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CRUZ VILLALÓN IN THE OMT CASE C-62/14

OMT is legal under EU law

EURO-CEFG Commentary

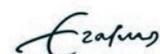
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OPINION OF ADVOCATE GENERAL CRUZ VILLALÓN IN THE OMT CASE C-62/14

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Professor Fabian Amtenbrink: “The opinion of Advocate General Cruz Villalón risks a constitutional standoff with the German Constitutional Court. The AG fails in finding a ‘golden mean’ to align the legal fears of the German Federal Constitutional Court with the economic necessity of the OMT. The limiting criterion of an ‘embargo period’ for the purchase of government bonds is not convincing in order to prevent monetary financing of Member States. Special attention should be given to the AG’s view that the ECB’s role in the ‘troika’ could surpass its monetary policy mandate. This could lead, in the last resort, to a withdrawal of the ECB from the ‘troika’ and its role assigned in the ESM Treaty.”

EXECUTIVE SUMMARY

In his today’s published opinion the Advocate General (AG) Cruz Villalón presented his proposals for an upcoming judgment of the European Court of Justice (ECJ) in the OMT case (Case C-62/14). In this preliminary ruling initiated by the German Constitutional Court the ECJ has to decide on the legality of the ECB’s announcement of summer 2012 to purchase an unlimited amount of government bonds on the secondary markets if needed. Overall, the AG considers the OMT to be compatible with EU law. In his opinion it falls within ECB’s mandate to conduct monetary policy. In an exceptional situation, also measures with an indirect effect on price stability are covered by the discretion that the ECB enjoys. However, the purchase of government bonds is considered to turn into a prohibited economic policy measure if the ECB enforces Member State’s compliance with economic policy goals set by the ESM. Those policy goals are defined by the ECB itself as a result of its participation in the ‘troika’. In other words – if this opinion is followed by the ECJ – the ECB would have to withdraw from the ‘troika’ and its role assigned by the ESM Treaty, if it was to implement the OMT. Finally, the purchase of government bonds on secondary markets is not considered to violate the prohibition of monetary financing of Member States foreseen by EU law, as long as this does not influence the formation of prices in the primary government bond markets. In the view of the AG this is to be guaranteed by an ‘embargo period’ of some days before the ECB buys government bonds.

If followed by the ECJ, the solution suggested by the AG has the potential to result in a constitutional standoff with the German Federal Constitutional Court, at least, if the latter sticks to its reasoning in the reference for order to the ECJ. Contrary to the AG the German Court considers the OMT as an economic policy measure violating the prohibition of monetary financing of Member States that could only be upheld if EU law requires a limitation of the overall amount of government bonds that can be bought under the OMT. Accordingly, the German judges would have to declare the OMT to be incompatible with the German constitution. In such a case the German central bank (Bundesbank) would be prohibited from taking part in a future implementation of the OMT. Moreover, it could be very likely that the ECB would, if the solution of the AG became the final judgment, replace the OMT by ‘quantitative easing’ which allows the purchase of government bonds of all Member States. This way, in the absence of a link to the conditionality under financial assistance programmes, the ECB could maintain its position in the ‘troika’ and the ESM Treaty without giving up the instrument of government purchases.

THE “OUTRIGHT MONETARY TRANSACTIONS” PROGRAMME OF THE EUROPEAN CENTRAL BANK AND THE CONTROVERSIAL CRITICAL ASSESSMENT BY THE GERMAN FEDERAL CONSTITUTIONAL COURT

For the first time in its history, in February 2014, the German Federal Constitutional Court (Bundesverfassungsgericht) has referred preliminary questions to the European Court of Justice (ECJ). The fundamental legal issue in questions concerns the legality of the ‘Outright Monetary Transactions’ programme of the ECB (OMT) under EU law. It is in particular debated, whether the OMT is covered by the statutory mandate of the ECB to exclusively conduct monetary policy (Article 127 TFEU) or actually amounts to the conduct of economic policy. With regard to the latter the EU only has a coordinating competence (Article 5 TFEU). The ECB is only allowed to support the general economic policies in the Union as a secondary objective (Article 127 TFEU). Moreover, the question has been raised by the German Court whether the OMT violates the prohibition of monetary financing (Article 123 TFEU). In its order for reference the German Court has stated in rather unusually clear language that it would consider this programme in violation of the German constitution (Grundgesetz), if it was considered in its entirety to be in conformity with EU law. In such a case the German Court could end up declaring this programme to be incompatible with the German constitution, as a consequence of which the Bundesbank, the German central bank, 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](#)).

The OMT is a programme of the ECB to purchase government bonds on secondary markets. The most important feature of the OMT is that it does not set any ex ante quantitative limits on the size of transactions. According to an ECB press release of 6 September 2012 which outlines the framework of the OMT, the ECB will only purchase government bonds of Member States which are covered by a programme under the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM). Participation in those programmes is attached to a strict conditionality requiring the achievement of certain policy objectives. The liquidity created through OMT shall be, according to the ECB, fully sterilised.

Despite their clearly critical approach to OMT, the German constitutional judges do consider the possibility of an interpretation of the OMT that would in their opinion be in conformity with EU law and thus covered by the German Constitution. This would require an interpretation of EU law that effectively imposes limits on the possible amount of purchases of government bonds. In order to gain clarity on the legal status of the OMT under EU law, the German Federal Constitutional Court has asked the ECJ to rule on the compatibility of the OMT with EU law.

In its preliminary ruling in due course the ECJ will have to cut a Gordian knot. On the one hand, it seems improbable that the European judges will risk a constitutional conflict with the highest German court by simply upholding the OMT in its entirety. On the other hand, an imposition of limits on the overall amount of purchases of government bonds could compromise the success of the mere announcement of the OMT and, moreover, provoke a resurgence of the Euro area debt crisis. Arguably the (potential) dilemmas this involves are reflected in the opinion on this case by Advocate General Cruz Villalón published today.

SUMMARY OF THE MAIN ARGUMENTS OF ADVOCATE GENERAL CRUZ VILLALÓN

The OMT is, according to Advocate General (AG) Cruz Villalón, compatible with EU law. The AG considers the OMT to be an ‘unconventional monetary policy measure’, which is covered by the ECB’s exclusive competence to conduct the monetary policy of the Union. The ECB is considered to have a broad discretion for the purpose of framing and implementing the Union’s monetary policy.

According to this view 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 and as such may include economic policy aspects. In the opinion of the AG this is compatible with the ECB’s mandate only as long as it serves to ‘support’ economic policy measures and is subordinate to the ECB’s overriding objective. At the same time the AG stresses that any concrete measures implementing the OMT (the ECB’s press release of 6 September 2012 on the OMT is not considered to be such a legally binding act) will require a proper justification

(given their ‘unconventional’ character) namely against the background of the EU principle of proportionality that applies to all measures taken by EU institutions.

The AG does questions the monetary character of the OMT to the extent that the ECB is substantially involved in the ‘troika’. 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 such programmes. If the ECB is at the same time within the ‘troika’ in the driving seat of the negotiation and the supervision of financial assistance programmes and decides on the implementation of the OMT, the strict border-line between economic and monetary policy gets blurry. The AG therefore requests that the ECB refrains from any direct involvement in the EFSF/ESM financial assistance programmes once the OMT is to be implemented.

The OMT is also not considered to violate the prohibition of monetary financing of Member States (Article 123 TFEU). This prohibition covers primarily the purchase of government bonds on primary markets. Secondary market operations shall, furthermore, not circumvent this prohibition. Under the ECB statute the ECB is entitled to open market operations (Article 18.1) which covers the purchase of government bonds on secondary markets. Such operations may, in the eyes of the AG, circumvent the prohibition of monetary financing of Member States by influencing the formation of market prices for government bonds. He therefore suggests that a possible implementation of the OMT must contain 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.

HAS ADVOCATE GENERAL CRUZ VILLALÓN FOUND THE ‘GOLDEN MEAN’?

The opinion of Advocate General Cruz Villalón fails in finding the ‘golden mean’. In fact, should the ECJ follow its AG, a constitutional standoff between the German and Luxemburg court becomes a realistic scenario. In its order for reference to the ECJ, the German Federal Constitutional Court has clearly formulated that it considers the correction of a disruption to the monetary policy transmission mechanism not to be a monetary policy measure. The German judges have interpreted the discretion of the ECB for the implementation of the monetary policy of the Union less broad than what can be found in the reasoned opinion by the AG. For the German Court the purchase of government bonds under the OMT may support monetary policy, but is to be classified as an economic policy measure, whereas the AG takes up the opposite stance. The suggested withdrawal of the ECB from the ‘troika’ will not fundamentally alter the stands by the Bundesverfassungsgericht, which considers the OMT by itself to already constitute an independent measure of economic policy.

Furthermore, the Bundesverfassungsgericht considers any purchase of government bonds on secondary markets as an influence on the formation of market prices for government bonds on primary markets. If the Court sticks to its reasoning in its order for reference, it will have to declare the OMT (if interpreted in the light of the opinion of AG Cruz Villalón) as incompatible with the German constitution.

Special attention should be given to the classification made by the AG that ECB’s action in the context of the financial assistance programmes amounts to an economic policy measure which surpasses the mandate of the ECB. It is, indeed, hard to see how the negotiation of economic policy goals and the subsequent monitoring within financial assistance programmes under the ESM can be considered as monetary policy. Certainly, according to the AG, the purchase of government bonds on secondary markets can be considered as monetary policy measures. In order to prevent ‘moral hazard’ such measures may even be made conditional upon the implementation of certain economic goals. The ECB may, however, not set those economic goals. Otherwise the OMT turns into an implementation measure for economic goals that are set by the ECB, which would indeed be beyond the powers of the ECB. In his reasoned opinion the AG links this argument to the conditionality of the OMT. This argument can, however, also be detached from the OMT and further generalised: The negotiation of policy goals and the subsequent monitoring cannot be considered to be covered anymore by the monetary policy mandate of ECB. Accordingly, the ECB should withdraw from the ‘troika’ as a full negotiation partner. Finally, the requirement of an ‘embargo period’ of a given number of days before the Eurosystem will purchase government bonds appears not to prevent the circumvention of the prohibition of monetary financing of Member States. Private investors and banks

will price in the fact that the Eurosystem will purchase government bonds after an ‘embargo period’. This leads to the assumption made by the German Federal Constitutional Court that the quantity of purchases of government bonds influences the formation of market prices for government bonds on primary markets rather than the time of purchases. 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 effects of the OMT in general, it becomes less convincing if one refers to the ‘formation of market prices on primary markets’ – as does the Advocate General – in order to assess a possible circumvention of the prohibition of monetary financing of Member States through purchases of government bonds on secondary markets.

CONCLUSION AND CONSEQUENCES

A final judgment of the ECJ that follows the reasoned opinion of the Advocate General will most likely lead to two main consequences. First, the Bundesverfassungsgericht will – if it sticks to the reasoning in its order for reference – declare the OMT to be unconstitutional which will result in the Bundesbank not taking part in the future implementation of the OMT. Second, and this will prevent the first, the ECB will replace the OMT by ‘Quantitative Easing’. Such an unconventional monetary policy measure that covers the purchase of government bonds of all Member States will have no link with the compliance of 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 of Member States is suited to also approve quantitative easing. Should the ECJ join the AG in his critical reasoning on the ECB’s participation in the financial assistance programs, an amendment of the ESM Treaty would be needed. The ESM Treaty in its current form provides for an active role of the ECB, namely in the procedure for granting financial stability support and the negotiations of the economic policy conditionality.

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