Finanzgruppe
Deutscher Sparkassen-
und Giroverband

**STANDPUNKTE
DER CHEFVOLKSWIRTE**

More transparency
- Essential consequence of the judgment of the BVerfG

The ruling of the Federal Constitutional Court (BVerfG) on the constitutional complaints regarding the ECB's PSPP bond purchase programme present policymakers with difficult tasks. The Chief Economists of the institutes affiliated in the DSGV advocate that the objections identified by the Constitutional Court should be taken seriously and at the same time that pragmatic conclusions should be drawn. The tension that has arisen should be "cooperatively balanced in accordance with the European integration idea and defused by mutual consideration", as the court demands.

- The Federal Constitutional Court requires the European Central Bank Council to explain in resolution form why the PSPP bond programme is part of monetary policy and why it is proportionate, and is thus thus ultimately calling for a proportionality test of the monetary policy of recent years. However, government bond purchases are not prohibited in principle. Although the European System of Central Banks (ESCB) already provides explanations and considerations, we consider an expansion and deepening of this communication to be essential for anchoring monetary policy in European society.

- In recent years, the Eurosystem has already intensified its guidance on monetary policy and, particularly with regard to government bond purchases, has highlighted the link between the objective of price stability and other economic policy objectives such as employment, growth and savings. This path of increased transparency - which is essential for the acceptance of monetary policy by the public - must continue. However, this must come from the ESCB itself - we do not believe that new mandatory consultation or justification obligations would be conducive to achieving this goal.

May 25th 2020

Authors
Uwe Burkert - LBBW
Uwe Dürkop - Berliner Sparkasse
Jochen Intelmann - Haspa
Dr. Ulrich Kater - DekaBank
Christian Lips - NORD/LB
Dr. Jürgen Michels – BayernLB
Dr. Reinhold Rickes - DSGV
Dr. Gertrud Traud - Helaba
Prof. Dr. Carsten Wesselmann
- Kreissparkasse Köln

Coordinators
Dr. Sonja Scheffler
sonja.scheffler@dsgv.de
Dr. Holger Schulz
holger.schulz@dsgv.de

Transgression of competences and monetary financing under discussion

Building on the inadequate control approach identified by the European Court of Justice (ECJ), the decision of the Federal Constitutional Court of 5 May 2020 deals with two sets of questions, namely, firstly, the accusation that the ECB has exceeded its competence and, secondly, the accusation of prohibited monetary financing.

The first accusation (ultra vires) is that the ECB is no longer pursuing only monetary policy with its PSPP bond purchase programme, as the effects of these measures have spill-over into almost all aspects of economic policy (distribution policy, savings policy, debt policy, innovation policy, competition policy, etc.). As a European institution, the ECB receives its mandate in the form of a limited individual authorisation, here the exercise of monetary policy, and in the case of such a limited transfer of sovereignty, it is up to the respective institution, here the ECB, to justify that it remains within this individual authorisation with its measures. Such justification would have to include, in particular, an examination of the proportionality of the positive (serving the monetary policy objective) and negative (affecting other policy areas) aspects of monetary policy. Here, statements by the academic staff or individual functionaries of the ESCB are not sufficient for the BVerfG; instead, the decision-making bodies must act as responsible bodies. According to the BVerfG's judgment, no such justification has been given. Moreover, the Federal Government and the Bundestag had violated their duties of supervision by not demanding this justification. Therefore, the BVerfG judgment calls upon them to induce the ECB to conduct such a proportionality review.

Ultra vires: Are ECB government bond purchases acceptable?

Second, the complaint procedure concerned the allegation that the PSPP programme involved prohibited monetary financing and, as such, a violation of Article 123 TEU. The court rejected this accusation against the PSPP programme. The criteria established and applied by the ECB should lead to further discussions on the new ECB Pandemic Emergency Purchase Programme (PEPP).

The reason why the BVerfG is so clearly opposed to the previous judgment of the European Court of Justice (ECJ) is that the German court considers the answers of the Luxembourg judges to the submission questions to be no longer plausible and therefore "objectively arbitrary" - which means that the ECJ itself is acting ultra vires in the eyes of the BVerfG. The control approach of the ECJ towards the ECB was allegedly insufficient. This includes the fact that the ECJ left the Federal Constitutional Court's question regarding the consequences of a state insolvency for the ECB, in particular the possibility of loss sharing between the Member States, unanswered because it classified this question as inadmissible since it was hypothetical. From an economic point of view, this assessment as "hypothetical" is not tenable if one considers the partial default of Greek government bonds in 2012, for example.

The BVerfG ruling is the first time that a German court has openly disregarded the jurisdiction of the European Court of Justice. In this respect, the EU Commission has announced that it intends to examine infringement proceedings against the Federal Republic of Germany. The actual initiation of infringement proceedings would lead to a political impasse. A constitutional crisis in Europe must be averted - it would go far beyond the question of the proportionality of the ECB's monetary policy and the Bundesbank's involvement. The division of competences between the supreme courts is not an economic issue, but a political and legal one. From an economic point of view, it can only be stated that a network of unclear legal competences in Europe would seriously curtail legal certainty and should be prevented at all cost. Not least because this would undermine the credibility of monetary policy in the financial markets.

... now also infringement proceedings?

Ultra vires accusation

EU institutions must always declare that their actions are in accordance with the limited individual empowerment which is the basis of their activities. The declaration required by the Federal Constitutional Court in connection with the PSPP programme can and should be provided by the ESCB. From an economic point of view, such an explanation would be feasible, and in our opinion there is a good chance of plausibly demonstrating that the ECB's instruments are being used within the bounds of monetary policy. The Eurosystem is constantly carrying out such studies and the ESCB has also expressed its views on them in the Bundestag in the past. It remains important to continue and expand broad communication and discussion activities and, in doing so, to illustrate the relationship between safeguarding price stability and other macroeconomic indicators such as growth, employment, distribution and savings. This has already been practised by the Eurosystem through mechanisms such as discussions with parliament and society at large, as well as through written statements such as reports, protocols and press releases. It could, however, be further developed, particularly with regard to the strategy discussion (e.g. by appointing capital ambassadors from the Eurosystem who are available in the Member States to explain monetary policy to the national parliaments).

Monetary policy always affects prices, growth, savings, etc.

In our opinion, the call by a constitutional court for monetary policy to fulfil its obligations under European law does not undermine the independence of the central bank - as long as it is only a matter of complying with the procedures and mechanisms required by the EU Treaty. We do not see this in any way as implying a review of the content of monetary policy and thus regulations on the implementation of monetary policy. The question in this context is whether the Federal Constitutional Court can impose this on the ECB and thus also on the entire Eurosystem via the Federal Government and the Bundestag. A compromise could be for the Bundesbank to assume this task within the national framework. Even in this case, however, the ECB should, on its own initiative, as in the four annual monetary dialogues in the European Parliament, take a position on important decisions, before national parliaments as well. This would enhance transparency and would anchor monetary policy more firmly in the Member States as part of the overall national and European policy architecture. It would also fit in with the strategy review announced by ECB President Lagarde. It remains important that the existing underpinnings in the European Treaties are respected, and that new binding mechanisms are not unilaterally translated into law by national parliaments.

In our view, the purchase of bonds is within the purview of monetary policy. It is true that such asset purchases have an unusual volume by historical standards. However, this is due to the likewise historically unusual challenges of achieving the ECB's objective of price stability - currently supplemented by an economic crisis of historic proportions. In terms of their effect mechanisms, the "unconventional" measures used in the past are similar to the "conventional" measures used previously. The level or scope of the measures is also a result of missing or insufficient measures in the fiscal policy area. In its opinions, the ECB has pointed out the distinction between monetary policy and fiscal policy and called on the Member States to adopt fiscal and growth policy measures to stabilise the economy in the euro area. By setting interest rate and liquidity conditions, the aim is to stimulate lending and economic activity, and thus inflationary dynamics, via various channels as long as these dynamics remain below the ECB's target of "close to but below 2 percent". In principle, "unconventional" measures do not intervene differently in the framework conditions for commercial enterprises and private households than previously implemented "conventional" measures. Moreover, such measures are also used internationally by many central banks in the various currency areas. This is particularly true concerning the dominant global currency, the US dollar.

ECB purchase of government bonds is an unconventional measure

It should also be noted that reductions in interest rates always favour the debtor over the creditor. Through their impact on asset prices, they also have more wide-reaching distributional consequences. The fact that monetary policy is currently operating at the zero interest rate bound is also new only in the nominal sense: negative real interest rates and thus the so-called "expropriation" of savers' purchasing power were frequent in earlier phases of monetary policy. There is no monetary policy that is neutral in terms of the real economy. Such discussions also took place in the days of the D-Mark. For example, the Deutsche Bundesbank raised its key interest rates in the wake of German reunification - this too was highly controversial at the time, but no one thought to appeal to the Constitutional Court on this matter.

Negative interest rates and bond purchases are explained by the ECB...

The effectiveness and limits of monetary policy have to be explained again and again. The members of the Governing Council, most notably the Chief Economist, Philip Lane, have already elucidated the impact of monetary policy on the key variables of inflation and GDP growth in speeches and publications on a number of occasions in the past and have provided a methodological background on this score which is in keeping with state-of-the-art academic knowledge in this field. In our view, this justification is conclusive.

... and declarations must be strengthened

Currently, there is an increase in new debt and issuance of government bonds due to the coronavirus pandemic. This is acceptable in view of the crisis, even if it means that key parameters such as the purchase of government bonds by states in accordance with their capital ratios are currently not being adhered to, as we make clear in the annex. However, the nature and scope of the PEPP, which was not (yet) the subject of discussion in Karlsruhe, makes it liable to trigger new lawsuits before the BVerfG. In contrast to the PSPP, the PEPP entails an even more flexible approach to the Eurosystem capital key and also contains exceptions for poor credit ratings and short-term debt instruments. We regard this programme as an emergency measure to stabilise the economy and financial markets in the biggest recession in a century. Its design should be compatible with the prohibition of monetary financing. As the economic recovery progresses, this programme should be terminated.

Where we level criticism at the current monetary policy stance is not at its direction, but at its scale. We doubt the marginal utility of ever new measures, instead perceiving the necessity - as we have already argued elsewhere - of corresponding fiscal policy measures at both European and national level. We

Corona pandemic is an exception!

see monetary policy “pushing on a string”, with the exception of measures to stabilise the financial system as in the acute economic crisis. In our opinion, however, this statement belongs in an economic category, not a constitutional one.

Irrespective of such current developments, it is essential for us to determine the long-term approach of the central banks. A key factor here is that a time perspective is given on the current measures. The ECB provides such a guideline through its forward guidance. Accordingly, net purchases under the PSPP will end shortly before the first interest rate hike in the new cycle and the reinvestment of maturing securities will end some time thereafter. It should be noted that the ECB cannot determine the term of its programmes in advance, as this would reduce the effectiveness of its measures. Any "collateral damage" of this monetary policy can and should be the subject of justification and consideration of its policy by the ESCB itself. In the light of current scientific research in these areas, there is a good chance that such a justification will also stand up to legal scrutiny.

Allegation of prohibited monetary financing

As an institutional precaution against the occurrence of unsound budgetary policies and high inflation rates, the European Treaty prohibits the use of credit facilities for the direct purchase of debt instruments from public institutions (Article 123 TEU). In contrast, the purchase of government bonds on the secondary market is a standard instrument of monetary policy which has been used to varying degrees by different central banks in the past. It is necessary to assess when bond purchases in the context of monetary policy cross the line to prohibited monetary financing due to their volume or regularity or other characteristics. In this context, the criteria according to which the court has examined the allegation of prohibited monetary financing are reasonable from an economic point of view, but they are not exhaustive. Formalisms such as holding periods, announcements and secondary market purchases are important criteria. However, the catalogue needs to be expanded to include economic criteria such as the reliability of central-bank purchases or the reaction of market prices to deteriorations in creditworthiness.

Buying government bonds on the secondary market is normal by international standards

The Federal Constitutional Court has not identified any prohibited monetary financing in the PSPP programme. We agree with this. The decision to borrow and the decision to transfer bonds to the ECB balance sheet continue to be two independent processes.

If, in an extension of its borrowing programmes, the ECB wishes to purchase securities with a lower credit rating, the European Budget should provide funds/guarantees to absorb possible losses sustained by the ECB. For purchases in excess of the respective capital-key ratio, funding should also be made available by the country concerned to mitigate risk.

The future shape of monetary policy in the euro area

In our view, monetary policy in the euro area should continue to be geared towards achieving its inflation target over the long term. This currently includes extremely low interest rates, partly as a consequence of government bond purchases. However, even the ECB could draw conclusions from such a weighing up of interests as to how far monetary policy should actually go. The ECB could also comment on this issue in the context of the current review of the monetary

A broad social-policy task: improving public understanding of monetary policy

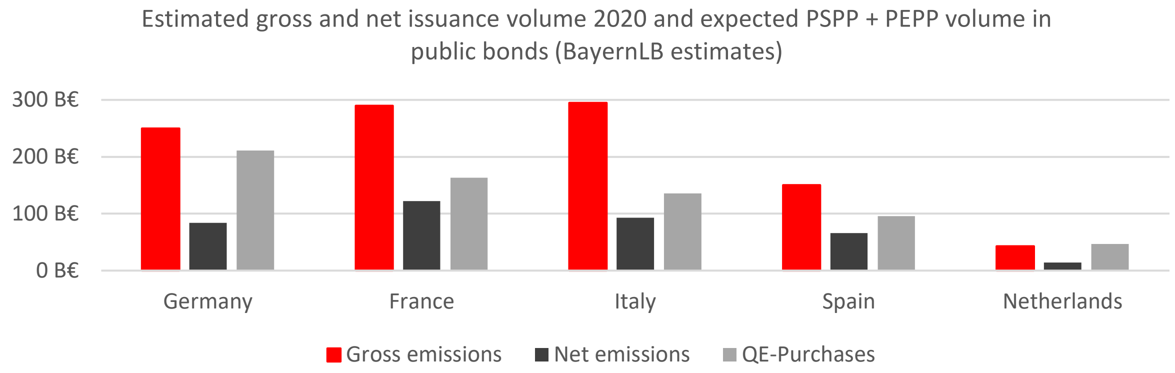
policy strategy. This would not even be addressed exclusively to the courts, but to the public. Although the broad effects of monetary policy as identified by the Federal Constitutional Court are, in our view, legally unassailable, a central bank, despite its independence, is dependent on support from society. To explain here how monetary policy works, why monetary policy measures are taken and what alternatives there are, is more important than ever.

In our opinion, the scope of monetary policy has been largely exhausted, both in terms of interest rate instruments and quantitative measures. We regard the latest bond purchase program (PEPP) as a crisis stabilization program that should be phased out as soon as the crisis subsides.

After the Corona-induced recession, the consequences of which are likely to be felt for another one to two years, European fiscal policy must make a decision on how to achieve a sustainable consolidation of the public debt burden, which will increase again after Corona. Possible strategies are growth promotion and budget consolidation, probably supported by negative real interest rates. In the absence of such an outlook, the euro area has come dangerously close to the state of prohibited monetary financing, from an economic perspective as well. In this respect, it remains crucial to take fiscal policy rules seriously again now, already with a view to the post-Corona period. The balance between individual responsibility, European solidarity and sustainable debt reduction will determine the integration policy debates in Europe over the course of this decade.

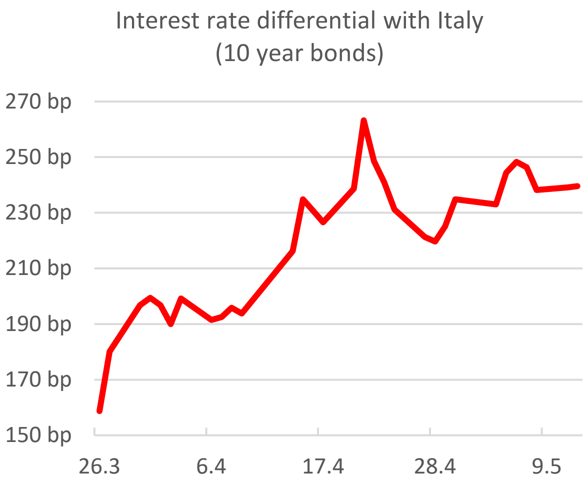
Annex

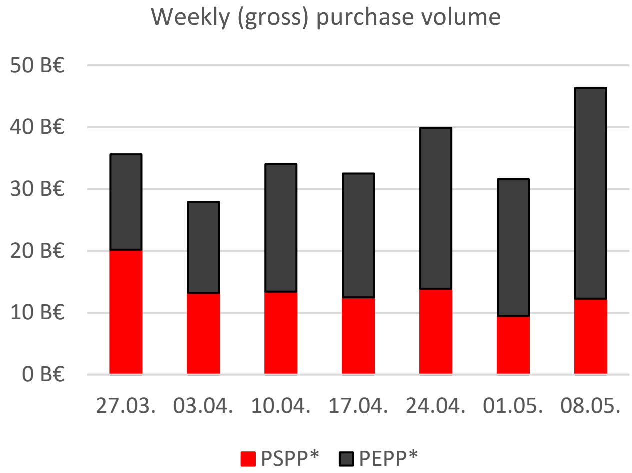
The surge in corona-related new debt is leading to a higher issuance volume by euro area member states. The increase in ECB government bond purchases is thus meeting with a higher volume, which can therefore be mopped up by the ECB.



Source: ECB, BayernLB Research

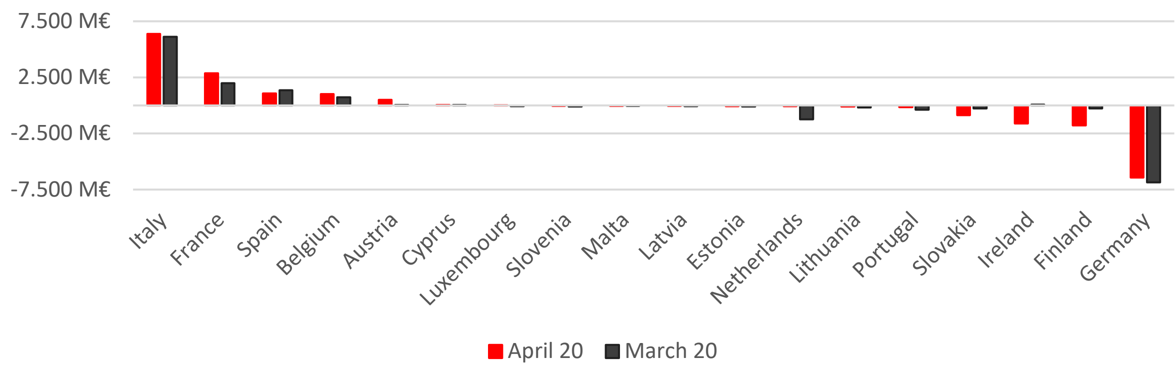
It is true that the interest rate differential vis-à-vis Italy increased during the Corona crisis. The increase in ECB government bond purchases has so far limited the rise in the interest rate differential between Germany and Italy.





Source: Bloomberg, ECB, BayernLB Research

Due to increased government bond purchases, the imbalances in the European currency area are increasing. In addition to TARGET balances that are increasing again, there are deviations from the ECB capital key, which are acceptable in view of the crisis.



Source: BayernLB

*Public Sector Purchase Programme and Pandemic Emergency Purchase Programme

Disclaimer

The present position paper of the Chief Economists does not necessarily correspond to the attitude of the DekaBank or the attitude of the respective Landesbanken and Savings Banks or the DSGV.

Imprint

Published by
Deutscher Sparkassen- und Giroverband
Abteilung Volkswirtschaft, Finanzmärkte
und Wirtschaftspolitik
Charlottenstraße 47 10117 Berlin
Telefon: 030 20225-5303
DSGV-Volkswirtschaft@DSGV.de
www.DSGV.de

Editorial Deadline
22nd May 2020

Layout
Franz Metz, Berlin

Photography
Pixabay/homer0922

Management
Pia Jankowski – DSGV
Director
Head of Economics, Financial
Markets and Economic Policy
Pia.Jankowski@DSGV.DE

Dr. Reinhold Rickes – DSGV
Head of Economics
Economics, Financial Markets
and Economic Policy
Reinhold.Rickes@DSGV.DE

Remark
You can access this document at
https://www.dsgv.de/positionen.html#standpunkte

ISSN
2509-3851