



German Constitutional Court vs ECB: Law, Economics and Politics

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The judgment of the German Constitutional Court that challenged the legality of the ECB's QE is based on a legal principle: proportionality. In economic terms proportionality implies an evaluation of the monetary policy redistributive effects. Two problems arise: the economics of the redistributive effects of the ECB's QE is not easy to compute. Moreover the ECB's redistributive monetary policies affect in a heterogenous way European citizens and EU countries; then any proportionality evaluation can be disputed. Given that redistribution is a political issue, the debate on proportionality is likely to further contribute to various forms of resentment and hostility against the ECB.

1. Introduction

In May 2020 the German Constitutional Court (GCC) delivered a ruling on the monetary policy of the ECB, which began in 2015 through the implementation of the unconventional program for the purchase of private and public securities (BVerfG, 2020). German judges advanced the hypothesis that the ECB may have implemented an illegitimate policy, violating the legal principle of proportionality of the monetary tools implemented by the central bank aim in the pursuit of the monetary stability goal. It is worth noting that in February 2014 the German Constitutional Court declared the ECB Outright Monetary Transactions (OMT) programme to be inconsistent with EU Law (Siekmann and Wieland 2014).

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The ruling of the German Constitutional Court has been classified as a legal missile against the ECB (Fabbrini and Kelemen 2020, Wolf, 2020). Yet the Court ruling has at least one merit, indicating what the Achilles heel of monetary policy is today: its redistributive effects. In fact the judgement of the Court is based on arguments regarding the monetary policy effects on “public debt, personal savings, pension and retirement schemes, real estate prices, and the keeping afloat of economically unviable companies”, which are redistributive issues, although they have been summarized inside the legal category of the “principle of proportionality” that the ECB shall respect in achieving its monetary stability aim, following the Court interpretation.

In other words, in terms of economic analysis, the German judges asked the ECB to explain whether the monetary policy action took into account the side effects on other economic policies, from fiscal to banking.

The Karlsruhe judges asked a question waiting for an answer. The problem is that the answer is relatively easy if monetary policy is conducted with conventional methods, while it becomes very insidious if the methods are unconventional. Furthermore, as unconventional policies have redistributive effects, and redistributive effects are politically relevant, any response by the ECB can be eventually disputed, given that its political evaluation is intrinsically heterogeneous and subjective.

All in all, the German Judges asked a legal question without an indisputable economic answer, given the link between the legal principle of proportionality, the redistributive effects of any unconventional monetary policies of the ECB and its political relevance. The details of such a link can be easily highlighted using a simple theoretical framework (Masciandaro 2020).

2. Unconventional Monetary Policy and the Proportionality Principle

A general and easy way to show which conundrum the GCC ruling implies for the central bank is to discuss the proportionality principle through two subsequent steps. In the first step we assume that the central bank is able to calculate the redistributive effects of its monetary policy choices. Given a fiscal policy, any incumbent government can raise taxation or issue debt, taking into account the monetary policy decisions, and we assume that the central bank is independent from politics, acting as a long-sighted social planner, as the ECB actually is.

Any of the ECB's action, including the unconventional monetary programmes, shall be motivated by an independent evaluation of its Board regarding its effectiveness in pursuing its monetary-stability goal in the medium term, including the need to address and fix any euro re-denomination risk. In doing such an overall evaluation, the ECB can consider also the redistributive effects, which in the case of unconventional monetary policy are particularly relevant.

The unconventional monetary policies are associated with the so-called “three D” (distributional, directional, duration) effects (Goodhart and Lastra 2017). The distributional effects result from changes in interest rates, which is the channel usually associated with conventional monetary policies. The directional effect captures the impact of public policy on a certain sector and/or constituency of the economy (Brunnermeier and Sannikov 2013). The duration effect measures the effect of monetary policy on overall public-sector liabilities, including the central bank's balance sheet. The duration effect is associated with the dimensions and risk profile of the central bank's balance sheet with its increasing relevance in the perimeter of monetary policy (Curdia and Woodford 2011, Reis 2013). All in all, and at least theoretically, the ECB can be able to take into account the overall consequences of its unconventional monetary policies, motivating its proportionality evaluation. The problem is that the more redistributive effects are likely, the less the central bank's perspective will be accepted without discussion. Yet the opposite will be true.

3. One Proportionality Doesn't Fit All

The political cost and benefit analysis can be very different from the economic one when redistribution is possible. If citizens are heterogeneous, unconventional monetary policies may have relevant redistributive effects. In fact, the net transfers implied by efficient policies can be positive for some and negative for others. Moreover, if a policy has distributional effects, the politicians would like to control those effects (Alesina and Tabellini 2007).

The redistributive effects are relevant as long as the policies are chosen through the political process, i.e. when the citizens vote. The economic and financial profile of the median voter will tell us how the “three D” effect will hit different citizens. Each voter’s preferences can differ from those of the central bank, representing the political distortion due to citizens’ heterogeneity.

Perception of an unfair monetary policy can contribute to various forms of resentment and hostility against the central bank. This possibility is so evident in these days, after the judgment of the German Constitutional Court. Other things being equal, the hostile sentiments against the ECB’s monetary policies can be a factor to consider when explaining the various forms of nationalism, populism and euro scepticism (Morelli 2020). Moreover if we assume that a correlation holds between opinions on the issuing of so called “corona bonds” and hostility against the ECB, the current debate - for example in Germany (Waltenberger 2020) - can offer interesting insights. For this reason, the legal missile against the ECB could be really toxic. ■

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