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The Application of the Principle of Proportionality to Monetary Policy: an Impossible Task?

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☞ keywords to be inserted by the indexer

Abstract

The European Court of Justice (ECJ) has held that the European Central Bank (ECB) enjoys considerable discretion in the formulation and implementation of monetary policy and that the application of the principle of proportionality should accommodate that discretion. This article reviews a large body of evidence to conclude that, in an uncertain and evolving economic environment, it is probably impossible for the ECB to conform with a strict interpretation of the principle of proportionality. Even conformity with the simpler interpretation of the ECJ is not fully explained in the seminal judgments in Gauweiler and Weiss. This incomplete explanation is especially true with respect to the weighing of divergent interests and exposes the ECB to future legal challenges.

Introduction

The Treaty on the Functioning of the European Union (TFEU) does not explain why the EU has exclusive competence in the field of monetary policy in the Eurozone, nor why the European Central Bank is granted independence in the conduct of monetary policy.

There is, however, ample explanation in the literature. Central banks exercise independent decision-making powers because governments are not credible in their long-term commitment to low inflation. They are “time inconsistent”. Decision-making independence insulates central banks from political interference and enables them to make tough decisions today in order to prevent high inflation tomorrow.¹

In other words, independence is the institutional tool for achieving economic growth with low inflation. High inflation is costly because it messes up the signals of the price system and makes it difficult for companies and consumers to distinguish, on the one hand, between changes in the relative prices of goods and services and in the general level of prices, on the other. Inflation is also costly because economic agents expend scarce resources to insulate themselves from the loss in value of the currency.

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¹ See the seminal works of F. Kydland and E. Prescott, “Rules rather than Discretion: the Inconsistency of Optimal Plans” (1977) 85 *Journal of Political Economy* 473–491; and R. Barro and D. Gordon, Rules, “Discretion and Reputation in a Model of Monetary Policy” (1983) 12 *Journal of Monetary Economics* 101–121.

Decision-making independence, however, goes against the grain of democratic principles. To rebalance this “democratic deficit”, independence is linked to mechanisms or arrangements whose purpose is to ensure that central banks do fulfil their mandate by making them accountable. The typical such arrangements are in the form of obligations imposed on central banks to explain and justify decisions through appearances before the relevant committees of parliaments and submission of annual reports, obligations to make transparent decisions through press conferences and publication of the minutes of the decision-making bodies and obligations to follow certain procedures and to consult and inform stakeholders.

Not surprisingly, the ECB too is subject to these accountability arrangements.² According to art.284 TFEU and art.15 of Protocol 4 on the Statute of the European System of Central Banks and ECB, the president of the ECB has to appear before the European Parliament and answer questions by MEPs, while the ECB has to submit annual reports to the Parliament, Council and Commission. In addition, the ECB publishes “monetary policy accounts” (which are summaries rather than minutes of the meetings of the Governing Council) and several other periodic and one-off publications and holds press conferences.

Yet, there is an important element missing from these accountability mechanisms: sanctions. The notion of accountability carries with it the idea that the person who is accountable for something bears the consequences of failure. What are the consequences for the ECB in case of failure to fulfil its mandate or of exceeding its mandate?

The president and members of the Executive Board cannot be dismissed for poor performance as they are appointed for fixed terms of eight years. According to art.11(4) of the ESCB/ECB Statute, they can only be dismissed if the ECJ finds that a member “no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct”. These reasons do not cover poor performance as, for example, in case the ECB would conduct a too loose or too tight monetary policy.

The governors of national central banks are also protected. Article 14(2) of the ESCB/ECB Statute provides that a decision by a Member State to relieve a governor of his duties may be referred to the ECJ. Recently, in joined cases *Rimšēvičs v Latvia* and *ECB v Latvia*, the ECJ held in para.48 of its judgment that the independence of the ECB entailed that governors could be dismissed only in the case of incompetence or serious misconduct which, according to para.98 of the judgment, is to be verified by the ECJ.³

The European Parliament has no powers to censure the ECB as it can do in the case of the Commission forcing its members to resign according to art.17(8) TEU and art.234 TFEU. In fact, it would be difficult to sanction the ECB for poor performance. The Treaty does not define monetary policy. It only defines, in art.127(1) TFEU, the primary objective of the ECB which is price stability. Neither does the Treaty define exhaustively the instruments of monetary policy.⁴ It only outlines, in art.127(2) TFEU, in very broad terms the “basic” tasks of the ECB, and confers to the ECB the right to “define and implement monetary policy”. Article 282(4) TFEU empowers the ECB to adopt measures which are “necessary” for its tasks. Articles 18 and 19 of the ECB Protocol enable the ECB to carry out open market operations and to set minimum bank reserves, respectively, while art.20 of the ESCB/ECB Statute provides that,

² For an analysis and a review of the literature on independence and accountability of the European Central Bank see M. Dawson, A. Maricut-Akbik and A. Bobic, “Reconciling Independence and Accountability at the European Central Bank” (2019) 25 E.L.J. 75–93; F. Amténbrink, “The European Central Bank’s Intricate Independence versus Accountability Conundrum in the Post-crisis Governance Framework” (2019) 26 *Maastricht Journal of European and Comparative Law* 165–179.

³ Joined cases *Rimšēvičs v Latvia* (C-202/18) and *ECB v Latvia* (C-238/18) EU:C:2019:139; [2019] 2 C.M.L.R. 26.

⁴ See *Pringle* (C-370/12) EU:C:2012:675 at [53]; *Gauweiler v Deutscher Bundestag* (C-62/14) EU:C:2015:400; [2016] 1 C.M.L.R. 1 at [42].

“the Governing Council may, by a majority of two thirds of the votes cast, decide upon the use of such other operational methods of monetary control as it sees fit, respecting Article 2.” (Article 2 of the Statute reproduces art.127(1) TFEU.)

The ECB is very independent, the accountability arrangements that apply to it are not really strong, and it enjoys pretty wide discretion in how it defines monetary policy and in the instruments it uses to achieve price stability.

However, according to art.5(2) TEU, the ECB, like all EU institutions, may only act within the limits of the powers conferred to it. Moreover, it has to comply with the principle of subsidiarity and proportionality. Given that art.3 TFEU stipulates that monetary policy falls within the exclusive competence of the EU, that, according to art.5(3) TEU, the principle of subsidiarity does not apply to policies which belong to the exclusive competence of the EU, and that the list of monetary policy instruments is open-ended, the only way to check whether the ECB does not exceed its mandate is through the principle of proportionality.

Like all other EU institutions, the decisions of the ECB can be annulled by the ECJ if they violate the principle of proportionality that requires that “action shall not exceed what is necessary to achieve the objectives of the Treaties.”

There is a large literature that examines how EU courts have assessed compliance with the principle of proportionality. It has detected variations both in the interpretation of the components that make up the overall concept of proportionality and in the application of those components to cases in different policy fields.⁵

Recently, Chiti et al carried out an extensive and meticulously documented review of the principle of proportionality in EU law and its application to monetary policy and banking regulation.⁶ They concluded that,

“it is difficult to identify a stable rule concerning the intensity of the judicial review of proportionality operated by the EU judges. Despite the incredible amount of case law where the possible infringement of the principle is evoked, cases in which EU judges declared legislative or administrative measures taken by EU authorities unlawful for breach of the principle of proportionality are very rare.”⁷

The objective of this article is to extend this line of research and ask what is, perhaps, a more fundamental question that has not yet been fully explored in the literature: Can the principle of proportionality be applied in a meaningful manner to monetary policy?⁸

⁵ For a review of early case law see N. Emiliou, *The Principle of Proportionality in European Law, A Comparative Study* (Alphen aan den Rijn: Wolters Kluwer, 1996). For a more recent review see H. Hofmann, “Between Discretion and Proportionality” (University of Luxembourg Law, 2020) Working Paper No.9. More references to important papers are provided in the section reviewing the case law on proportionality.

⁶ M. Chiti, M. Macchia and A. Magliari, “The Principle of Proportionality and the European Central Bank: Part I” (2020) 26 *European Public Law* 643–678; and M. Chiti, M. Macchia and A. Magliari, “The Principle of Proportionality and the European Central Bank: Part II” (2020) 26 *European Public Law* 843–866.

⁷ Chiti, Macchia and Magliari, “The Principle of Proportionality and the European Central Bank: Part II” (2020) 26 *European Public Law* 869.

⁸ See also a preliminary analysis in P. Nicolaides, “The Judgment of the Federal Constitutional Court of Germany on the Public Sector Asset Purchase Programme of the European Central Bank: Setting an Impossible and Contradictory Test of Proportionality” (15 May 2020) *EU Law Live.com*, <https://eulawlive.com/op-ed-the-judgment-of-the-federal-constitutional-court-of-germany-on-the-public-sector-asset-purchase-programme-of-the-european-central-bank-setting-an-impossible-and-contradictory-test-of/> [Accessed 30 October 2021].

The judgment of 5 May 2020 of the German Federal Constitutional Court (FCC) on the issue of proportionality in the *Weiss* case has provoked much commentary in the blogosphere and articles in journals. We cite some of them in the section that reviews the *Gauweiler* and *Weiss* cases. Different authors have expressed different views on the FCC’s interpretation of the principle of proportionality and on whether the ECB complied with that principle. However, as

This article argues that the root of the problem is not necessarily the flexible interpretation of EU courts, even though in itself it reduces legal certainty, but the impossibility of monetary policy to satisfy that principle with sufficient precision. Evidence that this issue has been neglected despite its importance is the many papers that have been presented at the annual ECB legal conferences in 2018, 2019 and 2020. The vast majority of the 100 or so papers spanning over 1000 pages did not ask whether the principle of proportionality could be applied meaningfully to monetary policy.⁹ Only one paper came close to the issue at hand by examining possible conflicts between proportionality, on the one hand, and price stability and open markets, on the other.¹⁰

The conclusion is that EU courts will always be in the unenviable position of assessing the implementation of a policy that cannot be assessed precisely with legal instruments. The article reaches that conclusion after examining a large body of evidence and considering how in theory a proportionality test should be structured and carried out. First, it identifies the various interpretations and uses of the principle of proportionality in the EU case law. Then it develops a theoretical framework to appreciate the complexity of the task of establishing whether a public policy measure is proportional. Next it revisits the relevant parts of the judgments in *Gauweiler*¹¹ and *Weiss*¹² cases to identify what the ECJ said or did not say on proportionality. After that it asks how the ECB understands and proves compliance with the principle of proportionality. The penultimate section reviews ECB decisions to find out how they explain conformity with the principle of proportionality. The last section summarises the main findings and concludes.

The fluidity of the proportionality test in the case law

Article 5(4) TEU merely states that “the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.”

There is a huge literature on the interpretation of the principle of proportionality by EU courts.¹³ Without attempting an unnecessary duplication, it is instructive to point out its findings which are relevant to this article.

far as we are aware there has not been any systematic analysis of whether the proportionality of monetary policy can be assessed meaningfully.

⁹ ESCB Conference 2018 (December 2018), https://www.ecb.europa.eu/pub/pdf/other/ecb_escblegalconferenceproceedings201812.en.pdf [Accessed 30 October 2021]. ESCB Legal Conference 2019 (December 2020), https://www.ecb.europa.eu/pub/pdf/other/ecb_escblegalconferenceproceedings201912~9325c45957.en.pdf?258d648ffc1be39f9d927e5c13f393f [Accessed 30 October 2021]. ESCB Legal Conference 2020 (February 2021), https://www.ecb.europa.eu/pub/pdf/other/ecb_escblegalconferenceproceedings2020~4c11842967.en.pdf [Accessed 30 October 2021].

¹⁰ K. Kaiser, “The objective of price stability and the principle of an open market economy: what trumps?” ESCB Legal Conference 2018, pp.26–35.

¹¹ *Gauweiler v Deutscher Bundestag* (C-62/14) EU:C:2015:400.

¹² *Proceedings brought by Weiss* (C-493/17) EU:C:2018:1000; [2019] 2 C.M.L.R. 11.

¹³ In addition to the review by Chiti, Macchia and Magliari, “The Principle of Proportionality and the European Central Bank: Part I” (2020) 26 *European Public Law* and the many references cited therein, please also see N. Emiliou, *The Principle of Proportionality in European Law: A Comparative Study* (1996); G. De Búrca, “The Principle of Proportionality and its Application in EC Law” (1998) 13 *Yearbook of European Law* 105; E. Ellis (ed), *The Principle of Proportionality in the Laws of Europe*, (Oxford: Oxford University Press, 1999); T.-I. Harbo, “The Function of the Proportionality Principle in EU Law” (2010) 16 E.L.J., 158–165; W. Sauter, “Proportionality in EU Law: A Balancing Act?” (2013) 15 *Cambridge Yearbook of European Legal Studies* 439–466; C. Hugué-Moizard and Y. Sanchez, “The Principle of Proportionality in European Law” in S. Ranchordas and B. de Waard (eds), *The Judge and the Proportionate Use of Discretion* (Abingdon-on-Thames: Routledge, 2015); H. Hofmann, “Between Discretion and Proportionality” (University of Luxembourg Law, 2020) Working Paper No.9. For an analysis of the use of proportionality in the judgment of the German Federal Constitutional Court in the *Weiss* case see M. Höpner,

The literature by and large concludes that EU courts identify three components that make up the concept of proportionality: 1) a public measure or policy instrument has to be “appropriate” or “suitable” to achieve the objective of the policy in question; 2) the measure or instrument has to be “necessary” in the sense that the objective cannot be achieved otherwise; 3) the measure or instrument must not be excessive or go beyond what is sufficient to achieve that objective (this is also called proportionality *stricto sensu*).

As noted in the literature, EU courts have not been consistent in the precise definition of proportionality. For example, the ECJ ruled in *Association Kokopelli* that,

“(38) according to settled case-law, the principle of proportionality ... is one of the general principles of EU law and requires that measures implemented through provisions of EU law be appropriate for attaining the legitimate objectives pursued by the legislation at issue and must not go beyond what is necessary to achieve them”.¹⁴

It appears here that the Court identifies only two components: appropriateness and absence of excessiveness. It does not include necessity in the relevant components that make up the overall concept of proportionality. The Court relies on the same definition in the landmark judgment in *Gauweiler*.¹⁵

In other judgments it has used a more elaborate definition. For example, in *Afton Chemical* it stated that the acts of EU institutions may,

“not exceed the limits of what is appropriate and necessary in order to attain the objectives legitimately pursued by the legislation in question; when there is a choice between several appropriate measures recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued”.¹⁶

More recently, the General Court relied on the same interpretation of proportionality in a case concerning banking regulation:

“(67) The acts adopted by EU institutions must be appropriate for attaining the legitimate objectives pursued by the legislation at issue and must not exceed the limits of what is necessary in order to achieve those objectives; where there is a choice between several appropriate measures, recourse must be had to the least onerous; and the disadvantages caused must not be disproportionate to the aims pursued”.¹⁷

The General Court went on to add an important qualification:

“(68) It must also be borne in mind that the assessment of the proportionality of a measure must be reconciled with compliance with the discretion that may have been conferred on the EU institutions at the time it was adopted”.¹⁸

It appears that in some cases EU courts identify four components. The components are appropriateness, necessity, absence of excessiveness (least onerous) and what may be called “balancing” of effects in the

“Proportionality and Karlsruhe’s ultra vires verdict: Ways out of constitutional pluralism?” MPIfG Discussion Paper No.21/1.

¹⁴ *Association Kokopelli v Graines Baumaux SAS* (C-59/11) EU:C:2012:447.

¹⁵ *Gauweiler v Deutscher Bundestag* (C-62/14) EU:C:2015:400; [2016] 1 C.M.L.R. 1 at [67].

¹⁶ *Afton Chemical Ltd v Secretary of State for Transport* (C-343/09) EU:C:2010:419; [2011] 1 C.M.L.R. 16 at [45].

¹⁷ *Landeskreditbank Baden-Württemberg v ECB* (T-122/15) EU:T:2017:337; [2018] 1 C.M.L.R. 7.

¹⁸ The judgment of the General Court was upheld on appeal in *Landeskreditbank Baden-Württemberg v ECB* (C-450/17 P) EU:C:2019:372. The Court of Justice agreed that “(53) the General Court, in paragraph 68 of the judgment under appeal, correctly recalled that the assessment of the proportionality of a measure must be reconciled with compliance with the discretion that may have been conferred on the EU institutions at the time it was adopted”.

sense that disadvantages may not exceed the, presumed positive, effects of the policy in question.¹⁹ In a more recent judgment, the ECJ confirmed that the requirement for a measure or instrument to be proportional is attenuated or moderated by the extent of discretion enjoyed by an institution.²⁰ Presumably this means that an institution that enjoys extensive policy discretion may implement a measure or use an instrument with (more) disproportionate effects than otherwise. This in itself implies some sort of balancing whose trade-off is as yet undefined in the case law.

Indeed, the literature considers that the principle of proportionality does require EU institutions to achieve an appropriate trade-off between conflicting objectives and interests:

“The principle of proportionality—just like other EU general principles and procedural guarantees—is not only aimed at protecting the rights of the addressees, but it also helps achieve a well-balanced decision, resulting from an all-encompassing assessment of divergent interests.”²¹

“Proportionality obliges the Union legislator to strike a balance between all the principles, objectives and interests involved”.²²

“The principle of proportionality is a tool that assesses the legality of the exercise of power where a legitimate aim is pursued but another interest deserving of legal protection (typically a right) is damaged. Proportionality always requires a set of conflicting interests that need to be ‘balanced’”.²³

Two conclusions of relevance to this article may be drawn from the above brief review of the literature. First, there is no concrete definition of proportionality that is applied consistently in the case law:

“Monetary policy and supervision demonstrate that the proportionality test is not a model crafted once and for all, but rather a test which is multi-faced, flexible, and assumes new character depending on the situation.”²⁴

Secondly, compliance with the principle of proportionality in essence requires EU institutions to carry out three sorts of calculations. At a high level, when they define a policy objective, they must strike the right balance between conflicting interests. At a lower level, when they choose from among different policy instruments with which to achieve that objective, they must opt for the one which is the least onerous or costly, and they must also ensure that its negative effects are not disproportionate to its benefits. The last calculation implies that even the least onerous instrument must be rejected if it causes more harm than good.

¹⁹ See, for example, the judgments in *Jippes v Minister van Landbouw, Natuurbeheer en Visserij* (C-189/01) EU:C:2001:420 at [81]; *Raffinerie Mediterranée (ERG) SpA v Ministero dello Sviluppo Economico* (C-379/08) EU:C:2010:127; [2010] 3 C.M.L.R. 10 at [86]; *Afton Chemical* (C-343/09) EU:C:2010:419 at [45]. By contrast, in *SPCM* (C-558/07) EU:C:2009:430 at [41], the Court referred to only two components: appropriateness and absence of excessiveness.

²⁰ See the judgment in *Landeskreditbank Baden-Württemberg v ECB* (C-450/17 P) EU:C:2019:372 at [53].

²¹ Chiti, Macchia and Magliari, “The Principle of Proportionality and the European Central Bank: Part I” (2020) 26 *European Public Law* 653.

²² C. Zilioli, “Proportionality as the Organizing Principle of European Banking Regulation” in T. Baums et al (eds), *Zentralbanken, Währungsunion und stabiles Finanzsystem (in the honor of Helmut Siekmann)* (Berlin: Duncker & Humblot, 2019).

²³ V. Kosta, “The Principle of Proportionality in EU Law: An Interest-based Taxonomy” in J. Mendes (ed), *EU Executive Discretion and the Limits of Law* (Oxford: Oxford University Press, 2019), Ch.8, p.206.

²⁴ Chiti, Macchia and Magliari, “The Principle of Proportionality and the European Central Bank: Part I” (2020) 26 *European Public Law* 657.

We will see later that it is a rather impossible task for any institution to perform all three calculations and achieve an appropriate balance with sufficient precision and objectivity.²⁵

A bit of a theory

The previous section has argued that the application of the principle of proportionality in fact requires several computational steps. Therefore, before we proceed further it is necessary to consider in more theoretical terms how the proportionality of the impact of public policy may be measured or demonstrated. We illustrate our analysis with reference to monetary policy which is after all the subject-matter of this article.

Let us start with the primary mandate of the ESCB, which is to safeguard price stability. For ease of exposition, we simplify and consider that the ECB has a target rate of inflation indicated as π^T (“below, but close to 2%”). Moreover, we assume that the ECB has a policy instrument, m , (e.g. interest rate) which determines actual inflation π according to the following function:

$$\pi = f(m)$$

If changes in m did not affect anything else in the economy but the rate of inflation π , and if the function f were fully known and would deterministically describe the relation between m and π , then the ECB would simply set the value of m at the point that would bring actual inflation as close as possible to target π^T . If that would be the case, compliance with the principle of proportionality would require nothing more than setting the value of m at the appropriate point. A higher value would be disproportionately high, while a lower level would be disproportionately low. Let’s call this type I or “simple” proportionality. It corresponds to the criterion in the case law of doing only the “minimum necessary” to achieve a certain policy objective.

In reality, of course, the world is much more complex. First, a simple and deterministic function f does not exist and cannot be used to set the appropriate level of instrument m with certainty. Specification of such function f is difficult because of our imperfect knowledge and understanding of the transmission of any change in policy m to the final effect on π . This transmission has multiple channels and, in the end, depends on the cumulative effect of individual and uncertain reactions by companies, households, investors and speculators to changes in monetary policy.²⁶ It gives credence to the old saying that monetary policy works with “long and variable lags”.

²⁵ As noted in the introduction, findings of infringement of proportionality are very rare. In the few cases where the Court of Justice concluded that an EU institution or a Member State acted disproportionately it was not because of some incorrect “balancing” but of absolute deprivation of rights or of reliance on unjustified or inappropriate restrictions. Consider the following examples. In *Groupe Canal+ v Commission* (C-132/19 P) EU:C:2020:1007, the Court found that the Commission acted disproportionately by making Paramount’s commitments compulsory as in this way it deprived Groupe Canal+ of its contractual rights in relation to Paramount. In *Commission v Portugal* (C-126/15) EU:C:2017:504, the Court concluded that Portugal acted disproportionately by imposing a prohibition on the sale of cigarettes to prevent avoidance of higher excise taxes when no increase of taxes was foreseen. In *Danske Svineproducenter v Justitsministeriet* (C-316/10) EU:C:2011:863, the Court held that Denmark acted disproportionately by defining limits concerning the transport of animals when itself had adopted less restrictive standards.

²⁶ See, ECB, “Monetary Policy Transmission in the Euro Area” (May 2010) *Monthly Bulletin* 85–98; A. Bayer et al, “The transmission channels of monetary policy” (May 2017) Occasional Paper No.191, <https://www.ecb.europa.eu/pub/pdf/scops/ecb.op191.en.pdf> [Accessed 30 October 2021]. See also the diagram on monetary policy transmission on the ECB website: <https://www.ecb.europa.eu/mopo/intro/transmission/html/index.en.html> [Accessed 30 October 2021].

Secondly, the transmission channels themselves are not immutable. They change as the economy develops, technology evolves and the behaviour of economic actors adjusts. For example, in the current period, where interest rates are at zero, central banks have had to change their monetary policy instrument from interest rates to asset purchases—the so-called unconventional monetary instruments or “quantitative easing”—creating in turn different transmission channels.²⁷

Thirdly, the economy is not deterministic but stochastic. Unpredictable shocks to the system or events make the impact of a policy change today on future inflation difficult to estimate. At any time in the transmission period, new events influence the relation between policy instrument and inflation outcome. For the reasons explained above, even when we only consider the relation between m and π , in practice it cannot be stated with much precision whether a monetary policy change is proportional or not.

The complexity of policy implementation further increases when bearing in mind that a monetary policy aimed at price stability may have additional effects on other socio-economic outcomes. In traditional monetary policy analysis, this is reflected in the co-called “Taylor” rule. The Taylor rule links the optimal interest rate to both deviations of inflation from the “target” and to the level of output of the real economy. In other words, The Taylor rules is an indicator of the trade-off between inflation and output. Therefore, central banks do have to take at least some other economic effects of monetary policy into account when setting their policy rate.²⁸

The economy is an integrated whole, so it is not surprising at all that monetary policy affects non-monetary or economic policy factors.²⁹ For example, the International Monetary Fund reported recently that the injection of very cheap liquidity in major industrialised countries to combat the Covid-19 pandemic has also shored up companies that would have otherwise gone bankrupt. Keeping alive artificially these so-called “zombie” companies is an undesirable effect of much needed support for the economy.³⁰ Similarly, monetary policy choices typically have distributional effects across as well as within countries. The current low interest policy for instance benefits borrowers, while it hurts savers, like pensioners and pension funds—but these spill-over effects do not necessarily have an overall negative impact on the economy as a whole. Low interest rates stimulate investment which fuels growth and generates jobs.

That monetary policy can impact on the real economy is recognised in the TFEU which states in art. 127 that,

“...without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union [...] as laid down in Article 3 of the Treaty on European Union. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources”.

Recently, has begun on another linkage between monetary policy and economic policy: i.e. whether monetary policy should take climate change into account.³¹

²⁷ See M. Joyce et al, “The United Kingdom’s Quantitative Easing Policy: Design, Operation and Impact” (2011) *Bank of England Quarterly Bulletin*.

²⁸ See J.B. Taylor, “Discretion versus Policy Rules in Practice” (1993) 39 *Carnegie-Rochester Series on Public Policy* 195–214, and V. Castro, “Can Central Banks’ Monetary Policy be Described by a Linear (Augmented) Taylor Rule or by a Nonlinear Rule?” (2011) 7 *Journal of Financial Stability* 228–246.

²⁹ In fact, the Court of Justice has also (correctly) stated that economic policy may affect monetary policy and vice versa. See the judgments in *Pringle* (C-370/12) EU:C:2012:675 and *Gauweiler* (C-62/14) EU:C:2015:400, on economic policy and monetary policy, respectively.

³⁰ See K. Allen, “Keeping Zombie Companies Alive is the Right Call” *Financial Times*, 3 February 2021. See also S. Djankov and E. Zhang, “As COVID rages, bankruptcy cases fall” (4 February 2021) *voxeu.org*, <https://voxeu.org/article/covid-rages-bankruptcy-cases-fall> [Accessed 30 October 2021].

³¹ See ECB, press release, *ECB sets up climate change centre* (25 January 2021) [ecb.eurpa.eu, https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210125_1~3fc4ebb4c6.en.html](https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210125_1~3fc4ebb4c6.en.html) [Accessed 30 October 2021].

It is in fact the presence of these externalities which the principle of proportionality focuses on. It requires EU institutions to take into account all effects of their actions. Assume, now, that in the field of monetary policy these effects, denoted by e , can also be calculated according to the following function:

$$e = g(m)$$

In addition, let us assume that social welfare, denoted by w , is a function of inflation π and all other relevant outcomes e , both of which are determined by m . That is,

$$w = h[\pi(m), e(m)]$$

If Δ denotes change, then a change in monetary instrument m , i.e. Δm , produces a change in π and e , i.e. $\Delta\pi$ and Δe . Assume that interest rate m is adjusted so as to push inflation in the right direction, and that the direct impact of $\Delta\pi$ on social welfare is positive, but we also have to take into account the indirect impact on social welfare through e . It is this indirect impact that creates the problem when we want to determine the proportionality of all of the effects caused by an intervention in the economy. Assume that the change of m , i.e. Δm , on e , i.e. Δe , eventually leads to a reduction of social welfare.³² We express this as:

$$\Delta w_{\pi}(\Delta m) > 0 \text{ and } \Delta w_e(\Delta m) < 0$$

In this case, the ECB would act proportionally only if, in absolute terms,

$$\Delta w_{\pi}(\Delta m) > \Delta w_e(\Delta m)$$

This is what may be called type II or “strict” proportionality. The positive effects outweigh the negative effects or as the ECJ expressed it “the disadvantages caused must not be disproportionate to the aims pursued”.³³

The key question then is whether the ECB is able to make such evaluation. Most likely the answer is no, as quickly becomes clear when we consider the way monetary policy is implemented. In principle, the ECB Governing Council takes monetary policy decisions with a six-week frequency. Prior to these meetings, the ECB staff prepare the so-called macroeconomic projections, using a wide range of mathematical and statistical models and forecasting techniques.³⁴ Then,

“... the outcome of the macroeconomic projection exercises conducted by Eurosystem/ECB staff is presented to the Governing Council as an input to its monetary policy deliberations. The Governing Council then makes its own overall assessment of the economic situation and outlook, as well as of the risks to medium-term price stability, using all the information available to it, including the Eurosystem/ECB staff projections”.³⁵

The bottom line is that the making of monetary policy decisions by the ECB is a mix of quantitative (model) and qualitative assessments, taking into account as many economic and financial developments as possible. In particular, information is collected on the external, global, economic and financial environment, and on the internal Eurozone developments with focus on the labour market (unemployment),

³² If the impact of Δm on Δe increases social welfare, then there is no issue.

³³ See *Afton Chemical* (C-343/09) EU:C:2010:419 at [45].

³⁴ See ECB, *A guide to the Eurosystem/ECB staff macroeconomic projection exercises* (July 2016).

³⁵ ECB, *A guide to the Eurosystem/ECB staff macroeconomic projection exercises* (July 2016), p.2.

prices and costs, financial markets, money and credit, and fiscal policy. Some of the models used focus on only one specific market or variable, while others try to describe a broader segment of the economic system.

Despite all of this, no model—or policymaker—has the knowledge to compare all possible competing interests in the economy, let alone measure them quantitatively. Typically, issues like income and wealth inequality, health, environmental and climate change effects, to name a few, cannot be captured by these models. Obviously, the ECB is well aware of this and is continuously trying to update and broaden the models and approaches it uses.³⁶

Since the financial crisis more than a decade ago, the ECB has been given a new role in safeguarding financial stability in general and in banking supervision in particular, next to its original mandate of price stability. This deserves separate attention here. In the end, the ECB Governing Council is responsible and accountable both for monetary policy decisions and for supervisory decisions related to financial stability. The governance and decision-making process differs, however. The ECB Governing Council takes monetary policy decisions itself based on preparatory work and previous decisions. On the other hand, draft supervisory decisions are taken by the Supervisory Board—which is an internal ECB body—and are subject to the “no-objection” procedure. The latter entails that the draft decision becomes final if the Governing Council does not object within a certain time frame. This governance structure has been chosen specially to ensure some distance between the two as their optimal policy setting may conflict in some situations. Implicitly, it admits that there can also be a trade-off between economic (price) stability and financial stability. For example, the ECB may be tempted to inject excess liquidity into the economy causing higher inflation but at the same time helping one or more struggling banks to avoid bankruptcy and ensure financial stability. The latter is achieved at the expense of price stability. We see that, despite the formal separation between monetary policy and financial supervision, there can be a close relationship between the two and, therefore, the optimum policy balance may be difficult to pre-define in any meaningful manner, let alone confirm empirically.

In summary, the strict form of proportionality is possible in narrow sectors or for narrow tasks such as limiting the size of nets to help fish stocks to recover or building a tunnel to prevent noise pollution to surrounding urban areas or lowering the speed limit to reduce car emissions, but it is neither theoretically achievable, nor practically feasible in the complex and uncertain context the ECB’s decisions on monetary policy that affects the whole of the economy. In fact, compliance even with the simple form of proportionality is not an easy task, in view of the uncertainty and trial-and-error of responses to changes in the structure of the economy and behaviour of economic agents.

Indeed, given the inherent uncertainty and incomplete knowledge of the functioning of monetary policy, the only way to demonstrate that a decision or the use of a policy instrument is disproportional is ex post assessment of whether it has over- or under-reached its objective. Therefore, the only meaningful statement that can be made ex ante is whether a decision or the use of a policy instrument is “manifestly” inappropriate because, for example, it is discriminatory or obviously wrong by targeting something completely outside the monetary policy field. The very few cases where the ECJ has found breach of the principle of proportionality lends credence to the view that it is difficult to prove ex ante that an intervention is disproportional.³⁷

Yet, we will see in the following sections that the ECJ applied the simple but not the strict form of proportionality to monetary policy in its judgments in the *Gauweiler* and *Weiss* cases. This in itself is not a problem, except that the Court in other cases defined proportionality both in its simple and strict form.

³⁶ See V. Constâncio, Opening speech at the Annual ECB Research Conference, Frankfurt am Main, *Developing models for policy analysis in central banks* (25–26 September 2017).

³⁷ See Chiti, Macchia and Magliari, “The Principle of Proportionality and the European Central Bank: Part II” (2020) 26 *European Public Law* 869, and fns 7 and 20.

Moreover, as we will also see below, the ECB itself, rather confusingly, refers to both the simple and strict form of proportionality, even though, as explained above, the latter is largely unattainable. Perhaps the ECB simply pays lip service to the strict form to mollify its critics.

The Court's approach in *Gauweiler* and *Weiss*

In this section, we review the interpretation of the principle of proportionality by the ECJ in the *Gauweiler* and *Weiss* cases both of which concerned the exercise of monetary policy by the ECB.³⁸ We will show that the Court's analysis was incomplete.³⁹

The ECJ began its assessment in *Gauweiler* of whether unconventional monetary measures adopted by the ECB/ESCB were proportional, by pointing out that,

“(66) it follows from Articles 119(2) TFEU and 127(1) TFEU, read in conjunction with Article 5(4) TEU, that a bond-buying programme forming part of monetary policy may be validly adopted and implemented only in so far as the measures that it entails are proportionate to the objectives of that policy.”

Then it recalled the meaning of the concept of proportionality:

“(67) In that regard, it should be borne in mind that, according to the settled case-law of the Court, the principle of proportionality requires that acts of the EU institutions be appropriate for attaining the legitimate objectives pursued by the legislation at issue and do not go beyond what is necessary in order to achieve those objectives”.

At this point, the Court cited *Association Kokopelli*.

Then it made two qualifications. First, it acknowledged the discretion enjoyed by the ESCB and explained how that affected the Court's review:

“(68) As regards judicial review of compliance with those conditions, since the ESCB is required, when it prepares and implements an open market operations programme of the kind announced in the press release, to make choices of a technical nature and to undertake forecasts and complex assessments, it must be allowed, in that context, a broad discretion”.

Here the Court cited several judgments including *Afton Chemical*.

³⁸We do not review the judgment of the German Federal Constitutional Court in the corresponding cases. For analysis of the judgment in the *Weiss* case which caused more controversy, please see F. Mayer, “The Ultra Vires Ruling: Deconstructing the German Federal Constitutional Court's PSPP decision of 5 May 2020” (2020) 16 *European Constitutional Law Review* 733–769; P. Nicolaides, “An Assessment of the Judgment of the Federal Constitutional Court of Germany on the Public Sector Asset Purchase Programme of the European Central Bank” (2020) 47 *Legal Issues of Economic Integration* 267–288; F. Amtenbrink and R. Repasi, “The German Federal Constitutional Court's Decision in Weiss: A Contextual Analysis” (2020) 45 E.L. Rev. 757–778; P. Koutrakos, “Longing for Less Interesting Times? The German Federal Constitutional Court and the Supremacy of EU Law” (2020) 45 E.L. Rev. 293–294; M. Höpner, “Proportionality and Karlsruhe's Ultra Vires Verdict: Ways Out of Constitutional Pluralism?” MPIfG Discussion Paper No.21/1, Max Planck Institute for the Study of Societies, Cologne; F. Annunziata, “Cannons over the EU Legal Order: The Decision of the BVerfG (5 May 2020) in the Weiss Case” (202) 28 *Maastricht Journal of European and Comparative Law* 123–142; O. Scarcello, “Proportionality in the PSPP and Weiss Judgments: Comparing Two Conceptions of the Unity of Public Law” (2021) 13 *European Journal of Legal Studies* 1–14.

³⁹For different perspectives see T. Tridimas and N. Xanthoulis, “A Legal Analysis of the Gauweiler Case” (2016) 23 *Maastricht Journal of European and Comparative Law* 17–39; P. Craig and M. Markakis, “Gauweiler and the Legality of Outright Monetary Transactions” (2016) 41 E.L. Rev. 4–24; A. Mooij, “The Weiss Judgment” (2019) 26 *Maastricht Journal of European and Comparative Law* 449–465. A. Bobic and M. Dawson, “Court of Justice Quantitative Easing at the Court of Justice—Doing Whatever it Takes to Save the Euro: *Weiss* and Others” 56 C.M.L. Rev. 1005–1040.

Secondly, because of the wide discretion enjoyed by the ESCB, the Court considered necessary that the ESCB complied with certain procedural safeguards:

“(69) Where an EU institution enjoys broad discretion, a review of compliance with certain procedural guarantees is of fundamental importance. Those guarantees include the obligation for the ESCB to examine carefully and impartially all the relevant elements of the situation in question and to give an adequate statement of the reasons for its decisions.”

The Court went on, in [72]–[80], to find that the measures adopted by the ESCB were an appropriate response to the financial crisis that broke out in 2008. In particular it noted that even though the analysis of the ESCB,

“(75) has been subject to challenge does not, in itself, suffice to call that conclusion [that it was well reasoned] into question, since, given that questions of monetary policy are usually of a controversial nature and in view of the ESCB’s broad discretion, nothing more can be required of the ESCB apart from that it use its economic expertise and the necessary technical means at its disposal to carry out that analysis with all care and accuracy.”

Then the Court examined whether the measures adopted by the ESCB did not go beyond what was necessary. In [81]–[90], the Court found the measures not to go beyond what was necessary because the ESCB had adopted restrictive eligibility criteria for its prospective purchases of government bonds and defined limits to its intervention.

However, it must be noted that the Court identified restrictive criteria and limits without actually assessing whether those criteria and limits ensured that the intervention was the minimum necessary. The fact that there exists a limit, does not automatically mean that if the intervention remains below the limit it is necessarily proportional in the light of its objective. If, for example, the ECB commits not to buy more than 30 per cent of government bond issue does not by itself guarantee that its purchases will not have a disproportional influence on bond prices.

Next, the Court referred to the “weighing”, i.e. the balancing, of different interests. Yet, in its definition of proportionality in para.67, the Court identified only two components: appropriateness and not going beyond what is necessary. The Court dealt with the issue of “weighing” in a mere sentence by stating that,

“(91) the ESCB weighed up the various interests in play so as to actually prevent disadvantages from arising, when the programme in question is implemented, which are manifestly disproportionate to the programme’s objectives.”

It is not explained in the judgment what those interests were, how the ESCB carried out the weighing, how it prevented disadvantages and how their “manifestly disproportionate” nature was established.

In *Weiss* the Court again examined whether measures adopted by the ECB/ESCB in the context of monetary policy were proportional.⁴⁰ It began its analysis by repeating the definition of proportionality in *Gauweiler* and cited *Gauweiler*, but this time it substituted “appropriateness” for “suitability”.⁴¹ Then it restated that the ESCB must be allowed “broad discretion”, without, however, referring to procedural safeguards.⁴²

The Court considered the measures in question to be a suitable response to the economic impact of the financial crisis.⁴³ It found the measures not to go beyond what was necessary, primarily because,

⁴⁰ *Weiss* (C-493/17) EU:C:2018:1000.

⁴¹ *Weiss* (C-493/17) at [72].

⁴² *Weiss* (C-493/17) at [72].

⁴³ *Weiss* (C-493/17) at [74]–[78].

“in view of the foreseeable effects of the PSPP [Public Sector Asset Purchase Programme] and given that it does not appear that the ESCB’s objective could have been achieved by any other type of monetary policy measure entailing more limited action on the part of the ESCB, it must be held that, in its underlying principle, the PSPP does not manifestly go beyond what is necessary to achieve that objective.”⁴⁴

Please note that the absence of other monetary policy measure with smaller effects does not automatically entail that the effects of the PSPP (the measure in question) did not go beyond what was necessary. However, the Court also considered that an intervention of small size or shorter duration would not have been as “effective” as the PSPP.⁴⁵ This illustrates that whether a measure is proportional critically depends on what its desired effects are. A measure is proportional or disproportional only against the benchmark of what is intended to achieve.

Next, the Court reviewed the various criteria and limits of the PSPP which, in its view, corroborated the finding that the PSPP was proportional and, as in *Gauweiler*, reiterated that, given the “broad discretion” of the ESCB, the fact that the PSPP was controversial did not prove that the ESCB had committed a “manifest error”.⁴⁶

Lastly, the Court found that the ESCB had “weighed up the various interests involved so as effectively to prevent disadvantages which are manifestly disproportionate to the PSPP’s objective”.⁴⁷ As in *Gauweiler*, it is not explained how this weighing was achieved or how the Court was persuaded that it was achieved. However, this time the Court referred to potential losses which were minimised by the limits of the PSPP and concluded that the “ESCB duly took into consideration the risks”.⁴⁸ Nonetheless, these considerations are not equivalent to weighing of “various interests” because they concern only the interest of the ESCB to avoid losses in case of a fall in the price of bonds. More importantly, the limitation of this kind of losses was a direct consequence of the limited purchases of government bonds voluntarily assumed by the ESCB so as not to violate art.123 TFEU, which prohibits monetisation of public debt. The very essence of weighing implies that the form and/or size and/or duration of intervention is adjusted so that it does not harm excessively something or someone else. At the most what can be said is that the ECB put an upper limit to its potential losses by not buying too many bonds of any particular issue or country, not that it weighed the impact of its intervention, for example, on savers.⁴⁹ We will see in the next section that the ECB does claim that it considers all effects of monetary policy. The point is that it is not obvious how that is done in practice and whether what is done amounts to weighing. Given the theoretical difficulty of weighing disparate effects across the economy, such claims should be received with scepticism.

The following three conclusions can be drawn from the judgments in *Gauweiler* and *Weiss*. First, the principle of proportionality applied by the Court has three components: appropriateness, not going beyond the minimum necessary (proportionality *stricto sensu*) and weighing of interests.

Secondly, the findings of the Court with respect to proportionality *stricto sensu* can satisfy type I (simple) proportionality, especially in the case of *Weiss*, but do not satisfy type II (strict) proportionality.

⁴⁴ *Weiss* (C-493/17) EU:C:2018:1000 at [81].

⁴⁵ *Weiss* (C-493/17) at [92].

⁴⁶ *Weiss* (C-493/17) at [82]–[90].

⁴⁷ *Weiss* (C-493/17) at [93].

⁴⁸ *Weiss* (C-493/17) at [98].

⁴⁹ An anonymous referee has suggested that the Court of Justice referred to “weighing” because in both judgments it was responding to the questions and concerns of the German Federal Constitutional Court. Although, this may indeed be so, the judgments do not explain why the Court addressed the issue of weighing or how the weighing could be inferred from its definition of proportionality.

Thirdly, the weighing of interests is reduced to a discussion of the possible effects of monetary instruments other than the intended ones, without any indication of the weight or significance attributed to those effects.

The review carried out by the ECJ does not appear to assess sufficiently all the components of the principle of proportionality, especially the weighing of interests. It seems unlikely that the review by EU courts can be improved because it is probably impossible for monetary policy to comply with the requirements of type II (strict) proportionality (see the analysis in the next two sections).

Before concluding this section, it is necessary to point out that in both *Gauweiler* and *Weiss*, the ECJ did not examine how price stability, which is the “primary objective” of monetary policy, may affect the assessment of the proportionality of monetary instruments.⁵⁰ The ECB had to implement “unconventional” monetary instruments because other instruments were unable to pull the Eurozone economy out of its slump and bring the rate of inflation to its target of 2 per cent. According to Eurostat, the rate of inflation in the Eurozone has remained persistently below 2 per cent since 2009, with only a few exceptions in 2011, 2012 and most recently in the first half of 2021 as a result of the rebounding of spending as the pandemic is brought under control. If the primary task of the ECB is to reach its inflation target by constantly injecting liquidity in the economy through both conventional and unconventional means which are determined by the Court to be appropriate for that purpose, in what sense can they be deemed to be disproportionate when they cannot yet bring inflation rate to 2 per cent? How can there be a balancing of different interests if price stability is the primary objective, which implies that it supersedes other concerns? The Court did not answer these questions, as its assessment was framed by the questions of the referring German court.⁵¹

The next section examines how the ECB itself justifies compliance with the principle of proportionality.

How does the ECB understand and comply with the principle of proportionality?

In a speech in 2019 at the conference on the “ECB and its Watchers XX”, Yves Mersch, member of the ECB’s Executive Board, provided an extensive and detailed defence of the proportionality of monetary policy.⁵² Accordingly,

“for monetary policy, proportionality implies that the ECB’s actions must, first, be suitable to address the identified risks to price stability. Second, the ECB’s measures must be necessary to achieve their intended objective. In other words, alternative monetary policy measures that entail more limited action would not enable the objective to be achieved as effectively and rapidly. Third, proportionality *stricto sensu* implies that the expected benefits of the ECB’s actions must outweigh their costs. These principles provide for a hierarchy of tools, where unconventional measures should be used only once conventional measures have been exhausted.”⁵³

⁵⁰ Karin Kaiser of the ECB has argued that “if there is a conflict between price stability, which is primarily concerned with the business cycle, and financial stability, which is more concerned with the financial cycle, and some trade-off between the two is required, the Treaties require primacy to be given to price stability. Financial stability cannot take precedence over price stability.” See K. Kaiser, “The objective of price stability and the principle of an open market economy: what trumps?”, ESCB Legal Conference (2018), p.16.

⁵¹ It should be noted that in its judgment in *Weiss*, the FCC employed a much more expansive definition of proportionality. Given the difficulty of satisfying even the simple form of proportionality, the FCC in effect set up an impossible test for the ECB. See P. Nicolaidis, “The Judgment of the Federal Constitutional Court of Germany on the Public Sector Asset Purchase Programme of the European Central Bank: Setting an Impossible and Contradictory Test of Proportionality” (2020).

⁵² Y. Mersch, “Necessity, proportionality and probity—central bank independence in unconventional times” (27 March 2019), The ECB and its Watchers XX conference, Frankfurt am Main https://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp190327_4~4ccf5d35bc.en.html [Accessed 30 October 2021].

⁵³ Mersch, “Necessity, proportionality and probity” (27 March 2019), para.19.

The above criteria match the criteria defined by the ECJ in the case law: appropriateness or suitability, necessity and not going beyond what is necessary. However, we will see below that when it comes to weighing of interests, the ECB asserts rather than confirms that benefits outweigh costs. This is not surprising because, the ECB does not have a formula which provides it with a common unit of measure in order to calculate the magnitude of possible effects and balance them. The review of the case law in the previous section showed that the ECJ skirts around this issue too.

Mersch states, correctly, that “monetary policy always has distributional effects”⁵⁴ and that there are “undesirable but unavoidable side effects of monetary policy measures”⁵⁵. All public policies have some undesirable effects to a varying degree. This is because all public interventions disturb the status quo in the market and, consequently, affect someone’s interests.

Mersch goes on to stress, again correctly, that “any distributional consequences of monetary policy action need to be set against the distributional consequences of *inaction*.”⁵⁶ Indeed, if the consequences are more severe in the alternative scenario of inaction, then the ECB intervention in a way kills two birds with one stone: It achieves price stability and reduces adverse distributional consequences. However, if the distributional consequences in the alternative scenario of inaction are less severe, then an inevitable trade-off between price stability and undesirable side effects arises.

In this connection, he points out that “the ECB also attempted to minimise unwanted side effects by carefully designing our tools.”⁵⁷ “We established many safeguards and restrictions, particularly in our public sector purchase programme, to avoid interfering with fiscal and economic policy and providing monetary financing to governments.”⁵⁸ He concludes that “while our unconventional measures undoubtedly have side effects, the essential point is that these side effects are not manifestly disproportionate to the primary objective of the measures — contributing to price stability.”⁵⁹

His conclusion is not controversial. Unconventional measures, like conventional measures, have side effects. As already explained, this is true of any public policy. It may be possible for the ECB to reduce side effects by appropriate design of monetary instruments. However, there is nothing deterministic in the conduct of monetary policy that guarantees that the distributional consequences associated with price stability are necessarily less severe than in alternative scenarios.

Therefore, it is important to note that achieving price stability without causing unnecessary or excessive distributional effects is not the same as claiming that the distributional effects with price stability are lower than if no action is taken. It is also important to note that, given the absence of a measure of social welfare that takes into account all possible effects of monetary policy in the economy, achieving price stability at the lowest possible side effects is not the same as proving that the “expected benefits of the ECB’s actions ... outweigh their costs”,⁶⁰ as was claimed at the beginning of Yves Mersch’s speech.

Nevertheless, the ECB official explanation is that its instruments are proportional to their objective. The need to demonstrate compliance with the principle of proportionality became more urgent in early 2020, as the ECB responded to the economic impact of the Covid-19 pandemic by launching the Pandemic Emergency Purchase Programme (PEPP). The ECB committed initially EUR 750 billion which by the end of 2020 was raised to EUR 1850 billion.⁶¹ By any standard, this is intervention on a grand scale. Recently, Yves Mersch, reiterated in relation to the PEPP that,

⁵⁴ Mersch, “Necessity, proportionality and probity” (27 March 2019), para.22.

⁵⁵ Mersch, “Necessity, proportionality and probity”, para.37.

⁵⁶ Mersch, “Necessity, proportionality and probity”, para.24.

⁵⁷ Mersch, “Necessity, proportionality and probity”, para.25.

⁵⁸ Mersch, “Necessity, proportionality and probity”, para.26.

⁵⁹ Mersch, “Necessity, proportionality and probity”, para.29.

⁶⁰ Mersch, “Necessity, proportionality and probity”, para.19.

⁶¹ More information on the PEPP at <https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html> [Accessed 30 October 2021].

“the proportionality assessment of the PEPP must be supported by economic analysis which shows that the measure: (i) is suitable for attaining the monetary policy objective in current and future environments; (ii) does not go beyond what is necessary in order to achieve this objective; and (iii) weighs up the various interests involved to prevent any disadvantages which are manifestly disproportionate to the objectives set.”⁶²

He then contended that “the PEPP complies with the proportionality principle as it is both suitable and necessary to attain the monetary policy objective.”⁶³

Explanation of conformity with the principle of proportionality in ECB decisions

In view of the legal significance of the principle of proportionality, it is rather surprising that the Annual Reports of the ECB are largely silent on whether monetary policy conforms with that principle. The exception is the 2018 Annual Report which referred to the judgment of the ECJ in the *Weiss* case. In this connection, the ECB stated that in deciding to launch the PSPP it,

“weighed up the various interests involved so as to actually prevent disadvantages which are manifestly disproportionate to the PSPP’s objective from arising on implementation of the programme.”⁶⁴

There is no explanation of how the weighing was done, what the “various interests” were and how precisely it was determined that “disadvantages” were manifestly disproportional.

A more detailed explanation can be found in the “monetary policy accounts” which are anonymised but extensive summaries of the deliberations of the Governing Council. Between February 2015, when the accounts were first published, and January 2021, there were 42 meetings of the Governing Council of the ECB and, therefore, 42 monetary policy accounts.⁶⁵ Careful reading of the 42 accounts reveals that only three explain whether monetary policy is compliant with the principle of proportionality.⁶⁶ These three accounts—of June 2020, December 2020 and March 2020—are examined below in order of their significance in terms of the amount of detail and length of assessment of proportionality.

The most extensive analysis of proportionality is in the monetary policy account of 3–4 June 2020, which came precisely a month after the judgment of the German Federal Constitutional Court (FCC) in the *Weiss* case. By contrast, the account of the meeting in July 2015, after the judgment in the *Gauweiler* case is silent on the issue of proportionality of monetary policy.

With respect to the *Weiss* case, as it may be recalled, the FCC ruled that the ECJ acted “ultra vires” in finding that the Public Sector Purchase Programme (PSPP) of the ECB did not violate the principle of proportionality as defined in art.5 TEU.⁶⁷

⁶² Y. Mersch, “Legal aspects of the ECB’s response to the coronavirus (COVID-19) pandemic” (February 2021), ESCB Legal Conference pp.9–17 at p.11. For different views on the ECB’s handling of the PSPP and the legality of the PEPP, please see S. Grund and F. Grle, “The European Central Bank’s Public Sector Purchase Programme (PSPP), the Prohibition of Monetary Financing and Sovereign Debt Restructuring Scenarios” (2016) 41 E.L. Rev. 781–803; A. Mooij, “The Legality of the ECB Responses to COVID-19” (2020) 45 E.L. Rev.

⁶³ Mersch, “Legal aspects of the ECB’s response to the coronavirus (COVID-19) pandemic” (February 2021), ESCB Legal Conference p.11.

⁶⁴ ECB, *Annual Report 2018* (April 2019), p.89, <https://www.ecb.europa.eu/pub/pdf/annrep/ar2018-d08cb4c623.en.pdf> [Accessed 30 October 2021].

⁶⁵ The monetary policy accounts can be accessed at <https://www.ecb.europa.eu/press/accounts/html/index.en.html> [Accessed 30 October 2021].

⁶⁶ These findings are based on the authors’ own research. A similar assessment is carried out in P. Nicolaidis, “The ECB is Responding to the Federal Constitutional Court of Germany: A Comparison of Monetary Policy Accounts” (29 June 2020) *EU Law Live.com*, <https://eulawlive.com/op-ed-the-ecb-is-responding-to-the-federal-constitutional-court-of-germany-a-comparison-of-monetary-policy-accounts-by-phedon-nicolaidis/> [Accessed 30 October 2021].

⁶⁷ Decision BverfG (2 BvR 859/15) 5 May 2020.

After the launch of the PEPP in March 2020, the ECB had to justify its magnitude. The account of the June 2020 meeting, first, explained the need for the PEPP. The account confirmed that,

“the PEPP was a measure which was proportionate to counter the serious risks to price stability, the monetary policy transmission mechanism and the economic outlook in the euro area”.⁶⁸

It went on to reiterate that purchases of government bonds under the Asset Purchase Programme (APP), PSPP and the PEPP were,

“an effective tool for delivering on the Treaty-assigned price stability objective”, “efficient, especially in combination with other policy measures” and “proportionate measures under the current conditions for pursuing the price stability objective”.⁶⁹

It acknowledged that,

“the proportionality assessment of any monetary policy measure had to consider, among other things, the degree to which the measure contributed to achieving the monetary policy objective, on the one hand, and possible unintended side effects, on the other hand. It required a judgement as to whether other policy measures were available that were as effective and efficient while offering a better balance between intended and unintended effects”⁷⁰;

“with policy interest rates close to their effective lower bound, unconventional instruments were needed”⁷¹;

“in assessing the benefits and costs of asset purchases, the relevant benchmark was not the status quo, but a counterfactual situation in which policy accommodation through asset purchases had not been provided”⁷².

In terms of their side-effects, the APP, PSPP and PEPP were claimed to “help viable businesses continue to operate”⁷³; “preserving jobs”⁷⁴; protect “the financial security of individuals and families in the euro area”⁷⁵; “net borrowers had benefited from lower interest rates”.⁷⁶

All these effects may indeed be actual, positive and realised, but it is not so clear whether and how they can be summed up to prove that they outweigh negative effects. Naturally, they cannot be simply summed up as they are very distinct effects in nature.

In fact, the account did concede that there were negative side-effects: “low interest rates might incentivise market participants to adopt excessive risk-taking behaviour”; “low interest rates ... could strain the profitability, and hence the capitalisation, of banks”; “banks financed inefficient firms”; “low interest rates were also challenging for earnings on the savings of households and insurance companies”; “net savers had seen a decline in their interest income”.⁷⁷

On the overall balance between positive and negative effects, the monetary policy account noted that

⁶⁸ ECB, Monetary policy account of meeting 3–4 June 2020, para.29 <https://www.ecb.europa.eu/press/accounts/2020/html/ecb.mg200625~fd97330d5f.en.html> [Accessed 30 October 2021].

⁶⁹ ECB, Monetary policy account of meeting 3–4 June 2020, para.34.

⁷⁰ ECB, Monetary policy account of meeting 3–4 June 2020, para.73.

⁷¹ ECB, Monetary policy account of meeting 3–4 June 2020, para.75.

⁷² ECB, Monetary policy account of meeting 3–4 June 2020, para.77.

⁷³ ECB, Monetary policy account of meeting 3–4 June 2020, para.34.

⁷⁴ ECB, Monetary policy account of meeting 3–4 June 2020, para.34.

⁷⁵ ECB, Monetary policy account of meeting 3–4 June 2020, para.34.

⁷⁶ ECB, Monetary policy account of meeting 3–4 June 2020, para.78.

⁷⁷ ECB, Monetary policy account of meeting 3–4 June 2020, para.76.

“while different weights might be attached to the benefits and side effects of asset purchases, the negative side effects had so far been clearly outweighed by the positive effects of asset purchases on the economy in the pursuit of price stability”.⁷⁸

Well, it is not so clear as claimed. Perhaps, the motive of the ECB was not so much to provide a hard proof of compliance with the principle of proportionality but to assure the FCC that it did take into account the impact of monetary policy on different groups in society. Formally, of course, the ECB is not accountable to the FCC. On the date of the judgment of the FCC the ECB put out a press releasing merely stating that it took note of the judgment and reiterating its commitment to do,

“everything necessary within its mandate to ensure that inflation rises to levels consistent with its medium-term aim and that the monetary policy action taken in pursuit of the objective of maintaining price stability is transmitted to all parts of the economy and to all jurisdictions of the euro area”.⁷⁹

The account of the meeting of 9–10 December 2020 argues that,

“the recalibration of the PEPP was proportionate to the risks facing the fulfilment of the Governing Council’s mandate. It continued to be more efficient than a rate cut in the current pandemic conditions characterised by high uncertainty.”⁸⁰

Then it concluded that “on balance, the benefits of PEPP purchases outweighed the potential costs also continued to hold”⁸¹ and that given the inflation aim the PEPP “was an appropriate and proportional response”⁸². Once more, it is not really explained how the balancing was carried out.

Lastly, the account of the meeting of 18 March 2020 claimed that “the size and duration of the [PEPP] was proportionate to the risks ... in full respect of the price stability mandate”,⁸³ “the PEPP ... was an appropriate course of policy action, proportionate to the risks faced”⁸⁴ and that “the Governing Council’s policy actions had to remain clearly within its remit and fully proportionate to the risks to the ECB’s price stability mandate.”⁸⁵

The overall conclusions that can be drawn from this review of the explanations offered by the ECB in annual reports and monetary policy accounts are the following:

First, the assessment of the proportionality of monetary policy is not an exercise that is carried out continually, or at least reported regularly.

Secondly, the ECB opts for the most effective instrument for achieving price stability, and given the objective of price stability, it tries to design it so as to reduce undesirable side-effects.

Thirdly, it is not clear how the side-effects are smaller in the factual situation in comparison to the side-effects in the counterfactual situation. The decisive element is always the effectiveness of the intervention with respect to price stability. Designing the intervention so as to reduce the size of side-effects does not prove that these side-effects are smaller than in the counterfactual situation.

⁷⁸ ECB, Monetary policy account of meeting 3–4 June 2020, para.82.

⁷⁹ ECB, press release, “ECB takes note of German Federal Constitutional Court ruling and remains fully committed to its mandate” (5 May 2020), <https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200505-00a09107a9.en.html> [Accessed 30 October 2021].

⁸⁰ ECB, Monetary policy account of meeting 9–10 December 2020, para.39 <https://www.ecb.europa.eu/press/accounts/2020/html/ecb.mg210114-14ef04b8bd.en.html> [Accessed 30 October 2021].

⁸¹ ECB, Monetary policy account of meeting 9–10 December 2020, para.39.

⁸² ECB, Monetary policy account of meeting 9–10 December 2020, para.70.

⁸³ ECB, Monetary policy account of meeting 18 March 2020, para.20 https://www.ecb.europa.eu/press/accounts/2020/html/ecb.mg200409_1-baf4b2ad06.en.html [Accessed 30 October 2021].

⁸⁴ ECB, Monetary policy account of meeting 18 March 2020, para.27.

⁸⁵ ECB, Monetary policy account of meeting 18 March 2020, para.29.

Fourthly, it is not clear how the benefits outweigh the costs of the side-effects, given that they are not comparable.

Conclusions

The ECJ has held that the ECB enjoys considerable discretion in the formulation and implementation of monetary policy and that the application of the principle of proportionality should take into account that discretion. Since there is an element of uncertainty in the implementation of monetary policy and given the incomplete models with which central banks steer the economy, it is right that the ECB has been granted that kind of discretion. The corollary of that uncertainty and incompleteness is that the ECB and other central banks need to experiment to calibrate their instruments and adjust them as the underlying economic conditions change. In principle, therefore, criticism of the ECB that its actions are disproportional miss the point that it may have to go beyond preconceived boundaries in order to discover the extent of the effectiveness of its monetary instruments. The fact that opinions on monetary policy vary should not be a relevant issue with respect to the legal limits of the ECB's discretion, unless the ECB does something that is "manifestly" wrong or discriminatory.

This article has reviewed a large body of evidence to conclude that, in an uncertain and evolving economic environment, it is probably impossible for the ECB to conform with a strict interpretation of the principle of proportionality. Even conformity with the simpler interpretation of the ECJ is not fully explained in the seminal judgments in the *Gauweiler* and *Weiss* cases. This incomplete explanation is especially true with respect to the weighing of divergent interests. Since the ECJ is satisfied with the limits that the ECB has imposed on its interventions and with the statements of the ECB that conflicting interests are taken into account without demanding more detailed proof, the ECB is unlikely to change its approach and will continue to use unconventional instruments to achieve price stability at a rate of inflation close but below 2 per cent.

One may conclude that all is well that ends well. However, the current state of legal interpretation of proportionality is too fluid and exposes the ECB to continuous legal challenges such as those launched before the FCC, especially given the fact that the notion of proportionality used by the FCC is much wider than that in the case law of the ECJ.

An appropriate resolution of this unsatisfactory state of affairs from the perspective of legal compliance and certainty would not be for the ECJ, like the FCC, to demand more detailed proof when there is no credible scientific evidence that such proof can be provided, but to reconsider the application of the principle of proportionality to monetary policy. Apart from recognising the discretion enjoyed by the ECB, the ECJ has still to acknowledge that the principle of proportionality cannot be applied in a straightforward manner to monetary policy. Perhaps an institution such as the ECB should be censured only when, in the exercise of its discretion, it commits a "manifest error" that obviously goes beyond what is necessary.