

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

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# Syllabus

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

# 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)

### 3. Crisis of law?

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

# 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

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- 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”)

(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

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

### 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

### **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 “Organstreit” 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

### **(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**

## **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.**

### **Differences from OMT**

- no special selection of Member States
- no conditionality tied to measures of economic policy

### **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

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