

The Bundesverfassungsgericht Preliminary Reference on the OMT Program: “In the ECB We Do Not Trust. What About You?”

By Thomas Beukers*

A. Introduction

It should be no surprise that a case can be made both for and against the legality of secondary market bond purchases by the European Central Bank (ECB), and of the Outright Monetary Transactions (OMT) Program in particular.¹ It is also no secret that the ECB—like many other institutional actors in Europe—is in several ways testing the boundaries of legal provisions as a consequence of the financial and sovereign debt crisis. Still, the *Bundesverfassungsgericht* (Federal Constitutional Court) Order of 14 January 2014 on the OMT Program is surprising for several reasons.²

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¹ In fact, examples of both abound, including lawyers and economists. Arguing for the legality of bond purchases/OMT are e.g.: Paul De Grauwe, *The European Central Bank as Lender of Last Resort in the Government Bond Markets*, 59 CESIFO ECON. STUDIES 520, 529 (2013); Tolek Petch, *The Compatibility of Outright Monetary Transactions with EU law*, 7 LAW & FIN. MARKETS R. 13 (2013); Phoebus Athanassiou, *Of Past Measures and Future Plans for Europe's Exit from the Sovereign Debt Crisis*, 36 EUR. L. REV. 558 (2011); Christian Bordes & Laurent Clerc, *The ECB's Separation Principle: Does It 'Rule OK'? From Policy Rule to Stop-and-Go*, 65 OXFORD ECON. PAPERS 166 (2012); René Smits, *Correspondence*, 49 CML REV. 827 (2012); Guntram Wolff, *The ECB's OMT Programme and German Constitutional Concerns*, in *THE G-20 AND CENTRAL BANKS IN THE NEW WORLD OF UNCONVENTIONAL MONETARY POLICY*, 26 (Atiyas et al. eds., 2013). Arguing against the legality of bond purchases/OMT: Matthias Ruffert, *The European Debt Crisis and European Union law*, 48 CML REV. 1777 (2011); *Economists Call ECB's Bond Buying Plan Unlawful*, WALL ST. J., 11 September 2013, available at <http://blogs.wsj.com/economics/2013/09/11/economists-call-ecbs-bond-buying-plan-unlawful/>; Wolfgang Münchau, *136 Economists Sign Letter to Condemn OMT as Illegal*, EUROINTELLIGENCE, 12 September 2013, available at www.eurointelligence.com/professional/briefings/2013-09-12.html?cHash=69678b635f863ea2fef582bae804034c. Critical of bond purchases/OMT: KAARLO TUORI & KLAUS TUORI, *THE EUROZONE CRISIS. A CONSTITUTIONAL ANALYSIS* 165–168 (2014); Sylvester Eijffinger & Lex Hoogduin, *The European Central Bank in (the) Crisis*, 10 CESIFO J. FOR INST. COMPARISONS 32 (2012).

² Bundesverfassungsgericht [BVerfG – Federal Constitutional Court], Case No. 2 BvR 2728/13, (Jan. 14, 2014), https://www.bundesverfassungsgericht.de/en/decisions/rs20140114_2bvr272813en.html [hereinafter *Decision*]. Note that the text of the Order is also available in English.

Procedurally, it is an unprecedented decision to refer preliminary questions to the European Court of Justice (ECJ), and therefore a historic event in the ongoing dialogue between supreme courts in Europe. Interestingly, the German court not only asks preliminary questions, but also pre-drafts its own interpretation of EU law,³ rather forcefully in this case.⁴ The preliminary reference combined with its own proposed interpretation represents a new *Bundesverfassungsgericht* contribution to the development of EU law, next to earlier contributions through for example its famous *so lange* and “yes but” case law that impacted not only national but also European developments.⁵

Substantively, the decision is surprising as well.⁶ Discretion in the use of executive powers—especially in the context of a crisis—could have led any court to make a prudent judgment and to leave the ECB with a significant margin of appreciation.⁷ The same is true for the relevance to a judgment of complex macroeconomic and monetary policy assessments not traditionally within the expertise of courts. But this is not the approach taken by the *Bundesverfassungsgericht*. The German Federal Constitutional Court does not accept the ECB argument that the OMT Program is an element of its monetary policy, which could have had important consequences in terms of allowing this independent European institution a margin of appreciation in the exercise of discretionary powers.

³ This presentation of own views by national courts on the questions that they are referring has in the past been strongly advocated by Francis Jacobs. See for example, Francis Jacobs, *Further Reform of the Preliminary Ruling Procedure—Towards a “Green Light” System?* in *EUROPA UND SEINE VERFASSUNG. FESTSCHRIFT FÜR MANFRED ZULEEG 204* (Gaitanides et al. eds., 2005). The ECJ itself invites national courts to present their own views. See Recommendations to national courts and tribunals in relation to the initiation of preliminary ruling proceedings, 2012 O.J. (C 338) 1, point 24: “If it considers itself able to do so, the referring court or tribunal may, finally, briefly state its view on the answer to be given to the questions referred for a preliminary ruling. That information may be useful to the Court, particularly where it is called upon to give a preliminary ruling in an expedited or urgent procedure.”

⁴ Münchau concludes “[t]he ruling gives the distinct impression that the judges are referring the case not up to a higher court but down to a lower court.” See Wolfgang Münchau, *Germany’s Constitutional Court Has Strengthened the Eurosceptics*, *FIN. TIMES*, Feb. 9, 2014, available at <http://www.ft.com/intl/cms/s/0/8a64e3ac-8f25-11e3-be85-00144feab7de.html>.

⁵ See for example Carl Lebeck, *National Constitutionalism, Openness to International Law and the Pragmatic Limits of European Integration—European Law in the German Constitutional Court from EEC to the PJCC—Part I/II*, 7 *GERMAN L. J.* 907 (2006); Karsten Schneider, *Yes, But . . . One More Thing: Karlsruhe’s Ruling on the European Stability Mechanism*, 14 *GERMAN L. J.* 53 (2013).

⁶ See Thomas Beukers, *The New ECB and Its Relationship with the Eurozone Member States: Between Central Bank Independence and Central Bank Intervention*, 50 *CML REV.* 1579, 1613-15 (2013); Mattias Wendel, *Judicial Restraint and the Return to Openness: The Decision of the German Federal Constitutional Court on the ESM and the Fiscal Treaty of 12 September 2012*, 14 *GERMAN L. J.* 21, 51 (2013).

⁷ See Kenneth Dyson, *Sworn to Grim Necessity? Imperfections of European Economic Governance, Normative Political Theory, and Supreme Emergency*, 35 *J. EUR. INTEGRATION* 207 (2013).

Most surprising, however, I find that the decision on the OMT Program reads as a strong vote of no confidence against the ECB. According to the *Bundesverfassungsgericht*, the OMT Program is a way of providing financial assistance without parliamentary legitimation, and it has little if nothing to do with monetary policy. Moreover, discretion in the exercise of the ECB power to support economic policies must be excluded as much as possible.

In its proposed interpretation of EU law, the *Bundesverfassungsgericht* follows a pattern similar to that of the ECJ’s *Pringle* judgment.⁸ First, it discusses the delimitation between monetary and economic policy, second the division of powers in the area of economic policy between the Union (ECB) and the Member States, and third the limits to Union (ECB) action found in a specific provision (in this case the monetary financing prohibition of Article 123 TFEU). Along the way the *Bundesverfassungsgericht* gives detailed substance to the concepts of support and monetary financing, which challenges the ECJ to give important clarifications of these fundamental concepts of Economic and Monetary Union (EMU).

In the following, I will focus on the substantive EU law dimension of the *Bundesverfassungsgericht* Decision in what is intended as an analysis and comment of the Decision as opposed to a traditional case note that distinguishes between first a presentation of the Court Decision and only then a comment. I will discuss first the above-mentioned three main substantive elements of the Order leading to the Court’s conclusion that OMT violates EU law (sections B-D), then the opening offered by the German Court in the form of an EU law compatible interpretation of OMT (E), then the invisible elephant in the Decision (F), and finally its consequences (G), including the future ECJ ruling.

B. The Delimitation Between Monetary and Economic Policy

A most remarkable element of the Order, both in terms of reasoning and outcome, is the *Bundesverfassungsgericht*’s distinction between monetary and economic policy, and in particular its treatment of the ECB’s official motivation for the OMT Decision. Although the Court diligently follows the ECJ’s approach to the distinction between monetary policy and economic policy, as applied in the *Pringle* case, its application leads the German Court to several conclusions that are not necessarily shared by the ECJ.

According to both Courts, the relevant factors in delimitating monetary and economic policy are the objectives of an act, the instruments provided to achieve the objectives, and the link to other provisions.⁹ “Based on an overall assessment of the delimitation criteria

⁸ See Thomas Pringle v. Government of Ireland, ECJ, Case C-370/12, (Nov. 27 2012), <http://curia.europa.eu/juris/recherche.jsf?language=en>.

⁹ See *Decision*, *supra* note 2, at para. 63. See also Pringle, *supra* note 8, at paras. 53–60.

that the *Federal Constitutional Court considers relevant*,¹⁰ the *Bundesverfassungsgericht* concludes that the OMT Decision is not an act of monetary policy, but instead an act of economic policy. This is supported by its objective, selectivity, parallelism with an EFSF/ESM program, and the risk of undermining the objectives and requirements of such a program. Moreover, OMT falls outside the scope of allowed ECB support for economic policies (see for the latter section C).

I. The Objectives of OMT

With regard to assessing the objective of OMT, the *Bundesverfassungsgericht* recalls the ECJ's decision in *Pringle* that "an economic policy measure cannot be treated as equivalent to a monetary policy measure for the sole reason that it may have indirect effects on the stability of the euro."¹¹ The German Constitutional Court concludes that, therefore, bond purchases "may not qualify as acts of monetary policy for the sole reason that they also indirectly pursue monetary policy objectives."¹² This analogous reasoning may seem convincing at first sight. Let us have a closer look. In *Pringle*, the ECJ basically said that it would be strange to consider all acts that have an effect on price stability, even those by political actors like the member states of the Eurozone, as monetary policy measures only for the reason of that *effect*. In the case of OMT, the question seems to be different: What is the nature of an act of the ECB that has *multiple, closely intertwined, objectives*, some relating to economic policy, others related to monetary policy? Can a single act actually be one of monetary policy and economic policy at the same time? At this point the *Bundesverfassungsgericht* seems to concede that OMT might also have indirect monetary policy objectives.¹³ Later it argues that OMT has no monetary policy objective.¹⁴ This way it avoids answering the question of whether a single ECB act can have both *direct* monetary and economic policy objectives, and what the consequences of a positive answer to this question would be in terms of the nature of the act, and the powers of the ECB.¹⁵

¹⁰ *Decision, supra* note 2, at para. 69, italics added.

¹¹ *Pringle, supra* note 8, at para. 56.

¹² *Decision, supra* note 2, at para. 64.

¹³ And later in the Decision that bond purchases "can, under certain conditions, help to support the monetary policy objectives of the European System of Central Banks . . ." *Decision, supra* note 2, at 96.

¹⁴ *See Decision, supra* note 2, at para. 73.

¹⁵ In general, legal acts of the Union legislature can at the same time have different objectives, such as the internal market and environment (see, e.g., *Commission v. Council (Titanium Dioxide)*, ECJ, Case 300/89, (June 11 1991), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61989J0300:EN:HTML>). This can lead to debate about what legal basis is warranted when different legal bases have a different scope and prescribe different procedures. In this case however, there seems to be a single legal basis for the instrument of outright monetary transactions (Article 18(1) ESCB/ECB Statute), which is available for both the objectives of monetary policy and supporting economic policies. Therefore, it is not a matter of making a choice between different legal bases here, but of determining the scope of the ECB mandate on the basis of the objective of the instrument.

The *Bundesverfassungsgericht* argues that the aim of OMT is “to neutralize spreads on government bonds of selected Member States of the euro currency area which have emerged in the markets and which adversely affect the refinancing of these Member States.”¹⁶ Although the Court claims to make an assessment based on the wording¹⁷ of the OMT decision, it largely ignores the text of the OMT decision and the ECB’s official motivation reported there, according to which bond purchases on the secondary market “aim at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy.”¹⁸ The same is true for the many official statements by ECB representatives made in this direction.¹⁹

This is not to say that reducing spreads is not an objective of the OMT Program. However, the question seems to be whether it is the primary—even sole—objective or only a necessary intermediate one. According to the ECB, the OMT Decision has a monetary policy objective, and reducing spreads is a limited aim in the sense that the ECB will “only aim at that portion of bond yield spreads that are not fundamentally justified and based on undue risks of a euro area break-up.”²⁰ According to the *Bundesverfassungsgericht*, reducing spreads is the primary objective, or at least the necessary intermediate objective for the—also economic—objective of safeguarding the composition of the euro area.²¹ It is convinced that OMT has no monetary policy objective.²² By drawing the latter conclusion, it is basically saying that the ECB is not acting in good faith, and it avoids having to go into the merits of the ECB’s argument.

The *Bundesverfassungsgericht* easily discards the ECB’s objective—considered economic—of safeguarding the current composition of the euro currency area with the OMT

¹⁶ *Decision*, *supra* note 2, at para. 70.

¹⁷ *See Decision*, *supra* note 2, at para. 69.

¹⁸ Press Release, European Central Bank, *Technical features of Outright Monetary Transactions* (Sept. 6, 2012), available at http://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html.

¹⁹ *E.g.* Mario Draghi, President, European Central Bank, Press conference (Mar. 7, 2013); Mario Draghi, President, European Central Bank, Press conference (Aug. 1, 2013); Benoit Coeuré, Vice President, European Central Bank, *Outright Monetary Transactions, One Year On*, speech at the German Institute for Research and KfW Bankengruppe (Sept. 2, 2013).

²⁰ Coeuré, *supra* note 19.

²¹ *See Decision*, *supra* note 2, at para. 55.

²² *See Decision*, *supra* note 2, at para. 73.

Program.²³ The Court denies the ECB any serious responsibility for this.²⁴ It sees no need to discuss whether the OMT Program could be an appropriate means to this economic end.

In the discussion of the objective of reducing spreads, we find an interesting interpretation of *Pringle*. The *Bundesverfassungsgericht*, referring to the statement in *Pringle* that the prohibition of Article 125 TFEU (broadly known as the no-bailout clause) “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,”²⁵ concludes that spreads “cannot be lowered by bond purchases by central banks without suspending this independence.”²⁶ Spreads are not mentioned in *Pringle*, nor are limits to lowering spreads by central bank bond purchases, so the *Bundesverfassungsgericht*’s interpretation is—at least for now—that of the German Court alone.

The Court’s use of sources in what comes closest to a substantive assessment of the ECB motivation for the OMT Program is also interesting. The *Bundesverfassungsgericht* sides with the *Bundesbank* in the debate over whether spreads are partly based on fear of reversibility of the euro (ECB) or only reflect distrust in member state budgetary discipline (*Bundesbank*).²⁷ It also puts into question the possibility of dividing interest rates into a rational and an irrational part, again agreeing with the German Central Bank. On the one hand, one might have expected more data and economic literature here to support these claims.²⁸ The *Bundesverfassungsgericht* limits itself to a reference to a Report of the German Council of Economic Experts, which actually does conclude that fear of reversibility significantly impacted on the spreads of Italy and Spain, albeit not in the period directly preceding the OMT announcement of September 2012 (but instead in the

²³ See *Decision*, *supra* note 2, at 72. It does so in reference to a pre-OMT press release of 26 July 2012, by which it means the famous London speech of Draghi in which he pledged that “[w]ithin our mandate, the ECB is ready to do whatever it takes to preserve the euro,” saying immediately after that the main short-term challenge is the financial fragmentation. This preservation objective has been repeated also post-OMT announcement, see e.g. Coeuré, *supra* note 19; Asmussen in the June 2013 hearing before the *Bundesverfassungsgericht*, Jörg Asmussen, *Introductory Statement by the ECB in the Proceedings before the Federal Constitutional Court* (Jun. 13 2013).

²⁴ See *Decision*, *supra* note 2, at para. 73.

²⁵ *Pringle*, *supra* note 8, at para. 135.

²⁶ *Decision*, *supra* note 2, at para. 71.

²⁷ See *Decision*, *supra* note 2, at para. 71.

²⁸ Mody supports the *Bundesverfassungsgericht*’s position. “The court was right to question the factual basis of the ECB’s claim that the risk premiums reflected an unfounded market fear—a claim that was based on cherry-picked evidence.” See Ashoka Mody, *The ECB’s Bridge Too Far*, PROJECT SYNDICATE (Feb. 11, 2014), available at <http://www.project-syndicate.org/commentary/ashoka-mody-shows-why-the-ecb-s--outright-monetary-transactions--program-is-fundamentally-flawed>.

period from January to April 2012).²⁹ In fact, Fratzscher, Hüther, and Wolff offer a different reading of the Report: “In summer 2012, many capital markets were dominated by the bet against the euro and against individual countries. This was reflected in the interest rates required on government bonds of crisis countries, as calculations by the Germany Council of Economic Advisors show. The OMT announcement corrected these exaggerations. . .”³⁰ On the other hand, to the extent that the Court does not accept the ECB’s monetary policy motivation, and sees the reduction of spreads only as part of the economic objective of safeguarding the composition of the euro area, for which it denies the ECB responsibility, the outcome of the substantive assessment seems irrelevant.

II. Selectivity

The *Bundesverfassungsgericht* finds further support for the fact that OMT has no monetary policy objective in the program’s selectivity,³¹ in other words that it will be used to purchase bonds of selected member states only. It notices that the ECB monetary policy framework generally does not have a targeted approach. The targeted purchase envisaged by the OMT will level the spreads of selected Member States by changing market conditions, and put the government bonds of the other Member States at a disadvantage, according to the Court. However, what is generally the character of monetary policy measures alone does not seem to be enough to exclude the idea that unconventional monetary policy measures can nonetheless be targeted. Neither does the disadvantageous effect alone of a policy measure for some member states as opposed to others exclude a monetary policy objective (this effect also differs for non-targeted monetary policy measures). But the overall assessment of the German Court is nonetheless that selectivity means there is no monetary policy objective, and it is not alone in this view.³²

²⁹ See German Council of Economic Experts, Annual Economic Report 2013/14 n. 200. The German Council of Economic Experts itself bases its conclusions on Jens Klose & Benjamin Weigert, *Sovereign Yield Spreads During the Euro-Crisis—Fundamental Factors Versus Systemic Risk*, ARBEITSPAPIER 07/2012, SACHVERSTÄNDIGENRAT ZUR BEGUTACHTUNG DER GESAMTWIRTSCHAFTLICHEN ENTWICKLUNG [EXPERTS ON THE ASSESSMENT OF ECONOMIC DEVELOPMENT] (2012), available at http://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/download/publikationen/arbeitspapier_07_2012.pdf.

³⁰ Marcel Fratzscher, Michael Hüther & Guntram Wolff, *Taking the Mandate of the ECB Seriously*, BERLINOECONOMICUS, (Feb. 6, 2014), available at <https://berlinoeconomicus.diw.de/en/2014/02/06/taking-the-mandate-of-the-ecb-seriously>.

³¹ See *Decision*, *supra* note 2, at para. 73.

³² At least 136 German professors of economics share this point: “If monetary policy were its focus, the ECB would buy the representative bond portfolio, including sovereign or private debt from all member states. But this is not the policy. Instead the ECB concentrates on buying the bonds of over-indebted member states.” See WALL STREET JOURNAL, *supra* note 1.

III. Parallelism

The *Bundesverfassungsgericht* then turns to the issue of conditionality, in a part of the decision that has both the function of arguing that OMT is about economic policy, as well as that of arguing that it exceeds the powers of the ECB in the area of economic policy. The Court considers OMT to be an instrument of financial assistance because it is tied to full compliance with conditionality, which includes that the ECB retains its own conscientious examination.³³ The link between purchase and conditionality excludes OMT from the powers of Articles 119 (2), 127(1 and 2) TFEU.³⁴ The ECB engagement with an activity that belongs to the field of economic policy, namely assistance, speaks against compatibility of OMT with the mandate of the ECB.³⁵ In sum, the purchase of bonds appears “as the functional equivalent to an assistance measure of” the EFSF and ESM, assistance however without parliamentary legitimation.³⁶ And, by granting financial assistance, the ECB “pursues an economic policy that the European Union is prohibited from conducting.”³⁷

By not accepting the ECB’s monetary policy argument *a priori*, the *Bundesverfassungsgericht* also ignores the possibility, as argued by the ECB, that conditionality may be a necessary element for the effectiveness of monetary policy. In other words, there is no place for the argument that the success of its monetary policy depends on the economic policies conducted by the member states.³⁸ According to the ECB, conditionality functions as an element of pressure, securing the effectiveness of bond purchases, and at the same time avoiding a negative impact on discipline incentives.³⁹ In

³³ See *Decision* at 77. Compare Wolfgang Münchau, *Anleihekäufe: Wie die EZB das Verfassungsgericht clever umgehen kann* [Bond Purchases: How the ECB can Handle the Constitutional Court Clever], SPIEGELONLINE, (Feb. 12, 2014), available at <http://www.spiegel.de/wirtschaft/soziales/ezb-anleihenkaeufo-wolfgang-muenchau-zum-urteil-des-bvg-a-952997.html>: (“From a legal perspective the German Federal Constitutional Court has entirely correctly argued that we are clearly not dealing with monetary policy here. Because monetary policy does not pose conditions.”) (*own translation from German*); MODY, *supra* note 28 (“If the ECB were truly convinced that risk premiums were unreasonably high, and that distressed countries’ debt was sustainable, conditionality would have been unnecessary.”). For a different critique, see DE GRAUWE, *supra* note 1, at 528 (“in times of crisis, the central bank must be willing to provide unlimited support without making this support conditional on good behavior. Other institutions must as I have argued, enforce the latter.”).

³⁴ See *Decision*, *supra* note 2, at para. 74.

³⁵ See *id.* at para. 76.

³⁶ See *id.* at para. 78.

³⁷ *Id.* at para. 65.

³⁸ See *Monetary and Fiscal Policy Interactions in a Monetary Union*, ECB MONTHLY BULLETIN, 52 (July 2012).

³⁹ Dutch ECB Governing Council member Knot explains the dynamics as follows: “We deliberately waited with buying Italian bonds. As long as it took for Prime Minister Berlusconi to realize that he had to take measures. We did not tell Berlusconi what to do, but it was clear under what conditions we would step in. It provides us also with an instrument of pressure to keep Italy on track. If we stop buying their bonds for only half a day, the

fact, the ECB argues that conditionality "removes the privilege of governments to choose between economic adjustment and central bank intervention."⁴⁰ The Court does not consider this positive aspect of conditionality. Nor does it acknowledge the fact that conditionality might complement rather than undermine the objective of budgetary discipline through the markets, an objective which is at the basis of both articles 123 and 125 TFEU.⁴¹ Instead, the Court sees conditionality as determining prohibited financial assistance to be the true nature of the OMT Program, as determining the economic policy character of the Program, and even as undermining and bypassing the conditions envisaged by the secondary market bond purchase programs of the EFSF/ESM.

IV. Undermining EFSF/ESM Programs

The *Bundesverfassungsgericht* believes that the OMT is "likely to bypass the conditions and conditionalities envisaged by" the EFSF/ESM.⁴² It follows from the OMT announcement that the program under which a state must be in order to be eligible for ECB purchases, has to be one that includes the possibility of EFSF/ESM primary market purchases.⁴³ This means OMT secondary market purchases can be triggered in circumstances that are less strict than that of ESM secondary market purchases. For the latter purchases exceptional financial market circumstances and risks to financial stability must exist. Moreover, the conditionality of such a primary market purchase program, and thus that attached to OMT, is potentially lower than that envisioned for a secondary market purchase program of the EFSF/ESM (taking certain corrective measures as opposed to subjecting oneself to a macroeconomic adjustment program). The *Bundesverfassungsgericht* is obviously not assured that the ECB will strive for purchases only in case of an "acute crisis and within narrow limits."⁴⁴ But is there reason to worry?⁴⁵ That depends on how much faith one has that both elements will remain central to the ECB's monetary policy justification.⁴⁶ And

interest will go up and the pressure will rise on the government to take measures." (*own translation from Dutch*), Cees Banning & Egbert Kalse, *Overheidsfinanciën draaien nu alleen om geloofwaardigheid* [Public Finances are All About Credibility Now], NRC HANDELSBLAD (Sept. 23, 2011).

⁴⁰ Coeuré, *supra* note 19.

⁴¹ See Vestert Borger, *The ESM and the European Court's Predicament in Pringle*, 14 GERMAN L.J. 113, 119 (2013).

⁴² *Decision*, *supra* note 2, at para. 79.

⁴³ See Press Release, *supra* note 18.

⁴⁴ *Decision*, *supra* note 2, at para. 79.

⁴⁵ Another concern that has been raised in the literature is about the credibility of conditionality: once started purchases can no longer be stopped if conditions are not met, as this would be harmful to the monetary policy transmission mechanism. See WOLFF, *supra* note 1, at 26.

⁴⁶ Cf. Press Conference, Jean-Claude Trichet, President, European Central Bank (Oct. 6 2011) ("we had to consider that there is a serious problem of the transmission of our monetary policy decision because financial stability is

would not the independence of the ECB favor an independent assessment by this institution of the conditions of bond purchases? The *Bundesverfassungsgericht's* distrust in the ECB's monetary policy motivation leads to distrust in its assessment of the appropriate circumstances of activation and the appropriate conditions.

V. The Monetary Policy Transmission Mechanism

According to the *Bundesverfassungsgericht*, the accuracy or plausibility of the reasons of the ECB relating to monetary policy transmission mechanism is irrelevant, because the OMT Decision is in any event not an act of monetary policy.⁴⁷ The *Bundesverfassungsgericht* thus *a priori* accepts no effect of any monetary policy transmission mechanism justification on its assessment of a violation of the ECB mandate.⁴⁸ This way, it avoids a discussion of the motivation on the basis of merits.⁴⁹ The important consequence of the conclusion that OMT is not monetary policy—whether convincing or not—is that the *Bundesverfassungsgericht* does not have to address the question of whether the ECB might have broader discretionary powers and a margin of appreciation in its monetary policy assessments.

C. Supporting Economic Policies in the Union

The *Bundesverfassungsgericht* considers OMT to be an element of economic policy, an area in which responsibility lies with the member states unless powers are assigned to the Union.⁵⁰ Does the OMT Program fall within the ECB powers in this policy area? In answering this question, the Court goes into the meaning of the concept support of Article 127(1) TFEU. According to the *Bundesverfassungsgericht*, the powers of the ECB in the area of economic policy, and in particular, the possibilities to support economic policies in the Union, are limited in several ways.

not ensured at the level of the euro area as a whole and because we have a number of countries which have their own "risk-free" benchmark rates at levels that are quite different from country to country.").

⁴⁷ See *Decision*, *supra* note 2, at para. 96.

⁴⁸ The monetary policy transmission mechanism should ensure that banks transmit ECB conventional monetary policy to companies and consumers in the real economy. According to the ECB a number of factors, including financial instability, hinder a proper functioning of this mechanism during the crisis. See also BEUKERS, *supra* note 6, at 1605.

⁴⁹ "The ECB's argument that the two programmes are part of its monetary policy and designed to correct malfunctions in the transmission mechanism deserves a fair assessment, which must be informed by economic theory and monetary-policy practices." TUORI AND TUORI, *SUPRA* note 1, at 166.

⁵⁰ See *Decision*, *supra* note 2, at para. 68.

First, and logically since following from the text of Article 127(1) TFEU, the support may not compromise the objective of price stability.⁵¹ Interestingly, the Court does not investigate or even discuss this, even though it has been the subject of academic debate.⁵² The same is true by the way for the effect of the OMT Program on ECB independence. Apparently, the fundamental elements of price stability and ECB independence are not the Court’s main concern here,⁵³ as also illustrated by the fact that they are not singled out in the preliminary questions referred to the ECJ.

Second, the authority to support does not justify any steering (*Gestaltung*) of economic policies.⁵⁴ The ECB is “not authorized to pursue its own economic policy,” or to adopt an “independent act of economic policy.”⁵⁵ As discussed above, the *Bundesverfassungsgericht* considers that the element of conditionality means that OMT should not be counted among the powers assigned to the ECB.⁵⁶ The engagement in an activity that belongs to the field of economic policy speaks against compatibility with its mandate.⁵⁷ Peers argues that as long as OMT conditionality is consistent with the conditionality linked to the ESM and EU rules on economic governance, then the Program cannot be said to constitute a separate economic policy of the ECB.⁵⁸ Still, it is true that the ECB has no explicit powers to provide financial assistance.⁵⁹ The question is whether the ECJ will agree that OMT constitutes financial assistance. I would argue that this does not necessarily follow from the conditionality attached, even though the *Bundesverfassungsgericht*’s concerns with conditionality are not ungrounded. The conditionality *informally* attached to bond purchases in the case of Italy and Spain under the earlier Securities Market Program (SMP), famously formulated in ECB letters to the respective governments, may be at a tension with the idea of supporting—I have called these letters examples of central bank

⁵¹ See *id.*

⁵² E.g. Peter Sester, *The ECB’s Controversial Securities Market Programme and its Role in Relation to the Modified EFSF and Future ESM*, 9 EUR. COMPANY AND FINANCIAL L. R. 156, 167–168 (2012); DE GRAUWE, *supra* note 1, at 522–25.

⁵³ According to the case law of the *Bundesverfassungsgericht* compliance with the independence of the European Central Bank and the primary objective of price stability are permanent constitutional requirements of a German participation in the monetary union. See for example *Bundesverfassungsgericht [BVerfG – Federal Constitutional Court]*, 2 BvR 1390/12 of Sept. 12, 2012, para. 219 (English version).

⁵⁴ See *Decision*, *supra* note 2, at para. 68.

⁵⁵ See *Decision*, *supra* note 2, at para. 39.

⁵⁶ See *Decision*, *supra* note 2, at para. 74.

⁵⁷ See *Decision*, *supra* note 2, at paras. 65, 76.

⁵⁸ See Steve Peers, *Clash of the Judicial Titans: Will the Euro Survive?*, EU L. ANALYSIS, (Feb. 9, 2014), available at <http://eulawanalysis.blogspot.it/2014/02/clash-of-judicial-titans-will-euro.html>.

⁵⁹ Compare the limited power of the Council to provide financial assistance on the basis of Article 122 TFEU.

intervention⁶⁰—even if written in close cooperation with the respective Member State governments. Moreover, it is at a tension with the limited accountability of the ECB only to the European Parliament, and not to the national parliaments involved. The formal conditionality attached to OMT purchases will be decided on by the ESM Board of Governors, but it is obvious that the ECB will stay closely involved, considering its role in the Troika (Commission, ECB, and IMF) that negotiates conditionality, and its seat at the Board of Governors' table.⁶¹

Third, support may not lead to a possible thwarting of parallel assistance programs of the Member States and their underlying political decisions, and must therefore be limited in volume.⁶² It is not clear what signs of this risk have been detected by the German Constitutional Court in instances of bond purchases under the SMP Program that preceded the OMT. In any event, the limits posed by the OMT announcement itself, which states that “[t]ransactions will be focused on the shorter part of the yield curve, and in particular on sovereign bonds with a maturity of between one and three years,”⁶³ are not enough to reassure the *Bundesverfassungsgericht*. Nor is the ECB's intention to observe the emission behavior of individual Member States and react to Member States that change their refinancing policies to increase the volume of their governments bonds covered by the OMT program.⁶⁴

Fourth, according to the *Bundesverfassungsgericht*, any independent economic assessment needed for the decision whether, to what extent, and under what conditions to purchase (or stop purchasing) government bonds, extends beyond a mere support of economic policies in the Union.⁶⁵ This is a strange condition if any form of bond buying were accepted by the German Court, since it can actually be interpreted as a sign of central bank independence.

Finally, and importantly, it follows from the Decision that the possibility for the ECB to support economic policies in the Union is in several ways limited by the prohibition of monetary financing of Article 123 TFEU.⁶⁶

⁶⁰ See BEUKERS, *supra* note 6, at 1579.

⁶¹ See *id.* at 1607.

⁶² See *Decision*, *supra* note 2, at para. 83.

⁶³ Press Release, *supra* note 18.

⁶⁴ See also ASMUSSEN, *supra* note 23.

⁶⁵ See *Decision*, *supra* note 2, at para. 82.

⁶⁶ See *Decision*, *supra* note 2, at para. 100.

D. The Circumvention of the Monetary Financing Prohibition

Article 123 TFEU contains a prohibition of monetary financing, prohibiting not only direct purchases of government bonds by the ECB, but also those purchases in the secondary market that circumvent the objective of Article 123 TFEU.⁶⁷ The *Bundesverfassungsgericht* argues this,⁶⁸ the ECB itself has argued this,⁶⁹ and there is no doubt that the ECJ would agree that circumvention of the prohibition is not allowed.⁷⁰

The fundamental question is under what circumstances there is circumvention. And related to this is the question what the objective of Article 123 TFEU is. Is it merely to discipline member states through the markets and avoid moral hazard? Or does financial stability also play a role here as a higher objective in determining what is allowed under Article 123 TFEU, as it did in the ECJ’s interpretation of the limits of Article 125 TFEU in *Pringle*.⁷¹ Although the *Bundesverfassungsgericht* refers to the relevant paragraph in *Pringle* to argue for a teleological interpretation of also Article 123 TFEU,⁷² it does not mention this possible higher objective, which could arguably apply to many provisions of the TFEU chapter on EMU.⁷³ I will come back to this—to a large extent—invisible elephant of financial stability in section F.

The arguments of the *Bundesverfassungsgericht* for a violation of Article 123 TFEU are overwhelming.⁷⁴ It is not ready to allow the ECB much discretion.⁷⁵ Some elements seem

⁶⁷ A secondary market or indirect purchase means that ECB purchases bonds that are already on the market, and not directly from the Member States.

⁶⁸ See *Decision*, *supra* note 2, at paras. 85–86.

⁶⁹ See ECB Opinion of 25 March 2010 on Independence, Confidentiality and the Prohibition of Monetary Financing (CON/2010/25) at 4, available at http://www.ecb.europa.eu/ecb/legal/pdf/en_con_2010_25_f_sign.pdf.

⁷⁰ See Council Regulation 3603/93, 1993 O.J. (L 332) 1 (EC). De Grauwe is less concerned: “According to its statute, the ECB is allowed to buy government bonds in the secondary markets in the context of its open market operations. In doing so, the ECB does not provide credit to governments. What it does is to provide liquidity to the holders of these government bonds. These holders are typically financial institutions. In no way can this be interpreted as a monetary financing of government budget deficits.” DE GRAUWE, *supra* note 1, at 529.

⁷¹ See *Pringle*, *supra* note 8, at paras. 135–36.

⁷² See *Decision*, *supra* note 2, at para. 86. See also *Pringle*, *supra* note 8, at para. 133.

⁷³ See Bruno De Witte & Thomas Beukers, *The Court of Justice approves the creation of the European Stability Mechanism outside the EU legal order: Pringle*, 49 CML Rev. 805, 841 (2013).

⁷⁴ See *Decision*, *supra* note 2, at para. 87.

⁷⁵ Peers disagrees with the Court: “In the ordinary course of events, purchasing significant numbers of eurozone government bonds directly on the secondary market might not have a strong link to the existence of the single currency. But in the current circumstances, it does. So this justifies a flexible approach to the limits which might otherwise apply to the ECB’s actions.” Peers, *supra* note 58.

convincing, such as the argument that a debt cut—which becomes a real possibility considering the ECB announcement not to claim a preferred creditor status—would amount to an illegal monetary financing of the countries involved.⁷⁶ But, not only the debt cut itself is not allowed, but also purchases that carry an increased risk of a debt cut or of failure are likely to violate the prohibition of monetary financing. Article 123 TFEU prohibits “taking large and unnecessary risks of losses.”⁷⁷

At times, the argumentation becomes very hypothetical (and not just because OMT has not been activated yet), based on for example a mere option of keeping bonds until maturity⁷⁸ (would excluding this not interfere with ECB independence?), or the possibility of a timing of bond purchases that—if shortly after their emission—would interfere with market pricing.⁷⁹ This reflects distrust in the ECB,⁸⁰ and the insufficiency of ECB statements in the right direction made during the proceedings before the German Court.⁸¹ In other instances, the argumentation is rather thin, being based on the mere impression given to market participants of being available as a lender of last resort on the government bond market.⁸²

The above elements, “at least when taken together,”⁸³ lead to a violation of Article 123 TFEU. The *Bundesverfassungsgericht* adds further elements to this—discussed earlier in the context of deciding whether OMT is an act of monetary policy or not—to indicate that the OMT Decision aims at circumvention. Thus, neutralization of interest rate spreads,

⁷⁶ See *Decision*, *supra* note 2, at 88. Wolff considers this to be *a priori* a sensible point. See Guntram Wolff, *OMT Ruling: Karlsruhe Says No, Refers to ECJ and Suggests ECB Should Always be Preferred Creditor*, BRUEGEL, (Feb. 7, 2014), available at <http://www.bruegel.org/nc/blog/detail/article/1240-omt-ruling-karlsruhe-says-no-refers-to-ecj-and-suggests-ecb-should-always-be-preferred-creditor>.

⁷⁷ *Decision*, *supra* note 2, at para. 89.

⁷⁸ See *Decision*, *supra* note 2, at para. 91.

⁷⁹ See *Decision*, *supra* note 2, at para. 92.

⁸⁰ Compare also the Annual Economic Report 2013/14 of the German Council of Economic Experts, n. 202: “A legally binding rule on the standstill period would allow for a clearer picture in the assessment whether the ECB is engaging in monetary financing.” (*own translation from German*).

⁸¹ Compare the different emphasis: “A fourth way in which the programmes differ from one another is that, under the OMT programme, we are not only able to buy government bonds, but also to sell them again, and their valuation is based on market prices rather than on final maturity.” ASMUSSEN, *supra* note 23. And: “We therefore also interpret the prohibition of monetary financing as being comprehensive insofar as ways to circumvent it are addressed. It is not possible to purchase newly issued government bonds at certain times.”

⁸² See *Decision*, *supra* note 2, at para. 94.

⁸³ *Decision*, *supra* note 2, at para. 87.

selectivity, and parallelism with an EFSF/ESM program render OMT a violation of Article 123 TFEU (87)—this time, it seems, each individually.⁸⁴

Also here, a justification based on correcting the monetary policy transmission mechanism *a priori* has no chance of success, since accepting such justification would lead to a *carte blanche* for the ECB and therefore to a suspension of the prohibition of monetary financing. “If purchases of government bonds were admissible every time the monetary policy transmission mechanism is disrupted, it would amount to granting the European Central Bank the power to remedy any deterioration of the credit rating of a euro area Member State through the purchase of that state’s government bonds.”⁸⁵ The *Bundesverfassungsgericht*’s rhetoric illustrates how deeply concerned it is. But arguably the acceptance of any role—small or big—for government bond purchases in the monetary policy objective of restoring the transmission mechanism would not exclude putting limits to this activity. All monetary policy operations have to comply with the prohibition of Article 123 TFEU.

E. An Interpretation of OMT in Conformity with Union Law: Support Without Monetary Financing

I. The Proposed Conditions

In its Order, the *Bundesverfassungsgericht* offers an opening to the ECJ in the form of an interpretation of OMT that is consistent with Union law, including both the ECB mandate and the monetary financing prohibition of Article 123 TFEU. The OMT should not undermine the conditionality of assistance programs and should only be supportive, meaning that a debt cut must be excluded as a possibility, bonds may not be purchased up to unlimited amounts, and interferences with price formation on the market are to be avoided where possible.⁸⁶ In the first commentaries on the decision, generally one or more of the three latter elements gets attention.⁸⁷

Bonds may not be purchased up to unlimited amounts. Some say it is hard to see how the Program can still achieve its objectives.⁸⁸ The German Court does not propose numerical

⁸⁴ *Decision, supra* note 2, at para. 87.

⁸⁵ *Decision, supra* note 2, at para. 97. Münchau’s interpretation of this paragraph: “The court said bluntly that it was in the nature of a debt crisis for transmission mechanisms to break; they were no matter for the central bank or monetary policy.” MÜNCHAU, *SUPRA* note 4.

⁸⁶ *Decision, supra* note 2, at para. 100.

⁸⁷ See e.g. *The German Court and the European Central Bank. Who is Exceeding Their Powers?*, THE ECONOMIST FREE EXCHANGE, (Feb. 7, 2014), available at <http://www.economist.com/blogs/freeexchange/2014/02/german-court-and-european-central-bank>; PEERS, *supra* note 58; WOLFF, *supra* note 76.

⁸⁸ See PEERS, *supra* note 58.

limits, but the amount should be “so limited that parallel assistance programs of the Member States and their underlying political decisions could not be thwarted.”⁸⁹ A very different rule limiting the purchase amount had been proposed by Bennink and Huizinga: “[T]he ECB should be ready to provide Eurozone countries with OMT financing to cover their current expenditures, but not to pay off all long-term debt holders.”⁹⁰ The condition certainly takes away the important rhetorical aspect of the OMT Program, closely linked to Draghi’s pledge of July 2012 to do whatever it takes to preserve the euro. In other words, it takes away “the whole point of its magic.”⁹¹ The effect will probably also be determined by its combination with the second condition proposed by the *Bundesverfassungsgericht*.

This second condition is that the possibility of a debt cut must be excluded. A preferred creditor status for the ECB is seen as “tricky”⁹² and of central importance due to its potential effect on the possibility to end a program and get market access.⁹³ Private investors will require a higher yield if their debt is subordinate to that of the ECB. The combination of an exclusion of a debt cut and limited volume could have significant consequences for the effectiveness of the OMT Program.⁹⁴

Interferences with price formation on the market are to be avoided where possible. This is seen as “fudgeable,”⁹⁵ and in fact such interferences do not have to be excluded altogether, making the objection not insurmountable.

⁸⁹ *Decision, supra* note 2, at para. 83.

⁹⁰ Harald Bennink & Harry Huizinga, *How to Limit the ECB’s OMT?*, VoxEU, (Jul. 12, 2013), available at <http://www.voxeu.org/article/how-limit-ecb-s-omt>.

⁹¹ “That the OMT would be *ex ante* unlimited, meanwhile, was the whole point of its magic: [I]t is a very difficult commitment for the market to test, *ex ante*, by the same token. This is why the OMT has worked without ever, actually, being activated.” *The OMT—Um, What Does This Thing do Again? A Bundesverfassungsgericht Guide*, FT ALPHAVILLE, (Feb. 7, 2014), available at <http://ftalphaville.ft.com/2014/02/07/1766042/the-omt-um-what-does-this-thing-do-again-a-bundesverfassungsgericht-guide>.

⁹² See THE ECONOMIST, *supra* note 87.

⁹³ Wolff, *supra* note 76: “That the OMT would be *pari passu* with ordinary bondholders—in other words, that the ECB would observe the ordinary terms of the assets it was buying and not cheat by seeking special treatment—was very important for markets. One reason the SMP could never have supported Spain and Italy was that size meant more subordination for private creditors precisely when the risk of sovereign default was high: the SMP was senior.” FT ALPHAVILLE, *supra* note 91.

⁹⁴ Compare also the Annual Economic Report 2013/14 of the German Council of Economic Experts, n. 202: “A stricter limit and thereby the establishment of the maximum risk of losses for Germany could be one of the key factors for the German Federal Constitutional Court. Even a clearly limited OMT Program could still create a strong effect on government bond spreads, as long as the ECB continues to renounce seniority status. The SMP predecessor lost its effect only with the debt cut on Greek bonds.” (*own translation from German*).

⁹⁵ See THE ECONOMIST, *supra* note 87.

Not much attention has yet been paid to the condition that OMT may not undermine conditionality of an EFSF/ESM program. It follows clearly from the *Bundesverfassungsgericht* Decision that it is not only concerned over volume, but also over the conditions attached.⁹⁶ Does this mean the Court is demanding that the conditionality required by the ECB for the activation of a (limited) OMT must be equivalent to that attached to a secondary market purchase program in the context of the EFSF/ESM? Or does this only relate to the Court’s concern that volumes must be so limited that parallel assistance programs and their underlying political decisions could not be undermined?⁹⁷

II. Is the Bundesverfassungsgericht Consistent? Volume Versus Principle

It is instructive to compare the problems the *Bundesverfassungsgericht* identifies with the OMT with its proposed EU law compatible interpretation. Is the German Court consistent? It seems that the Court is willing to be flexible on principled issues (apart from the possibility of a debt cut), as long as the scale of the program is limited. That an OMT limited in volume is able to take away concerns over large and unnecessary risks of losses may be straightforward, but some other elements that led to a circumvention of Article 123 TFEU in the eyes of the German Court, and which do not come back in the list of conditions, raise some questions.

Why for example is the selectivity of OMT not problematic anymore if the above conditions are met? After all, for the *Bundesverfassungsgericht*, it is not only a sign of OMT being about economic policy,⁹⁸ but it also leads to a circumvention of the monetary financing prohibition of Article 123 TFEU.⁹⁹ Is a targeted purchase of government bonds of selected Member States acceptable, as long as it happens on a limited scale, because it will then only lead to a limited disadvantage of other Member States? The conclusion would have to be that, according to the *Bundesverfassungsgericht*, the monetary financing prohibition does not prohibit limited support that is given to select Member States.

What about the issue of parallelism, or the conclusion based on the link of OMT with conditionality that it constitutes an economic activity and a measure functionally equivalent to financial assistance that is prohibited to the ECB?¹⁰⁰ OMT may not undermine the conditionality of EFSF/ESM assistance programs. But conditionality itself does not return as part of the EU law compatible interpretation, nor the independent examinations

⁹⁶ See *Decision*, *supra* note 2, at para. 79.

⁹⁷ See *Decision*, *supra* note 2, at para. 83.

⁹⁸ See *Decision*, *supra* note 2, at para. 73.

⁹⁹ See *Decision*, *supra* note 2, at para. 87.

¹⁰⁰ See *Decision*, *supra* note 2, at paras. 65, 74–78.

that come with it. Is not an OMT which is limited in volume but linked to conditionality still to be considered as financial assistance, an economic activity prohibited to the ECB according to the *Bundesverfassungsgericht*?

Or take the objectives of the OMT Program as discussed by the *Bundesverfassungsgericht*, namely the reduction of spreads for the further economic objective of safeguarding the composition of the euro area. With regard to lowering spreads and its effect on the budgetary discipline objective of Articles 123 TFEU and 125 TFEU, the German Court clearly states that spreads “cannot be lowered by bond purchases by central banks without suspending this independence.”¹⁰¹ Is an OMT that is not unlimited in volume enough to take away this concern? And if safeguarding the composition of the euro is not the ECB’s responsibility, this objective can also not justify OMT in a limited form. It may be that the German Court envisages a form of OMT that cannot possibly be aimed at any of these two objectives; one that is reduced to aiming at supporting economic policies in the Union, including for example sustainable development based on balanced economic growth (Article 3(3) EU).

One way to interpret the opening offered by the *Bundesverfassungsgericht* is, therefore, to see it as a compromise between being strict on scale and more lax on principle. Another way to see it is that the Court’s primary concern is to neutralize OMT by taking out the (to a great extent rhetorical) element of unlimited purchases.

F. The Invisible Elephant in the Room: Financial Stability

The concept of financial stability is not easy to define.¹⁰² Several related aspects can be identified though, including price stability, stability of the financial system, and a stable composition of the euro area. Moreover, the roots of a crisis situation leading to financial instability can generally be found in the financial sector of a member state, its fiscal policies, structural policies, or in a combination of these causes. Only the aspect of stability related to the composition of the currency area is addressed by the *Bundesverfassungsgericht*, and any role for it in justifying OMT is easily discarded by the contention that the composition of the euro area is not the ECB’s responsibility.¹⁰³ Apparently, the Court sees no relevant link between imminent risks of a break-up of the euro area and price stability, and no responsibilities for the ECB in this regard.

Financial stability, therefore, mostly remains the invisible elephant in the room. This is due to the fact that the Court does not go into the merits of the ECB’s monetary policy

¹⁰¹ *Decision, supra note 2*, at para. 71.

¹⁰² *Cf. BORGER, supra note 41*, at 135.

¹⁰³ *See Decision, supra note 2*, at para. 72.

motivation for bond purchases related to the transmission mechanism, namely that a disruption in the functioning of the markets, the fragmentation of the markets, and financial instability hinder a proper functioning of the transmission mechanism during the crisis.¹⁰⁴ This reasoning cannot influence the scope of the ECB mandate, as the *Bundesverfassungsgericht* in any event considers OMT to be an economic policy measure. It is useful to recall that the ECB’s motivation, that links financial stability and monetary policy,¹⁰⁵ does meet support from academics, including economists.¹⁰⁶

If the monetary policy motivation of the ECB for bond purchases is not considered, could financial stability then play a role in interpreting Article 123 TFEU, and in defining the concept of support of economic policies in the Union? The *Bundesverfassungsgericht* in its Order refers to the teleological interpretation of Article 125 TFEU given by the ECJ,¹⁰⁷ but does not mention that this led the ECJ to conclude that the financial stability of the currency area is the higher objective of Article 125 TFEU. As mentioned, the German Court denies the ECB responsibility for the stable composition of the euro area. But, financial stability of the currency area is a broader concept that arguably also relates to stability of the financial system or sector—an area in which not only member states are (primarily) responsible, but also the ECB has powers and responsibilities—and even price stability—for which the responsibilities of the ECB are evident.¹⁰⁸ Tuori and Tuori for example argue that it can be seen as consisting of both economic and financial stability, and that the latter includes banking stability, which means “the capacity of the banking sector to fulfil[] its role in the economy even in deeper downturns,” whereas “amounts and interest rates of

¹⁰⁴ See Press Conference, Jean-Claude Trichet, President, European Central Bank (Jun. 10, 2010); Press Conference, Jean-Claude Trichet, President, European Central Bank (Oct. 6, 2011); Press Conference, Mario Draghi, President, European Central Bank (Mar. 7, 2013); Press Conference, Jean-Claude Trichet, Vice President, European Central Bank (Oct. 6, 2011).

¹⁰⁵ See *Monetary and Fiscal Policy Interactions in a Monetary Union*, ECB MONTHLY BULLETIN 52 (July 2012). For a recent discussion of this relationship, see Frank Smets, *Financial Stability and Monetary Policy: How Closely Interlinked?*, SVRIGSE RIKSBANK ECON. REV. 121, 151-52 (2013).

¹⁰⁶ “Financial stability should also be on the radar of a central bank. . . . With their unlimited firing power, central banks are the only institutions capable of stabilizing the financial system. The ECB finally recognized this old truth when it decided to commit itself to unlimited purchases of government bonds in times of crisis.” DE GRAUWE, *supra* note 1, at 529–30; “There is by now a consensus that monetary policy should take financial stability into account in the preventive phase but debate remains as to what extent this should be the case.” HANS GEEROMS, STEFAAN IDE & FRANK NAERT, *THE EUROPEAN UNION AND THE EURO. HOW TO DEAL WITH A CURRENCY BUILT ON DREAMS* 238 (2014). See also Fratscher, Hüther & Wolff, *supra* note 30); see Daniela Schwarzer, *The Euro Area Crisis, Shifting Power Relations and Institutional Change in the European Union*, 3 GLOBAL POL’Y 28, 34 (2012).

¹⁰⁷ See *Decision*, *supra* note 2, at para. 86.

¹⁰⁸ Compare Article 127(1) and (5) TFEU. Tuori and Tuori refer to stability of the euro area as a whole as the “most comprehensive stability concept.” See TUORI AND TUORI, *supra* note 1, at 57. They also state that “what ‘financial stability of the euro area as a whole’ exactly means is far from evident”.

banking loans constitute the main pass-through of monetary policy.”¹⁰⁹ This comes very close to the ECB monetary policy motivation given for government bond purchases. In other words, if the ECJ would conclude that also Article 123 TFEU has a higher objective related to financial stability, this could have important consequences. In the following section, I will come back to this, and discuss whether the ECJ could indeed interpret Article 123 TFEU as having such a similar higher objective.

G. Possible Consequences of the *Bundesverfassungsgericht* Decision

I. Crisis Resolution

The September 2012 OMT announcement by the ECB has been a key element of the European crisis resolution. If its effect on lending conditions has not been an indisputable success,¹¹⁰ its effect on preserving the euro as a single currency certainly has. Also, it is generally seen to have bought politicians time to develop a more appropriate institutional design of European crisis management and to implement structural reforms.¹¹¹

The *Bundesverfassungsgericht* Decision cannot undo the effects that OMT has had so far.¹¹² But it may have important future consequences. The Decision arguably takes away the rhetorical aspect of the unlimited purchases under OMT, related to the pledge to do whatever it takes to preserve the euro. In fact, it has been argued that the Decision castrates OMT.¹¹³ It should come as no surprise that responsible policymakers downplay the impact, and emphasize that what matters is the continued message that the ECB and Member States stand ready to do whatever it takes to preserve the euro.¹¹⁴ But OMT

¹⁰⁹ TUORI AND TUORI, *supra* note 1, at 58.

¹¹⁰ The effectiveness of OMT on the monetary policy transmission mechanism has been questioned. See Wolfgang Münchau, *The ECB's Priority Should be to Fix Southern Europe*, FIN. TIMES, (Apr. 8, 2013), available at <http://www.ft.com/intl/cms/s/0/df18590a-9d4b-11e2-a8db-00144feabdc0.html>; Edda Zoli, *Italian Sovereign Spreads: Their Determinants and Pass-Through to Bank Funding Costs and Lending Conditions*, 84 IMF WORKING PAPER (2013).

¹¹¹ Eijffinger and Hoogduin are critical of governments in this sense. “[G]overnments did not take sufficient measures to end the market turbulence or to make it possible for the ECB to (gradually) exit the programme.” EIJFFINGER & HOOGDUIN, *supra* note 1, at 34. “Now, there have been governments which have used their time well and others less well, but it is completely their own responsibility. It is not that OMT has in any sense changed things. OMT addresses other objectives.” Press Conference, Mario Draghi, President, European Central Bank (July 4, 2013).

¹¹² Also, it seems that in light of the conditions proposed for a compatible OMT the earlier SMP bond purchasing Program of the ECB is safe. Under the SMP, there was a preferred creditor status for the ECB and purchase volumes were not unlimited.

¹¹³ See THE ECONOMIST, *supra* note 87.

¹¹⁴ See Paul Taylor, *ECB's Ever More Virtual Deterrent Still Effective*, REUTERS, (Feb. 12, 2014), available at <http://uk.mobile.reuters.com/article/idUKBREA1B1GF20140212?irpc=932>.

might in effect develop from a bazooka into an instrument that is “neither scrapped, nor limitless.”¹¹⁵ Can such a limited OMT be effective in safeguarding the proper functioning of the monetary transmission mechanism and the singleness of the monetary policy?

The Decision may also have important consequences for European crisis resolution. Government bond purchases have consistently been seen by the ECB as an unconventional and temporary monetary policy measure.¹¹⁶ The ECB has argued that the emergency funds should take over this function,¹¹⁷ and in the summer of 2011, it successfully pressed for the EFSF power to purchase bonds¹¹⁸ in the wake of its decision to buy Italian and Spanish bonds. Now that the *Bundesverfassungsgericht* denies the ECB the authority to serve as a credible lender of last resort on the government debt market, this will put extra pressure on political actors. It will put pressure on a more prominent role for the ESM on the government bond market. Depending on market reactions—which have been mild for now—and future events, such as the outcome of the ECB stress test of the European banking sector, there will be increased pressure also on the ECB to, for example, shift its attention to banks and adopt unconventional policy measures such as Long Term Refinancing Operations (LTRO’s, providing massive liquidity through cheap loans to credit institutions). There will also be increased pressure on European politicians to develop the European banking union for the stability of the banking sector, to address the delicate issue of direct recapitalization support to banks by the ESM, including legacy issues, and to adopt structural reform.

The ESM can purchase bonds on the secondary market in case of exceptional market circumstances and when there is a risk to financial stability, but the ESM has a limited firepower preventing it—for now—from being a credible lender of last resort on the government bond market. Ironically, this could be solved by granting the ESM a banking

¹¹⁵ For proposals in this direction, See BENNING AND HUIZINGA, *supra* note 90.

¹¹⁶ Compare with Francesco Drudi, Alain Durré & Francesco Paolo Mongelli, *The Interplay of Economic Reforms and Monetary Policy: The Case of the Eurozone*, 50 J. COMMON MARKET STUD. 881, 894 (2012).

¹¹⁷ “Of course, what we expect is that the EFSF, which will have the capacity to intervene in the secondary markets, will be effective and efficient in its interventions. That would permit us not to have to intervene to help restore more appropriate monetary policy transmission.” Press Conference, Jean-Claude Trichet, Vice President, European Central Bank (Aug. 4, 2011).

¹¹⁸ See Statement by the Heads of State or Government of the Euro Area and EU Institutions, 21 July 2011, pt. 8, available at https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/123978.pdf.

license that would allow it to borrow from the ECB.¹¹⁹ The ECB, however, opposes this as it would violate the prohibition of monetary financing of Article 123 TFEU.¹²⁰

There are likely to be consequences also for the authority of the ECB in crisis resolution. There is no doubt that the ECB's acts are—and should be—subject to legal review by the ECJ.¹²¹ But a strict limit on the exercise of the ECB's discretionary powers that requires complex monetary and economic assessments may have an impact on its independence and authority. Also, if only a limited role for financial stability is acknowledged in determining the scope of both the ECB mandate and the monetary financing prohibition, this will mean that ECB responsibility for financial stability may not develop any further without an explicit mandate such as is being given in the area of banking supervision.

II. The European Court of Justice

The impact of the *Bundesverfassungsgericht* Decision on the position of the ECB, and other long term consequences, will ultimately also depend on the ECJ's preliminary ruling (and finally the reaction to it from the German Court). The element of time plays a dual role here. On the one hand, the prospect of having an answer from the ECJ in only 18 months might give the impression that OMT could continue to have an effect on economic and financial stability—even without activation—in its current form. On the other hand, a significant future role for OMT could be excluded even independently of the ECJ's answers, because of the limits already set by the *Bundesverfassungsgericht* and the importance of German participation in OMT.¹²² In fact, an expedited procedure leading to a response from the ECJ a few months after the referral would be desirable as it creates further legal certainty.¹²³

¹¹⁹ For a discussion of the indirect ways in which the ECB could function as a lender of last resort for sovereigns, including by making the ESM an eligible counterparty of the Eurosystem, and including political and legal hurdles, see Willem Buiter & Ebrahim Rahbari, *The ECB as Lender of Last Resort for Sovereigns in the Euro Area*, CEPR DISCUSSION PAPER SERIES No. 8974 (2012).

¹²⁰ Opinion of the European Central Bank on a Draft European Council Decision Amending Article 136 of the Treaty on the Functioning of the European Union with Regard to a Stability Mechanism for Member States Whose Currency is the Euro, 2011 O.J. (C 140) 8, at Recital 9. See also Pringle, *supra* note 8, at para. 127.

¹²¹ Compare with Article 263 TFEU.

¹²² Compare with MÜNCHAU, *supra* note 4.

¹²³ The President of the Court could exceptionally decide of his own motion that because of the nature of the case an expedited procedure should be used. See Article 105 of the Rules of Procedure of the Court of Justice, 2012 O.J. (L 265) 1. Such a procedure was used in the *Pringle* case. See Pringle, *supra* note 8.

The ECB Governing Council Decision of 6 September 2012 concerned the modalities of bond purchases under the OMT Program and was announced in a press release.¹²⁴ The legal decision has not yet been made,¹²⁵ and the Program has so far never been activated. At the same time, the admissibility of the motions before the *Bundesverfassungsgericht* is heavily disputed.¹²⁶ Nevertheless, as Thym argues, the ECJ "should set aside uncertainties about the admissibility of the reference in order to escape the allegation of judicial desertion."¹²⁷ In fact, the *Bundesverfassungsgericht* goes out of its way to make the relevance of its questions clear, and the ECJ will normally leave it to the national court to decide on this. Being too strict would not be a good signal to the German Federal Constitutional Court in its first preliminary reference ever.

Substantively, the outcome of the preliminary reference will depend on how the ECJ deals with a number of contentious issues: The objectives of OMT, and related to this, the nature of the instrument (monetary and/or economic policy); the link between conditionality and the nature of OMT (financial assistance or not); the objectives of Article 123 TFEU; the role of financial stability; and the proposed conditions limiting the scope of OMT. This contribution has neither the intention to predict the final outcome nor to exhaustively discuss the available options. Instead, it will offer some reflections on possible substantive choices.

At one extreme, the ECJ could decide not to follow the interpretation of the *Bundesverfassungsgericht* at all and be much more permissive of ECB action. It could disagree with the German Court on both the objective and the nature of OMT, by concluding that it has a clear monetary policy objective and therefore also constitutes an act of monetary policy next to economic policy. It could allow the ECB significant discretion in the exercise of its monetary policy powers, in particular under Article 18(1) ESCB/ECB Statute, and in light of its independence. It could use the objective of financial stability for a broad reading of the monetary policy mandate, and for a limited reading of the prohibition of monetary financing of Article 123 TFEU when it comes to government bond purchases on the secondary market. The latter reading of Article 123 TFEU would be similar to its reading of Article 125 TFEU in *Pringle*.¹²⁸ This approach would arguably put the ECJ on a collision course with the *Bundesverfassungsgericht*.

¹²⁴ Press Release, European Central Bank, *Technical Features of Outright Monetary Transactions* (Sept. 6, 2012), available at http://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html.

¹²⁵ Compare with Mario Draghi, ECB Press Conference, 4 April 2013: "(...) it is being worked on and will come out when it is time (...)".

¹²⁶ See *Decision* (Justice L  bbe-Wolff dissenting).

¹²⁷ Daniel Thym, *A Spring in the Desert; the German ECJ Reference on the ECB Bond Purchases*, VERFASSUNGSBLOG (Feb. 8, 2014), available at <http://www.verfassungsblog.de/en/eine-quelle-in-der-wueste/#.Uwp2oEpwaUk>.

¹²⁸ See *Pringle*, *supra* note 8.

Alternatively, the ECJ could decide not to reject the *Bundesverfassungsgericht's* interpretation of the nature of OMT, including its objective, but to partially disagree on its interpretation of the scope of the ECB's powers in the area of economic policy and that of Article 123 TFEU. Can the ECJ do this without confirming the assessment that OMT is not an act of monetary policy? It could stress that the instrument of Article 18(1) ESCB/ECB Statute is available for the objectives of the European System of Central Banks—including both price stability and supporting the economic policies in the Union—and that the separation between monetary and economic policy is not always clear (compare the dissenting opinion by Justice Gerhardt).¹²⁹ Independently of whether we are dealing with a monetary policy act or an economic policy act, in any event, it has to respect Article 123 TFEU.

In this so far more prudent approach, the ECJ could then conclude that even as an act supporting the economic policies in the Union, the limits to such support following from Article 123 TFEU are much less strict than suggested by the German Court. It could agree with the *Bundesverfassungsgericht* that Article 123 TFEU is not only about its letter, but also about its objectives and spirit. In particular, it could argue that this provision has the higher objective of financial stability in a broad sense, even without defining it, as it also did not consider it necessary in the *Pringle* judgment.¹³⁰ In an interpretation methodologically analogous to the *Pringle* interpretation of Article 125 TFEU, it could argue that direct purchases are textually prohibited, and that—because the objectives of Article 123 TFEU are not only discipline enforced through the markets, but also financial stability of the euro area—indirect purchases are compatible with Article 123 TFEU if conditional and necessary for the financial stability of the single currency.

This would lead to a reconciliation of monetary stability and financial stability that is similar to the interpretation of Article 125 TFEU in *Pringle*.¹³¹ It would allow the ECJ to put

¹²⁹ Dissenting Opinion of Justice Gerhardt: "This case shows in abundant clarity how difficult it is to handle the criterion 'manifest. . . Monetary and economic policies relate to each other and cannot be strictly separated. The delimitation of the objectives and duties of the European System of Central Banks in Art. 127 TFEU corresponds to this. A review with regard to whether the principle of conferral has been adhered to must take into account that, in consideration of the nature of independent central banks, the delimitation of their assigned powers has only been made with a view to their functions; this assignment of powers must, to a certain extent, include the authorisation to define one's own limits of actions. . . . It seems to me that the claim, that the objective of the OMT Decision is first and foremost the re-establishment of the monetary transmission mechanism, cannot be contradicted, at least not with the necessary unequivocalness."

¹³⁰ Tuori and Tuori note that "what 'financial stability of the euro area as a whole' exactly means is far from evident. None of the legal or political instruments employing it, including *Pringle*, have made any attempt at a definition. The wide variety of European measures taken to re-establish financial stability also testifies to the vagueness of the concept." TUORI AND TUORI, *supra* note 1, at 133.

¹³¹ See De Witte & Beukers, *supra* note 73, at 843.

conditionality in a different light, as it does not turn OMT into financial assistance, but reconciles it with the discipline objective of Article 123 TFEU. It would allow the ECJ to argue that in times of severe threats to the financial stability, selectivity in ECB support is permissible. It may even enable the ECJ to reconcile a debt cut with the objectives of Article 123 TFEU. Finally, it would allow the ECJ to grant the ECB considerable discretion in deciding on the volume of bond purchases and the avoidance of interferences with market pricing.

Such an interpretation would not come without challenges for the ECJ—for example the lack of explicit references to the concept in the text or the prevailing academic pre-crisis interpretation of Article 123 TFEU—nor is it likely to remain without criticism.¹³² At the same time, it may be seen as a logical step in the light of political crisis decisions taken so far and the recent ECJ’s *Pringle* judgment.

At the other extreme, the ECJ could also decide to follow the *Bundesverfassungsgericht* and to simply take over the conditions proposed by the German Court. It could nonetheless emphasize that the ECB should have discretion at least in applying these conditions, such as being able to determine the volume of bond purchases and the existence of interferences with market pricing. The challenge in this case would be to draft a judgment that does not read as a vote of no confidence against the ECB.

H. Conclusion

After the ECJ Judgment in *Pringle* of 27 November 2012 determined the scope of the no-bailout clause of Article 125 TFEU, the preliminary questions asked by the *Bundesverfassungsgericht* will lead to clarification of the scope of the monetary financing prohibition of Article 123 TFEU. In this way, the crisis not only leads to an overhaul of the EMU set-up with emergency funds, stricter rules on budgetary discipline, new rules on macroeconomic imbalances, and a developing banking union, but also to a refinement of fundamental EMU concepts. The ECJ has interpreted the prohibition of the no-bailout clause less strict than many Germans would have liked. The future ECJ judgment on the monetary financing prohibition might turn out to be similar in this respect.

The Decision at various places illustrates the *Bundesverfassungsgericht*’s lack of trust in the ECB. The ECJ will now have to draft a preliminary ruling that meets the concerns of the German Court at least to a certain extent, while taking into account the ECB mandate and the crisis context. The outcome of the preliminary ruling will to a great extent depend on the role acknowledged for financial stability in determining the scope of the ECB mandate and of the prohibition of monetary financing.

¹³² Compare with the ECJ’s interpretation of Article 125 TFEU in *Pringle*. TUORI AND TUORI, *supra* note 1, at 131.

It should come as no surprise that responsible policy makers downplay the impact of the German Federal Constitutional Court's Decision, and emphasize that what matters is the continued message that the ECB and Member States stand ready to do whatever it takes to preserve the euro.¹³³ Market reactions to the *Bundesverfassungsgericht* Decision have so far been calm,¹³⁴ and the pledge to do whatever it takes to preserve the euro, within the limits of the ECB's mandate, is currently not fully tested. However this may change.

European crisis resolution and Germany's involvement in it are at stake. At issue are also the authority of the ECB and its relationship with broader executive power in the Eurozone, or in other words, the government of the euro. Finally, this Decision, the ECJ preliminary ruling, and the following reaction from the *Bundesverfassungsgericht* will prove to be defining moments for the relationship between the two courts.

¹³³ See TAYLOR, *supra* note 114.

¹³⁴ See Sam Fleming, *ECB Governing Council Member Attacks German Court Ruling on OMT*, FIN. TIMES, (Feb. 17, 2014), available at <http://www.ft.com/intl/cms/s/0/286744cc-97e7-11e3-ab60-00144feab7de.html>.