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The ECB's quantitative easing programme as a constitutional game changer

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Abstract

The European Central Bank started its quantitative easing programme in 2015 in order to support euro area financial conditions and ultimately increase inflation. The controversial Public Sector Purchase programme has resulted in central bank purchases of government bonds in the magnitude of €2.1 trillion and the Eurosystem (the European Central Bank and the national central banks) become the largest creditor to the euro area Member States. The constitutional framework of the European Central Bank did foresee such a programme, which also makes it potentially problematic for the European Central Bank's accountability. The underlying source for constitutional concerns is the European Central Bank's exceptional independence, which could be justified with a narrow central banking model, but becomes problematic when the European Central Bank's influence on the society becomes more multifaceted, which blurs the borderlines between monetary policy and other economic policies. The specific constitutional concerns related to the Public Sector Purchase programme and accountability are highlighted by three claims: (a) With the Public Sector Purchase programme, the European Central Bank takes deeper inroads to the society than with traditional monetary policy; (b) Through the Public Sector Purchase programme, the European Central Bank became the largest creditor to Member States it was not allowed to finance; and (c) The Public Sector Purchase programme can lead to conflicts between the price stability objective and financial stability.

Keywords

European Central Bank, quantitative easing, QE, monetary policy, financing Member States, financial stability, accountability

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1. Introduction

Towards the end of 2014, European Central Bank (ECB) President Mario Draghi began to hint at measures to expand the ECB balance sheet, in practice, through a quantitative easing (QE) programme.[1] Traditional monetary policy was in full use with zero interest rates and unlimited provision of liquidity, but banks' demand for liquidity was, if anything, declining. The concrete measure was labelled the Public Sector Purchase programme (PSPP) announced in January 2015, through which the Eurosystem (the ECB and the national central banks (NCBs)) committed to buying mainly government bonds at large pre-announced quantities for a given period of time. As a result, the Eurosystem became a major force in government bond markets, and eventually the largest creditor to the euro area Member States.[2]

The QE programmes are new tools in the monetary policy toolbox (see more generally on the resort to unconventional monetary policies and their impact on the ECB's legitimacy: Högenauer and Howarth in this issue). In practice and even more so in theory, their influence on the economy is uncertain and can take multiple routes. They potentially alter the relationship between monetary policy and other economic policies as well as the borderline between public and private spheres. For the ECB these questions are particularly relevant, as they touch upon the borderlines of the ECB's constitutional protected competence conferred upon it by the Maastricht Treaty. Hence, for the broader constitutional architecture of Economic and Monetary Union (EMU), the PSPP can have far-reaching implications, touching upon a number of sensitive issues with regard to the mandate of the ECB and its accountability. The underlying source for constitutional concerns is the ECB's exceptional independence, which is arguably justified in the context of a narrow central banking model that focusses on price stability. However, in the course of the Great Financial Crisis (GFC), these justifications become problematic when the ECB's influence on the society becomes more multifaceted and less based on application of reliable scientific information. At the same time, the borderlines between monetary policy and other economic policies, mainly part of Member State sovereignty, became blurred. Thus, the combination of extreme independence and the new ECB measures needs to be explored. For the PSPP the specific constitutional concerns related to accountability[3] could be highlighted by focussing on three claims or problems:

1. With the PSPP, the ECB takes deeper inroads to the society than with traditional monetary policy.
2. Through the PSPP, the ECB became the largest creditor to Member States it was not allowed to finance.
3. The PSPP can lead to conflicts between the price stability objective and financial stability.

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1. Mario Draghi, 'Monetary policy in the euro area', *European Central Bank* (2014), https://www.ecb.europa.eu/press/key/date/2014/html/sp141121.en.html.
2. European Central Bank, 'Press Release: Monetary Policy Decisions', *European Central Bank* (2016), https://www.ecb.europa.eu/press/pr/date/2016/html/pr161208.en.html.
3. See, for example, K. Tuori, 'The Eurosystem and the European Economic Constitution' (University of Helsinki, 2017). The CJEU's *Gauweiler* judgment established that a strict constitutionality of the ECB's measures is not a real constraint, as long as the ECB claims that a measure helps to achieve price stability. Hence, the fact that a measure would be deemed constitutional by the CJEU, does not make it constitutionally unproblematic. See, Case C-62/14 *Peter Gauweiler and Others v. Deutscher Bundestag*, EU:C:2015:400.

The article starts by describing the PSPP. The second starting point is the ECB's assumed accountability framework, where the reader should also recall the Introductory Chapter of this special issue. These two provide the background for discussing the three problems with the PSPP mentioned above. The article concludes with some tentative constitutional implications.

2. Key features of the PSPP

In January 2015, the ECB Governing Council agreed upon the PSPP[4] followed by the formal decision in March 2015.[5] The programme had some unprecedented features: It involved government bonds and it specified monthly amounts and an intended overall minimum running period.[6] The decision was largely anticipated by the media, financial markets and even by other central banks,[7] as the ECB had guided the expectations.[8]

The purchased bonds need to fulfil the ECB Guideline on collateral eligibility,[9] practically equivalent to the lowest investment grade rating from the main rating agencies.[10] However, the credit quality threshold can be suspended by the Governing Council.[11] The ECB also left open what would happen to bonds that lost eligibility, but presumably they would be very difficult to sell

4. Formally it only expanded asset purchases to include also public sector assets. European Central Bank, 'Press Release: ECB announces expanded asset purchase programme', *European Central Bank* (2015), https://www.ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html.
5. Decision No. 2015/774/EU Secondary Markets Public Sector Asset Purchase Programme, [2015] OJ L 121/20. For updates, see European Central Bank, 'Expanded asset purchases programmes', *European Central Bank* (2019), https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html.
6. M. Draghi and V. Constancio, 'ECB press conference: Introductory Statement to the press conference (with Q&A)', *European Central Bank* (2016), https://www.ecb.europa.eu/press/pressconf/2016/html/is160310.en.html.

   European Central Bank, 'Press release: Monetary Policy Decisions', *European Central Bank* (2016), https://www.ecb.europa.eu/press/pr/date/2016/html/pr161208.en.html.
7. The Swiss National Bank discontinued its minimum exchange rate policy vis-à-vis the Euro, anticipating the ECB decision on QE. Swiss National Bank, 'Press Release: Swiss National Bank discontinues minimum exchange rate and lowers interest rate to -0-75%', *Swiss National Bank* (2015), http://www.snb.ch/en/mmr/reference/pre_20150115/source/pre_20150115.en.pdf.

   Draghi mentioned the anticipation in an ECB press conference: European Central Bank, 'Press Conference: ECB announces expanded asset purchase programme', *European Central Bank* (2015), https://www.ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html. In a survey of euro area economists conducted by the Financial Times in mid-December 2014, twenty-six economists forecasted the ECB would start purchasing government bonds in 2015 compared to five who thought it would not. See, Financial Times, 'Economists sceptical ECB bond-buying would revive eurozone', *Financial Times* (2015), http://www.ft.com/intl/cms/s/0/3496a4fa-91aa-11e4-bfe8-00144feabdc0.html#axzz3X6twS9GH.
8. This was in the ECB Statement in the ECB's press conference, see, M. Draghi, 'Press Conference: Introductory statement', *European Central Bank* (2014), https://www.ecb.europa.eu/press/pressconf/2014/html/is141106.en.html. However, President Draghi had already introduced the idea a month earlier. See, S. Riecher and S. Hamilton, 'Draghi Says Growing ECB Balance Sheet Is Last Stimulus Tool Left', *Bloomberg* (2014), http://www.bloomberg.com/news/articles/2014-10-11/draghi-says-growing-ecb-balance-sheet-is-last-stimulus-tool-left.
9. European Central Bank, Guidelines on monetary policy instruments and procedures of the Eurosystem, [2011] OJ L 331.
10. This refers to the ECB credit assessment framework that supplements credit rating agencies with assessment by the NCBs and some other rating tools. The ECB credit quality step 3 is equivalent to the lowest level of investment grade rating. (See, European Central Bank, 'Eurosystem Credit Assessment Framework (ECAF)', *European Central Bank* (2019), https://www.ecb.europa.eu/paym/coll/risk/ecaf/html/index.en.html.
11. Article 3(2)(c) of Decision No. 2015/774/EU Secondary Markets Public Sector Asset Purchase Programme, [2015] OJ L 121/20.

with the amounts involved. The programme set an interest rate limit for the purchases at the ECB deposit facility rate,[12] which was already negative at the time and thus the Eurosystem effectively pays interest on many purchased bonds.[13]

The PSPP set relative but not absolute limits on the specific bond issuer and specific bond issues. The idea was to avoid the Eurosystem gaining a blocking minority[14] that could be detrimental for the functioning of the markets.[15] In general, the purchases were limited to one-third of each bond issue and to one-third of each issuer's outstanding debt.[16] The purchases were also limited to secondary markets given that Article 123 Treaty on the Functioning of the European Union (TFEU) explicitly prohibits purchases in primary issues. Some guarantees were also provided against open circumvention of the prohibition;[17] a 'black-out period' around primary issues exclude purchases close to primary bond issuances.

The key feature of the PSPP is its size. The purchases totalled initially €60 billion monthly with some €50 billion involving government bonds[18] and were to continue until September 2016 and 'in any case, be conducted until the Governing Council sees a sustained adjustment in the path of inflation'.[19] After a few revisions, the PSPP ran at a reduced monthly amount until the end of 2018.[20] The initial total amount was €1.1 trillion, roughly 10% of the euro area GDP, and extensions pushed it to €2.1 trillion in public sector bonds and to €2.6 trillion in total.

A peculiar feature is the limited risk-sharing within the Eurosystem. Normally, ECB monetary policy operations have full risk-sharing, meaning that any risks involved are shared by all the euro area NCBs according to their share of the ECB capital. In the PSPP, this risk-sharing only covers 20%, involving securities of European institutions and the purchases by the ECB. The remaining 80% is at the risk of each NCB making the purchase. Banca d'Italia covers the risk related to Italian bonds it purchases and Bundesbank to the German bonds,[21] although they were bought at the instructions of the ECB. This was intended to 'mitigate the concerns that many participating countries in the euro area have about the unintended fiscal consequences of potential developments

12. Article 3(5) of Decision No. 2015/774/EU Secondary Markets Public Sector Asset Purchase Programme, [2015] OJ L 121/20.
13. European Central Bank, 'Press release: ECB provides further details on APP purchases of assets with yields below the deposit facility rate', *European Central Bank* (2017), https://www.ecb.europa.eu/press/pr/date/2017/html/pr170119_1.en.html.
14. In collective action clauses, a blocking minority means the share that gives the possibility to prevent an agreement among creditors.
15. Other holdings through the SMP as well as investment holdings by the ECB and the NCBs.
16. Article 3(3) of Decision No. 2015/774/EU Secondary Markets Public Sector Asset Purchase Programme, [2015] OJ L 121/20.
17. The issue was discussed more thoroughly as part of the operation framework of the ECB (Section 6.4).
18. No exact amounts have been communicated except informally. See, D. Goodman, L. Meakin and E. Nelson, 'The What and Why of ECB Bond Buying; For How, Watch This Space' *Bloomberg* (2015), http://www.bloomberg.com/news/articles/2015-01-22/the-what-and-why-of-ecb-bond-buying-for-how-watch-this-space.
19. Recital 7 of the Preamble to Decision No. 2015/774/EU Secondary Markets Public Sector Asset Purchase Programme, [2015] OJ L 121/20.
20. M. Draghi and V. Constancio, 'Introductory Statement to the press conference', *European Central Bank* (2016), https://www.ecb.europa.eu/press/pressconf/2016/html/is160310.en.html.
21. European Central Bank, 'Press release: ECB announces expanded asset purchase programme', *European Central Bank* (2015), https://www.ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html; M. Draghi and V. Constancio, 'Introductory Statement to the press conference', *European Central Bank* (2016), https://www.ecb.europa.eu/press/pressconf/2016/html/is160310.en.html.

in the future' and thus recognising that the PSPP has the potential of turning into a fiscal transfer mechanism between the Member States.[22]

As to the legal basis, the Governing Council decision in March 2015[23] referred to the first indent of Article 127(2) TFEU as well as Article 12.1 European System of Central Banks Statute (Statute) in conjunction with the first indent of Article 3.1, and Article 18.1 Statute. It was part of the task to conduct monetary policy, and more specifically under open market and credit operations.[24] The reference to Article 12.1 Statute pointed to the Governing Council's guidelines and decisions to formulate monetary policy that form the basis under which the ECB Executive Board, for example, gives binding instructions to NCBs for the decentralised implementation.[25] The legal basis was thus practically the same as with earlier programmes, particularly the Outright Monetary Transactions (OMT) programme, which was reviewed both by the German constitutional court and the European Court of Justice (CJEU).[26]

The decision made a reference to the monetary financing prohibition of Article 123 TFEU, declaring that the prohibition was not applicable. However, the condition that 'purchases made on the secondary market must not be used to circumvent the objective of that Article'[27] was not addressed. This relates directly to the question whether the Eurosystem can become a major creditor of the Member States without questioning the objectives of Article 123 TFEU. Some of the discontented members of the Governing Council might have hinted in that direction.[28]

In sum, the PSPP was largely similar to earlier programmes by other major central banks apart from some peculiarities, but also a fundamentally new type of programme in the ECB context. To see why it could have been a major change in the ECB's role as the central bank for the euro area and raise issues concerning its accountability, it is necessary first to briefly look at the accountability mechanisms available for the ECB before turning to the specific concerns raised by the PSPP.

3. Accountability of the ECB

The bulk of general discussion on the ECB's accountability is collected in the introductory Chapter of this special issue and only a few remarks concerning the approach of this article are added here. The accountability of the ECB was one of the most difficult issues when the new central banking

22. For example, President Draghi in the Q&A session of the ECB press conference 22 January 2015.
23. Decision No. 2015/774/EU Secondary Markets Public Sector Asset Purchase Programme, [2015] OJ L 121/20.
24. Recital 1 of the Preamble to Decision No. 2015/774/EU Secondary Markets Public Sector Asset Purchase Programme, [2015] OJ L 121/20.
25. The decentralized nature of the programme also was possible on the basis of Article 12.1 Statute.
26. (DE) BVerfG, Order of the Second Senate (14 January 2014) 2728/13 para. 1-24; and Case C-62/14 *Peter Gauweiler and Others v. Deutscher Bundestag*.
27. Council Regulation No. 3603/93/EC of 13 December 1993 on specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b (1) of the Treaty, [1993] OJ L 332.
28. For example, in December 2014 the Bundesbank President Jens Weidmann claimed that: '[T]here's a whole row of economic reasons that speak against government-bond purchases, even before you consider the legal question of whether they're compatible with the ban on monetary financing (. . .) a broad QE program can – bypassing parliaments and governments – lead to a redistribution of risks between taxpayers in the member countries, unless the purchases are limited to the countries with the highest credit rating or each central bank purchases bonds at the risk of its own country'. See, J. Black and J. Randow, 'ECB's Weidmann Rejects Sovereign QE With No Deflation Seen', *Bloomberg* (2014), www.bloomberg.com/news/articles/2014-12-16/weidmann-rejects-sovereign-bond-buying-even-if-deflation-emerges.

system was designed, as the ECB and the whole Eurosystem was intentionally disentangled from political pressures to facilitate its focus on its primary objective of price stability. The Maastricht Treaty created an extremely independent central bank at the supranational level that could not count on existing models of accountability developed at the national level. Furthermore, even at the national level the time-inconsistency problems in central banking were solved by increasing central bank independence with weakened direct accountability of central banks.[29]

The questions related to accountability are particularly difficult concerning QE programmes, as the distance between the measure, purchasing government bonds in vast quantities, and its stated aims is exceptionally long and vague. At the same time, QE can have far-reaching and even unanticipated effects for the social fabric. Thus, discussing the PSPP purely from a procedural perspective, as is often preferred in judicial review, can miss the essence of the question. However, analysing the substantive elements of the PSPP is easily criticised for going beyond the strict competence and accountability questions. The paradox can be described by the question: shouldn't the ECB do whatever it can to get the economy out of recession? Many observers have answered in the positive. However, some constitutional lawyers and even economists maintain that constitutions could have a role in protecting the deeper values of the society against short-term temptations or misguided motivations.[30] In the following, the PSPP is scrutinised beyond the formal procedures by taking the perspective of its potential substantive effects and reflecting them on the EMU constitutional principles against which the ECB should be accountable.

4. Potential problems with the Eurosystem PSPP

The three claims or problems with the ECB's PSPP are meant to highlight its impact on the constitutional architecture of the Maastricht Treaty. By nature, these problems contain both economic and constitutional issues, of which the economic rationale and the expected economic outcome of the PSPP can be decisive for the assessment. Hence, the economic effects of the programme need to be reflected on the relevant constitutional framework.

A. The PSPP takes deeper inroads to the society than traditional monetary policy

The economics of QE programmes is a complex issue and cannot be exhaustively analysed.[31] However, it can be argued that QE in general and the PSPP in particular affect the underlying societies differently from traditional monetary policy. In particular, their direct effects on wealth distribution have raised doubts and concerns. To assess this effect, it is necessary to understand how the QE was supposed to work and how that transmission could be different from traditional monetary policy. The starting point is the ECB's economic justification for the programme.

29. K. Tuori, *The Eurosystem and the European economic constitution: A constitutional analysis of common central banking before and during the crisis*; B. Weber, 'Bitcoin and the legitimacy crisis of money', 40 *Cambridge Journal of Economics* (2016), p. 17; and R. Elgie, 'The politics of the European Central Bank: principal–agent theory and the democratic deficit', 9 *Journal of European Public Policy* (2002), p. 186.
30. J. Olsen 'Democratic accountability and the changing European political order', 24 *European Law Journal* (2018), p. 77.
31. See more discussions in K. Tuori, *The Eurosystem and the European economic constitution: A constitutional analysis of common central banking before and during the crisis*.

The main stated aim of the PSPP was to achieve the price stability objective. The purchases were 'to address the risks of a too prolonged period of low inflation'. Traditional monetary policy measures, particularly official interest rates, had already been used to the full, and further easing of the monetary policy stance required new measures.[32] The logic of the PSPP was that the purchases of government bonds ease monetary and financial conditions, thereby leading to cheaper terms of financing for firms and households, which would support investment and consumption and finally inflation.

The ECB mentioned two main channels through which the PSPP was to support growth and increase inflation. First, a signalling effect is caused by the decision itself, which strengthens confidence and supports inflation expectations, thus reducing expected real interest rates. Second, a portfolio rebalancing effect happens when the purchases reduce government bond yields that act as benchmark interest rates for other securities and financial instruments: bank loans, corporate loans, equities and real estate. This reallocation towards other assets should increase asset prices, which in turn should support lending to firms and households.[33] Central banks have emphasised the portfolio rebalancing effect. 'Our purchases reduce returns on safer assets. This encourages investors to shift to riskier, higher-yielding assets. Pension funds, banks and other market participants that we buy securities from are likely to substitute these for other long-term assets, thereby eventually pushing up prices more broadly'.[34] Thus the ECB has described the PSPP as a monetary policy measure that aims at ensuring price stability through changes in wealth and even in (capital) income distributions.

The primary question with regard to the PSPP, is whether its economic aims and rationales qualify it as a monetary policy measure. The economics of QE are notoriously ambiguous and inconclusive to the point that the former Federal Reserve Governor Bernanke stated that 'the problem with QE is that it works in practice, but it doesn't work in theory.'[35] However, it can be concluded that QE can economically be classified as monetary policy,[36] backed up by tentative empirical research and also the fact that most central banks describe QE as monetary policy.[37]

32. European Central Bank, 'Press release, 'ECB announces expanded asset purchase programme', *European Central Bank* (2015), https://www.ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html.
33. ECB Letter from the ECB President to Mr Enrique Calvet Chambon, MEP, on the extended asset purchase programme titled Re: Your letter (QZ-21) 10 March 2015. L/MD/15/139.
34. M. Clinch and A. Weisbach, 'Draghi: ECB QE Risks are Contained', *CNBC* (2015), http://www.cnbc.com/id/102494922.
35. R. Harding, 'US quantitative measures worked in defiance of theory', *Financial Times* (2014), http://www.ft.com/intl/cms/s/0/3b164d2e-4f03-11e4-9c88-00144feab7de.html#axzz3X6twS9GH.
36. See, N. Wallace, 'A Modigliani-Miller Theorem for Open Market Operations', 71 *The American Economic Review* (1981), p. 267. The article uses the basic Modigliani-Miller Theorem in government finances and shows that the same irrelevance also holds in that environment; G. Eggertson and M. Woodford, 'The Zero Bound on Interest Rates and Optimal Monetary Policy', *Brookings Papers on Economic Activity* (2003), p. 139; and P. Krugman, 'It's Baaack! Japan's Slump and the return of the Liquidity Trap', *Brookings Papers on Economic Activity* (1998), p. 137; B. Bernanke and V. Reinhart, 'Conducting Monetary Policy at Very Low Short-Term Interest Rates', 94 *American Economic Review* (1994), p. 85; G. Eggertsson, 'The Deflation Bias and Committing to Being Irresponsible', 38 *Journal of Money, Credit, and Banking* (2006), p. 283; V. Cúrdia and M. Woodford, 'The Central-bank Balance Sheet as an Instrument of Monetary Policy', 58 *Journal of Monetary Economics* (2011), p. 54; M. Gertler and P. Karadi, 'A Model of Unconventional Monetary Policy', 58 *Journal of Monetary Economics* (2011), p. 17.
37. A. Krishnamurthy and A. Vissing-Jorgensen, 'The Effects of Quantitative Easing on Interest Rates: Channels and implications for policy', *Brookings Papers on Economic Activity* (2011), p. 215; A. Krishnamurthy and A. Vissing-Jorgensen, 'The Aggregate Demand for Treasury Debt', 120 *Journal of Political Economy* (2012), p. 233; S. D'Amico

Interestingly, both empirical and also theoretical evidence suggest that the QE is most likely to work, when financial instability is a major factor in asset prices, which was not the case with the ECB.[38]

Thus, with some assumptions, the PSPP can be considered monetary policy and also its relative size is comparable to other major central banks' programmes, reaching roughly one-quarter of the GDP, similar to the USA and also the UK.[39] How could it then be considered more far-reaching than traditional monetary policy? The claim relates to some key features of the PSPP that could make it constitutionally different from traditional monetary policy.

The PSPP has asset prices as its direct target, and it would not be considered successful without an effect on asset prices. Unlike traditional monetary policy that has an ambiguous effect on bond yields, the PSPP affects longer-term interest rates directly, which not only increases its influence on other asset prices but also increases a central bank's direct influence on market pricing over the whole yield curve.

The impact on market pricing also goes beyond the euro area benchmark yield curve, as the PSPP targets all the government bonds of the euro area states with the exception of Greece.[40] This contrasts with other central banks: the US programmes targeted benchmark government bonds and mortgage-backed securities; and the UK programmes bought solely, and the Japanese programmes mostly, government bonds, the lowest risk and yield assets in their respective economies. As a consequence, it could be argued that the yield curves in euro area countries have lost much of their information value.[41] In an economic model that relies on resource allocation decisions by private parties, the heavy-handed influence of the central bank could be considered exceptional.

The main counterargument is that also traditional monetary policy affects asset prices, as, generally speaking, increasing interest rates reduces asset prices and vice versa. Thus, the PSPP should not be fundamentally different from more traditional monetary policy. However, the link between asset prices and traditional monetary policy is less causal and depends more on the private sector allocation decisions. For example, an increase in official interest rates is assumed to have a

and T. King, 'Flow and stock effects of large-scale treasury purchases: Evidence on the Importance of Local Supply', *Finance and Economics Discussion Series* (Federal Reserve Board, 2012); J. Gagnon, Matthew Raskin, J. Remache and B. Sack, 'Large-scale asset purchases by the Federal Reserve: Did They Work?', *Federal Reserve Bank of New York Staff Report* (2010), p. 441; C. Li and M. Wei, 'Term structure modelling with supply factors and the Federal Reserve's Large Scale Asset Purchase Programs', *Washington D.C., Federal Reserve Board of Governors, Division of Monetary Affairs* 2012-37 (2012); R. Jarrow and H. Li, 'The impact of quantitative easing on the US term structure of interest rates', 17 *Review of Derivatives Research* (2014), p. 287; J. Hamilton and J.C. Wu, 'The effectiveness of alternative monetary policy tools in a zero lower bound environment', 44 Journal of Money, Credit, and Banking (2012), p. 3.

38. M. Joyce et al., 'The financial market impact of quantitative easing', 50 *Bank of England Quarterly Bulletin* (2010), p. 205; G. Kapetanios et al., 'Assessing the economy-wide effects of quantitative easing', *Bank of England Working Paper* (2012), p. 443; B. Fawley and C. Neely, 'Four Stories of Quantitative Easing', 95 *Federal Reserve Bank of St. Louis Review* (2013), p. 51.
39. In Japan, the QE is substantially larger. B. Fawley and C. Neely, ', 95 *Federal Reserve Bank of St. Louis Review* (2013), p. 51; Board of Governors of the Federal Reserve System (US), 'All Federal Reserve Banks – Total Assets', *Federal Reserve Bank of St. Louis*, https://research.stlouisfed.org/fred2/series/WALCL.
40. At the time, only Germany had the highest credit rating from all the major rating agencies. High ratings were also with Austria, Finland and the Netherlands. See, for example, Trading Economics, 'Euro Area – Credit Rating', http://www.tradingeconomics.com/euro-area/rating.
41. For example, in a number of studies the BIS economists have found that the yield curve is driven largely by monetary policy measures not real economy developments.

negative influence on bond prices and other asset prices. However, if this monetary policy action is deemed necessary to maintain price stability, it can actually lower longer-term bond yields and increase asset prices. The measure aims at maintaining price stability and the rest is for the private sector participants to figure out. The full effect of the central bank measure is a combination of a change in short official rate, impact on liquidity, and resulting changes in market perceptions.

Thus there is arguably a difference between a central bank being aware that its monetary policy measure could affect asset prices and a central bank attempting to increase asset prices directly. In the former case, the central bank is primarily enhancing the functioning of the economy, which can lead to higher asset prices. In the latter case, the central bank is aiming at this outcome in asset directly, regardless of the economic conditions. In the broader context of a liberal capitalist economy, this difference can be constitutionally relevant. The direct influence on asset prices and particularly on property prices is equivalent to influencing the distribution of wealth within the society, which even leads to intergenerational wealth transfers, as younger generations generally have less wealth. However, even if increased asset prices was the primary result of the PSPP and if that was considered an inappropriate target for the ECB, it is difficult to make the ECB accountable for this policy when it is classified as monetary policy The discretion awarded to the expert organisation prevails, although the timing of the programme could hint at influences for the PSPP other than price stability. This leads to fundamental questions concerning independent experts being in the position of making potentially value-loaded discretionary decisions.

B. The ECB has become the largest creditor to Member States it was not allowed to finance

One key element in EMU constitutional architecture was the Member States' responsibility over their public finances. A list of constitutional safeguards were built to prevent situations where Member States' public finance failures would burden other Member States or common monetary policy. These included the Stability and Growth Pact,[42] non-bailout clause (Article 125 TFEU), and key prohibition of central bank financing of governments (Article 123 TFEU). Starting from the Delors Report, the need and also limitations of the market discipline on Member States through higher interest rates on government bonds of reckless Member States was well established.[43]

The market discipline was not very effective in the run-up to the GFC when the interest rates on government bonds failed to take into account differences in Member State economic positions. During the GFC, the mechanism was hardly allowed to function, when alongside other EU rescue measures the ECB reacted to differentiated bond yields in the form of the Securities Markets Programme (SMP), the OMT and even the 3-year long-term refinancing operations.[44] Arguably, the PSPP in turn continued to hamper the market-disciplining mechanism: The Eurosystem

42. The term 'Stability and Growth Pact' refers to a combination of legal acts: Resolution on the Stability and Growth Pact of Amsterdam, [1997] OJ C 236/1; Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies and Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, [1997] OJ L 209/1.
43. Delors Committee, 'Report on an Economic and Monetary Union in the European Community', *Committee for the Study of Economic and Monetary Union* (1989), p. 11.
44. For the broader EU rescue measures, see K. Tuori and K. Tuori, *The Eurozone economic crisis: a constitutional analysis* (Cambridge University Press, 2014).

became the most active participant in the government bond markets and the largest holder of government bonds of all the euro area Member States. This influence in the bond markets was underlined by events in Italy: The populist parties gained the majority in general elections on 4 March 2018, but Italian government bonds remained unaffected.[45] The ECB also noted that the impact of the PSPP on compressing the bond yields could have increased as the holdings of bonds increased.[46] Thus, the PSPP purchases might have reached a point where the ability of bond markets to discipline or even signal unsustainable economic policies is seriously hampered.

The prohibition of central bank financing of governments was important for market discipline, but it has even more fundamental reasons linked to price stability and the ECB's independence. However, the PSPP decision did not discuss the applicability of Article 123 TFEU, although it included the minimum formal requirement of excluding direct purchases of bonds from governments. It can be assumed that the article was used alongside moral hazard considerations by those that insisted on the specific risk-sharing structure of the PSPP. President Draghi said that monetary policy measures can have some fiscal consequences and

> these fiscal implications are dealt with easily within a one-country framework, between the central bank and the treasury. But in the euro area, there is no European treasury, and each national treasury gives an implicit or explicit indemnity to its own central bank, but not the euro system as a whole.[47]

A comparison with the SMP (and OMT) can be informative, which were arguably more problematic with regard to Article 123 TFEU. Indeed, the SMP had a different aim; the purchases of the bonds of troubled Member States were to repair a perceived market malfunctioning and thus also the monetary policy transmission mechanism. The SMP was discretionary with unclear amounts, which made it ineffective in signalling monetary policy. And as the ECB insisted on a preferential creditor status, the programme even harmed the bond markets in question and in the case of Greece, the SMP could even have increased the debt burden after the 'voluntary' debt restructuring in 2012.[48] All these features are absent in the PSPP: It is not selective[49] and the central bank has an equal position with other bondholders.

It is thus unlikely that the PSPP could be judged unconstitutional on the grounds of Article 123 TFEU, even though the ECJ's earlier reasoning referred to the assumed telos of that article of protecting sound public finances, which is not present with the PSPP. The main constitutional problem in relations to Article 123 TFEU is the outcome of the PSPP. The Eurosystem is now the largest holder of Member States' government bonds. Through the PSPP, the it has replaced private investors as creditors of the Member States. The same outcome would have resulted if the Eurosystem had issued central bank money and lent it directly to governments. This is monetising government debt, regardless of primary or secondary market purchases.

45. K. Allen, 'Italian policymakers' debt holdings overtake those of banks'. *Financial Times*, (2018), https://www.ft.com/content/716390f6-22b0-11e8-add1-0e8958b189ea.
46. B. Cœuré (2018), 'The persistence and signalling power of central bank asset purchase programmes', Speech at US Monetary Policy Forum, New York City, 23 February 2018.
47. M. Draghi, 'Introductory statement to the press conference', Frankfurt am Main, 22 January 2015, www.ecb.europa.eu/press/pressconf/2015/html/is150122.en.html.
48. In the restructuring of March/April 2012 the bonds and loans held by the official bodies and other Member States were not cut. See, J. Zettelmeyer, C. Trebesch, and M. Gulati, 'The Greek Debt Restructuring: An Autopsy', 13-8 *Peterson Institute for International Economics* (2013), p. 2.
49. With the exception of Greece.

Thus, financing of the Member States is one of the key concerns of the PSPP. In fact, a need to create a lender of last resort for governments was a recurring theme in the euro area economic policy discussions.[50] However, it was never mentioned with regard to the PSPP, although the PSPP explicitly aimed at lowering the borrowing costs of the Member States. On economic grounds, the stated monetary policy aim and the actual government financing aim are inseparable in the case of the PSPP, although the limited risk-sharing somewhat reduced the interstate financing element. The transformation of public sector liabilities took place from longer maturities to cash (centrak bank money), but not fully from the Member-State level to the euro area level.

In sum, three constitutional implications of the PSPP for the euro area public finance framework could be suggested:

1. The role of market discipline through government bond markets is at least temporarily dysfunctional. However, the whole macroeconomic framework for controlling Member States' public finances has been rewritten with the Six Pack and the Two Pack legislation and the Fiscal Compact, in which the role of market discipline is smaller and thus the damage caused by the PSPP is similarly less severe.
2. The fact that the Eurosystem is the largest creditor of the Member States can have profound implications for the euro area's institutional balance.
3. The accountability of the ECB will be affected if the actual motivations of its actions do not come under scrutiny (as will be discussed in the conclusion).

C. The PSPP can lead to conflicts between the price stability objective and financial stability

Part of the experimental nature of the QE and probably a reason for the ECB's initial hesitation is the lack of clarity on how to exit the programme and with what implications. The seeds of the next crisis are often sown with the measures to combat the previous crisis. In this regard, the QE is amongst the main suspects. The concern is that the PSPP can cause financial instability when it needs to be withdrawn. As the PSPP has affected asset prices, in some cases even substantially, a reversal in this process can be a major disruption and a cause of financial instability particularly in those countries where banks remain vulnerable.

It can be recalled that financial stability considerations were integral in most QE programmes. The main suspect for the ECB financial stability motivation was the situation in the euro area banking sector. During the crisis, and encouraged by the ECB's earlier 3-year long-term refinancing operation, banks in troubled countries had become major holders of local government debt. As a consequence, banks' ability to lend had become negatively correlated with bond prices. When the ECB took over the supervisory responsibility it conducted a comprehensive assessment of banks, linking its credibility to the fate of these banks, thereby indirectly linking its credibility to the bond

50. P. De Grauwe, 'The European Central Bank as Lender of Last Resort in the Government Bond Markets', 59 *CESifo Economic Studies* (2013), p. 520; as well as W. Buiter and E. Rahbari, 'The European Central Bank as Lender of Last Resort for Sovereigns in the Eurozone', 50 *Journal of Common Market Studies* (2012), p. 6.

prices of the troubled Member States. It cannot be verified whether this has played a role in the PSPP, but, it can paradoxically result in financial instability over longer term.[51]

From the financial stability perspective, the role of asset prices is pivotal but not straightforward. It can be recalled that asset price increases and related credit expansion contributed to the GFC,[52] as the elevated and leveraged asset holdings enabled the negative spiral when the credit cycle turned. In order to halt the debt deflation spiral, monetary policy can legitimately target asset prices to stabilise the economy. However, this was not the case with the PSPP, when most asset prices in the euro area were already elevated. The PSPP did contribute to a further increase in asset prices: In many countries, government and corporate bonds, equities and even real estate, have reached close to their all-time high levels.

The previously discussed feature of the PSPP that it included not only the lowest risk benchmark government bonds,[53] but the bonds of all Member States with the exception of Greece,[54] underlines its financial stability concerns. Portfolio rebalancing did not take place only from the least risky assets to other assets, but between assets of similar risk characteristics. This larger impact on market pricing could make its withdrawal more destabilising for financial markets.

The main question from financial stability perspective is, what could happen if the ECB needed to exit the PSPP quickly amidst increasing inflation expectations. It is not a very unlikely scenario that the ECB would end up having only difficult options at its disposal. For example, if inflation expectations start to increase even fairly moderately and the ECB does not remove monetary policy stimuli, inflation expectations could further increase, pushing government bond yields up (and prices down). However, if the ECB starts to unwind the PSPP, this could affect market pricing, and also financial stability substantially. This situation is made more difficult by the cross-country differences within the Eurozone due to uneven recovery as well as the strength of the banking sector. For example, if the Italian banks still hold more than €300 billion worth of government bonds, when a negative effect hits the market, it is possible that their financial problems become destabilising for the economy as well, although banks in most other countries would welcome a normalisation of monetary policy.

In constitutional terms, the linkage between financial stability concerns and primary objective of price stability is particularly difficult in the euro area context now that the ECB has been allocated financial stability responsibilities. This has direct implications also on the accountability and credibility of the ECB. When a measure affects the institution's objectives in a conflicting manner, its accountability becomes blurred. If the institution responds by denying the conflict, it starts to damage its credibility.

51. See, for example, European Central Bank Statistical Data Warehouse, 'CISS contribution from equity market sub-index', *ECB*, http://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=290.CISS.D.U2.Z0Z.4F.EC.SS_EM.CON.
52. This was pointed out quite early on by the work done at the BIS. For example, C. Borio and P. Lowe, 'Asset Prices, Financial and Monetary Stability: Exploring the Nexus', *Bank for International Settlements Monetary and Economic Department Working Paper* 114 (2002), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=846305.
53. It should be recalled that the euro area lacks the benchmark bond markets of the US, the UK or Japan.
54. See changes and holdings at 'Asset Purchase Programmes: Expanded asset purchase programmes', *ECB*, https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html.

5. Conclusion: The problems with the PSPP and the accountability of the ECB

The accountability of the ECB was a difficult issue, when the ECB was established and the common monetary policy framework was created. Fundamentally it relied on the new institution's willingness and also incentives to become accountable. The ECB was given a relatively narrow mandate and a straightforward objective, rationalising its exceptional independence. With the GFC and particularly the sovereign debt crisis, the measures of the ECB have expanded to new areas and it has been assigned and has taken over new tasks and objectives. In this complex setting, the PSPP that creates €2.6 trillion of central bank money to purchase mainly government bonds of the euro area Member States can raise a number of problems that also have a bearing on the ECB's accountability.

Indeed, for a long time the ECB was hesitant towards QE due to institutional and legal considerations. President Draghi addressed the issue in his first press conference: 'we should not try to circumvent the spirit of the Treaty. No matter what the legal trick is, I think what matters for the people and what matters for the confidence and credibility of the institution is the spirit of this provision of the Treaty.' When asked why the ECB did not engage in QE, President Draghi referred again to the Treaty.

> [E]ach central bank has its institutional set-up, within which it operates. The ECB operates within the limits of the Treaty, and I said a moment ago what our primary mandate is, and especially what the Treaty says the ECB cannot do. I think any central bank is constrained by its institutional set-up. In the United States, as you know, the primary mandate of the Federal Reserve is completely different from ours. And the same is true of the Bank of England.[55]

The constitutional concerns of the PSPP can be discovered combining constitutional law with economic, comparative and institutional analysis. The first question should be whether the PSPP is a monetary policy measure that can be resorted to in the EMU context of supranational monetary policy constrained by legal and institutional limitations arising from the initial conferral of competences. However, after the CJEU's *Gauweiler* judgment, this question has become largely void. The attention shifts to the question, what implications and what constraints a euro area QE programme could have. This was approached by assessing three types of perceived problems with the PSPP.

First, does the PSPP have a deeper reach to the societies than traditional monetary policy, and what implications it has? The main claim is that the PSPP aims directly at increasing asset prices, which is different from traditional monetary policy. This was positive for the owners of assets, but it had a less obvious impact on inflation, its primary target. For the accountability of the ECB, this can be detrimental, if the stated justifications and assumed justifications differ. With regard to the PSPP and asset prices, financial stability and inflation objectives were initially aligned, avoiding a clear conflict in the ECB's communication. However, even assuming that inflation was the sole aim of the PSPP, it is not clear how far the ECB can go to achieve its objectives. Are there any limitations to central bank's interference with underlying societies? In the case of the ECB, it could be claimed that its exceptional independence excludes some elements in its policy. For example, as has been pointed out by the ECB presidents, the distributional policies are problematic, even if they could be useful in

55. M. Draghi and V. Constancio, 'Introductory statement to the press conference (with Q&A)', Frankfurt am Main, ECB press conference, 8 December 2011, https://www.ecb.europa.eu/press/pressconf/2011/html/is111208.en.html.

achieving some objectives. Clearly, the ECB is ill-equipped to make value judgments, which raises the question of who defines what policy choices contain value judgments – and how the ECB's accountability serves the purpose of bringing this issue to public deliberation when doubts arise.

Second, the outcome of the PSPP that the Eurosystem is now the largest creditor of the euro area Member States is problematic for a number of reasons. The ECB's creditor status has potentially changed its relationship with Member States in a profound manner. The problem with the prohibition of public financing of Article 123 TFEU seems clear and the defence on the basis of excluding direct purchases from governments is hardly in line with the telos of this article. Surprisingly, though, the very telos could come to its rescue, as the reason for the prohibition related to the historical and theoretical concern is that an excessive supply of money leads to inflation, and central bank financing of governments can equal money supply. In the PSPP, this telos can be turned around. If price stability required higher inflation, this can be achieved by increasing the money supply, operationalised by purchasing government bonds. Hence, the PSPP could be against the idea of Article 123 TFEU but in conformity with its ultimate telos. Naturally, this interpretation is friendly to the PSPP, and does not justify purchasing poorly rated bonds. However, the main problem of the PSPP is that a creditor–debtor relationship fits poorly in the principal–agent framework underlying the ECB's accountability; if the agent is controlling the principal, not much is left of its accountability.

Third, the PSPP relates to the potential for a conflict of interest between financial stability and price stability objectives. Initially, the PSPP affected asset prices with a positive effect on financial stability, although the ECB did not make this argument explicit. At the time, the main financial stability concern related to some banks in the euro area that had bought excessive amounts of government bonds. With the PSPP, these bond prices increased probably more than country fundamentals and inflations expectations should have suggested. The problem arises with increasing inflationary pressures. Price stability and financial stability objectives could give conflicting policy suggestions. The problem becomes an accountability problem, if the ECB denies the existence of financial stability consideration. And it becomes a credibility problem, if it is perceived to act on financial stability considerations.

In conclusion, the problems with the PSPP highlight the complications involved when an extremely independent organisation takes new types of measures and is allocated new tasks and even objectives. The whole structure was and is a balancing act involving a need for flexibility on one hand and constitutional constraints on the other. The accountability of the ECB is at the heart of this dilemma. The ECB as an independent monetary policy expert is awarded some discretion in deciding about the appropriate measures. The constitutional review does not offer protection against poor policy choices as such, it can only try to avoid manifest errors of assessment.[56] However, the ECB always needs to make the case that its measures aim at legitimate monetary policy aims.

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56. Case C-62/14 *Gauweiler and Others*, EU: C:2015:400, para. 74.