Legal limits for the outright purchase of sovereign debt by the ESCB

Professor Dr. Dr. h.c. Helmut Siekmann

Institute for Monetary and Financial Stability - IMFS
Johann-Wolfgang-Goethe-Universität, Frankfurt am Main
Syllabus

A. Introductory remarks
B. Purchase Programs
C. Court decisions
D. Legal assessment
E. Quantitative Easing
F. Conclusion
A. Introductory remarks

Fundamental questions:

1. Economic decision-making and obedience to rules
   - efficiency of following the rules
   - short-term gains by disobedience
   - time consistency of rules ("veil of ignorance")
   - rules in economic reasoning and modeling
2. Legal restrictions

- stability of European integration
- substantive rule of law
- distribution of powers
- government by the people
- infraction of fundamental rights

(substantial regional and interpersonal wealth transfer)
A. Introductory remarks

3. Crisis of law?

- EU founded on law and its recognition
- strictly limited transfer of competences and powers to EU and ECB
A. Introductory remarks

The problem of the “last word”

1. members of the executive branch of government
   guided and influenced by

2. ad-hoc advice from economists or generalized insight (models)

3. the courts
B. Purchase Programs

2009 Covered bonds programme (I)
2010 Securities Markets Programme (SMP) (I)
2011 Securities Markets Programme (SMP) (II)
2011 Covered bonds programme (II)
2011/12 Long Term Refinancing Operations (LTRO)
2012 Outright Monetary Transactions (OMT)
2014 Targeted Long Term Refinancing Operations (TLTRO)
2015 Expanded Asset Purchase Programme (EAPP) (“Quantitative Easing – QE”)
B. Purchase programs - SMP

(i) 2 July 2009 implementation by European Central Bank of

Covered Bonds Programme

(ii) 3 November 2011 resumption of the program

(iii) spring 2015 incorporation into EAPP
Decision of the European Central Bank of 14 May 2010 establishing a

**Securities Markets Programme**

(i) purchases of debt from selected Member States until spring 2011

(ii) resumption 8 August 2011 with extension to debt from additional Member States; termination 6 September 2012
B. Purchase programs - OMT

Decision of ECB Governing Council of 6 September 2012

**Outright Monetary Transactions - OMT**

- adherence to a European support programme ("conditionality")
- no *ex-ante* quantitative limits ("coverage"),
- same creditor treatment with private creditors ("creditor treatment")
- full "sterilisation" of the created liquidity
Announcement of 22 January 2015

**Expanded Asset Purchase Programme (EAPP)**

1. encompassing the purchase programmes for
   - asset backed securities
   - covered bonds
2. new: purchase of sovereign debt
3. total volume € 60 per month
C. Court decisions

European Court of Justice - ECJ

- judgment of 27 November 2012 - *Pringle* – Case C-370/12

  on ESM-Treaty, Articles 3(1)(c) TFEU and 127 TFEU
C. Court decisions

German Federal Constitutional Court - GFCC

- judgment of 7 May 2010, BVerfGE 125, 385 preliminary injunction denied – support of Greece

- Judgment of 9 June 2010, BVerfGE 126, 158 preliminary injunction settled - European Financial Support Facility (EFSF)

- judgment of 7 September 2011, BVerfGE 129, 124 (128 et seq.) – support of Greece, EFSF

- judgment of 28 February 2012, BVerfGE 130, 318 – role of Deutscher Bundestag (German Federal Parliament); Democracy
History of proceedings (1) - OMT

Constitutional complaints and “Organsstreit” filed at the German Federal Constitutional Court (GFCC)

Initial subject matter:

German acts approving

- amendment of Article 136 TFEU: insertion of a new paragraph 3
- Treaty of 2 February 2012 establishing the European Stability Mechanism (ESM)
- Treaty of 2 March 2012 on Stability, Coordination and Governance in the Economic and Monetary Union (new fiscal compact)
History of proceedings (2) - OMT

- 12 September 2012 rejection of a petition for a temporary injunction (provisional order) to halt ratification procedures (with some caveats), BVerfGE 132, 195

- 14 January 2014 separation of judgment on OMT and referral to ECJ for a preliminary ruling pursuant Art. 19 section 3 lit. b, BVerfGE 134, 366

- 18 March 2014, BVerfGE 135, 317 – final decision on the parts not referred to the ECJ
Principal holdings

- transgression of “mandate” (I)
- violation of prohibition of monetary financing of budgets (II)
- no justification by a “disruption of the monetary policy transmission mechanism” (III)
- alternative interpretation of OMT in conformity with Union law possible (IV)
(I) transgression of Competences ("mandate")

interference with competences of Member States for economic policy:

- ECB aims to neutralise risk premiums on the debt of certain sovereigns which are market results.

- Differentiation between Member States does not fit in decision-making framework for a monetary union.

- Linkage to the conditionality of an ESM programme indicates that OMT reaches into the realm of the economic policies.

- Purchase of government debt exceeds the support of the general economic policies "in" [not "of"] the European Union.
(II) violation of prohibition of monetary financing of budgets

- Article 123 TFEU as “an expression of a broader prohibition of monetary financing of the budget”
- willingness to participate in a debt cut
- increased risk of such a cut
- the option of keeping the purchased bonds until maturity
- the interference with the price formation on the markets, and the encouragement of market participants to purchase government bonds
C. Court decisions – OMT

(III) no justification

- disruption of mechanism “irrelevant”
- amount to granting “plain power to the ECB”
- correction of “irrational” interest rate: “arbitrary interference with market activity”
- distinction between “rational and irrational” ultimately “meaningless in this context”
(IV) possible alternative interpretation

- exclusion of the possibility of a debt cut;
- no purchases of selected Member States’ debt up to unlimited amounts;
- the avoidance of interference with the price formation on the market as where possible
Questions of GFCC with regard to the competence of the Eurosystem

- conditionality
- selectivity
- parallelism
- bypassing
Questions of the GFCC with regard to the prohibition of monetary financing

- volume
- market pricing
- interference with market logic
- default risk
- debt cut
Objectives

- Primary objective: price stability, Art. 127 (1), 282 (2) sentence 2 TFEU
- Support of general economic policies “in” the Union only without prejudice to the primary objective, Art. 127 (1), 282 (2) sentence 3 TFEU
Criticism of OMT-judgment

- decisions of economic policy by courts
- impossibility of distinction between monetary and economic policy
- margin of judgment for governments
Basic tasks of the ESCB

Art.127 (2) TFEU

- Define and implement the monetary policy of the Union
- Conduct foreign-exchange operations with prejudice to Art. 219 TFEU
- Hold and manage foreign reserves
- Promote smooth operation of payment systems
D. Legal assessment

Not a basic task of the ESCB

- General economic policy
- Stability of the financial system
- Supervision of financial institutions
Transfer of sovereign powers was limited.
E. Quantitative Easing

Differences from OMT

- no special selection of Member States
- no conditionality tied to measures of economic policy
E. Quantitative Easing

**Concerns**

- Objective: attainment of a specific nominal inflation rate
- Side effect (1): negative real interest rate
- Side effect (2): sharp drop of exchange rate
- Uncontrolled distributional effects
Prof. Dr. Dr. h.c. Helmut Siekmann

Institute for Monetary and Financial Stability
Goethe-Universität
Theodor-W.-Adorno-Platz 3
60629 Frankfurt am Main
Germany

Phone: +49 (0)69 798-34014
Fax: +49 (0)69 798-33913
E-Mail: geld-und-waehrung@imfs-frankfurt.de