

BLOG POST

JUDGES VS. TECHNOCRATS WHAT LESSONS CAN BE LEARNED FROM THE KARLSRUHE COURT RULING?

13/05/2020 | PIERRE JAILLET | LAW AND INSTITUTIONS

*Pierre Jaillet, Economist, associate research fellow, Institut des relations internationales et stratégiques (IRIS),
Professor at IRIS sup, Expert associate at Jacques Delors Institute*

The ruling of the German Constitutional Court in Karlsruhe issued on 5th May 2020 sparked angry reactions, particularly as it appears to want to clip the ECB's wings just as it is on the front line in supporting the crisis-hit economy. Why the urgency to respond, under these circumstances, to a ruling of the European Court of Justice (CJEU) of December 2018 regarding the public sector asset purchase programme (PSPP) implemented in 2015?

To the great relief of the markets, this ruling does not concern the Pandemic Emergency Purchase Programme (PEPP) announced on 18th March by Christine Lagarde, which includes €750 billion in asset purchases. However, the PEPP's features are not that different from those of the PSPP, which it extends and in which it is inserted. It is therefore likely that in the event of an appeal in the near or more distant future, the same argument may be resumed and even strengthened.

The ruling of the German Constitutional Court takes aim at several targets: the German federal government and the Bundestag, for lack of supervision (if not negligence), the CJEU for incompetence (if not abuse of power) and the ECB, which it criticises for having conducted since 2015, with the approval of the CJEU, a monetary policy which goes beyond the scope of its mandate and to which it gives formal notice to provide evidence to the contrary within three months.

That a Member State's jurisdictional body (which in the case in point is based on German constitutional rule) contests the competences of the CJEU with regard to a community policy looks like a legal anomaly. The CJEU is the European Union's supreme court. It is naturally unacceptable for the other Member States and an endless source of legal complications. In this respect, the scope of the Karlsruhe Court ruling must be put into perspective. The follow-ups will most likely be managed by the Bundesbank and not directly by the ECB, an institution governed by EU law.

Another incongruity is that a legal body can contest a policy which does not fall under its expertise. The (tedious) reading of dozens of compact pages outlining the reasons behind the ruling gives the impression of confusion between economic and legal arguments, and between a review of legality and a review of merit. Incidentally, this statement is also applicable to the CJEU, for which notices (in particular those concerning monetary policy) should stick to compliance with the European treaties. It should be noted that the situation is much clearer in the USA, where the Supreme Court has always, out of principle, refused to monitor the Fed's monetary policy decisions.

The Constitutional Court's main grievance levelled against the ECB's monetary policy is a lack of *proportionality*. Unlike the principle of *subsidiarity*, which concerns the distribution of competences between the European Union and the Member States, this requirement aims to dictate taking the proper measure of issues; "it orders that one must not exceed what is necessary for the achievement of objectives" (Vie-publique.fr).

Yet, this legal notion of proportionality appears to be extremely expandable and of little relevance when appreciating the content and results of economic policies or their components. The German Court's ruling has given rise to several criticisms regarding analysis and method. Here are a few examples:

- The Court focuses on PSPP alone, a specific instrument within a range with various interacting elements (key rates, liquidity provision to banks, etc.);
- The Court overlooks the complex nature of the transmission channels from the monetary policy to the actual economy, which are multiple and must be assessed in different ways (credit, cost of financing, exchange rate, choice of portfolio, wealth effects, etc.);
- It isolates specific indicators, concerning the situation of some categories of national agents, to assess a policy defined for the euro area as a whole;
- It criticises the implicit redistributive effects of the ECB's policy, solely from the perspective of savers and asset holders (the plaintiffs) and overlooks the potential effects on business, employment or the borrowing capacity of future generations;
- Lastly, its assessment remains partial and cannot be adjusted to a (virtual) situation in which the PSPP was not implemented. This type of counterfactual analysis is naturally not within its expertise.

Some analysts were pleased that the Court rejected the complaint of "qualified violation" of article 123 of the TFEU prohibiting monetary financing. Yet its argument suggests that it is only a matter of time before this issue is raised. The Court thereby recognises that the criteria used to judge are "meaningless" or are "not ascertainable". It also notes the notional nature of the distinction between purchases at the time of issue and secondary market purchases (the lag being measured "in days rather than weeks"). The judges then state that their ruling is suspended upon the ECB's compliance with the rules set for asset purchases (limit of 33% of issues, ECB's capital key). Yet these conditions are precisely those which were lifted for the recent pandemic emergency programme. This is a thinly veiled warning.

What could be more natural, for all the reasons stated above, than the German Constitutional Court being almost unanimously vilified? The questionable legitimacy of its ruling, the holes in its arguments and even the fact that it occurs at such an inappropriate time can shock. However, the outraged reactions that it has caused must not obscure substantive questions:

- With the exception of a few limited circles, the ECB's monetary policy, its strategy and its instruments (including PSPP) and its ultra-accommodating policy for almost a decade, are absent from public and even political debate. It is from this standpoint symptomatic and even absurd that citizens should go to court to voice their disagreements or complaints (once again, the comparison with the USA is enlightening);
- Member States themselves appear to be disengaging from monetary policy, other than to ensure that the ECB will take all necessary measures at the right time to guarantee their solvency through increasingly massive and irreversible asset purchase programmes.
- Without a political union or even a genuine economic union and due to the structural heterogeneity of the euro area, a "federal" monetary policy will always be subject to illegitimacy hearings (in the present case, German savers consider themselves deprived by zero or negative rates, who will it be tomorrow?);

The Karlsruhe Court ruling may admittedly be considered as a prickly reaction from a few obtuse magistrates. It contributes, however, to instilling doubts regarding the validity and purpose of the single monetary policy and demonstrates its insufficient transparency and accountability¹.

It is still possible to dream of a future in which the Euro circulates in a united political and economic area, in which it could be, as the Deutsche Mark, Franc and Lira once were, a factor of cohesion and solidarity between peoples. In the meantime, it would be appropriate to clarify monetary policy, its objectives and its short- and long-term economic and financial implications.

In practical terms:

- The ECB announced in January 2020 that it was launching a review of its strategy (postponed to mid-2021 due to the COVID-19 crisis), which bodes well. This review should be as open as possible to the wide range of schools of thought and opinions. Yet we can go even further. The ECB could therefore, at regular intervals - say every five years -, present to the European Parliament (in euro area formation) the strategic options that could also be debated in national parliaments. The options selected by the ECB would then be approved by the European Council, thereby protecting it from criticisms regarding lack of transparency and isolation. The ECB would retain total autonomy in the selection of instruments (similar solutions are in place in the UK and Canada).
- The ECB (the Eurosystem) should regularly submit its policy to public debate, drawing inspiration from the Fed Listens Events. Between 2019 and 2020, this exercise brought together all the leaders of the US Federal Reserve to enter into debates with various groups (high-school pupils, university students, companies, local authorities, various communities, etc.) on all areas of monetary policy. It was unanimously welcomed.

Doubtless there is no miracle solution but the implementation of these proposals could already help to improve understanding and endorsement of a policy often deemed complex and too far-removed from citizens' concerns, if not acting against their interests. While we must abstain from exaggerating the scope of the Karlsruhe Court's ruling, it would be dangerous to imply that the debate on monetary policy in the euro area can remain confined to a pseudo-dialogue between judges and technocrats.

1. Jaillet P. 2019. "Is central bank independence an obsolete concept?", Jacques Delors Institute, December 2019

Managing Editor: Sébastien Maillard ■ The document may be reproduced in part or in full on the dual condition that its meaning is not distorted and that the source is mentioned ■ The views expressed are those of the author(s) and do not necessarily reflect those of the publisher ■ The Jacques Delors Institute cannot be held responsible for the use which any third party may make of the document ■ Original version ■ Translation from French: Barbara Banks ■
© Jacques Delors Institute