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Monetary Policy in the European Union

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Prompt for Discussion

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The European Central Bank played an important and powerful role in the management of the eurocrisis. Today, in the midst of the COVID-19 pandemic, the ECB once more emerges as a crucial actor. With its Pandemic Emergency Purchase Programme it is taking decisive steps to address the fallout from the crisis – not only attempting to safeguard financial stability, but also to prevent massive unemployment. As the ECB becomes an indispensable actor in crisis management, as its private and public sector bond purchase programmes become ever more far-reaching and larger in volume, it attracts more and more attention. A vibrant debate amongst legal and economic experts and with civil society actors confronts ECB practice with important questions of legality, democracy and policy.

Questions of legality include the following: Is the ECB still acting within its mandate? Can quantitative easing programmes – such as the public sector purchase programme or the pandemic emergency purchase programme – be qualified as monetary policy measures; or are they really economic policy measures that remain within the competence of member states? Is the ECB

acting in violation of the prohibition of monetary financing (Art. 123 TFEU) when it purchases public sector bonds in such large quantities and with the aim of ameliorating refinancing conditions of member states? Is the ECB pursuing with its crisis measures the primary objective of price stability (as mandated by Art. 127 TFEU) or are the ECB's policy decisions not only informed, but guided by other – secondary – objectives? These questions have been at the heart of two constitutional complaints before the German Federal Constitutional Court (FCC) against two ECB quantitative easing programmes (OMT and PSPP) which triggered a confrontation between the FCC (doubting the legality of the programmes) and the Court of Justice of the European Union (adopting a quite lenient standard of review and confirming their legality).

Apart from debates of legality, questions of legitimacy, democracy and social justice take center stage: Given that the ECB is such a powerful actor and given the distributive consequences of its policy measures, shouldn't it be subject to greater democratic control? Should monetary policy be democratized? What would it mean to democratize ECB policy? Here, too, views are divided. They are divided as concerns the empirics – the effects of QE programmes on social inequality, the actions of corporations and capital concentration. They are also divided as concerns democracy and democratization: Should central bank independence from politics be safeguarded and in return monetary policy powers be reined in and subjected to strict judicial review (this appears to be the view of the FCC)? Or should the conduct of monetary policy – in recognition that monetary policy cannot be neatly separated from non-monetary economic policy – be “politicized” and become more transparent and inclusive.

Finally, policy considerations are heatedly debated: If the ECB has such powerful policy instruments at its disposal, might it/must it employ them to address pressing public concerns such as climate change, social inequality and

structural imbalances between member states? Suggestions for the (re-)deployment of monetary policy abound: to selectively support green industry; to engage in more outright monetary financing to support the budgets of member states; to start a programme of peoples' QE, *inter alia* to promote social cohesion. Yet, can monetary policy make up for the “design flaws” of European monetary union with its separation of monetary policy (as an exclusive EU competence) from fiscal/economic policy (remaining largely a competence of the member states)? Can “more money” – even if directed with precision towards social objectives – be a solution to the current existential crises or does it fuel a growth spiral that is co-responsible for the social and ecological crises we are in?

While the ECB currently addresses some of these questions in its Strategy Review 2020, we wish to join the debate with this roundtable. Our aim is, ideally, to forge a transatlantic debate. We hope to address common concerns raised by central bank monetary policy and in particular quantitative easing – once considered unconventional monetary policy and today widely used by the ECB, the Fed and other central banks around the world. We also want to identify the specificities of ECB monetary policy that result from the particular institutional design of the European monetary union when compared, for example, to the United States system of government.

Contributions

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The Hegemony of Central Bankism and Authoritarian Neoliberalism as Obstacles to Human Progress and Survival

Jeremy Leaman, Loughborough University

February 18, 2021

Opening up ECB's Black Box and Painting it Green- the Monetary Policy Mandate in the Age of New Challenges and Uncertainty

Agnieszka Smoleńska, European Banking Institute

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The Distributive Impact of Central Banks' Quantitative Easing Program

Brigitte Young, University of Münster

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Money and the Debunking of Myths

Jamee K. Moudud, Sarah Lawrence College

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Post-Crisis Central Banking and the Struggle for Democratic Oversight in Europe – a Trilemma and a Paradox

Sebastian Diessner, European University Institute and London School of Economics

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The ECB, the climate, and the interpretation of “price stability”

Jens van't Klooster, KU Leuven

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Beneath the Spurious Legality of the ECB's Monetary Policy

Marco Dani, University of Trento, Edoardo Chiti, Sant'Anna Scuola Universitaria Superiore Pisa, Joana Mendes, University du Luxembourg, Agustín José Menéndez, Universidad Autónoma de Madrid, Harm Schepel, University of Kent, Michael A. Wilkinson, London School of Economics

January 4, 2021

Rekindling Public Trust in Central Bankers in an Era of Populism

Annelise Riles, Northwestern University

December 28, 2020

Quantitative Easing, Quasi-Fiscal Power and Constitutionalism

Will Bateman, Australian National University

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Beneath the Spurious Legality of the ECB's Monetary Policy

January 12, 2021

Marco Dani, University of Trento, Edoardo Chiti, Sant'Anna Scuola Universitaria Superiore Pisa, Joana Mendes, University du Luxembourg, Agustín José Menéndez, Universidad Complutense de Madrid, Harm Schepel, University of Kent, Michael A. Wilkinson, London School of Economics

Asked recently whether the European Central Bank (ECB) would provide debt relief to Eurozone Member States by cancelling their bonds that it holds, President of the ECB Christine Lagarde replied categorically that it would not, because the Treaty forbids it. She was referring to Article 123 TFEU, which prohibits the monetisation of public debt by the ECB. By doing so, Lagarde was merely echoing the prevailing view that this provision, along with Article 125, which prohibits the assumption by the Union of Member State debt, is a core part

of the European monetary constitution. Or, what is the same, that it is a “constitutional red line” which the ECB must respect, and which is subject to the control of the Court of Justice (“Court”). Articles 123 and 125 TFEU are fundamental pillars, supporting not only ‘price stability’ (the core mandate of the ECB according to Article 127 TFEU) but also ‘sound public finances’ (Article 119(3) TFEU). There is, therefore, no doubt about the correctness of Lagarde’s stern assertion. Or is there? Are European Treaty provisions real constitutional norms or are they honoured primarily in the breach, perhaps because they are impossible to comply with? The last decade has shown that constitutional curbs and boundaries are, at the very least, surmountable.

The track record of the ECB is mixed, at best. Over the last decade, the ECB has departed from a strict mandate of price stability to provide stimulus and support to the Eurozone economy. In so doing it has elided the artificial Treaty distinction between monetary and economic policy which anchors the institutional structure of Economic and Monetary Union (EMU), as well as its democratic legitimacy. In key moments, and with the support of the European Council, the ECB established programmes that stretched the boundaries of price stability and the prohibition of monetary financing. Its Outright Monetary Transactions (OMT) Programme (announced in 2012), designed for an exceptional economic context, signaled the mutation of the ECB into a conditional buyer of government debt (the 2010 Securities Markets programme was a timid, albeit relevant, precedent). The quantitative easing programmes pursued by the ECB since 2015 have seen it acquiring both corporate and sovereign bonds outside of any explicit crisis situation. In response to persistently low inflation and the need to inject liquidity and stimulate economic growth, the ECB has turned squarely into a ‘market maker’.

The justification for these interventions, however, continues

to be price stability and the preservation of the mechanisms of transmission of monetary stimuli into the “real” economy. Such was the argument that the legal service of the ECB defended before the Court in both the *Gauweiler* and the *Weiss* proceedings and such was the verdict of the Court. Faced with the need to determine how far ECB monetary policy programmes may encroach into economic policy, the Court chose to defer to the ECB, from whom “nothing more can be required” than a careful and accurate deployment of its “economic expertise and the necessary technical means at its disposal” (*Gauweiler*, para 74; *Weiss*, para 91). The way the Court delimited the boundaries of monetary policy (by reference to its objectives and instruments) and adopted an innocuous interpretation of the proportionality principle – strongly contested by the German Constitutional Court (GCC) – was key in this regard. Importantly, however, both courts held that the ECB programmes satisfied the Treaty’s prohibition of monetary financing. The programmes’ conditions upheld the incentives for Member States to maintain sound budgetary policy, as the Treaty requires, and preserved uncertainty for market operators and Member States, which is key to maintaining market discipline, both in exceptional (*Gauweiler* rulings) and in normal (*Weiss* rulings) circumstances.

Despite the political implications of the ECB’s inflated balance sheet, the ECB’s status of independence from political interference and its technical expertise in stabilising prices continue to coat the legitimacy of its actions. But the veneer can hardly hide the cracks. Under the pandemic programme (PEPP), the ECB is purchasing unprecedented amounts of sovereign bonds (since March an estimated 71% of the total debt issued by Eurozone states), and while it is clearly breaching the limits set by the *Weiss* rulings to avoid monetary financing, the members of its executive board cannot but insist that the ECB is acting well within the limits of the Treaty’s strictures. “Forceful action” is needed to maintain “the singleness of our monetary policy and the

effectiveness of the transmission mechanism". The ECB's actions remain, purportedly, "temporary, targeted and proportionate". The preservation of "market functioning and price formation mechanisms" continues to justify the PEPP, even though the ECB is going much further than before and occupying terrain that would have been politically unimaginable and legally unfeasible before 2010. There are plenty of reasons to doubt that the 'money' the ECB is guarding remains the same as it was ten years ago.

What has clearly changed is the ECB itself. How far can the Frankfurt-based institution go in re-shaping its mandate while continuing to resort to the justification of ensuring the singleness of the EU's monetary policy and the effectiveness of monetary transmission mechanisms? The *Weiss* saga made clear that judicial review cannot safeguard Treaty boundaries, at least as long as the Court maintains a view of monetary policy that leaves the ECB the power to determine its own mandate, and as long as proportionality is something that the ECB can demonstrate by simply showing that it has weighed the economic effects of its monetary policy instruments. The conundrum now, as before, is clear: while legality may be difficult to maintain, a conclusion of illegality would curtail action, which –at least in the short term– has been as functionally necessary as it has been politically disputed, as well as having quite problematic distributive implications. Should the Court ever be required to review PEPP, it would again become the arbiter of contending political views on the legitimate reach of the ECB's action (the identity of the plaintiffs in the cases that have hitherto reached the Court via preliminary references confirms as much).

Irrespective of the Court's assessment of the legality of the programme, such an assessment would not be sufficient to compensate the weak legitimacy of an interventionist ECB. It would not be sufficient to justify an unprecedented degree of central bank discretion. No judicial verdict can resolve the

fundamental political and economic problem that the ECB faces. The ECB was meant to operate in an institutional framework which separated monetary and economic policy. It has now become a massive holder of government debt, acquired “in a flexible manner allowing for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions” (Article 5(2) PEPP Decision) in order to support the Member States’ economies. The imbrication of monetary and fiscal policies has ultimately led the ECB to face the political ‘red line’, the “forbidden” act of debt monetisation, and thus, debt cancellation.

With the *de facto* enlargement of the ECB’s mandate, EMU is profoundly transformed. The current line between EU monetary competences and national-subject-to-EU-surveillance fiscal policies, if formally upheld, has already shifted. This raises issues far deeper than the question of legality. Unsurprisingly, the transformation is occurring through the same executive logic that has guided the birth and evolution of the EMU over the past decade. The agents and proponents of this transformation – lawyers, economists, academics, and officials – are of course aware of its radical character. They rely on the existing EU institutions and procedures to sustain its legitimacy and legality due to the sheer difficulty of formal treaty amendment,. Although aspects of this transformation can be legally contested, judicial channels often give the green light. They thereby strengthen the position of the ECB and of its preferred solutions to problems which the legal framework not only cannot resolve but also was not designed to address.

With German and European Courts holding that the ECB’s buying of sovereign bonds under the PSPP did not cross the ‘red line’ of monetary financing, only to see a new programme doing just that in a context of the pandemic crisis, political leaders shy away from proposing radical solutions such as sovereign debt cancellation. The course set appears to depend more on

the discretion of the ECB, in turn dependent on the political struggles within its Governing Council and on their perceived leeway of action, than it does on the rules of the Treaty or the possibilities of political action.

No matter what the future holds, political battles about how the economy should function ought to be fought through democratic channels, not in court, nor in the backrooms of central bank governors through processes that are fully in their hands (such as the on-going ECB strategy review). Maybe law, by a stretch of its techniques of interpretation can accommodate such processes, but it is in danger of losing any trace of the political and social legitimacy that grounds its constitutive function. It might still be law, but certainly not democratic law, and thus lacking the integrative properties of the latter. By the same token, the transformation of the ECB is the result of EMU's institutional flaws and the inadequacy of its political economic paradigm. As long as these remain, and the official and legal justification for the ECB's decisions continues to invoke existing Treaty provisions subject to judicial control, the EU's biggest challenge – how to generate social and political legitimacy – lingers on, unaddressed