

Outright Monetary Transactions before the ECJ: In search of the ‘golden mean’

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On 14 January 2015 – exactly one year after the German Constitutional Court (GCC) had referred for the first time in its history [preliminary questions](#) to the European Court of Justice (ECJ) – Advocate General (AG) Cruz Villalón presented [his opinion](#) in the OMT case (Case C-62/14). The case is, in essence, about the legality of the ‘[Outright Monetary Transactions’ programme of the ECB \(OMT\)](#) under EU law. This concerns first of all the question, whether the OMT is covered by the ECB’s monetary policy mandate (Article 127(1) TFEU) or rather amounts to the conduct of economic policy, for which the Union only has a coordinating competence (Article 5(1) TFEU). Moreover, the question has been raised whether the OMT violates the prohibition of monetary financing (Article 123(1) TFEU). In its order for reference the GCC had stated in a rather unusually clear language that the OMT violates the German Basic Law (*Grundgesetz*) if it was considered in its entirety to be in conformity with EU law. The finding of the unconstitutionality of the OMT would mean that the German central bank (*Deutsche Bundesbank*) would be prohibited from taking part in a possible future implementation of the OMT. The legal validity of these arguments has been discussed rather controversially (see e.g. the [special issue on this topic of the German Law Review](#)).

In its preliminary ruling in due course the ECJ will have to find the ‘golden mean’. On the one hand, it is improbable that the European judges will risk a constitutional conflict with the highest German court by given their unqualified approval of the OMT. On the other hand, not only the unlikely rejection of the OMT in its entirety, but also the imposition of limits on the overall amount of purchases of government bonds could compromise the success of the mere announcement of the OMT in calming the markets and, moreover, provoke a resurgence of the Euro area financial and debt crisis. Arguably the dilemmas this involves are reflected in the opinion on this case by Advocate General Cruz Villalón.

AG considers OMT to be a monetary policy measure

The AG considers the OMT to be an ‘unconventional monetary policy measure’ covered by the ECB’s mandate. For the purpose of framing and implementing the Union’s monetary policy the ECB enjoys a broad discretion because of its technical expertise and reputation. According to this view even a measure such as the OMT that is not producing immediate effects on price stability but aimed at sending out signals to the real economy is still covered by the mandate of the ECB.

Should the ECJ follow the AG’s reasoning, a constitutional standoff between the Karlsruhe and Luxemburg court becomes a realistic scenario in case the GCC sticks to its original position. Indeed, in its order for reference the GCC clearly stated that it does not consider the correction of a disruption to the monetary policy transmission mechanism to be a monetary policy measure, thereby favouring a narrower interpretation of the scope of discretion of the ECB in conducting monetary policy than what can be found in the opinion of the AG. Contrary to what the AG argues, the purchase of government bonds under the OMT may, in the eyes of the German Court, support monetary policy, but is nevertheless to be classified as an economic policy measure.

Arguably the position of the AG is more convincing. In fact, the inclusion of measures that may have economic policy effects in the category of monetary policy measures is a consequence of the broad discretion of the ECB in the conduct of monetary policy. This view is not only backed by the wording of Article 127(1) TFEU, which includes the support of the general economic policies as a secondary, albeit subordinated, objective of the ECB, but also by the scope and limits of judicial review of central bank decisions. Judicial interpretation cannot substitute a central bank’s understanding of complex economic situations. It would, moreover, open the door for judge’s personal views on matters of public policy entering the decision-making process. Courts have to control the limits of discretion which are set by the EU principle of proportionality that applies to all measures taken by EU institutions.

The AG dedicates around forty paragraphs to the proportionality test of a possible implementation of the OMT. It would exceed the limits of this blogpost to go into the details of the suggested proportionality test. The test requires, in brief, a written justification for the concrete measure which must be exceptional and restricted to specific cases. The boundaries of proportionality are crossed only where purchases would *inevitably* lead the ECB to a situation in which it is facing insolvency (para 195).

ECB's action within 'troika' is an economic policy measure

Special attention should be given to the argument that the ECB's role in the financial assistance programmes amounts to an economic policy measure which surpasses the mandate of the ECB. Since the implementation of the OMT is linked to the compliance with certain policy goals under financial assistance programmes of the EFSF/ESM, the OMT can be considered as an implementing measure of those programmes.

It is, indeed, hard to see how the negotiation of economic policy goals and the subsequent monitoring within financial assistance programmes can be considered as monetary policy. Certainly, according to the AG, purchases of government bonds on secondary markets are monetary policy measures. In order to prevent 'moral hazard' such measures may even be made conditional upon the implementation of certain economic policy goals. The ECB may, however, not set those economic goals. Otherwise the OMT turns into an implementation measure for economic policies defined by the ECB which would be beyond its powers. In his opinion the AG links this argument to the conditionality under the OMT. The argument can, however, be detached from the OMT and further generalised: The negotiation of policy goals and the subsequent monitoring cannot be considered to be still covered by the monetary policy mandate of ECB. Accordingly, the ECB should withdraw from the 'troika' and be removed from the ESM Treaty. In implicitly drawing the dividing line between monetary and economic policy the AG is closing ranks with the ECJ's anything but uncontroversial reading of the material scope of the ESM Treaty as being linked to economic rather than monetary policy in its [Pringle judgment \(Case C-370/12\)](#).

The prohibition of monetary financing and the 'embargo period'

Open market operations (Article 18.1 ECB Statute) such as purchases of government bonds on secondary markets do not, in principle, infringe the prohibition of monetary financing of Member States (Article 123 TFEU) unless, in the eyes of the AG, they influence the formation of market prices for government bonds on primary markets. In order to avoid such an influence he suggests an 'embargo period' of a given number of days before the Eurosystem will purchase government bonds. In his view this would permit a market price to form for the relevant government bonds.

The suggested 'embargo period' appears, however, not to be able to prevent a potential circumvention of the prohibition of monetary financing. Private investors and banks will anticipate and price in the fact that the Eurosystem will purchase government bonds after an 'embargo period'. This leads to the assumption made by the GCC that the quantity of purchases of government bonds rather than the time of purchases influences the formation of market prices on primary markets. Interestingly, in the opinion of the AG, an *ex ante* quantitative limit on purchases of government bonds "would seriously undermine the effects which the intervention on the secondary market seeks to achieve, with the risk of triggering speculation" (para 182). Whilst this argument appears convincing with regard to the economic effects of the OMT in general, it becomes debatable if one refers to the 'formation of market prices on primary markets' in order to assess a possible circumvention of the prohibition of monetary financing through purchases of government bonds on secondary markets.

Outlook

Given the catch-22 situation the AG, unsurprisingly, fails in finding the 'golden mean'. A final judgment of the ECJ that would rubberstamp the opinion of the AG would most likely have to two main consequences. First, the GCC has – if it sticks to the reasoning in its order for reference – little choice but to declare the OMT to be unconstitutional, whereby the Bundesbank could not take part in a future implementation of the OMT. Second, the ECB could decide to use 'Quantitative Easing' as a substitute. Such an unconventional monetary policy measure that covers the purchase of government bonds of *all* Member States and would not be linked to the

compliance with policy goals set by financial assistance programmes of the ESM. This would save the ECB's position in the 'troika' without having to give up the instrument of government bond purchases. The AG's view on the violation of the prohibition of monetary financing is suited to also approve 'quantitative easing'. Should the ECJ join the AG in his critical reasoning on the ECB's participation in financial assistance programmes, an amendment of the ESM Treaty would be called for, as the latter in its current form provides for a direct involvement of the ECB, namely in the procedure for granting financial stability support and the negotiations of the economic policy conditionality.

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