



Governor Olli Rehn

Opinion

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Grand Committee of the Parliament of Finland

Expert opinion to the Grand Committee

Case: O 39/2020 vp Significance of the judgment of the German Federal Constitutional Court regarding the Public Sector Purchase Programme of the ECB

The German Constitutional Court pronounced on 5 May 2020 a judgment on the Public Sector Purchase Programme (PSPP) of the European Central Bank (ECB). In its judgment, the Federal Constitutional Court finds that the ECB has not sufficiently substantiated the proportionality of the PSPP, which amounts to an exceeding of the ECB's competences. The Federal Constitutional Court argued that given the powerful economic policy effects of the PSPP, the ECB should have identified, weighed and balanced against one another the PSPP's monetary policy objective and economic policy and fiscal policy effects, particularly taking into account the significant size of the programme. In accordance with the principle of proportionality, the content and form of the activities of the Union may not go beyond what is necessary to achieve the objectives of the Treaties.

In its judgment given in December 2018, the Court of Justice of the European Union (CJEU) argues that the ECB is acting within the limits of its price stability objective. The Court argued that the purchases under the PSPP have been proportionate to the objective and that the PSPP does not infringe the principle of proportionality.

The purpose of the PSPP is to contribute to the achievement of the price stability objective. The CJEU argued that taking account of its objective and of the means provided for achieving that objective, a



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decision on the PSPP falls within the sphere of monetary policy – even if it may have indirect effects that can also be sought in the context of economic policy.

In its judgment, the CJEU assessed whether the bond-buying programme forming part of monetary policy is proportionate to the monetary policy objectives and whether the PSPP manifestly goes beyond what is necessary to achieve those objectives.

According to the ECB's economic analysis, the PSPP is appropriate, in the monetary and financial conditions of the euro area, for contributing to achieving the objective of maintaining price stability.

In those circumstances, in view of the foreseeable effects of the PSPP and given that it does not appear that the ECB's objective could have been achieved by any other type of monetary policy measure entailing more limited action on the part of the ECB, the CJEU held that, in its underlying principle, the PSPP does not manifestly go beyond what is necessary to achieve that objective.

The German Constitutional Court did not follow the preliminary ruling requested from the CJEU in that regard and disregarded the CJEU's interpretation of EU law and the position of the CJEU as its primary interpreter.

The CJEU issued a press release on 8 May 2020 following the judgment of the German Constitutional Court. It recalled that the CJEU has consistently held that a judgment in which the Court gives a preliminary ruling is binding on the national court for the purposes of the decision to be given in the main proceedings. In order to ensure that EU law is applied uniformly, the CJEU alone – which was created for that purpose by the Member States – 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



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authorities of the Member States, national courts are required to ensure that EU law takes full effect.

The activities of the ECB are regulated by the EU Treaty. It defines the objectives, tasks, powers and independence of the ECB. In accordance with the Treaty, monetary policy falls within the exclusive competence of the Union.

The monetary policy decisions of the euro area are taken by the Governing Council of the European Central Bank, which acts independently and has, within the limits set by the Treaty, wide discretion as to the measures to be applied. The powers conferred on the ECB by the Treaty are intended to serve the achievement of the ECB's objectives and the fulfilment of the tasks assigned to it. Decisions on the instruments to be used in monetary policy depend, among other things, on the Governing Council's assessment of the effectiveness of the various instruments in the particular situation. The use of the chosen instruments is limited by the fact that they must be proportionate to the objective pursued.

The Treaty gives the ECB an independent role in the performance of its tasks. It prohibits the ECB, a national central bank or their decision-making bodies from seeking or taking instructions from Union institutions, from any government of a Member State or from any other body. The Union institutions and the governments of the Member States undertake to respect this principle and not to seek to influence the central banks in the performance of their tasks. (Article 130 TFEU.)

The judgment of the German Constitutional Court does not have a direct impact on the monetary policy of the ECB. The ruling does not concern the Pandemic Emergency Purchase Programme (PEPP) or other crisis measures. It is also essential that the Federal Constitutional Court agrees with the assessment of the CJEU that the PSPP in question does not violate the prohibition of monetary financing of Member States.



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The judgment of the German Constitutional Court was not addressed to the ECB but to the Federal Government and the Bundestag. The Court required them to take steps to ensure that the ECB conducts a proportionality assessment in relation to the PSPP within three months. Otherwise, according to the Federal Constitutional Court, the Bundesbank is not allowed to participate in the implementation of the programme and has to sell its holdings of government bonds.

There is no doubt that the German Federal Government and the Bundestag have access to appropriate and convincing material on the basis and scale of purchase programmes, starting with the published minutes of the Governing Council, for example.

It should be underlined that EU action is based on the fact that the CJEU has jurisdiction to rule whether an act of an EU institution is contrary to EU law, not national courts. Any compromise in this respect could lead to very negative consequences for European cooperation.

The Governing Council considered the matter provisionally on 5 May 2020 and took note of the judgment of the German Constitutional Court. In its press release issued after the meeting, the Governing Council noted that the CJEU ruled in December 2018 that the ECB is acting within its price stability mandate. It is the CJEU, not national courts, that has exclusive jurisdiction over the ECB and its actions.

The ECB's mandate

The purchase programme, which is the subject of the judgment of the German Federal Constitutional Court, supports the transmission of monetary policy across all euro area countries and eases the monetary policy stance in a situation where a significant reduction in monetary policy interest rates is no longer sufficiently available to achieve price stability. Quantitative easing is one of the monetary policy instruments of central banks.

An important element of the independence conferred on central banks by legislation is that they are free to decide independently on



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the instruments and stance of monetary policy in order to achieve their objective. It is precisely because of its independence that the ECB has been able to make extensive and rapid decisions, especially during economic crises. The independence of the central bank with regard to the available monetary policy instruments is the cornerstone of credible monetary policy.

In legislation, central banks have been given a certain objective, and the means a central bank may or may not use to achieve that objective are also often specified. This competence of a central bank is customarily referred to as the bank's mandate. Nowhere has a central bank been given unlimited powers.

The primary objective of most central banks in developed economies is price stability or low inflation. The ECB's mandate was defined in the Maastricht Treaty, which entered into force in 1993. It stipulates that the primary objective of the ECB is to maintain price stability. In addition to the primary objective of price stability, a secondary objective was set for monetary policy, according to which the ECB shall support the general economic policies in the European Union, without jeopardising the objective of price stability. According to Article 3 of the Treaty, the European Union "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 [...]".

The main responsibility for action in the area of economic policy therefore lies elsewhere than with the central banks – it is the responsibility of the governments of the Member States and, in part, of other EU institutions. The ECB does not have a separate economic policy mandate, but its monetary policy supports the general economic policies in the Union without jeopardising the objective of price stability.

In recent years, the mandate of central banks has, from time to time, become the subject of extensive public debate. Criticism has come from two completely opposite directions.



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Firstly, it has been proposed that central banks have exceeded their mandate because they have begun to purchase government bonds on the secondary market. Criticism in the other direction has, on the other hand, seen that the ECB acts too slowly and takes too small steps forward. It is not just a European debate; similar debates have also arisen in the United States.

The response to this criticism is that the task of ensuring price stability entrusted to central banks means combating both detrimental inflation and deflation. Non-standard monetary policy measures, such as asset purchases, have been used to prevent the economy from entering a spiral of falling prices and worsening unemployment.

Secondly, the mandate of the central banks has been considered too narrow. Critics see that the focus on safeguarding price stability has restricted the use of monetary policy to stimulate the economy. According to these views, the ECB's mandate should be extended in such a way that monetary policy would not only target price stability but also growth and employment.

In the current situation, where inflation is below the target and there is unemployment and spare capacity in the economy, there is no conflict between the price stability objective and an objective pertaining to employment. Both require expansionary monetary policy.

Another question is how quickly monetary policy affects economic developments. So far, experience and research data have supported the view that stabilising inflation expectations at the target level and maintaining financial stability are the best guiding principles of monetary policy for promoting long-term growth and employment, even though monetary policy does not define long-term economic growth.



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The growing emphasis of central bank independence coincided with the widespread adoption of price stability (slow and stable inflation) as the primary objective of monetary policy in the 1990s. The argument for central bank independence originates in a need to ensure confidence in the central bank actually delivering on its mandate. This is designed to enhance the credibility of the objective and, ultimately, confidence in the value of money.

On central bank independence

Central bank independence may be institutional, operational, organisational or financial. In principle, one could envisage full institutional independence. This would mean that the central bank could itself decide on the objectives of monetary policy, such as whether to adopt an inflation target or an exchange rate target, or whether to steer the amount of money in the economy. As a rule, no central bank anywhere enjoys the independence in defining its own mandate.

A central bank receives its mandate and accordingly its operational independence from legislation. Central bank independence can therefore be understood as the means chosen by democratic bodies to make a credible long-term commitment to mutually agreed principles of monetary policy.

Operational independence is used to denote the degree of freedom of the central bank to choose the instruments to achieve its primary objective. First and foremost, this means the independence of the central bank to decide on its key policy rate. In addition, such independence with regard to instruments can also be considered to cover the independence of the central bank in all decisions relating to the monetary policy implementing framework, including the conditions for banks' access to central bank funding, details of the standing facilities, the minimum reserve system, securities purchases and sales, and collateral policy.

Organisational independence means that the board of the central bank takes its decisions autonomously within the mandate afforded



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to the central bank, independently of government or any other appointing body. Generally, independence is strengthened by separating the term of office of the executive management from the term of office of government, and by limiting the number of terms of office.

Financial independence means that the central bank is independent of the state budget and that government or parliament does not seek to interfere with the central bank's budget other than when deciding on the central bank's profit distribution. Central banks are known to transfer a considerable portion of their profits to the state.

ECB monetary policy during the Covid-19 crisis

With the global financial crisis, the European sovereign debt crisis and the current Covid-19 crisis, ECB monetary policy has been faced with a new situation. Rather than a surging rate of inflation, the challenge has been a protracted period of below-target inflation and the threat of a deflationary spiral. Within the scope of its mandate, the ECB's monetary policy has supported price stability and achievement of the policy objectives subordinate to it. Strong monetary accommodation is still necessary to ensure convergence of the rate of inflation to levels closer to or below 2% in the medium term, in line with the price stability objective.

According to current projections, inflation is not expected to pick up after the acute phase of the Covid-19 crisis. ECB monetary policy will remain accommodative for a prolonged period, thus supporting recovery from the crisis in all euro area countries. The commitment to pursue monetary accommodation for a prolonged period, and at least until the sustained convergence of the rate of inflation to the price stability objective, is a measure of so-called non-standard monetary policy known as forward guidance. Commitment to this policy is a key monetary policy instrument in the zero interest rate environment.

According to the ECB Governing Council, an ambitious and coordinated fiscal stance is crucial for fiscal policy to avoid weaker-



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than-expected economic performance amid the worsening outlook. Fiscal policy measures within the scope of the common framework and the fiscal space of individual countries are important not only for Europe as a whole but also in view of Finland's own economic interests. If Finnish exports decline in response to the Covid-19 crisis, domestic fiscal policy will not be able to provide the stimulus required, whereas common fiscal policy will do so.

Monetary and fiscal policy therefore work together in an environment of too low inflation. Due to the uncertainty related to the zero lower bound constraint and the effectiveness of non-standard monetary policy tools, it is also desirable from the perspective of the objectives of the central bank that fiscal policy provide support to expansionary monetary policy. Coordination of monetary and fiscal policy may also have some benefits under these conditions. From the perspective of central bank independence there are two limits to such fiscal-monetary coordination. First, the coordination must be consistent with the central bank's objectives and mandate. Second, coordination can be justified only when the same results cannot be achieved by other economic policy means without fiscal-monetary coordination. Central banks always have the right to discontinue any measures that are in violation of their mandate.

The monetary policy measures adopted most recently have already proven effective and necessary. In March (18 March), the ECB Governing Council decided on additional measures to mitigate the economic consequences of the Covid-19 crisis. It decided to launch a new Pandemic Emergency Purchase Programme (PEPP) with an overall envelope of EUR 750 billion. Purchases will be conducted until the end of 2020 and will include all the asset categories eligible under the existing Asset Purchase Programme (APP). Greek government bonds are also eligible under the PEPP.

The Governing Council also clearly stated that it is ready to revise the self-imposed limits on its purchases and, where necessary, to increase the size of the programme. In addition to launching this



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new purchase programme, the ECB Governing Council on 18 March decided to expand the range of eligible assets under the Corporate Sector Purchase Programme (CSPP). At the same time, the Governing Council also announced that it will ease the collateral standards for participation in the refinancing operations. The ECB Governing Council underlined that it will do everything necessary under its mandate to support all citizens of the euro area through this extremely challenging time – “there are no limits in our commitment to the euro”, as President Christine Lagarde has so pointedly stated.

On 30 April, the ECB Governing Council supplemented its previous decisions by further easing the conditions of the transactions under the third series of targeted longer-term refinancing operations. For counterparties whose eligible net lending reaches the lending performance threshold, the interest rate over the period from June 2020 to June 2021 will be 50 basis points below the average deposit facility rate prevailing over the same period.

In addition, the ECB Governing Council further eased monetary policy by a new series of pandemic longer-term emergency refinancing operations (PELTRO) to provide liquidity support to the euro area financial system and to contribute to preserving the smooth functioning of money markets by providing an effective backstop.

The PELTROs will be conducted as fixed rate tender procedures with full allotment. The interest rate will be 25 basis points below the average rate applied in the main refinancing operations over the life of the respective PELTRO.