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by Lorenzo Bini Smaghi 20 May 2020



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The German constitutional court ruling on the European Central Bank's public sector purchase programme is based fundamentally flawed analysis. Furthermore, it creates serious risks for the ECB's independence.

Separating monetary from fiscal policy, and allocating the former to an independent institution, is justified only if the central bank's mandate is well-defined and does not involve major trade-offs between divergent targets. Like most central banks, and following Bundesbank tradition, the ECB's mandate obliges it to maintain price stability. By appearing to set the ECB to multiple targets, the court could expose the ECB to pressures from different countries and interest groups, leading to political tensions and a loss of independence.

The Karlsruhe court considers that, in implementing the PSPP, the ECB did not violate the European treaty provision which prohibits monetary financing of member states, but may have violated the principle of proportionality. The court says it was not able fully to ascertain such a violation because the ECB and the European court of justice – which approved the PSPP in December 2018 – did not provide evidence that proportionality had been duly considered. The ECB has been given three months to produce a 'proportionality assessment'. If the ECB fails to provide adequate evidence, the court stands ready to ban the Bundesbank from further PSPP participation.

In examining the PSPP's presumed 'negative' consequences, Karlsruhe cites easier financing conditions for member states or the banking system, and 'penalising' savers. The court fails to provide evidence about supposed perverse incentives, for example in the programme's alleged encouragement of higher budget deficits – which in the euro area have fallen in recent years.



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The court seems to ignore that the PSPP's effects are not any different from those of other ECB instruments, such as purchasing private assets or lengthening fixed-term full-allotment refinancing operations. The court seems to suggest that the sheer size of the €2.2bn programme provides a measure of the negative collateral effects. Empirical evidence suggests otherwise. The record of government bond yields and spreads indicates that other policy instruments, such as changes in policy rates, including cuts into negative territory, or the 2012 outright monetary transactions programme, have had a similar or bigger impact.

If the PSPP creates disproportionate consequences, but these consequences are not proven to be qualitatively and quantitatively different from those of other instruments not considered to violate 'proportionality', only two conclusions are possible. Either the PSPP does not violate the proportionality principle, or all ECB instruments do. In that case, the ECB has violated the principle since it started. The court should either condemn all ECB instruments over the last few years, or none.

The ECB's statutes indicate that, subject to the objective of price stability, the ECB should support member states' general economic policies. The statutes also make reference to the principles of subsidiarity, open market economy and free competition.

By giving prominence to proportionality, the Karlsruhe verdict implies that the ECB should assess the effects of its actions on other policies, in particular those within member states' competence, such as fiscal policy. Should the ECB change its policy decision once it has conducted such an assessment? If, for instance, in considering an interest rate rise to counter inflationary pressures, the ECB found this would produce losses for bondholders, increase unemployment, or spur tax increases to cover higher debt costs, how should the ECB take this information into

account?

Should it change its decision to avoid or mitigate these effects – deciding a smaller interest rate rise and accepting higher inflation? If the answer is positive, the ECB would no longer have a single primary objective, but several – which would expose the ECB to near irreconcilable conflicts. If the answer is negative, this would indicate that the court's main purpose is to check formally that the ECB bases its decision on thorough analysis, considering all possible implications. In that case, the 5 May ruling would have no material consequences for monetary policy. There is ample evidence that the ECB takes all relevant issues into consideration. In providing the desired proportionality assessment, it would be sufficient to provide the court with accounts of the ECB policy meetings, monthly bulletins and speeches and other background material, mostly readily available.

It is a bad idea for the courts to decide whether a given monetary policy is consistent with the treaty, in particular with the principle of proportionality. If, however, a court is called to express a judgment, it should, at a minimum, equip itself with the necessary analytical tools to examine the case in a rigorous way, rather than giving the impression that its ruling reflects prejudices or preconceptions. Unfortunately, this latter impression is exactly the one that the Karlsruhe verdict has left.

*Lorenzo Bini Smaghi is Chairman of Société Générale and a former member of the European Central Bank's Executive Board. This is an edited version of an [article](#) for the Luiss School of European Political Economy.*

### Further reading

- [Ignazio Angeloni: Key role for Bundesbank after German court ruling](#)
- [Marco Annunziata: Court ruling brings crucial questions to boil](#)