

The German court ruling against ECB asset purchases doesn't make economic sense



On 5 May 2020, the German constitutional court ruled that the European Central Bank's public sector purchase programme (PSPP), the main part of its quantitative easing, is overstepping the ECB's competencies, in its current form. The effects of this decision on monetary policy will probably be minimal: the court decided that the decisions were not appropriately justified, so that the ECB can continue with its programmes, as long as it puts more efforts into justifying them.

The ECB may increase its efforts to provide the reasons for its decisions, but it may also choose not to (the ECB cannot be forced by national courts to change its actions and the European Court of Justice [had decided](#) that the ECB's asset purchase programme does not infringe EU law) and leave it up to the Bundesbank to provide the relevant reports and communication. The court ruled that after three months the Bundesbank may no longer participate in the ECB's PSPP, should no better reasons be provided for the monetary policy decisions.

This is clearly an empty threat. The German constitutional court cannot preclude the ECB and other national central banks from engaging in the asset purchase programme and the only country who would suffer from the Bundesbank no longer participating would be Germany. However, the ruling will not make the conduct of monetary policy easier, in times in which the survival of the monetary union may depend on decisive action by the ECB. This is particularly unfortunate, as the ruling is not based on sound economic reasoning.

Not economically substantiated

Asset purchase programmes (quantitative easing), as the one decided upon by the constitutional court, have been employed by most large central banks after the last financial and economic crisis – the ECB followed suit rather late. Macroeconomists consider such asset purchases by now a standard instrument of monetary policy to be used in times when both inflation and interest rates are low. It is not useful for the court to point out that the ECB's measures have an [“economic and social impact on virtually all citizens”](#), as this applies to all monetary policy decisions.

It is particularly strange that the German constitutional court [accuses the ECB](#) of not taking into account the effects of its measure on the economy: “It would have been incumbent upon the ECB to weigh these and other considerable economic policy effects and balance them, based on proportionality considerations, against the expected positive contributions to achieving the monetary policy objective the ECB itself has set.” This accusation is inappropriate for two reasons.

First, usually the criticism coming from sceptics is the exact opposite – claiming that the ECB is not only caring about its mandate of ensuring price stability but instead engaging in economic policy. Now, the constitutional court acknowledges that the measures can help to increase inflation, but it would like to see more considerations of economic side effects. Does this open the door for the ECB to deviate from its price stability objective in general, because the side effects of the necessary actions are deemed disproportionate, also when inflation is above rather than below the inflation target?

Second, this accusation is inappropriate, because economic consequences of the asset purchase programmes have continuously been discussed and analysed; by the ECB's [research and policy departments](#), in national central banks, but also outside the eurosystem, in universities and research institutes. The monetary policy decisions are always accompanied by [monetary policy accounts](#) describing the reasoning behind the decisions. The governing council of the ECB that decided to launch the expanded asset purchase programme [with large majority](#) consists of the members of the ECB's executive board and the governors of the national central banks of the member states. That the non-economist judges of the German constitutional court claim that this set of economic experts (with all the resources at their respective institutions and the research that is in general available) has not sufficiently balanced the economic effects of such measures in their well-documented decisions is absurd.

The economic effects that the court mentions and apparently believes to have been overlooked include in particular the effects on private savers and the possibility that “as the PSPP lowers general interest rates, it allows economically unviable companies to stay on the market”. Clearly, these effects are well known among economists. However, it is impossible to conduct monetary policy to achieve stable inflation without any effects on private savers – when inflation is too high, the central bank increases interest rates with positive effects for private savers (assuming that these hold their money in regular interest-bearing bank accounts) and when inflation is too low, the central bank lowers interest rates, for example via asset purchases, with negative effects for private savers. The criticism that economically unviable companies might stay on the market can similarly be made at any moment when the central bank tries to increase inflation; however, the empirical evidence that this indeed happens is quite weak.

The court trusted the wrong experts

The reason that the German constitutional court brings such poor economic arguments may partly lie in the third-party experts that it heard. Unfortunately, the court invited a very biased selection. Out of the [ten experts](#) that it heard on 30-31 July 2019, only two are university professors (and probably among the most ECB-sceptical ones that you can find in Germany), and five of them are lobbyists from the banking and insurance industries. Banking and insurance are the industries that are hurt most from low interest rates and have an interest in fighting the ECB's policies.

The constitutional court may of course listen to all stakeholders, but it does not seem appropriate to invite so many representatives from one side and none from the other (parts of society who benefit from quantitative easing include workers in the private and public sector, tax payers, the unemployed, the manufacturing industry, and most parts of non-financial services; parts of these have economic experts that could be invited, such as economic research institutes close to labour unions). The best option may have been to get a wide variety of independent experts from universities and publicly funded research institutions. These are not directly affected by the ECB's monetary policy decisions and they understand the macroeconomic implications of such decisions best. It is a pity that the court did not make use of this option.



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