Borrowing Time

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When Christine Lagarde announced her first, moderate rescue package, she called upon member states to provide fiscal aid. But the markets showed to have lost confidence in fiscal policy. In the absence of strong monetary policy signals, the slide continued until Lagarde in her second attempt opened the floodgates. This time, she did not wait to see whether the euro finance ministers would agree on joint fiscal measures such as the corona bonds proposed by Italy, France and Spain (they have not yet managed to do so). For this bravery she deserves respect and recognition.

What is special about the new package called PEPP – Pandemic Emergency Purchase Programme is not so much its volume, which at 750 billion amounts to about half the current volume of the PSPP – Public Sector Asset Purchase Program currently on trial in Karlsruhe. Rather, the conditions of the new PEPP, which were published in detail yesterday, are where the music plays. Accordingly, PEPP is a hybrid between the well-known OMT programme and PSPP. In principle, the purchases are to be distributed among the member states according to the ECB's capital key, as in the case of PSPP. On the other hand, Art. 5 para. 2 of the PEPP Decision allows a flexible application of this scale. This means that the ECB may, at least temporarily, acquire publicly or privately issued securities from particularly affected Member States above the volume corresponding to the capital key. This would result in asymmetric purchases similar to those envisaged by the OMT programme, even though PEPP is not tied to ESM lending and corresponding conditionalities. In addition, the ECB adds Greek government bonds excluded from PSPP to its shopping list and overturns the self-imposed restriction never to acquire a blocking minority of a bond that would make it the linchpin in a restructuring. Finally, the ECB allows itself flexibility in the design of the PEPP portfolio. It does not commit to limit its purchase of individual asset classes such as government bonds.

To put it metaphorically: If I were to ask my three-year-old son to make a proposal defining how many hours of "Peppa Pig" he is entitled to watch during the closing of the kindergarten, the result would be similar. Certainly, unlike certain ayatollahs of monetarism, one should not confuse the European Treaties with an educational guide. Nevertheless, it seems appropriate to take a closer look at the legality of the new PEPP programme. How fortunate that the Federal Constitutional Court was able to postpone its ruling on PSPP for the time being.

According to the *Gauweiler* judgment, to qualify as monetary policy, ECB measures must have a monetary policy objective, make use of monetary policy instruments and be proportionate, and must not infringe Article 123 TFEU. The ECB defines an exclusively monetary policy objective for PEPP in accordance with its mandate. The objective is to ensure price stability and the effectiveness of monetary policy. There can hardly be any doubt that the crisis represents a recession that threatens price stability. Moreover, the crisis does not affect the euro area as a whole; Member States are following their own pace, according to the foresight of their governments, the insight of their citizens and the state of their health systems. If business life is not locking down everywhere equally, it seems plausible that the transmission of monetary policy cannot be equally effective throughout the euro area.

The ECB also implements PEPP through exclusively monetary policy instruments. Their proportionality should not raise serious questions given the scale of the crisis. The volume of 750 billion does indeed appear very high compared with fiscal policy packages. For example, the guarantees for the ESM amount to only 700 billion. However, the insolvency risk for central banks is much lower than for the treasury. The central bank's stomach can take losses well as long as confidence in the money it issues remains intact. By contrast, the treasury lacks the license to print money.

However, this calls for a closer look at Article 123 TFEU. Although monetary policy is not without fiscal policy side effects, even the best monetary policy must be able to defend itself against the accusation that it is a disguised form of fiscal policy. Case law has shown that the decisive factor here is whether the design of the programme thwarts the monetary policy objective. In this respect, some might doubt whether PEPP stands closer scrutiny.

According to the ECJ decisions in *Gauweiler* and *Weiss*, a decisive criterion for the compatibility of monetary policy measures with Art. 123 TFEU is that issuers cannot assume with certainty that they will eventually be able to drop their securities on the ECB. In the case of PSPPs, the ECB imposed certain blackout periods for the purchase of newly issued government bonds and made a secret of them. Such a precautionary measure seems unnecessary in the context of PEPP, as the composition of the PEPP portfolio is not fixed from the outset, neither by asset classes nor by the geographical origin of the assets to be purchased. The uncertainty is therefore much greater than with PSPP and OMT. Even if the ECB has to provide transparency on net purchases on a monthly basis, future purchases are likely to be determined by the course of the crisis, not by financial policy-driven algorithms that could be uncovered by market participants. In any case, issuers' financing security is much lower for short-term bonds, which are supposed to be at the heart of PEPP, than for securities with longer maturities.

The ECB's flexibility in the design of the PEPP portfolio also eliminates the need to restrict purchases to volumes below a blocking minority. Even if the ECB were to purchase all the bonds in an issue, this would be unpredictable for the issuers. The only question that remains in this respect is how the ECB should act if a Member State sought to restructure its debt. Is the ECB required under Article 123 TFEU to prevent the restructuring of a bond if necessary? In *Gauweiler* (para. 125) the ECJ stressed the fact that monetary policy cannot be conducted without financial risk for the central bank. The bankruptcy of Lehman Brothers alone caused temporary losses of 8 billion for the *Bundesbank*. Should the debt sustainability of a member state, the determination of which follows a controversial but well-established practice, require restructuring, the ECB should approve it. Monetary policy must not defeat fiscal policy.

But what about lifting all collateral requirements with respect to Greek government bonds? Isn't it precisely the hallmark of monetary policy that the assets pledged as collateral for fresh euros must meet certain requirements? One possible answer to this question is provided by the different objectives of PEPP compared to PSPP. PEPP reacts to the economic consequences of a health crisis, not to a financial and sovereign debt crisis. If the ECB buys up insecure government bonds in a sovereign debt crisis, it is complicit in combating the causes. If it only wants to fight deflation, it must not give preference to Greece. However, if the ECB wants to respond to a health crisis that affects Greece in the same way as other member states, it must accord equal treatment to it. Even within the framework of Article 123 TFEU, the limits of monetary policy cannot be determined in absolute terms, but only relative to the relationship between the objectives and the design of the programme.

This leaves only the question whether asymmetric purchases are legal if the country concerned is not subject to a structural adjustment programme governed by the ESM. In the *Gauweiler* case, the European Court of Justice (para. 120) and even more so the Federal Constitutional Court (para. 193) certainly attached importance to this circumstance, thereby once again entrenching the constitutional character of austerity. However, the asymmetry within the framework of PEPP is likely to be only temporary. Moreover, the Commission and the Council used the general exception clause provided for in the Stability and Growth Pact to suspend the stability criteria (Art. 2 para. 2 of Regulation 1467/97). It would be absurd for the ECB's monetary policy to be diametrically opposed to fiscal policy, especially since the ECB must also support economic policy, at least in addition to its obligation to ensure price stability.

Thus, the legality of PEPP seems beyond doubt. Does this make the legal framework of monetary policy a toothless paper tiger? No. First of all, especially in times of greatest need, synchronising monetary and fiscal policy is not a sign of moral hazard, but of practical reason. The more they are in tune, the more successfully the crisis can be overcome. This does not free the ECB from any legal constraints imposed by the TFEU. Rather, the ECB has to exercise the discretion it has granted to itself in implementing PEPP in accordance with the Treaty, i.e. in line with monetary policy criteria. Since it has to make its purchases transparent, this can be checked to some extent, at least retrospectively. Courts would do well to judge the ECB by its actions rather than by its announcements. Moreover, one should not forget that the impact of ECB purchases on fundamental rights is significantly lower than that of curfews.

The legal soundness of PEPP does not, of course, remove the question of the economic sense of a strategy that is again focused on monetary policy. Fiscal policy buys time, monetary policy only borrows time. It pumps credit into the economy. Whether such credit ever leads to investment is uncertain. Monetary policy also benefits the capital markets in the first place. Private and small businesses do not issue securities. Whether they receive loans depends on the banks. There is a strong case for the banks retaining some of their liquidity in order to be prepared for the foreseeable wave of bankruptcies. Monetary policy also does not alter the capital requirements that determine banks' lending policies.

Monetary policy therefore benefits above all the haves, not the have-nots. Only fiscal policy would be in the position to actively promote the necessary transformation of the European economy in the wake of climate change and digitalisation. This transformation is a task for the state; the market cannot do it alone. By contrast, monetary policy is dependent on the market. When the market switches to hibernation, it merely cements the status quo. All this should definitely be considered now, because it is crucial for the long-term management of the crisis and the associated recession. When the drumfire dies down, the borrowed time will reappear on the horizon.

This article has also been published in German.

Dieser Artikel ist auch in deutscher Sprache erschienen.

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All the best, *Max Steinbeis*

SUGGESTED CITATION Goldmann, Matthias: *Borrowing Time: The ECB's Pandemic Emergency Purchase Programme, VerfBlog,* 2020/3/27, https://verfassungsblog.de/borrowing-time/, DOI: https://doi.org/10.17176/20200328-002904-0.