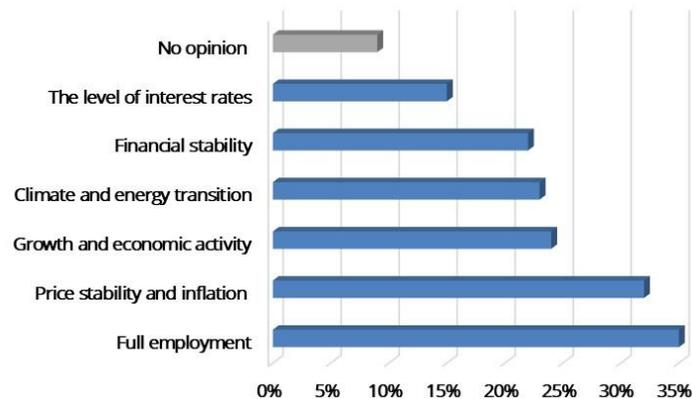
Chart 1. What is the primary objective of the ECB monetary policy?



Source: Survey conducted by Kantar on behalf of the Banque de France in October 2020 by phone.

Note: Sample: 1,005 individuals, 18 years and over.

A 2020 Banque de France survey shows that only a minority of French people (16%) know that price stability is the primary objective of the ECB's monetary policy (Chart 1). When asked about the two main economic concerns that the ECB should address (Chart 2), the vast majority favoured full employment (35%) and price stability (32%), followed by economic activity (24%), climate transition (23%) and financial stability (22%).

Chart 2. What are the two main economic concerns that the ECB should address?

*Source: Survey conducted by Kantar on behalf of Banque de France in October 2020 by phone.
Note: Sample: 1,005 individuals, 18 years and over. Two answers were possible for this question.*

History and economics of the primary objective of price stability

The political economy literature initiated by [Kydlan and Prescott \(1977\)](#) and [Barro and Gordon \(1983\)](#) introduced a rigorous framework for examining the role of policymakers in macroeconomic stabilisation. One lesson that emerged was that, in order to enforce a low inflation equilibrium, monetary policy must be delegated to a credible and independent – of political pressures – institution. Indeed, historical episodes worldwide show a clear “inflationary bias” of governments in the absence of an independent authority in charge of price stability (e.g. Germany in the early 1920s and several European countries in the 1970s and 1980s). As a result, the ECB was given a clear primary objective of price stability, set by the Treaty on the Functioning of the European Union (TFEU - hereinafter “the Treaty” -, Article 127). The quantitative definition of price stability has evolved over time and, since July 2021, it is defined as a 2% symmetric inflation target over the medium term. In addition, the principle of prohibition of monetary financing (TFEU, Article 123), together with the principle of central bank independence (TFEU, Article 130), was established to avoid any political pressure from euro area Member States on the Eurosystem. Finally, the ECB has been assigned the best instruments to control inflation, such as the setting of key interest rates.

A secondary objective without prejudice to the first

Despite the primacy of price stability, the ECB's legal mandate is not a single one, but rather a "hierarchical" mandate that includes a "secondary" objective. Indeed, Article 127 of the Treaty states that, without prejudice to price stability, the ECB "shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union". Among the latter: "full employment", "balanced economic growth", "high level of protection and improvement of the quality of the environment". Moreover, Article 127(5) provides that the ECB shall contribute to the "stability of the financial system".

Besides the requirement that it uses only the instruments provided for in the Treaty, the main conditions for the ECB to pursue the secondary objective are:

- The ECB's support for other economic policies must not be detrimental to price stability.
- The ECB is not allowed to *conduct* "economic policies", it has only a *supportive* role in them, as governments and parliaments have the primary responsibility for them.
- Any ECB action must not go beyond what is necessary to achieve it nor have negative consequences that would outweigh the positive expected results (proportionality test).

Opportunities and challenges of the new monetary policy toolkit

In the era of "conventional" monetary policy, the ECB's single-objective, single-instrument set-up made it more difficult to intentionally take account of considerations other than price stability into monetary policy decisions. Nevertheless, *de facto*, the ECB has always also considered a measure of activity (e.g. the output or the unemployment gap) when setting policy rates, in line with the prescriptions of a Taylor rule. In fact, trade-offs between activity and price stabilisation do not appear in the case of aggregate demand shocks. In the case of supply shocks, conversely, when such trade-offs might materialise, the "["medium-term" orientation](#)" of the ECB's objective allows it to "look through" the shock and respond only in the presence of second-round effects (e.g. on wages).

However, the gradual expansion of the ECB's toolkit, which now includes "new conventional" instruments, such as asset purchases, offers wider possibilities of support, which have to be assessed so as to identify the most relevant and efficient solutions.

The interactions between price stability and the secondary objective

Much work has been done during the 2020-21 [strategy review](#) to study the role of other considerations, related to the secondary objective, for the conduct of monetary policy, such as [employment](#), [financial stability](#), and [climate change](#). On the legal side, the review has led to a broad overview of the ECB's mandate, available [here](#), while the specific issue of the links between climate change and the mandate had been explored in previous works (see [here](#), chapter 7).

The [new ECB strategy](#) clearly reiterates that "a medium-term orientation allows the Governing Council to cater in its monetary policy decisions for other considerations relevant to the pursuit

of price stability” and specifies that “taking such considerations into account will often be necessary to maintain price stability over the medium term”.

In particular, it has become increasingly clear over recent years that climate change has consequences for the price stability objective through its impact on macroeconomic indicators such as inflation, output, employment or productivity. Besides, climate change has and will increasingly have severe consequences on many objectives of the Union, such as the well-being of its peoples, a balanced economic growth and the environment. Climate change is therefore also linked to the ECB’s secondary objective.

Consequently, as a part of the new strategy, the ECB has formulated a promising [action plan](#) regarding climate change, which includes possible refinements of monetary policy tools, such as asset purchases. The ECB’s *preventive* role, i.e. an action against climate change itself, is however bounded by the above-mentioned legal conditions. It must hence only be understood as being a *complementary* role alongside the main public players in the fight against climate change, who belong to the legislative and executive spheres.