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Whatever it takes

*ECB's Mandate of Purchasing Government Bonds on
Secondary Markets*

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Summary

When the European debt crisis struck the eurozone in late 2009, the European Central Bank (ECB) played a vital role to mitigate the economic situation. In 2012, the ECB announced the introduction of Outright Monetary Transactions (OMT), a government bond buying programme. In 2015, the ECB introduced the Public Sector Purchase Programme (PSPP), a quantitative easing programme similar to the OMT.

In 2014 and 2017 respectively, both programmes were challenged at the Federal Constitutional Court in Germany, which referred both cases to the Court of Justice of the European Union (CJEU). The complainers argued that both programmes were, in fact, monetary financing, which is forbidden by the TFEU, and ultra vires acts by the ECB. The CJEU concluded that neither the OMT programme nor the PSPP was monetary financing or an ultra vires act. This paper will analyse both cases in order to understand when purchases, by the ECB, of government bonds on secondary markets are not regarded as monetary financing, and where the line between monetary and economic policy goes according to the TFEU. The purpose of this is to understand which measures the ECB is permitted to take in the event of a future crisis. The methodology used is primarily the methodology of EU law: putting gravity in CJEU cases and principle when interpreting the Treaties.

The paper shows that the ECB must put up safeguards to remove the foreseeability of which bonds the ECB will purchase, when it will purchase them, and the size of the purchase volume. Furthermore, to tell a monetary policy measure from an economic measure, the objective of the measure and the instruments used must be monetary. Lastly, the principle of proportionality plays a vital part in concluding if enough safeguards have been put up. For instance, a severe economic situation justifies fewer safeguards.

Sammanfattning

När eurokrisen slog till i Europa i slutet av 2009, så fick den Europeiska centralbanken (ECB) en vital roll för att minska skadan av den dåvarande ekonomiska situationen. I slutet av sommaren 2012 kungjorde ECB *Outright Monetary Transactions* (OMT), ett program där ECB skulle köpa statsobligationer. År 2015 introducerade ECB *Public Sector Purchase Programme* (PSPP), ett kvantitativt lätttnadsprogram som är likt OMT.

År 2014 och 2017 tog personer de båda programmen till den tyska konstitutionsdomstolen, som begärde förhandsavgöranden från EU-domstolen i båda fallen. De klagande ansåg att båda programmen var dels de facto monetär finansiering (som är förbjudet enligt FEUF), dels ultra vires-handlingar av ECB. EU-domstolen konkluderade att varken OMT eller PSPP-programmet var monetär finansiering eller ultra vires-handlingar. Denna uppsats kommer att analysera båda fallen för att förstå när förvärv av statsobligationer på sekundärmarknader av ECB ska anses som monetär finansiering, samt var gränsen mellan monetär och ekonomisk politik går enligt FEUF. Syftet med detta är att förstå vilka handlingar ECB juridiskt sett får ta vid en framtida ekonomisk kris. Metoden den här uppsatsen har använt sig av är EU-rättslig metod. Detta innebär att fokus har legat på rättsfall från EU-domstolen samt grundläggande rättsprinciper inom EU när traktaten ska tolkas.

Uppsatsen visar att ECB måste sätta upp skydd för att ta bort förutsebarheten för vilka obligationer som ECB ska förvärva, när den kommer att förvärva dem samt storleken av förvärven. Uppsatsen visar även det som skiljer mellan en monetär och en ekonomisk politik är att målet med åtgärden, samt instrumentet som åtgärden använder sig av, ska vara monetär. Till sist så har proportionalitetsprincipen en väsentlig betydelse vid avgörandet om tillräckligt skydd har vidtagits. En allvarlig ekonomisk situation rättfärdigar exempelvis ett svagare skydd.

Abbreviations

ABSP	Asset-backed Securities Purchase Programme
APP	Expanded Asset Purchase Programme
BVerfG	Bundesverfassungsgericht, <i>the Federal Constitutional Court of Germany</i>
CBPP3	Third Covered Bond Purchase Programme
CJEU	Court of Justice of the European Union
CSPP	Corporate Sector Purchase Programme
ECB	European Central Bank
EFSF	European Financial Stability Facility
EMU	Economic and Monetary Union of the European Union
ESCB	Eurosystem of Central Banks
ESM	European Stability Mechanism
EU	European Union
OMT	Outright Monetary Transactions
PSPP	Public Sector Purchase Programme
QE	Quantitative Easing
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union

1 Introduction

*“Within our mandate, the ECB is ready to do whatever it takes to preserve the Euro. And believe me, it will be enough.”*¹

1.1 Background

The financial crisis of 2007–2008, *the Great Recession*, was a severe economic crisis that shocked the financial markets throughout the whole world.² Consequently, the euro area was struck by a grievous debt crisis, where the Member States of the European Union (EU) within the euro area received huge debt burdens. To combat the crisis, the Member States of the Economic and Monetary Union of the European Union (EMU), put forward saving packages to prevent, among others, Greece from becoming national insolvent and leaving the EMU.³ Besides these saving packages, the European Central Bank (ECB) played a vital role during the crisis as the central bank for the euro. Besides normal macroeconomic measures as reducing the interest rate, the ECB announced the introduction of Outright Monetary Transactions (OMT) in 2012.⁴ During this intensive period, the President of the ECB, Mario Draghi, famously stated that the ECB would do “whatever it takes to preserve the euro”⁵. In 2015, the ECB introduced the Public Sector Purchase Programme (PSPP), a programme similar to the OMT.⁶

In 2014, the legality of OMT was challenged at the Federal Constitutional Court of Germany, *Bundesverfassungsgericht* (BVerfG). The complainers claimed that OMT were an act of *ultra vires*⁷ and monetary financing of the

¹ Speech by Mario Draghi, President of the ECB at the Global Investment Conference in London, July 26th 2012, see ECB, ‘Verbatim of the remarks made by Mario Draghi’.

² See Havemann, J.

³ Ray, M.

⁴ ECB, ‘Technical Features of Outright Monetary Transactions’.

⁵ ECB, ‘Verbatim of the remarks made by Mario Draghi’.

⁶ ECB, ‘ECB announces expanded asset purchase programme’.

⁷ Beyond the legal power or authority.

Member States. The court did not come to a decision, and for the first time in its history, it referred to the Court of Justice of the European Union (CJEU) for a preliminary ruling.⁸ In 2017, the BVerfG made a similar referral to the CJEU. This time asking whether the PSPP was an act of ultra vires and monetary financing.⁹ The two cases have elucidated the obscure monetary mandate of the ECB. Hence, this paper will examine if the cases have made the limits of monetary policy in the EU clearer.

1.2 Purpose and the legal controversy

The economic distress caused by the Great Recession shaped the economic policies of today to prevent and mitigate future economic crises. It is important to highlight that economic crises are not something extraordinary – they have played a part in modern history and will most likely occur in the future.¹⁰ In the event of an economic crisis, central banks play one of the most vital roles to ensure the crisis does not deteriorate.¹¹ By enacting monetary policies, a central bank can affect deflation, hyperinflation, unemployment, and other consequences of economic nature.¹²

For this reason, it is crucial to know the legal limits of the mandate central banks have. As the EU is the second largest economy in the world¹³, the euro the second largest reserve currency in the world¹⁴, actions of the ECB have not only a huge impact in the eurozone and the EU, but the whole world.

Following the Great Recession, Europe was struck by a debt crisis in late 2009. After several measures by the ECB, it announced the introduction of

⁸ Di Fabio, U.

⁹ See *Gauweiler and Weiss*.

¹⁰ See *The Economist* 2014 and *The Economist* 2016.

¹¹ Schnabel, I pp. 49–51.

¹² The Editors of *Encyclopædia Britannica*, ‘Monetary policy’.

¹³ Central Intelligence Agency.

¹⁴ International Monetary Fund.

OMT in 2012. In this programme, the Eurosystem of Central Banks¹⁵ (ESCB) would purchase government-issued bonds on secondary markets if the Member States in need of OMT made certain concessions. Put differently, it would not buy the bonds from the issuers, the governments, but from creditors.¹⁶ In 2013, Gauweiler and more challenged OMT in the BVerfG. The court referred, for the first time ever, to the CJEU. The BVerfG argued, that OMT was a forbidden circumvention of the monetary financing prohibition in Art. 123 TFEU and an ultra vires measure by the ECB, as the programme infringed the economic policy mandate that has been given to the Member States by Art. 119 TFEU.¹⁷

In 2017, complaints were made to the BVerfG regarding the PSPP. In the programme, the ESCB would buy large quantities of government-issued bonds, this time with no sacrifice from the bond issuers. The BVerfG, for the second time in its history, referred the case to the CJEU, asking similar questions as in the Gauweiler referral.¹⁸

In 2015, the CJEU concluded in the OMT case, *Gauweiler and others v Deutscher Bundestag* (Gauweiler), that OMT was neither an act of monetary financing nor an act of ultra vires. In December 2018, the CJEU concluded in *Weiss and others* (Weiss) that the PSPP, as well, was an act of intra vires¹⁹ and not an act of monetary financing.²⁰ However, there are some uncertainties regarding the mandate. The first issue regards monetary financing. Art. 123(1) TFEU prohibits the purchase of government bonds on primary markets (monetary financing). Purchases on secondary markets are, as well, prohibited if the purchase has the same effects as if the purchase would have been made on the primary market. If the effects differ from those of monetary financing, it is permitted. The question is where this line goes.

¹⁵ The ECB and all central banks in the euro area.

¹⁶ ECB, 'Technical Features of Outright Monetary Transactions'.

¹⁷ 2 BvR 2728/13 pp. 6–7.

¹⁸ 2 BvR 859/15 pp. 6–8.

¹⁹ Within the powers.

²⁰ See rulings on Gauweiler and Weiss.

The second issue regards the conduct of monetary policy with economic policy effects. As both the OMT and the PSPP had the same effects as economic policy measures, it is, hence, appropriate to ask whether the measure in question was not, in fact, an economic policy measure. As written above, Member States have the exclusive competence of economic policy measures. The CJEU concluded that both programs were within the frame of monetary policy shaping, hence, it is unclear where the limit between economic and monetary policy goes.

Thus, the purpose of this paper is to clarify the limits of the monetary mandate of the ECB, regarding the purchase of government bonds on secondary markets. This is important since it is vital to know what type of measures the ECB is permitted to take in the event of a crisis.

This paper will hence answer the two following questions:

- When the ESCB purchases government bonds on secondary markets, which safeguards must be taken to make the purchase permitted regarding the monetary financing prohibition in Art. 123 TFEU?
- In the light of Arts. 119 and 127 TFEU, what differs a monetary policy from an economic policy measure?

1.3 Methodology

To answer these questions, this paper will primarily use the methodology of EU law²¹. Secondly, to a minor extent, it will be using the methodology of institutionalism. Using the methodology of EU law, the paper will mainly focus on the argumentation and judgment of the CJEU. This is because the CJEU has the exclusive competence over interpreting the treaties.²² In this type of methodology, general legal principles of EU law have the equivalent

²¹ My translation of 'EU-rättslig metod'.

²² Art. 19(3) TEU and Art. 267 TFEU.

status of the Treaties.²³ I will, therefore, focus on the principle of proportionality, which is relevant to decisions taken by EU institutions. Gravity will also be put into the objective of the articles of the treaties, as this too is an important factor in the methodology of EU law.²⁴

The methodology of institutionalism will also be incorporated in this paper. This is because the paper covers actions of one of the seven main bodies of the EU: The ECB. The institutionalism will examine ECB's role in the EU regarding its competence, expertise and relationship to the Member States.²⁵

The paper will examine the controversies from an international perspective. As the mandate of the ECB is supranational²⁶, the relation between this mandate and the competence of the Member States will be scrutinized, which covers the foundation of the international relations in the EU. To scrutinize the controversies, the paper will examine arguments used by the CJEU in *Gauweiler* and then in *Weiss*, in the light of the questions asked by the BVerfG and the two questions in section 1.3. It will, also, put these into the context of the principles of EU law.

1.4 Limitations

As the scope of monetary policies and monetary acts is wide, the paper will only focus on the purchase of government-issued (governments of Member States in the euro area) bonds on secondary markets by the ESCB. In both cases, *Gauweiler* and *Weiss*, this type of bond is the main subject.

It is important to state that *Weiss* was published on December 8th 2018. Consequently, no commentaries have been found on the case. Regarding OMT, most of the papers have examined the relationship between the CJEU

²³ See *Audiolux*, para. 63 and *NCC Construction Denmark*, para. 42.

²⁴ Reichel, J p. 122.

²⁵ Bakardjieva Engelbrekt, A pp. 266–268.

²⁶ Art. 119 TFEU and Lang, A pp. 950–951.

and the BVerfG. This paper will focus on the CJEU-cases. The reason is because according to EU law, CJEU has the exclusive competence of interpreting the treaties, and not national courts.

1.5 Research on the subject

Gauweiler was a landmark case since it was the first time the BVerfG referred to the CJEU. Many research papers on the subject have been published in prominent law journals, as *The Common Market Law Review* and *The European Law Review*.²⁷ However, the research that exists on this issue discusses the relationship between the BVerfG and the CJEU by analysing how differently the courts interpret the treaties.

This is not relevant for this paper as it will analyse EU law, which, as written above, is interpreted by the CJEU. Because of the separate discussion in other research papers and the quantitative limitation for this paper, it will not use other research to an extent. Lastly, I want to emphasise that the research that exists is research conducted on Gauweiler. Judgment in Weiss came December 8th 2018, ergo, I have not found any research on that judgment by the time this paper is published.

²⁷ See Lang, A and Grund, S & Grle, F.

2 Monetary financing and monetary policy

The central controversies in both cases regard two economic phenomena. To fully understand the legal controversies in the cases, this short chapter will expound the two phenomena and explain how they are regulated.

2.1 Monetary financing

As written above, one of the main tasks of a central bank is controlling the supply of money. To do this, the central bank is often the institution printing money – physically and digitally. Monetary financing is the act when a central bank prints money with the objective of using the newly printed money to fund the central government. An example is when a central bank uses the newly printed money to purchase government securities. Consequently, the treasury gets a financial injection directly from the central bank. In EU law, Art. 123 TFEU forbids monetary financing by prohibiting the ECB to purchase government-issued securities.²⁸

2.2 Economic and monetary policy

Economic policy is all policy that use economic instruments to affect the economy. A primary example of economic policy is fiscal policy. A government uses fiscal policy by regulating taxation levels and government expenditure. A secondary example of economic policy is monetary policy. This is policy a central bank utilizes by adjusting the interest rate and controlling the supply of money and credit.²⁹ In EU law, the frames of

²⁸ Sovereign money.

²⁹ The Editors of Encyclopædia Britannica, ‘Monetary policy’

monetary policy are vaguely³⁰ laid out in Art. 127 TFEU, which states the objective with the monetary policy of the Union – maintaining price stability. Furthermore, Art. 119 TFEU states that the mandate of monetary policy is given to the ECB and the economic policy to the Member States. Hence, the Member States have the exclusive mandate of all economic policy that is not monetary policy.

³⁰ CJEU's, as well as my, opinion, see Gauweiler para. 42.

3 Outright Monetary Transactions

3.1 The functioning of OMT

The OMT programme was announced August 2nd 2012 by the ECB.³¹ The programme never saw the light of day as the mere announcement of it had yearned desirable effects on the economy. Nevertheless, the legal aftermath made it all the way to the CJEU.

In the programme, the ESCB would buy short termed government-issued bonds, which would have a maturity date³² between 1–3 years, on secondary markets. The purchase quantity was unlimited, which meant the ESCB could buy as many as it deemed necessary.³³

If a Member State wanted the ESCB to implement OMT for its bonds, the ECB had set up a conditionality. The Member State must have had applied and received financial aid from one of the European bailout programs – the European Stability Mechanism (ESM) or the European Financial Stability Facility (EFSF). That means the state in question must have had agreed on certain austerity measures, as spending cuts and tax increases, in order to receive the OMT programme. The measures must have been complied with at the time of the OMT purchase.³⁴

³¹ ECB, ‘Introductory statement to the press conference (with Q&A)’.

³² Maturity date is when the bond becomes due. The investor is repaid and the interest payments stop.

³³ ECB, ‘Technical Features of Outright Monetary Transactions’.

³⁴ Ibid.

The expected outcome of OMT was a decrease in the bond yield³⁵, which would lead to reduced interest rates. Consequently, the huge debt burden would be more manageable for the states.

3.2 OMT in Bundesverfassungsgericht

In 2012, Gauweiler and others questioned the legality of OMT at the BVerfG. The applicants argued that OMT was an act of ultra vires by referring to Art. 119 and 127 TFEU, and a prohibited form of monetary financing, forbidden by Art. 123 TFEU.³⁶

BverfG reviewed the case and announced in 2014 that it would make no ruling in the case and instead, for the first time in its history, referred the case to the CJEU. Even though it was a referral, it is comprehensible that the court was sceptical to the legality of the OMT programme.³⁷ In its referral to the CJEU, the court first asked if OMT was not, in fact, an economic policy measure, a breach of Arts. 119 and 127 TFEU, and secondly, if the OMT was compatible with Art. 123 TFEU, which prohibits monetary financing.³⁸

3.3 OMT in the European Court of Justice

3.3.1 Monetary financing

The CJEU acknowledged in its judgment that the ESCB is forbidden to give any sort of financial assistance to a Member State, but permitted to purchase bonds issued by the Member State if it is purchased by a creditor to the state (on the secondary market). However, the CJEU explained, that these kinds of

³⁵ Bond yield is the return an investor receives for a bond.

³⁶ BVerfG 2 BVR 2728/13 para. 5.

³⁷ Ibid. ff. and Lang pp. 949–951.

³⁸ BVerfG 2 BVR 2728/13 p. 6.

purchases are forbidden if the effects from the purchases are the same as if the ESCB would have bought the bonds directly from the issuer (the government of the Member State). If that would be the case, it would evade the prohibition in Art. 123(1) TFEU, and hence be prohibited.³⁹

To decide whether a purchase of government bonds on the secondary market is compatible or not with Art. 123(1) TFEU, the objective of the measure must be determined.⁴⁰

By examining the preparatory work of the Treaty of Maastricht, the court found that the aim of Art. 123 is to encourage the Member States to follow a sound budgetary policy. If monetary financing of public deficits or the treasury was allowed, it could lead to massive public deficits and unduly high levels of debt. Hence, purchases on the secondary market should not circumvent this objective.⁴¹

If creditors of government-issued bonds would know for sure that the ESCB would purchase their bonds within a certain time period, the court acknowledged that the effects would be the same as if the ESCB would purchase the bonds on the primary market, making the creditors as de facto intermediaries. For a purchase not to breach Art. 123(1), enough safeguards must be put in place to make it tolerable.⁴²

The safeguards the ECB had put up to prevent this issue, were a few. One of the safeguards was a minimum time period between the issue of a bond and its purchase. The ESCB would also abstain from making any announcement regarding future purchases or the volume of these purchases. The court emphasised that these safeguards would remove certainty that the ESCB would purchase the bonds after their issue. Consequently, the programme

³⁹ C-62/14 paras. 95–97.

⁴⁰ Ibid. para. 98.

⁴¹ Ibid. paras. 98 and 100, European Economic Community pp. 24 and 54, and seventh recital in the preamble to Council Regulation (EC) No 3603/93.

⁴² C-62/14 paras. 102 and 104.

would not have effects equivalent to those of purchases of bonds on the primary market.⁴³

Consequently, because of the safeguards, the Member States could not foresee with certainty that the ESCB would purchase their bonds and that the OMT programme would not harmonise all the interest rates in the EU.⁴⁴

However, the court acknowledged that these purchases, even though they are permitted, could influence the functioning of the primary and secondary market. Nevertheless, this was not an issue, as these effects are generally inevitable when the ECB acts on secondary markets, which is permitted by the TFEU. In addition, these effects are vital for monetary policy measures.⁴⁵

Furthermore, the BVerfG argued that the OMT would minimize the incentive of a Member State to follow a robust budgetary policy. The CJEU did not agree. The court argued that ESCB shall, according to Arts. 119(2), 127(1) and 282(2) TFEU, support the general economic policies in the EU. Therefore, OMT could not in that regard lessen the effectiveness of those policies by minimizing the incentive to follow a robust budgetary policy.⁴⁶

3.3.2 Acting ultra vires

3.3.2.1 Objective and instruments

The BVerfG questioned whether OMT was an act of economic policy and not monetary policy, due to its effects of economic policy nature. CJEU wrote in its judgment that to assess if a measure is a measure of monetary policy, one has to look at firstly, the objective of the measure, and secondly the instruments used.⁴⁷

⁴³ Ibid. paras. 106–107.

⁴⁴ Ibid. para 113.

⁴⁵ Ibid. para 108.

⁴⁶ Ibid. para 109.

⁴⁷ Ibid. para. 46 and BVerfG 2 BVR 272813 p. 6.

The press release of the OMT stated that there were two objectives with the programme. The first objective aimed to protect ‘an appropriate monetary policy transmission’, and the second objective aimed to protect the ‘singleness of monetary policy’.⁴⁸ Art. 119 TFEU states that monetary policy in EU shall be single. Regarding the protection of appropriate monetary policy transmission, the court wrote that it is likely to preserve the monetary policy as single as well as maintaining price stability.⁴⁹

The primary aim of the ECB and the monetary policy of the EU is to maintain price stability. To influence price developments, the court argued, the ECB uses transmission of ‘impulses’ to the money market in various sectors of the economy. If this transmission gets interrupted, it would undermine its effectiveness of maintaining price stability and sabotage the singleness of monetary policy. Hence, if the objective of a measure is to maintain the transmission mechanism, it is equivalent to maintaining price stability – the primary objective of the ECB and the ESCB. Thus, by looking at the objective and instruments used for the programmes, the court concluded that it was within the frame of monetary policy. The condition of complying with ESM or EFSF was not a hinder to that conclusion.⁵⁰

3.3.2.2 Compliance with ESM and EFSF

Since the implementation of OMT conditioned compliance with one of the bailout programmes, ESM or EFSF, possible effects of OMT could be the increased incentive to comply with those programmes and thus stimulate the economic policy of those programmes. The court objected, however, that the OMT should be treated as equivalent to an economic policy measure merely because it had those indirect effects. This is because it is stated in the TFEU that ESCB shall support general economic policies in the EU.⁵¹

⁴⁸ C-62/14 para. 47.

⁴⁹ Ibid. paras. 47 and 49.

⁵⁰ Ibid. paras. 50 and 56–57.

⁵¹ Ibid. paras. 58–59, see Arts. 119(2), 127(1) and 282(2) TFEU.

The court emphasised that the objective of ESM was not one of monetary policy, it served to protect the stability of the euro area. The difference between ESM's and ECB's objectives is conclusive for the OMT. The fact that OMT conditions participation in a macroeconomic adjustment programme, would be regarded as economic policy if that was the primary objective. The ECB's objective with the OMT, however, has been maintaining price stability, whilst ESM's objective is to protect the stability of the euro area – the latter not being monetary policy. As the ECB's objective would not take the place of ESM's objective, but rather serve independently on the aims of monetary policy, it shall not be regarded as if OMT were implemented particularly to stimulate ESM's programme and thus shall be regarded as monetary policy.⁵²

3.3.3 Proportionality

The court emphasised that a bond-buying programme such as OMT must be proportionate to the objectives of the measure. The ESCB shall therefore not implement a policy that goes further than what is necessary. The situation in the EU when the press release was published was severe. Interest rates on certain government bonds had high volatility, amid speculations of a euro area break up. This severe situation gravely eroded the monetary transmission mechanism of the ESCB.⁵³

The court also put great trust in the economic expertise of the ESCB, and that OMT were likely to have reduced the high interest rates and minimizing the risk of a breakup of the euro area. Due to the fact that the programme itself never got implemented, as the mere announcement of it had the effects that were sought, shows that it did not 'exceed what is necessary'⁵⁴ to achieve the objective of price stability.⁵⁵

⁵² C-62/14 paras. 63–65.

⁵³ Ibid. paras. 66–67 and 72–73.

⁵⁴ The principle of proportionality in Art. 5(4) TEU.

⁵⁵ C-62/14 paras. 76–77 and 79–84.

3.4 Summary

The court found that the OMT was neither an act of monetary financing nor an act of ultra vires. Regarding the prohibition of monetary financing in Art. 123 TFEU, the court acknowledged that if buyers of the bonds knew for certain that the ESCB would purchase the bonds, it would have the same effect as if the ESCB would purchase the bonds on the primary market, and therefore would be illegal. But the court considered the safeguards the ESCB put up as sufficient for different effects.

When it comes to the possibility of acting ultra vires, the objective of the OMT was central when the court decided whether it was an ultra vires act or not. It was clear that the objective with the OMT was to keep the monetary policy single and maintaining price stability within the euro area (by keeping the transmission continuous). Furthermore, the court further wrote that even though these kinds of government-bond programs may force the Member States to comply with these adjustment programmes and therefore promote the economic policy of these programmes, it should not be seen as an economic policy measure, only as a support.⁵⁶

⁵⁶ Ibid. paras. 58–59.

4 The Public Sector Purchase Programme

4.1 The functioning of the PSPP

In 2015, the ECB decided to launch the Expanded Asset Purchase Programme (APP).⁵⁷ APP is a form of Quantitative Easing (QE), an instrument for implementing monetary policy, which has become popular among central banks post 2008.⁵⁸ QE is when the central bank prints money with the sole purpose of using it to purchase financial assets. By doing so, the sought effect is that yield decreases and, consequently, interest rates on loans. As a result, the reduced interest rate and money injections to the banks boost economic activity and, hence, increase inflation levels.⁵⁹

ECB's QE programme, APP, consists of four sub-programmes: The Corporate Sector Purchase Programme (CSPP), the Asset-backed Securities Purchase Programme (ASPP), the Third Covered Bond Purchase Programme (CBPP3), and the PSPP. PSPP is the only programme purchasing public securities, the other purchasing private. As of November 2018, the PSPP holdings equalled € 2,1 trillion.⁶⁰

As the ECB is prohibited to purchase government bonds directly from the governments, the ECB instead purchases the bonds from the creditors of these states – financial institutions such as banks, which have purchased these bonds from the governments. The securities the ESCB purchases are central government-issued bonds (from the Member States that have the euro as currency) that are inflation-linked and nominal, and bonds issued by

⁵⁷ ECB, 'ECB announces expanded asset purchase programme'.

⁵⁸ Ibid. and Encyclopædia Britannica '*Quantitative Easing*'.

⁵⁹ Bank of England.

⁶⁰ ECB, 'Asset purchase programmes'.

multilateral banks, recognised agencies, and international organizations located the euro area.⁶¹

4.2 The PSPP in Bundesverfassungsgericht

After Gauweiler was settled in the CJEU, the validity of the PSPP was questioned in the BVerfG. This time, the BVerfG applied the lessons learned from Gauweiler into the PSPP case, but nevertheless referred the case to the CJEU for a preliminary ruling.

Five questions were asked to the CJEU, the last was however declared inadmissible by the CJEU. The first two questions regarded the prohibition against monetary financing in Art. 123 TFEU. The third and fourth question regarded a possible ultra vires act by the ECB. BVerfG did not seem to have any objections against the PSPP in general, but found its extraordinary financial volume, its duration and the economic policy effects to be questionable.⁶²

4.3 The PSPP in the Court of Justice of the European Union

4.3.1 Monetary financing

4.3.1.1 Safeguards and circumvention of Art. 123(1)

The court pointed out that according to Decision 2015/774 the ECB under PSPP will not purchase bonds from the Member states or any of its bodies, but only indirectly on secondary markets. Nevertheless, when it purchases

⁶¹ Art. 3 Decision 2015/774.

⁶² BVerfG PSPP, para. 100 and Lang, A p. 929.

government-issued bonds on secondary markets, two limits shall be noted. Firstly, if the effects of a purchase on the secondary market are equivalent to that of a purchase on the primary market, the purchase is prohibited. Secondly, the ECB must build enough safeguards around the purchase so the intervention does not contravene the prohibition against monetary financing in Art. 123 TFEU, and that the incentive to follow a sound budgetary policy is not minimized, which is the aim of the article.⁶³

If, for instance, private operators knew for certain that the bonds they purchase from the Member States would later be purchased by the ESCB, the PSPP would breach Art. 123 TFEU as private operators would be acting as de facto intermediaries. The court acknowledged in the judgment that there exists foreseeability to some extent due to the fact that the ECB publishes features (the volume of purchases, duration, allocation rules and eligibility criteria) of the programme in advance. However, the ESCB has put enough safeguards to ensure that it will be practically impossible to calculate future purchases.⁶⁴

Firstly, there is a blackout period. The period ensures that there is a duration between the issue and the purchase by the ESCB of the bond. The length of this period is not stated, but according to the ECB, the period is measured in days and not weeks. The court concluded that the absence of information regarding the duration of the blackout period, limits the foreseeability for private operators and Member States regarding ESCB's intervention.⁶⁵

Secondly, the ESCB has introduced safeguards to prevent private operators from knowing what type and volume of bonds the ESCB will purchase under the PSPP. The ESCB will, primarily, not disclose the monthly volume of purchases in advance, hence, private operators will not know in beforehand how many bonds the ESCB will purchase the coming month. This volume

⁶³ C-493/17 paras. 104–107.

⁶⁴ Ibid. paras. 109–113 and 128.

⁶⁵ Ibid. paras. 114–116 and Art. 4(1) Decision 2015/774.

may change from month to month. Secondly, the ECB's capital will be distributed among the Member States' central banks, but it will be unknown how much a certain central bank purchases bonds issued by its government. Further flexibility makes it more difficult to foresee which bonds that will be purchased. For instance, substitute purchases and ad hoc deviations from the specialisation scheme⁶⁶ may be carried out.⁶⁷

Thirdly, the diversity among the bonds will be sizeable. Not only bonds from central governments will be purchased, but also bonds issued by regional and local governments. The bonds will also differ by having different types of maturity dates, yields and different quotas.⁶⁸

The court concluded that the PSPP will not reduce the incentive of conducting a sound budgetary policy (which evidently is why monetary financing is forbidden) among the Member States, as the implementation of the PSPP may be terminated, and in that case will be forced, if it has a deficit, to seek finance on the market taking advantage of the good finance effects of the PSPP.⁶⁹

4.3.2 Acting ultra vires

As in *Gauweiler*, the court acknowledged that a precise definition of monetary policy does not exist in the TFEU. Nevertheless, it defines the objective and instruments for implementing monetary policy. The primary objective of monetary policy is to maintain price stability. However, the court pointed out that the authors of the treaty, firstly, wrote this in a general and abstract manner, and secondly, chose to not quantify the price stability. Moreover, the ESCB shall also support the general economic policies in the union.⁷⁰

⁶⁶ The specialisation scheme shows which securities which central banks shall purchase.

⁶⁷ C-493/17 paras. 117–120.

⁶⁸ See *Ibid.* paras. 121–125.

⁶⁹ *Ibid.* para. 136.

⁷⁰ *Ibid.* paras. 50–51, 55 and Arts. 127(1) and 282(2).

Accordingly, to decide whether a measure is an act of monetary policy, one must look at the objectives for that measure, as well as the instruments used. The objective of the PSPP, the court wrote, is to return inflation levels below but close to 2 per cent, which is equivalent to the primary inflation goal.⁷¹

The court acknowledged that it is undisputed that the PSPP may have an impact on the finance on commercial banks and the Member States in a way that is equivalent to economic policy measures. However, the ESCB shall support the general economic policies in the EU, without breaching Art. 119. In conclusion, the authors of the Treaties did not make an absolute separation between economic and monetary policy. In addition, a monetary policy measure should not be treated as an economic policy measure merely because its indirect effects can be the same as an economic policy measure.⁷²

In summary, if the ESCB shall influence inflation rate in the union, it must conduct monetary policy measures that will impact, inter alia, balance sheets of commercial banks, financing conditions for the Member States, investments, consumption, and savings. Monetary measures will often impact the real economy, effects that are also sought with economic policy measures. Conclusively, if the ECB was prevented to take actions that in any way was foreseeable or had effects of economic policy nature, it would prevent it from using instruments that the Treaty has given to it to attain the monetary policy objective.⁷³

4.3.3 Proportionality

The CJEU emphasised in the judgment that once the PSPP was introduced, inflation levels were far below the target of below but close to 2 per cent, as they were not higher than -0,2 per cent. According to the ECB, large scale

⁷¹ Ibid. paras. 53–54 and 56.

⁷² Ibid. paras. 59–61.

⁷³ Ibid. paras. 58–59 and 64–67.

purchases of government bonds have the effects of decreased interest rates and boosted economic activity.⁷⁴

4.4 Summary

As in *Gauweiler*, the CJEU once again regarded the government-bond buying programme neither as an act of ultra vires nor as monetary financing. Regarding monetary financing, the purchase itself shall not be seen as financial assistance. However, if the purchase had the same effects as direct purchase, or enough safeguards did not exist, a consequence could be that the Member States would not follow a sound budgetary policy. The blackout period and the additional safeguards, however, are deemed enough for the CJEU.

Regarding the ultra vires act, the court, as in the *Gauweiler* case, implied that one must look at the objective of the action. The court emphasised that the authors of the treaties did not intend to make an absolute separation between economic and monetary policy. If a monetary policy measure has the same indirect effects as an economic policy measure, it shall not be treated as an economic policy measure.⁷⁵ Monetary policy acts will always entail effects on the financing conditions of the public deficits of the Member States.⁷⁶

⁷⁴ Ibid. paras. 75–77.

⁷⁵ Ibid. para. 61.

⁷⁶ Ibid. para. 65.

5 Discussion

5.1 Analysis

5.1.1 Monetary financing

Regarding the prohibition of monetary financing in Art. 123 TFEU, the CJEU acknowledged in both cases that the purchase of government-issued bonds on secondary markets is generally permitted as the article forbids purchases from the government issuer. It becomes prohibited once the effects of the purchase are those as if the purchase would have been on the primary market. This would circumvent the aim of the Article if the creditors on the secondary markets become de facto intermediaries. If this was the case, Member States would lose the incentive to follow a sound budgetary policy, which is the objective of Art. 123 TFEU. This is the danger with monetary financing – states could risk huge debt burdens.

To prevent them from becoming intermediaries and to prevent the same effects as a direct purchase from the government, the CJEU has emphasised that safeguards must be put up so information asymmetry exists between the Member States and creditors on one side, and the ESCB on the other. This is the case in both Gauweiler and Weiss. Firstly, both programmes have a time period between the issue and purchase.

Secondly, in Gauweiler the ESCB would not make any prior announcements regarding upcoming purchases or the volume of these purchases. In the PSPP, ESCB would not announce the volume of purchases the coming month. It did announce, however, the total purchase amount for the programme and the purchase volume of prior months.

Because of the information asymmetry, both the Member States and creditors will be uncertain on if and which bonds the ESCB will purchase. In the PSPP, Member States could assess the purchase volume of future months by looking at past months. However, the assessment could not be certain.

A safeguard that existed in the PSPP, but not under the OMT programme, was the fact that the ESCB would make sure that a vast diversity among the bonds purchased existed. The ESCB would purchase bonds from different types of governments, with different maturity dates and yield rates. Under the OMT programme, the purchases would focus on government bonds with a maturity of one to three years. This could strengthen the foreseeability of what types of bonds the ESCB would purchase. It is clear that the ECB weakened the foreseeability in the PSPP. The court rejected, however, the notion that the Member States ‘could rely with certainty’ that the ESCB would purchase their bond in OMT. In my opinion, there is a vast difference between the foreseeability in the OMT and the PSPP.

In summary, by minimizing the foreseeability and increasing the information asymmetry, the objective of Art. 123 TFEU does not get undermined. However, it raises the question to what extent the information asymmetry must be. I will return to this in section 5.1.3.

5.1.2 Acting ultra vires

Even if neither the OMT programme nor the PSPP was regarded as monetary financing, it is undisputed that both programmes had effects of economic policy nature, which is under the competence of the Member States. Even though a precise definition of monetary policy does not exist in the TFEU, it does define the objective and instruments of monetary policy. Moreover, it states that the ESCB also shall support the general economic policy in the EU. Consequently, the objective of the measure and the instruments used must be evaluated to determine whether it is within the frame of monetary policy.

In Gauweiler, the primary objectives with OMT were to preserve the singleness of monetary policy and to protect an appropriate monetary policy transmission. The CJEU concluded that protecting an appropriate monetary policy transmission was equivalent to maintaining price stability, as the transmission in question is necessary to maintaining price stability. Preserving the singleness of monetary policy objective was aimed at keeping the monetary union intact and complying with Art. 119(2) TFEU. The main objective of the PSPP was to bring back inflation levels below but close to 2 per cent. This is also the main objective for the ECB – maintaining price stability.

Looking at the objectives, both programmes had clear monetary goals. Nonetheless, they both had indirect effects of economic policy nature. In the OMT programme, the economic policy effects emerged from the condition of participating in one of the bailout programmes. The effects of the PSPP were, inter alia, that the programme could affect both balance sheets of commercial banks and the financing of Member States. These are effects that could be pursued by economic policy measures.

The court thus acknowledged that the effects of the two programmes could be the same as those effects that are sought with economic policy. In Gauweiler, the court reasoned that since the ESCB shall support the general economic policies of the EU, it does not mean that the OMT should be treated as an economic policy measure even if it could have indirect effects that would promote the ESM and EFSF. The fact that the ECB had a monetary objective with the programme was also decisive for the court. In the PSPP, the court acknowledged that monetary policy acts have indirect effects equivalent to effects of economic policy measures in most cases, and completely avoiding them would make it unfeasible to achieve the aim of price stability in the union.

5.1.3 Proportionality

According to Art. 5(4) TEU, measures by institutions of the EU shall be carried out under the principle of proportionality. In both cases, the CJEU recognized the serious situations surrounding the policy decisions. When the ECB announced OMT, the EU was in turmoil. Interest rates on certain government bonds made it very onerous for the ECB to transmit its ‘impulses’ to the economy and thus maintaining price stability, whilst the EMU was on the brink of collapse. When the PSPP was introduced under the APP, the situation was not equally critical as when the OMT was announced. Although the EMU was not as intimidated as it was three years earlier, deflation still occurred in the EU.

By looking at the economic policy effects by the measures, OMT seemed to have economic policy effects that were larger than the PSPP, due to the conditionality of participating in one of the bailout programmes. This is justified as the economic situation in the EU was much more severe in 2012, since the EMU was close to disbandment (and the interest rates higher). The CJEU emphasised that actions taken shall not ‘exceed what is necessary’, and since OMT never reached reality, it did have sought effects on the economic markets. Thus, ECB did not go beyond what was necessary. The principle of proportionality can also be seen by looking at the volume of the PSPP. The PSPP has more safeguards put up, compared with the OMT programme. This is reasonable once you look at the size of the programmes. The PSPP has an estimated worth of € 2,1 trillion. This means that the ESCB has purchased an enormous volume of government bonds. Ergo, more safeguards must be put up by the ECB.

5.2 Conclusion

To conclude, several measures must be taken by the ECB when it purchases government bonds on secondary markets. Firstly, it must decrease the foreseeability among the Member States and the private operators. Safeguards taken by the ECB which the CJEU regarded as sufficient are firstly the minimum period between the issue of the bond and the purchase by the ESCB. Secondly, the ECB should take measures that increase the uncertainty of which bonds the ESCB would purchase. For instance, bonds from different issuers, bonds with different maturity dates, bonds that are both inflation-linked and nominal, and keeping purchase volume confidential.

When the ECB decides to purchase government bonds, or taking any other act for that reason, it is vital that the primary objective for the measure, as well as the instruments, are monetary. A monetary objective that is desirable, is maintaining price stability. Nevertheless, there are other objectives that are acceptable. If a policy measure equals the objective of maintaining price stability, the objective would be acceptable. In *Gauweiler*, the transmission was vital to maintain price stability, and thus equalled the primary objective.

The ECB must also put gravity in the principle of proportionality when it conducts its monetary policy. The safeguards in the PSPP was larger and more diverse, compared to those in the OMT programme. However, the situation in the EU in 2012 was much more severe than in 2015, which could justify the scarcity of safeguards in the OMT programme.

At last, depending on how the ECB and other central banks will evaluate the use of QE (and OMT) in response to the Great Recession and the European debt crisis, QE might be used in a future crisis to combat deflation and mitigate the situation. It is clear that because of *Gauweiler* and *Weiss*, the mandate of the ECB has become less obscure and vague.

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