

The German Federal Constitutional Court (Bundesverfassungsgericht) submitted an order for referral to the European Court of Justice (CJEU) in 2014, asking it to clarify the compatibility of the “Outright Monetary Transactions” (OMT)-Programme with European Union law. The OMT-Programme prepares the ground for the selective purchasing of government bonds of crisis-struck Member States of the European Monetary Union (EMU). A year later, the CJEU decided that the OMT-Programme is covered by the mandate of the European Central Bank (ECB) and does not violate the prohibition of the monetary financing of Member States. Concerns raised by the Federal Constitutional Court were only partially addressed. Now the ball has been passed back to the Federal Constitutional Court.

In this study, the Kronberger Kreis, Scientific Council of the Stiftung Marktwirtschaft, explains why the CJEU’s reasoning would have irreversible consequences, if the German Federal Constitutional Court were to follow. The CJEU’s judgment dismantles the boundaries of the ECB’s monetary policy mandate and significantly weakens the prohibition of the monetary financing of Member States in the long run. Effective judicial review of the scope of the ECB’s competence would no longer be guaranteed. An act of crisis intervention by the ECB threatens to irrevocably turn the future structure of the EMU into the wrong direction.

Nonetheless, the Federal Constitutional Court remains obliged to execute its ultra vires control in an EU-friendly manner. A rupture in the cooperative relationship between the German Federal Constitutional Court and the CJEU could have far-reaching consequences, especially considering the current crisis-riddled state of the EU. The Federal Constitutional Court may therefore want to follow the operative part of the CJEU’s judgment, but base it on a different legal reasoning, so as to reserve itself the possibility for future judicial review of the acts of the ECB based on more demanding legal standards than those laid out by the CJEU.

“More courage for the market” is the slogan of the Kronberger Kreis. Thwarting the expansion of the paternalistic state and contributing to the advancement of free society in Germany and Europe using consistent market-oriented ideas: these are the goals of the Kronberger Scientific Council (Kronberger Kreis) which was founded in 1982. Its proposals have a significant influence on economic and political discussion in Germany.



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## Dismantling the Boundaries of the ECB’s Monetary Policy Mandate

### The CJEU’s OMT Judgement and its Consequences



Kronberger Kreis

Lars P. Feld, Clemens Fuest, Justus Haucap,  
Heike Schweitzer, Volker Wieland, Berthold U. Wigger

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Stiftung Marktwirtschaft (Ed.)  
Charlottenstraße 60  
10117 Berlin  
Telefon: +49 (0)30 206057-0  
Telefax: +49 (0)30 206057-57  
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	Executive summary	5
I	The ECB's mandate and its limitations – an introduction	7
II	The adoption of OMT by the ECB	11
III	The proceedings before the Federal Constitutional Court	15
IV	The CJEU's OMT judgement – a critical appraisal	17
	1 Judicial review of the actions of the ECB	17
	2 Has the ECB exceeded the EU primary law limitations of its mandate with its OMT decision?	18
	3 Does OMT violate the prohibition of monetary financing of the Member States?	28
V	What's next?	33

## Executive summary

The sovereign debt crisis of 2008 caused many to doubt the continued existence of the European Monetary Union (EMU). Today, its legal foundations are at risk.

In the EMU, monetary policy has been centralized and placed in the hands of the European System of Central Bank (ESCB). The primary goal of monetary policy is price stability. Economic policy has remained in the hands of the Member States, but is coordinated by the European Union. Within this framework, the fiscal policies of the individual Member States are constrained by the markets for government bonds, which are meant to have a disciplining effect. Any repayment of debt by other Member States (“Bail-Out”) and any monetary financing of Member States by the European Central Bank (ECB) are prohibited.

By interpreting the No Bail-Out Clause restrictively, the Court of Justice of the European Union (CJEU) found the creation of the European Stability Mechanism (“ESM”) to be legitimate and compatible with EU law in its *Pringle* judgement of 2012. When the interest rates of the government bonds of crisis-struck Member States continued to rise nonetheless the ECB decided to intervene. In the pending case on the ECB’s “Outright Monetary Transactions” Programme (OMT), the German Federal Constitutional Court (Bundesverfassungsgericht) must now clarify the limits of the ECB’s competences and the content of the prohibition of monetary financing of the Member States. For the first time in its history, the Federal Constitution Court made an order for referral to the CJEU. In its judgement of 16<sup>th</sup> June 2015 (C-62/14) the CJEU declared the OMT programme to be compatible with European Union law. Now the ball has been passed back to the Federal Constitutional Court.

In the opinion of the *Kronberger Kreis*, the scientific advisory board of the *Stiftung Marktwirtschaft*, the CJEU’s judgement dismantles the limitations of the ECB’s monetary policy mandate. The CJEU does agree that acts of the ESCB are subject to judicial review. Yet, its finding that the ESCB’s competences encompass the rectification of disruptions in the monetary policy transmission mechanism and the uniform transmission of monetary policy signals into each Member State is bound to lead to systematic and continuous intrusions into the field of economic policy. The non-uniform impact of monetary policy measures in different Member

States can, *inter alia*, be the result of differences in the importance of their economic sectors, which is a manifestation of an open market economy with free competition. It can also stem from different ways of regulating financial, labour and goods markets, all of which fall within the responsibilities of the Member States. Hence, a common monetary policy does not need to result in the ECB making sure that monetary policy signals have the same effect in all Member States. This would override the market discipline on financial markets that exists within the system of the EMU by virtue of its legal design. Market discipline cannot be replaced with the conditionality of stability and adjustment programmes.

The OMT programme was aimed directly at the preservation of the current composition of the euro area – an aim that does not fall within the scope of monetary policy. Where the limitations of the ECB's monetary policy mandate dissolve, the legitimacy of the ECB as an independent institution is bound to vanish. The more intertwined monetary and economic policies become, the more the relationship between the ECB, the euro area Member States and the EU becomes one of political cooperation, and the primacy of price stability will be overshadowed by other policy goals.

With the selective purchase of government bonds that yield higher and unsecured risks, the prohibition of the monetary financing of the Member States, which is meant to ensure market discipline on the euro area Member States, is undermined. The CJEU has interpreted this prohibition so narrowly that it can no longer fulfill its central function.

However, the *Kronberger Kreis* also acknowledges the perils that would be associated with a full rupture in the cooperative relationship between the CJEU and the Federal Constitutional Court. The Federal Constitutional Court is obliged to execute its ultra-vires control in an EU-friendly manner and must not jeopardise the existence of the EU as a legal community. The Federal Constitutional Court may therefore choose to follow the operative part of the CJEU's judgement, but base its ruling on an autonomous reasoning. It could then use its judgements to lay out more demanding legal standards and retain scope for future judicial review of the measures and acts of the ECB.

## I The ECB's mandate and its limitations – an introduction

In the European Monetary Union (EMU), the European System of Central Banks (ESCB) has been assigned the task of setting and executing the EMU's monetary policy (Art. 127 (2) TFEU). The primary aim of this mandate is to maintain price stability (Art. 127 (1); Art. 119 (2) TFEU). Without prejudice to, and only in so far as price stability is maintained, the ESCB supports the general economic policies of the EMU. Art. 130 TFEU guarantees the independence of the European Central Bank (ECB) and the other members of the ESCB from instructions or any other influences of other Union institutions, governments of the Member States or other bodies.

In an Economic and Monetary Union that has placed the competence for monetary policy with the ESCB whilst the economic and budgetary policy competences remain with the Member States, it is crucial to have rules to coordinate and control the economic and budgetary policies of the Member States. In addition, a clear distinction is needed between monetary policy on the one hand and budgetary and economic policies on the other. One of the basic principles of the EMU is the disciplining function capital markets perform to restrain national budgetary policies. Member States shall not rely on budgetary guarantees by the Union or other Member States (“No Bail-Out Clause”, Art. 125 (1) TFEU) or on funding from central banks (prohibition of monetary financing of Member States, Art. 123 TFEU).<sup>1</sup> Hence, interest rates on government bonds may vary depending on the fiscal performance and conduct of the Member State in question. Neither the ESCB nor the governments of the Member States shall interfere with this disciplining function of the capital markets. Legally, the functional principle of market discipline is supplemented by the excessive deficit procedure (Art. 126 TFEU) and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (also called the “European Fiscal Compact”) from 2013.<sup>2</sup>

The sovereign debt crisis has put the integrity and the legal foundations of the EMU at risk. Applying a very narrow interpretation of Art. 125 TFEU, the Court of Justice of the European Union (CJEU) has found the creation of the European

<sup>1</sup> Opinion of General Advocate Kokott, para. 129 et seq., in Case C-370/12, 27.11.2012, *Thomas Pringle v Government of Ireland*.

<sup>2</sup> Treaty on Stability, Coordination and Governance in the EMU, TSCG, of 02.03.2012.

Stability Mechanism (ESM) by the euro area countries to be in line with the No Bail-Out Clause in 2012.<sup>3</sup> When the interest rates for government bonds of crisis-struck Member States continued to rise in spite of various rescue measures, the ECB decided to intervene. In his famous speech of 26<sup>th</sup> July 2012, the president of the ECB, Mario Draghi, announced that the ECB was ready to do “whatever it takes to preserve the euro.” On 6<sup>th</sup> September 2012, the ECB Council decided on the basic criteria for its Outright Monetary Transactions (OMT) programme, which it had heralded at a press conference in August 2012. With the announcement of this programme, the ECB declared its principle willingness to purchase government bonds of crisis-struck Member States on secondary markets on a large scale. The purchase of government bonds on the secondary market is, however, subject to a condition of compliance with a macroeconomic adjustment programme of the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM) – so-called “conditionality”.

While the intervention of the ECB brought about a turnaround in interest rates, it also stretched the limits of its mandate – many would argue, too far. Under reservation of a possibly narrow interpretation of the OMT programme, the majority of the judges of the Second Senate of the German Federal Constitutional Court (*Bundesverfassungsgericht*) found that the ECB had exceeded its mandate. For the first time in its history, the Federal Constitutional Court submitted a referral to the CJEU and asked it to clarify the compatibility of the OMT programme with European Union law.<sup>4</sup>

While the CJEU, in its ruling of 16<sup>th</sup> June 2015,<sup>5</sup> confirmed that acts of the ESCB are subject to judicial review, we show that the lines of reasoning that the CJEU develops to determine the scope of the competences of the ESCB and the admissibility of its action will not allow for effective judicial review of the ESCB's actions in the future.

Now the ball has been passed back to the Federal Constitutional Court. It is faced with a daunting decision. Should it decide to break with the reasoning laid out by the CJEU it jeopardises its already tricky cooperative relationship with the CJEU. This could have severe consequences for future cooperation between the high courts in the European Union.

<sup>3</sup> Case C-370/12, 27.11.2012, *Thomas Pringle v Government of Ireland*.

<sup>4</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 134, 366 (369) – “Order for reference OMT”.

<sup>5</sup> Case C-62/14 *Peter Gauweiler and Others v Deutscher Bundestag*, 16.06.2015 (OMT).

If, however, the Federal Constitutional Court sets its doubts aside, the crisis interventions of the ESCB will have created a precedent for an unacceptable future course of action: the CJEU's ruling amounts to a dissolution of the limitations of the monetary policy mandate of the ECB and ESCB. On the grounds that it is necessary to rectify certain disruptions in the monetary policy transmission mechanisms, the ESCB's Governing Council could, in the future, justify far-reaching interventions into the areas of economic and budgetary policies. Furthermore, the prohibition of monetary financing of Member States and its fundamental importance in the legal architecture of the EMU would be severely weakened. We are therefore convinced that the Federal Constitutional Court in its pending decision should not follow the legal reasoning of the CJEU.

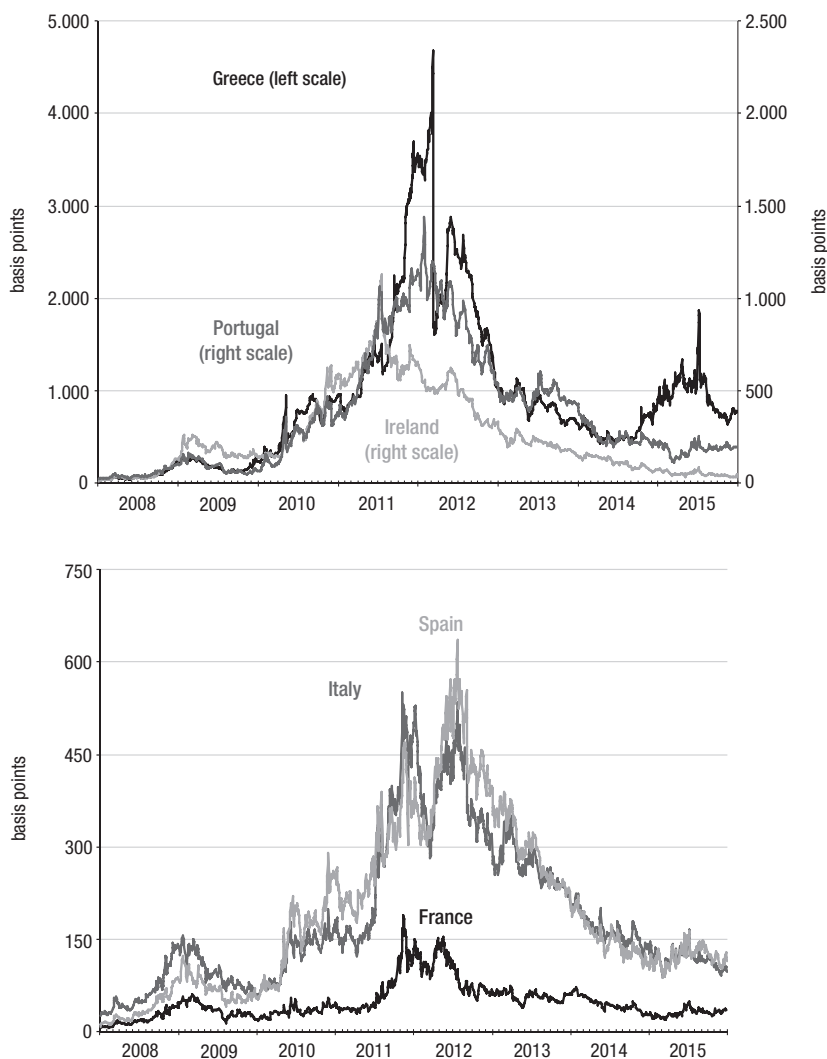
## II The adoption of OMT by the ECB

In the proceedings pending before the Federal Constitutional Court, several complainants have brought an action against the participation of the German Bundesbank (German central bank) in the implementation of the OMT decision and the inaction of the federal government.

The decision of the Council of the ECB from 6<sup>th</sup> September 2012 on the “Technical Features of Outright Monetary Transactions” establishes the criteria and mechanisms for future purchases of government bonds of the Member States in the euro area. The ECB announced its willingness to purchase such bonds on secondary markets, provided that the Member State in question is part of an EFSF- or ESM programme and adheres to its conditions. OMT should also be restricted to sovereign bonds with maturity of no longer than 3 years. There have been no further restrictions relating to the quality of the bonds. Quite the opposite: the OMT programme is designed to be so far-reaching that it is able to have a significant effect on the risk premia of the Member States' bonds in the primary markets. The ECB also announced that it would be willing to accept the same conditions as private creditors (*pari-passu treatment*) and promised complete sterilization of the liquidity created. Hence the expansion of balance sheets should be prevented by other means.

The OMT decision was passed because of the continuous rise of risk premia on government bonds of different Member States between 2011 and 2012 (see Figure 1).

The rise in risk premia was a reflection of investors' doubts in the solvency of the Member States in question as well as their doubts concerning the willingness and ability of those states to take the necessary actions in order to secure their membership in the euro. The increase in risk premia led to further scepticism concerning the solvency and the willingness of said Member States to make budgetary adjustments. Amidst this rapid decline, OMT was announced to re-establish trust in the common currency and its members. According to the ECB's press statement of 6<sup>th</sup> September 2012, OMT aims at safeguarding an appropriate monetary policy transmission mechanism and the “singleness” of the monetary policy. In this context, the monetary transmission mechanism refers to the channels

**Figure 1:** Yield spreads\* for selected Member States of the euro area

100 basis points are equivalent to 1 percentage point.

\* Yield spreads on 10-year government bonds of the respective country to German government bonds.

Sources: German Council of Economic Experts, Thomas Financial Datastream.

through which monetary policy impulses are transmitted first onto market interest rates, then on to consumption, investment and foreign demand for goods and services and ultimately onto the pricing behaviour of companies in the euro area.

Whilst the ECB has yet to purchase sovereign bonds as part of the OMT programme, the announcement of this programme alone has had a significant effect on the markets and caused a significant reduction in the interest rates of the crisis states' government bonds. The interest rates of Spanish and Italian sovereign bonds continued to decline after Draghi's speech in the summer of 2012. According to an empirical study, the announcement of OMT reduced the yield on Spanish and Italian government bonds with a maturity of two years by two percentage points.<sup>6</sup> Irish and Portuguese interest rates had already dropped significantly by the middle of 2011 and the beginning of 2012 respectively. German and French yields remained unchanged. Hence, ECB President Mario Draghi has called OMT the most successful monetary policy measure of modern times, as it brought stability, not only for markets in Europe but world wide (ECB press conference, June 2013).

<sup>6</sup> See Altavilla/Giannone/Lenza, *The Financial and Macroeconomic Effects of the OMT Announcements*, CSEF Working Paper 352, January 2014.



### III The proceedings before the Federal Constitutional Court

The non-activation of the OMT programme has led to a dispute about the admissibility of the constitutional complaints before the Federal Constitutional Court. Some have challenged the existence of a measure with direct effect in relation to third parties. In its order for referral from 14<sup>th</sup> January 2014, the Federal Constitutional Court, however, accepted the admissibility of the complaint. Since the activation of OMT would have uncorrectable consequences, the Court felt it was necessary to grant preventive legal protection.<sup>7</sup> There is little reason to doubt that the Federal Constitutional Court will stick to this reasoning in the pending proceeding.<sup>8</sup>

The Federal Constitutional Court has to decide whether the ECB's decision to adopt the OMT programme constitutes an ultra vires act. This is the case if the ECB clearly overstepped its mandate by announcing OMT, or if the activation of the programme would violate the prohibition of monetary financing of the Member States (Art. 123 TFEU), and if such infringements would lead to a "structurally significant shift in competences to the detriment of the Member States".<sup>9</sup> In its reference to the CJEU, the Federal Constitutional Court has preliminarily affirmed such an infringement. The OMT programme would patently reach beyond the realm of monetary policy and into that of economic policy – a competence held solely by the Member States. Due to their financial and political relevance, decisions trying to safeguard the euro, and hence with a potential to affect the composition of the euro area are, at their core, decisions concerning economic policy. Their legitimacy depends on the application of democratic procedures in the Member States.<sup>10</sup>

In its reference to the CJEU, the Federal Constitutional Court also assumed an evident violation of the prohibition of the monetary financing of the Member States. Given the importance of this prohibition for the Monetary Union as a stability community – a precondition for Germany's joining the EMU<sup>11</sup> – this infringement

<sup>7</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 134, 366 (391) – "Order for reference OMT".

<sup>8</sup> In particular, see Klement, *Der geldpolitische Kompetenzmechanismus. Sind die Outright-Geschäfte der EZB zugleich rechtmäßig und rechtswidrig?*, JZ 2015, 745, 756.

<sup>9</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 126, 286 (309) – "Honeywell".

<sup>10</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 134, 366 (393) – "Order for reference OMT".

<sup>11</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 89, 155 (205) – "Maastricht".

must likewise be afforded “structural importance”: all the more since Art. 123 TFEU ensures the overall budgetary responsibility of the Bundestag.<sup>12</sup>

In order to meet its obligation of executing its ultra vires control in an EU-friendly manner, the Federal Constitutional Court referred the question concerning the compatibility of OMT with European Union law to the CJEU (Art. 267 TFEU). In its reference, the Federal Constitutional Court sketched out an alternative narrow reading of the OMT programme that could lead to its compatibility with EU law:<sup>13</sup> the OMT programme would not be ultra vires if it did not undermine the conditionality of the EFSF and ESM programmes. The OMT programme could then be interpreted as merely supporting economic policies in the EMU, as is permitted by Art. 119 (2) TFEU. But to be legitimate, the OMT programme's volume must be restricted ex ante. Furthermore, the ECB must not be allowed to participate in a haircut, as this would violate the prohibition of monetary financing of the Member States (Art. 123 TFEU). In order to avoid direct monetary financing, there would also need to be a sufficient time interval between the emission of government bonds and their purchase by the ECB. Interferences in market-driven pricing mechanisms would need to be avoided as far as possible. For the same reason, government bonds once purchased by the ECB may not be held to maturity.

<sup>12</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 134, 366 (394) – “Order for reference OMT”.

<sup>13</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 134, 366 (417) – “Order for reference OMT”.

## IV The CJEU's OMT judgement – a critical appraisal

With its OMT judgement, the CJEU has not, on its part, made use of the opportunity to enliven the cooperative relationship between itself and national constitutional courts<sup>14</sup> by earnestly considering the Federal Constitutional Court's concerns.<sup>15</sup> By proposing certain restrictions and limitations to the OMT programme, the Federal Constitutional Court had outlined a possible compromise.<sup>16</sup> Yet, the CJEU has interpreted the ECB's mandate and the prohibition of monetary financing of the Member States in a manner that is ultimately irreconcilable with the concerns raised by the Federal Constitutional Court.<sup>17</sup> What the Federal Constitutional Court considers a blatant violation of the fundamental principles of EU law would become normality under the judgement of the CJEU.

### (1) Judicial review of the actions of the ECB

In conformity with the Federal Constitutional Court (para. 58 et. seq.), the CJEU first confirms that the actions of the ECB are subject to judicial review (CJEU, OMT, para. 41). The ECB's mandate is limited to monetary policy measures. The question which measures constitute monetary policy is subject to full judicial review.

Yet, by extending the ECB's mandate so far as to encompass any “rectification” of disruptions in the monetary policy transmission mechanism, the court's judicial review practically becomes an illusion. What's ultimately left of judicial control is a review of the proportionality of ECB measures: “the principle of proportionality requires acts of the EU institutions to 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” (CJEU, OMT, para. 67). In making

<sup>14</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 126, 286 (303) – “Honeywell”.

<sup>15</sup> On the importance the Federal Constitutional Court attaches to the duty of loyal cooperation between the Organs of the European Union and the Member States and on the efforts of compensation when Member States note conflicts with provisions of their national constitutional law, see Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 89, 155, 200 et seq. – “Maastricht”.

<sup>16</sup> See Siekmann/Wieland, *The German Constitutional Court's Decision on OMT: Have Markets Understood?* CEPR Policy Insight No. 74, October 2014.

<sup>17</sup> See Klement, *Der geldpolitische Kompetenzmechanismus. Sind die Outright-Geschäfte der EZB zugleich rechtmäßig und rechtswidrig?*, JZ 2015, 754.

choices of a technical nature based on forecasts and complex assessments, the ECB must, however, always be allowed a broad discretion (para. 68). The respect for the special expertise of the ECB regarding monetary policy in conjunction with its guaranteed independence lets us question the effectiveness of judicial proportionality review.

**(2) Has the ECB exceeded the EU primary law limitations of its mandate with its OMT decision?**

*(a) Monetary and economic policy in the EMU*

The ECB's mandate is stipulated in Art. 282 (1) and (4) TFEU. According to Art. 282 (1) TFEU the ECB, together with the national central banks of the Member States whose currency is the euro, shall conduct the monetary policy of the Union. The ECB adopts measures necessary to carry out this task (Art. 284 (4) TFEU). According to Art. 127 (1) TFEU, the foremost aim of the ECB's monetary policy is to maintain price stability.

In contrast, the competence of carrying out economic and budgetary policy lies with the Member States. The Member States and the EU have, however, committed themselves to a close coordination of their economic and fiscal policies (Art. 119 (1) TFEU). The EU's competence in the field of economic policy is limited to the coordination of the policies of the Member States with a view to the goals set out in Art. 3 TEU.<sup>18</sup> The European System of Central Banks (ESCB) supports the general economic policy in the Union, but only insofar as this does not come into conflict with the aim of maintaining price stability (Art. 127 (1) (2) TFEU; see also Art. 119 (2) TFEU and Art. 2 (2) ESCB Statute). It may not carry out its own economic policy.

If economic policy is the sum of all measures by which sovereign authorities intervene in the economy in order to influence its evolution, then monetary policy is always a part of economic policy. However, the division of competences in the EU and the principle of conferred powers (Art. 5 (2) TEU) require a justiciable containment of the monetary policy mandate. It must be derived from an analysis of the EU rules on the monetary union as a whole, starting from the goals of monetary policy<sup>19</sup>: within the EMU, monetary policy's primary aim is price stability (Art.

<sup>18</sup> See Art. 119 (1) TFEU and Case C-370/12, 27.11.2012, *Thomas Pringle v Government of Ireland*.

<sup>19</sup> See Case C-62/14 *Peter Gauweiler and Others v Deutscher Bundestag*, 16.06.2015 (OMT), Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 134, 366 (398, 401 et seq., 404) – "Order for reference OMT".

127 (1) TFEU). Concerning economic policy, the ESCB only has a supporting role (Art. 119 (2) TFEU, Art. 127 (1) TFEU). Apart from the aims, the instruments available to the ESCB – as well as those that are prohibited, such as monetary state financing – are relevant for defining the normative boundary between economic and monetary policy.<sup>20</sup> The instruments of monetary policy available to the ECB and ESCB are laid down in Chapter IV of the Protocol of the Statute of the ESCB and ECB.

Finally, the determination as to whether a measure is of a monetary policy nature must take into account the context of the measure at issue (Federal Constitutional Court, Order for reference, para. 63, 69), including the rules governing the division of competences and responsibilities within the EMU.

*(b) Did the OMT decision pursue monetary policy objectives?*

When it comes to monetary policy measures, already the determination of the objective of a measure can be difficult. In its judgement, the Federal Constitutional Court tried to determine the immediate aim of the OMT programme objectively (Federal Constitutional Court, Order for reference, para. 63): the OMT decision was meant to reduce the spreads between government bonds of Member States not directly affected by the crisis and by crisis states. According to the Federal Constitutional Court, the OMT programme was therefore aimed at protecting the composition of the euro area. The selectivity and conditionality of the OMT programme turned it into a functional equivalent of the support schemes established by the Member States of the euro area. Decisions concerning the composition of the euro area do not, however, fall within the competences of the ECB. According to the Federal Constitutional Court, the ECB was also not merely supporting the economic policy of the EU. Unlike the ESM, the activation of the OMT programme does not require extraordinary circumstances in financial markets or a threat to financial instability. OMT could therefore potentially lead to the massive expansion of financial assistance as well as an undercutting of the conditions of the ESM programme. Ultimately, the balance between credit volume and conditions as established by the ESM programme could be thwarted (para. 73 et seq.; 80 et seq.).

In contrast to the Federal Constitutional Court's objective approach to determining the aim of the OMT decision, the CJEU based its judgement solely on the ECB's

<sup>20</sup> See also Case C-370/12, 27.11.2012, *Thomas Pringle v Government of Ireland*.

press release of 6th September 2012. According to this press release, the OMT programme aims at safeguarding an appropriate monetary policy transmission and the “singleness” of monetary policy (CJEU, OMT, para. 47). And according to the CJEU, this aim is fully covered by the ECB's mandate:

“The ability of the ESCB to influence price developments by means of its monetary policy decisions in fact depends, to a great extent, on the transmission of the “impulses” which the ESCB sends out across the money market to the various sectors of the economy. Consequently, if the monetary policy transmission mechanism is disrupted, that is likely to render the ESCB's decisions ineffective in a part of the euro area and, accordingly, to undermine the singleness of monetary policy. Moreover, since disruption of the transmission mechanism undermines the effectiveness of the measures adopted by the ESCB, that necessarily affects the ESCB's ability to guarantee price stability. Accordingly, measures that are intended to preserve that transmission mechanism may be regarded as pertaining to the primary objective laid down in Article 127(1) TFEU.” (CJEU, OMT, para. 50)

Whether a measure was only meant to end a disruption of the transmission mechanism also contributes to stabilizing the euro area – which is an economic policy goal, according to the CJEU's *Pringle* judgement<sup>21</sup> – was apparently not relevant to the CJEU. Since rectifying the disruption of the transmission mechanism allegedly falls within the scope of monetary policy, the CJEU does not question the selectivity of the OMT programme either, because such a disruption will only exist in a limited number of Member States. According to the judgement, there is no provision in the Union Treaties that requires the ECB to intervene only by way of general measures that apply to all Member States equally.

Similarly, the CJEU considers the conditionality of OMT to be a legitimate means of supporting general economic policies in the Union. Conditionality is also a means of guaranteeing that the OMT programme does not create incentives for further fiscal deterioration in the Member States. The fact that OMT has different and fewer requirements than an ESM programme is not seen as a circumvention of those standards, but it is rather found to be an expression of the independence of the ECB and its monetary policy. The CJEU does not address the potential conflicts of interest the ECB will be faced with when being responsible for drafting,

<sup>21</sup> Case C-370/12, 27.11.2012, *Thomas Pringle v Government of Ireland*.

approving and monitoring financial assistance programmes on the one hand and conditionally purchasing government bonds on the other.<sup>22</sup>

The reasoning of the CJEU is remarkable in three respects:

First, the sole reliance on the statements of the ECB to determine the aim of OMT – without any further effort to determine its inner logic objectively – severely restricts the scope and function of judicial review. Whether a measure is legitimate then largely depends on the way it is framed and defended by the EU institution that invented it.

Second, the monetary policy mandate of the ECB is said to cover any and all measures attempting to rectify a “disruption” in the monetary policy transmission mechanism. When it comes to identifying such a disruption, the ECB enjoys broad discretion. The Federal Constitutional Court, by contrast, rightly considered that in many cases an increase in interest rates on government bonds may reflect a legitimate scepticism of market participants concerning the fiscal discipline of certain Member States. In such cases, the selective purchasing of government bonds by the ECB overrides the principle of national fiscal responsibility.<sup>23</sup> The CJEU's ruling does not address this concern. If the ECB considers a rise of interest rates to be caused by unjustified and ultimately self-fulfilling fears of a break-up of the euro area, it may assume that the transmission of monetary signals is malfunctioning and that an intervention is necessary (CJEU, OMT, para. 76 et seq.) Once the ECB finds a disruption in the transmission mechanism, it is, therefore, only the proportionality of its measure that will be subject to judicial review – a review which is limited to an assessment of manifest errors, and in effect a mere review of its plausibility. Quite predictably, the CJEU thus confirmed both the necessity and the appropriateness of the OMT programme.

Third, the CJEU seems to interpret the ECB's obligation to conduct a “single” monetary policy (Art. 119 (2) TFEU) as implying a mandate to ensure a uniform transmission of monetary policy signals into all EMU Member States.<sup>24</sup>

<sup>22</sup> Opinion of General Advocate Villalón, para. 145 et seq., in Case C-62/14 *Peter Gauweiler and Others v Deutscher Bundestag*, 16.06.2015 (OMT).

<sup>23</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 134, 366 (405) – “Order for reference OMT”.

<sup>24</sup> See Case C-62/14 *Peter Gauweiler and Others v Deutscher Bundestag*, 16.06.2015 (OMT), para. 47 which states that: “[...] the aim of the programme is to safeguard both ‘an appropriate monetary policy transmission and the singleness of the monetary policy’” and para. 48 which highlights that “under Article 119 (2) TFEU, monetary policy must be ‘single’.” And see also para. 50 which finds that a disruption in the monetary policy transmission mechanism “is likely to render the ESCB's decisions ineffective in a part of the euro area and, accordingly, to undermine the singleness of monetary policy”. This means that the conduct of a single monetary policy is related to the unified effectiveness of monetary policy measures in the Member States.

The “monetary policy transmission mechanism” refers to the channels through which monetary policy measures influence the economy and their effectiveness. First, this concerns the ECB’s influence on market interest rates. The ECB uses open market operations to provide banks with liquidity at appropriate rates. The central bank rate influences the interest rates in the inter-bank markets and banks’ lending activities regarding households, companies and sovereigns. In addition to the current central bank rate, market expectations concerning the future development of interest rates play a crucial role. Monetary impulses do not only work through interest rate channels. Exchange rates and asset prices are important channels as well. Furthermore, the monetary transmission mechanism also concerns the transmission of monetary impulses onto the real economy. Interest rates, exchange rates and asset prices play an important role in the consumption decisions of households and the investment strategies of companies at home and abroad. In addition, there exist direct wealth effects of monetary policy on consumption and investment behaviour. Hence, a central bank can influence aggregate demand, for example by purchasing securities, even if the central bank rate remains unchanged.

Central banks can influence the behaviour of market participants with relatively small changes to the conditions of open market operations. The reason is that monetary policy is relevant for income and inflation expectations in all sectors of the economy. Thus, their influence does not depend on the importance of the banking sector in a given economy. The primary goal of monetary policy is to influence economic activity and price formation in goods and services markets in a manner that stabilizes the price level in the medium term. The ECB has defined price stability as an increase in the consumer price index of less than but close to 2% per year.

The effectiveness of a monetary policy measure – such as the degree to which a lowering of the central bank’s interest rate by 1% affects short, medium or long term interest rates of banks, as well as inflation and GDP in the medium term – depends on a multitude of factors. These can be structural factors or temporary shocks. Both can strongly influence the effects of a cut in interest rates, and lead to varied effects from region to region. Lasting differences can also result from differences in the importance of certain sectors for the overall economy. These differences are the result of a competitive and open market economy with free competition (Art. 119 (1) TFEU). They may also result from different regulations of financial and product markets for which the Member States have remained competent. In addition, a variety of macroeconomic shocks and fluctuations can counteract the effects of an interest rate reduction.

The heterogeneous effect of a single monetary policy measure in economically heterogeneous regions such as the EU Member States is not a new development. The effects of a reduction of central bank interest rates will always have different effects across regions and sectors. The transmission of monetary policy measures in any given currency area will never be equally effective, neither across regions or Member States nor over time. Within EMU, the different effects of monetary measures are also a consequence of a common market with undistorted competition and linked to the decentralized, namely national competence for economic policy. It follows that the ECB’s mandate to conduct a “single monetary policy” (Art. 119 (2) TFEU) cannot imply a mandate to ensure uniform effects of monetary policy measure across all euro area Member States. Rather, the mandate reflects the “singleness” of the currency,<sup>25</sup> uniform central bank interest rates, and the need for orienting a monetary policy for a single currency towards area-wide objectives rather than individual Member States. Thus, the price stability objective, which the ECB is tasked to pursue, is defined with respect to area-wide (i.e. average) price-level developments and not particular regions or individual member states. Also, the ECB is to offer the same refinancing options and interest rates to all banks regardless of their location or the use of this liquidity. The ECB cannot, however, guarantee that these rates and refinancing options have the same effects on bank lending rates, bond yields, GDP or inflation, and achieve the same results in all regions. Quite the contrary: because the transmission of monetary policy measures is influenced by budgetary and economic policies of the Member States, any attempt to ensure uniform transmission would distort the mechanisms that provide important incentives for the adjustment of economic policies in the EMU (see Federal Constitutional Court, Order of reference, para. 71; see also CJEU, Pringle, para. 135).

The notorious infringements of Member States’ budgetary and economic competences that would result from an ECB mandate to “rectify” distortions in the transmission of monetary policy are also democratically illegitimate,<sup>26</sup> as the Federal Constitutional Court has rightly emphasized:<sup>27</sup> the independence of the ESCB, as an exemption from the general rule of democratic legitimacy, is only justified in so far as the ECB’s mandate is limited to carrying out a monetary policy mandate directed at maintaining price stability. An independent central bank is

25 See Selmayr, § 23: Das Recht der Europäischen Währungsunion, in: Müller-Graff (Ed.), *Europäisches Wirtschaftsordnungsrecht, Enzyklopädie Europarecht* Vol. 4, 2015, para. 81 et seq.

26 See Schmidt, *Die entfesselte EZB*, JZ (Juristen Zeitung) 2015, 317, 325; see Klement, *Der geldpolitische Kompetenzmechanismus. Sind die Outright Geschäfte der EZB zugleich rechtmäßig und rechtswidrig?*, JZ 2015, 745, 758.

27 Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 134, 366 (399) – “Order for reference OMT”.



better suited to securing price stability than any other political agent. This justification, however, only works if the ESCB does not reach beyond this mandate and does not meddle in Member States' economic and budgetary competences.

If one rejects the CJEU's conclusion that the ESCB holds a general mandate for rectifying disruptions in the transmission mechanism, then the only way to justify the OMT programme as a monetary policy measure is by interpreting it as an extraordinary measure to rebalance a negative market equilibrium resulting from a self-fulfilling prophecy, with little costs to the general public. The ECB argued that the interest rate spreads on government bonds of certain Member States were an expression of an unjustified and widespread fear of the unwillingness or inability of these Member States to live up to their payment obligations. It further argued, that it was only as a result of these irrational fears that risk premia continued to rise, creating a risk of default of the crisis-struck Member States. Hence, the OMT announcement allowed the ECB to eliminate this negative market equilibrium and to restore confidence in the solvency of the relevant Member States, leading to a return to more appropriate interest rates. The OMT announcement also eliminated the temporary superposition of the ECB's monetary policy signals by speculation and unfounded fears of investors.

In reference to the opinion of the Bundesbank and the fact that the ECB does not have the competence to protect the composition of the euro area (see above), the Federal Constitutional Court has rejected this interpretation of OMT. The Bundesbank argued that, rather than being unjustified, the interest rate spreads reflected the scepticism held by market participants that the Member States in crisis would not comply with adequate market discipline. The scepticism was thus an expression of the kind of market discipline that is a constitutive and desired part of the system created by the TFEU. A differentiation between rational and irrational occurrence of interest rate spreads would be practically impossible (para. 71).

The Federal Constitutional Court's conclusion that it does not lie within the scope of the competence of the ECB to protect the composition of the currency area already suggests that it considers "preventing a self-fulfilling prophecy concerning a sovereign default" inadmissible within the EMU system. This finding is supported by the fact that the prevention of sovereign default is primarily a matter of budgetary policy and not one of monetary policy.<sup>28</sup> It is incumbent upon the governments of the Member States to credibly signal their solvency to the markets. In case

<sup>28</sup> See Fuest, *EZB in der Grauzone zwischen Geld- und Fiskalpolitik*, Wirtschaftsdienst 2013, p. 441.

a Member State runs into severe financing problems, it can apply for financial assistance from the ESM. Prior to the ESM, the EFSF or the IMF provided such support. If ESM funding were insufficient, the Member States could increase its funds. In addition, debt restructuring remains an important option within the ESM-adjustment programme, albeit reserved for cases in which solvency related fears turn out to be justified.

In the event of high interest rate spreads which may lead to solvency problems, an argument in favour of an intervention of the ECB in secondary markets could be its practical effectiveness. In a scenario with multiple equilibria, an intervention by the ECB may prevent a negative equilibrium with sovereign default or a euro-exit without losses for the central bank. The success of the announcement of the OMT programme has been cited as an example.

The fact that the ECB has the ability to avoid a pessimistic equilibrium by announcing bond purchases and tilting the market towards an optimistic equilibrium does not, however, change the objective of the OMT programme: the ECB intervenes in order to secure the medium term solvency of a Member State, thereby guaranteeing the existence of the euro area. This is not a monetary policy objective. By means of broad interpretation, one could, at best, qualify it as a means of supporting the "general economic policy of the Union" (Art. 119 (2) TFEU).

### *c) Instruments of monetary policy and the overall assessment of ECB measures*

Even then, the ECB remains bound to the basic principles of the EMU. In particular, the ECB must respect the principle of national fiscal responsibility. Market discipline is a necessary corollary for national budgetary policies. The theory of multiple equilibria does not necessarily assume irrational expectations, herding behavior or the likes. The expectation of both the positive and the negative equilibrium may be fully justified. A possible pessimistic outlook on future development is an intrinsic part of market discipline.<sup>29</sup> A substitution of market discipline by conditionality and the corresponding oversight of the ECB is foreign to the conception of the EMU.

<sup>29</sup> See Konrad, *Haftungsrisiken und Fehlanreize aus ESM und OMT-Programm*, Wirtschaftsdienst 2013, p. 431, 437 who states that any intervention by the ECB with the forces of the market by means of its OMT programme constitutes a violation of the obligation contained in Art. 127 TFEU to act in accordance with the logic of the open market economy, free competition and its allocation of resources. The selective purchase of bond titles of crisis-struck member states changes both the conditions of scarcity and the expectations of the market participants. Thus the ESCB can manipulate the market prices and the interest rates on government debt of individual states by these means. National budgetary incentives and decision will also be distorted, if this crucial mechanism of controlling national budgetary policies is overridden or put out of force.

In any case, the ECB still remains limited in its choice of instruments, in particular by the prohibition of monetary state financing. According to Art. 123 (1) TFEU “overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States [...] in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings [...] shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.” If the ECB were to purchase government bonds with the likely expectation that there may later be a haircut, such purchases would illegally circumvent the prohibition in Art. 123 (1) TFEU. This, however, seems to be a likely outcome of the OMT programme: it implies the targeted purchasing of government bonds of Member States that find themselves amidst a worsening crisis. While the ECB usually only purchases safe assets outrightly<sup>30</sup>, the default risks of the bonds destined to be purchased in the course of the OMT programme are inherently far larger. The ECB has made no provisions to avoid the risk of default and will have the same priority as other investors.<sup>31</sup> For these reasons, the Federal Constitutional Court preliminarily found a violation of Art. 123 TFEU: by outrightly and extensively purchasing risky and unsecured government bonds, the ECB would be acting as the “bad bank”, thereby contributing directly to their budgetary financing (Federal Constitutional Court, order for reference, para. 88 et seq.).

Under the assumption of multiple equilibria as well as the ECB's ability to induce an optimistic equilibrium in favor of crisis struck Member States, there is no need for a subsequent haircut. However, it is impossible to predict this outcome with some certainty and to distinguish it from other scenarios that would lead to a massive transfer of wealth, most likely to the detriment of taxpayers and other Member States.<sup>32</sup> Detecting multiple equilibria is not comparable to detecting whether the ECB will meet its price stability objective or not. There are no standard tools

30 Since January 2015 the ECB has excluded Greek government bonds from its public sector purchase programme (PSPP) due to risks surrounding Greece's political refusal to adhere to the conditions of ESM programme. The public sector purchase programme uses balance sheet expansion in order to combat the risks of deflation in the euro area. Large scale bond purchases are not made selectively but according to the ECB's capital key. The risk sharing principle of the members of the ESCB applies to only 20% of the purchases. In addition, the proportion of the total portfolio of individual issuers is limited to 33% and a single bond issue is limited to 25% (with an appropriate examination of the blocking minority of 33%).

31 It is unclear whether the ECB would agree to a possible haircut concerning a bond issuance in a case where it made extensive OMT purchases and acquired more than a blocking minority of 25% of a bond issuance.

32 Accordingly, Uhlig presents several vivid abstract examples, see Uhlig, Remarks on the OMT Program of the ECB, in Siekmann/Wieland/Vig (Eds.), *The ECB's Outright Monetary Transactions in the Courts, IMFS Interdisciplinary Studies in Monetary and Financial Stability*, 1/2015. For an in-depth model-based analysis, see Roch/Uhlig, *The dynamics of sovereign debt crisis and bailouts*, draft, University of Chicago, 2014.

available for evaluating such multiplicity, unlike, for example, the kind of tools that are available to analyse the fiscal sustainability of Member States government debt. While the latter is also characterized by substantial uncertainty, it can be estimated by employing frequently used empirical methods. Yet, by attempting to demonstrate a scenario in which the central bank can prevent sovereign default by announcing a massive market intervention scheme without a risk of substantial losses, the ECB would dive into uncharted waters. Both the effectiveness of the prohibition of monetary financing and the system of competences and responsibilities in EMU would be undermined if the legality of such an ECB intervention were based solely on the ECB's assessment whether a haircut is ultimately likely or not.<sup>33</sup> In the EMU, an intervention that is associated with the assumption of a high default risk must be reserved for the Member States. They must decide whether and under what conditions such risks resulting from the sphere of one Member State should be shouldered by the others.

The issue could be remedied if the ECB were to enjoy preferred creditor status when activating the OMT programme, and would thereby exclude an absorption of losses. However, this could impair the effectiveness of the intervention. In particular in cases where markets expect that only a transfer of risks can prevent sovereign default, the central bank's acceptance of *pari passu* status gains decisive importance. A preferred creditor position would transfer the risks directly onto the other creditors, who would try even harder to get rid of their bonds, which in turn would drive up risk premia even more.<sup>34</sup>

Alternatively, the ECB could strictly limit the share of bonds it purchases on the secondary market in order to protect the functioning of market discipline. In such a scenario, the price would reflect investors' knowledge that, in case of default, they would have to carry a significant portion of the losses.<sup>35</sup> In suggesting limits to OMT, the Federal Constitutional Court was guided by this idea and has required a public announcement of the limits of OMT *ex ante*. This, however, is currently

33 See Case C-62/14 *Peter Gauweiler and Others v Deutscher Bundestag*, 16.06.2015 (OMT), para. 72, 75: “[...] questions of monetary policy are usually of a controversial nature [...] 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.”

34 This may have been the case concerning the prior purchase of Greek government bonds as part of the ECB's Securities Markets Programme. Here the ECB had exempted itself from debt restructuring. In the interim, however, the tax payers of other member states have seen themselves ‘forced’ to cover the defaults on the ECB's holdings of Greek government bonds.

35 See Uhlig, Remarks on the OMT Program of the ECB, in Siekmann/Wieland/Vig (Eds.), *The ECB's Outright Monetary Transactions in the Courts, IMFS Interdisciplinary Studies in Monetary and Financial Stability*, 1/2015.

not provided for by the OMT programme. Also, even a limited purchase of particularly risky bonds would not avoid public sector financing, it would merely limit it.

The CJEU avoids addressing these questions by defining the ECB's mandate too broadly. It merely refers to Art. 18 of the Protocol on the ESCB and ECB to conclude that the ECB may buy and sell marketable instruments. An overall assessment of the functioning of OMT in light of the guiding principles of the EMU is absent from the CJEU's judgement. Regarding the assumption of default risks implicit in the OMT programme, the CJEU finds that it is implicit in all open market transactions (CJEU, OMT, para. 125). It neglects both the highly unconventional nature of the OMT programme<sup>36</sup> and the greatly increased risk of losses. Instead, the CJEU focusses on the guarantees that are built into the programme and that are meant to incentivize Member States to follow a sound budgetary policy (CJEU, OMT, para. 123). The substitution of market discipline through institutional surveillance is, however, foreign to the system of the EMU. Past experience sheds serious doubts on its effectiveness.

### (3) Does OMT violate the prohibition of monetary financing of the Member States?

The CJEU tackles the possible violation of the prohibition of monetary financing of Member States by analysing whether bond purchases on the secondary market circumvent the prohibition of government bond purchases on primary markets. It does not consider whether the assumption of increased default risks may constitute a violation of Art. 123(1) TFEU.

Art. 123 (1) TFEU prohibits the purchase of government bonds on primary markets. The Federal Constitutional Court and the CJEU agree that Art. 123 (1) TFEU requires a functional interpretation:<sup>37</sup> it prohibits the monetary financing of budget deficits, which would erode market discipline and may lead to excessively high levels of debt. The goal to incentivize Member States to follow a sound budgetary policy must not be circumvented by the purchase of government bonds on secondary markets (CJEU, OMT, para. 100–102).

<sup>36</sup> Established instruments of monetary policy can be found in Art. 12 para. 1 of the Statute of the ECB and Art. 18 et seq. of the Protocol on the Statute of the ECB. For a restriction of the ECB's measures to established instruments of monetary policy, see Schmidt, *Die entfesselte EZB*, JZ (Juristen Zeitung) 2015, 317, 321.

<sup>37</sup> Case C-62/14 *Peter Gauweiler and Others v Deutscher Bundestag*, 16.06.2015 (OMT), para. 98; see also Case C-370/12, 27.11.2012, *Thomas Pringle v Government of Ireland*, para. 133.

The CJEU has highlighted the fundamental and structural importance of this aim in its interpretation of the “No Bail-Out Clause” (Art. 125 TFEU):

“The prohibition laid down in Article 125 TFEU ensures that the Member States remain subject to the logic of the market when they enter into debt, since that ought to prompt them to maintain budgetary discipline. Compliance with such discipline contributes at Union level to the attainment of a higher objective, namely maintaining the financial stability of the monetary union.” (CJEU, Pringle, para. 135)

Art. 125 TFEU and the prohibition of monetary financing of Member States are the fundamental rules, which characterise the EMU as a community based on stability (Federal Constitutional Court, para. 43; 86 et seq.).

The CJEU and the Federal Constitutional Court agree that Art. 123 (1) TFEU does not prohibit the ECB to buy government bonds per se. Such purchases are an instrument of monetary policy that is essential when the central bank interest rate approaches zero. Under such circumstances, further interest rate cuts are ineffective because investors can resort to cash reserves that provide a nominal interest rate of zero. Bond purchases allow the central bank to expand its balance sheet and increase the base money supply. Via various transmission channels, the ECB can use government bond purchases to influence long-term interest rates, exchange rates and assets prices in similar ways as it would with central bank rate cuts.<sup>38</sup> The states whose bonds the ECB purchases receive no money from the ECB, nor does the coupon of the bond change. While the drop in interest rates that are a result of the bond purchases may allow governments to issue new bonds at lower interest rates, this kind of influence of monetary policy on primary markets is inherent in any use of government bond purchasing as a monetary policy instrument (CJEU, OMT, para. 108). The CJEU does not address the question whether this should also hold true for government bond purchases so extensive as to create incentives for a substantial increase in government debt, thus substantially weakening market discipline.

The illegality of purchases of government bonds on secondary markets that have the same effects as purchases on primary markets is uncontroversial. What is, however, highly controversial, is when exactly we should assume these “similar

<sup>38</sup> See Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, Jahresgutachten 2015/16, para. 284 et seq.



economic effects”. The Federal Constitutional Court does not only regard the selective purchase of government bonds with a high risk of default as impermissible (see above). It also finds a violation of Art. 123 (1) TFEU when there is an insufficient time lag between the issuance and the purchase of government bonds: bond purchases would then influence the formation of prices, incentivize market participants to purchase the same bonds on the primary market and thus undermine market discipline. Also, the possibility of the ECB to hold government bonds up to their final maturity would intervene into the market logic if a substantial part of the government bonds of one Member State were thereby permanently withdrawn from the market.

The CJEU does not deal with the concerns of the Federal Constitutional Court in any greater detail and applies a very narrow functional interpretation of Art. 123 (1) TFEU. According to the CJEU, bond purchases on secondary markets only have an effect equivalent to that of direct purchases:

“(…) if the potential purchasers of government bonds on the primary market knew for certain that the ESCB was going to purchase those bonds within a certain period and under conditions allowing those market operators to act, de facto, as intermediaries for the ESCB for the direct purchase of those bonds from the public authorities and bodies of the Member State concerned.” (CJEU, OMT, para. 104)

If market participants cannot be “certain” of the purchase of government bonds by the ECB, then the bond purchase programme does not, according to the CJEU, have the same or equivalent effect as the direct purchase of government bonds (see para. 107). Furthermore, the Court finds that the announcement of the ESCB Council that it will buy government bonds on the secondary market only after the lapse of a minimum period following their issuance on the primary market will suffice to exclude market participants’ certainty (para. 106). The Member States’ incentives to maintain sound budgetary policies are allegedly kept in place by the conditionality of OMT (para. 116): the programme is limited to certain types of bonds issued only by those Member State that are subject to a structural adjustment programme, in full compliance with the programme’s requirements and which have regained access to the bond market. In addition, the CJEU underlines the fact that the OMT programme is not aimed at complete harmonisation of interest rates of all euro area Member States; the ESCB can react to a change in the issuance behavior in a given Member State at any moment (para. 112–117). The fact that the ESCB can hold bonds to maturity does not

play a decisive role for the analysis of Art. 123 (1) TFEU, according to the CJEU, as there is no certainty in this regard either (para. 118).

If market participants’ “certainty” to be able to pass on government bonds to the ECB is the yardstick for deciding whether there is an infringement of Art. 123 (1) TFEU in the case of secondary government bonds purchases by the ECB, an infringement will rarely be found. Even a precise prior announcement of the technical features of a bond purchasing programme will not suffice if the ECB is not willing to purchase almost all of the bonds in question. Nonetheless, such programmes or announcements can influence purchasing incentives and behavior of market participants long before that threshold is reached. The mere expectation that the ECB will step in to stabilize markets may well be sufficient to change the market behavior of investors.

In its interpretation of the prohibition of monetary financing of Member States, the CJEU furthermore assumes that the effects market discipline has on the Member States’ budgetary policies can be replaced with subjecting Member States to a structural adjustment programme. As long as incentives for pursuing solid budgetary policies exist due to the conditionality of OMT, there is no violation of Art. 123 (1) TFEU, even in case of a selective and targeted lowering of some Member States’ interest rates – so runs the logic – and in spite of the fact that such programme is clearly aimed at allowing the beneficiary Member States additional borrowing on the market.<sup>39</sup>

<sup>39</sup> Similarly but related to Art. 125 TFEU: Case C-370/12, 27.11.2012, *Thomas Pringle v Government of Ireland*, para. 137: “Article 125 TFEU does not prohibit the granting of financial assistance by one or more Member States to a Member State which remains responsible for its commitments to its creditors provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy.”

## V What's next?

The German Federal Constitutional Court is now faced with a difficult dilemma. The European Union can only survive as a legal community if – as stated by the Federal Constitutional Court in its *Honeywell* ruling – the inevitable tensions between national constitutional laws and the CJEU can be overcome by mutual consideration and balanced cooperation that is in line with the European intergrationist idea.<sup>40</sup> The Federal Constitutional Court is therefore obliged to undertake its ultra vires review in a cooperative and Europe-friendly spirit. Within the EU, the task to interpret EU law in a uniform, coherent and in principle binding manner has been assigned to the CJEU. The existence of the EU as a community of law depends on the guarantee of the uniform effectiveness of EU law in all Member States.<sup>41</sup>

At the same time, the Federal Constitutional Court retains a monitoring function: according to German constitutional law, it holds the mandate to guard the EU's adherence with the legal basis for further European integration. While it must normally follow the CJEU's interpretation of EU law within the confines of what is tenable, it must intervene in cases where the interpretations of the CJEU would blatantly and openly lead to structurally important modifications of the Treaties or an expansion of its competences beyond what is covered by the German ratification of the Union Treaties.

The legal structure of EMU as foreseen in the TFEU is based on a strict distinction between the centralization of monetary policy in the hands of the ESCB – whose primary aim it is to guarantee price stability – and the decentralised, albeit coordinated, budgetary and economic policies of the Member States that remain subject to market discipline in government bond markets. However, the dissolution of the limitations of the ECB's competence for monetary policy as developed by the CJEU in its OMT judgement does not provide a basis for a legally controllable future containment of the ECB's monetary policy mandate. A general competence of the ECB for rectifying any "disruption" to the monetary transmission mechanism and ensuring the uniformity of the transmission of monetary policy signals will not be able to distinguish between monetary policy and economic policy, and it

<sup>40</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 126, 286 (303) – "*Honeywell*".

<sup>41</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], BvR 126, 286 (301 et seq.) – "*Honeywell*".

threatens to undermine the effects of market discipline. The marginal judicial review of the proportionality of ECB measures will not compensate for the elimination of the legal boundaries of the ECB's mandate.

The CJEU's review of the instruments of monetary policy measures is purely formal; their compatibility with the basic principles of the EMU is reviewed on the basis of a very narrow interpretation of Art. 123 (1) TFEU. The basic principle of the EMU that the ECB must not detract Member States' national budgetary policies from market discipline and replace the latter with institutional controls has de facto been put out of force. More than the OMT programme itself, the interpretation of Art. 119 and Art. 123 TFEU in the CJEU's OMT judgement implies a structural shift in the system of competences and substantive rules of the EMU. The resulting dissolution of the limitations of the monetary policy mandate undermines the legitimacy of the ECB's independence. The more economic and monetary policies competences merge, the more politicised the relationship between the ECB, the Member States and the EU becomes. A new cooperative political relation emerges, where the primacy of price stability risks to get clouded by a multitude of other goals.

The Kronberger Kreis is therefore convinced that the CJEU's judgement represents an apparent and structurally significant modification of the Treaties. EU law in general and the provisions governing EMU in particular are designed to be developed over time under circumstances that cannot be predicted and in light of unforeseeable challenges and conflicts. Germany – while placing particular importance on framing the EU as a community of stability – must accept unfavourable but reasonable and legitimate Treaty interpretations by the CJEU.

Yet, with its verdict, the CJEU de facto abandons the possibility of a justiciable limitation of the ECB's competences. The competences of the ECB are interpreted in accordance with the principle of maximum efficiency of ECB interventions with the goal of protecting a given composition of the euro area rather than in accordance with the operational principles of the TFEU. For this reason, the German Federal Constitutional Court cannot follow the CJEU's reasoning.

Whether the Federal Constitutional Court could dismiss the pending claims on procedural grounds, as has been suggested by some,<sup>42</sup> is unclear. In principle, the Federal Constitutional Court has already affirmed the admissibility of the legal

actions in its order for reference. Since then, the implementation of the OMT programme has become less likely: the EFSF and ESM utilities to which the OMT programme links up have largely expired. The aid for Cyprus expires by end of March 2016. Nonetheless, the OMT programme has not become legally moot. Greece's ESM programme remains in place until 20<sup>th</sup> August 2018. In addition, future applications – for example by Portugal or Spain – remain possible. While it does not seem likely that the OMT programme will be activated soon, considering the current expansion of the ECB's balance sheet by means of broad, non-selective government purchases as part of the PSPP, it certainly is not impossible either.

If the German Federal Constitutional Court is required to rule on the substance of the case, then a substantial divergence from the CJEU's OMT judgement seems inescapable. In order to respect its duty to perform the ultra vires control in a Europe-friendly manner, and in order to minimize damage to the EU as a community of law, the Federal Constitutional Court may, however, wish to contain the conflict as far as possible. An option may be to uphold the CJEU's judgement in effect, but base this finding on a different reasoning. A different and independent interpretation of the relevant provisions would mean that the Federal Constitutional Court could rely on its own legal standards when dealing with future cases. At first glance, this path is facilitated by the fact that the CJEU has confirmed certain limitations to the OMT programme, concerning in particular the scope of the programme, the required lapse of time between emission and purchase of government bonds and the strict adherence to conditionality. However, crucial limitations are missing from the judgement of the CJEU. The ECB's acceptance of an increased risk of default and its waiver of a privileged creditor position are, according to the reasoning of the Federal Constitutional Court and in the understanding of the Kronberger Kreis, clearly in tension with the prohibition of monetary state financing. If the Federal Constitutional Court were to follow the verdict of the CJEU nonetheless, it would be testing the boundaries of what, concerning the basic principles of the EMU, is tenable.

<sup>42</sup> See Klement, *Der geldpolitische Kompetenzmechanismus. Sind die Outright-Geschäfte der EZB zugleich rechtmäßig und rechtswidrig?*, JZ 2015, 745, 756.

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## About the Kronberger Kreis / Council Members



**Prof. Dr. Lars P. Feld**

Spokesman of the Kronberger Kreis, Director of the Walter Eucken Institute Freiburg, Member of the German Council of Economic Experts and Professor of Economic Policy, Albert-Ludwigs-University of Freiburg.



**Prof. Dr. Clemens Fuest**

President of the Centre for European Economic Research (ZEW) in Mannheim, Member of the Scientific Advisory Council of the German Ministry of Finance.



**Prof. Dr. Justus Haucap**

Director of the Düsseldorf Institute for Competition Economics (DICE) at the Heinrich-Heine-University Düsseldorf, Chairman of the working group "Competition" of the German Economic Association.



**Prof. Dr. Heike Schweitzer, LL.M. (Yale)**

Managing Director of the Institute for German and European Economic Law, Competition Law and Regulatory Law, Freie Universität Berlin.



**Prof. Volker Wieland Ph.D.**

Managing Director of the Institute for Monetary and Financial Stability (IMFS), Frankfurt, Member of the German Council of Economic Experts and of the Scientific Advisory Council of the German Ministry of Finance.



**Prof. Dr. Berthold U. Wigger**

Karlsruhe Institute for Technology (KIT), Member of the Scientific Advisory Council of the German Ministry of Finance, research professorship at the ZEW Mannheim, Research Fellow at CESifo Munich.