



ECJ accepts OMT: 6 Questions, 6 Answers

On Tuesday the European Court of Justice (ECJ) presented its final decision on the question whether Outright Monetary Transactions (OMT) by the European Central Bank (ECB) are legally compatible with the EU treaties. [The ECJ ruled that OMT purchases are compatible with EU law.](#)

[The ECJ made three key judgments.](#) (1) OMT is part of monetary policy - not economic policy. (2) OMT contributes to keeping price stability as the primary objective of monetary policy. (3) Given the safeguards the ECB is undertaking, OMT is not regarded as equivalent to monetary state financing.

[The judgment separates the role of the ECB from economic policy making.](#) This suggests that the role of the ECB in future Troika reviews could be confined to non-binding economic assessments leaving economic policy recommendations to the other official institutions. This, however, would require an amendment of the ESM treaty.

[Tuesday's ECJ judgment does not affect the implementation of QE.](#) Purchasing government bonds in the secondary market is legitimate as long as appropriate safeguards are taken. Since the rationale for QE is more obviously in the realm of monetary policy, there is less ground for objection.

[The case will now go back to the German Constitutional Court \(GCC\) which originally triggered the ECJ judgment.](#) The GCC could leave open certain aspects in their judgment and deliberately create new starting points for subsequent constitutional complaints - not least because the ECJ did not unanimously concur (two dissenting votes).

[Other constitutional complaints ahead!](#) It can be taken for granted that the plaintiffs will launch further complaints in the context of the ECB's non-conventional policy. According to recent press reports, several prominent German entrepreneurs are about to submit a constitutional complaint addressing the current QE-program - once the GCC has published its judgment on OMT in the second half of the year. In any case, the GCC will remain a crucial institution determining Germany's role in the Euro area.



Decision on Outright Monetary Transactions (OMT)

On Tuesday the European Court of Justice (ECJ) has presented its final decision on the question whether Outright Monetary Transactions (OMT) by the European Central Bank (ECB) are legally compatible with the EU treaties. The judgment is a reaction to a request for preliminary ruling by the German Constitutional Court (GCC) dating from February 2014. The judgment of the ECJ will have implications for the final ruling of the GCC on the OMT case which we will expect for the second half of the year.

The following Q&A shall provide an overview of the backgrounds and implications of this decision.

1 Recap – What has happened so far?

The legal proceedings go back to various constitutional complaints that were filed at the German Constitutional Court (GCC) in 2011 and 2012. They questioned Germany's involvement with the ESM and the ECB's sovereign bond purchases on secondary markets. While the GCC had deemed Germany's participation in ESM as being constitutional already in late summer 2012, it separated the aspect of the ECB's sovereign bond purchases on secondary markets from the proceedings and examined it separately. The plaintiffs further extended their constitutional complaints upon the ECB's OMT announcement – although the program had never been activated. On 7 February 2014 the GCC passed the case against the OMT to the ECJ and stayed the proceedings. For the first time in history the GCC involved the ECJ in a preliminary ruling on constitutional issues.

When the GCC forwarded the case to the ECJ it stated that it regarded the OMT decision as exceeding the competences that were given to the ECB by the European Treaties. The GCC considered OMT as not being covered by the mandate of the ECB on monetary policy (Art. 119 and 127 TFEU) and in violation with the prohibition of monetary financing of the budget (Art. 123 TFEU). Thus the Court sent a list of specific questions regarding the legality of OMT to the ECJ. The GCC has so far put on hold its inquiry on OMT until it gets the legal opinion from the ECJ.

In the opinion of the German judges, the only possibility to render OMT compliant with EU Treaties would be the following four-fold specification of the – never spelled out – OMT program:

1. OMT should not undermine the conditionality of the assistance programs of the EFSF and the ESM
2. the acceptance of a debt cut must be excluded (which would imply that the ECB should be cautious when purchasing bonds that include CACs, and would by construction go against the ECB's intention to be "pari passu")
3. government bonds of selected Member States should not be purchased up to unlimited amounts, and
4. interference with price formation on the market is to be avoided where possible.

It is important to note that even after referring on the case to the ECJ, the GCC considers itself principally entitled to reject the decisions or opinions of the ECJ if it still considers actions taken to be "manifestly in violation of powers, and that the challenged act entails a structurally significant shift in the allocation of powers to the detriment of the Member States".



2 What has the ECJ decided?

The ECJ addressed three domains in its judgment.

- **OMT is part of monetary policy – not economic policy.** The Court stated that “the OMT programme, in view of its objectives and the instruments provided for achieving them, falls within monetary policy and therefore within the powers of the ESCB” as the OMT would safeguard an appropriate monetary policy transmission.
- **OMT contributes to keeping price stability as the primary objective of monetary policy.** The Court stated that “the fact that the OMT programme might also be capable of contributing to the stability of the euro area (which is a matter of economic policy) does not call that assessment into question.” A monetary policy measure could not be treated to an economic policy measure merely because it was likely to have indirect effects on the stability of the euro area.
- **OMT is not regarded as equivalent to monetary state financing.** The Court stated that the prohibition of monetary state financing would not prevent the “ESCB from adopting a programme such as the OMT programme and implementing it under conditions which do not result in the ESCB’s intervention having an effect equivalent to that of a direct purchase of government bonds from the public authorities and bodies of the Member States.” It further pointed out that the EU Treaty does not prohibit transactions on the secondary market but sufficient safeguards have to ensure that the intervention is not breaching the prohibition of monetary financing. The ECJ referred to the statement by the ECB to ensure that “a minimum period is observed between the issue of a security on the primary market and its purchase on the secondary market and also to refrain from making any prior announcement concerning either its decision to carry out such purchases or the volume of purchases envisaged”. The Court took that statement as an indication that the “implementation of the OMT programme will not, in practice, have an effect equivalent to that of a direct purchase of government bonds from public authorities and bodies of the Member States.”

3 What will be the implications for the role of the ECB in the troika?

The Court clearly demarcated the role of the ECB from economic policy making. This suggests that the role of the ECB in future troika reviews could be confined to non-binding economic assessments while economic policy recommendations would not apply any more. This, however, would require an amendment of the ESM treaty.¹

4 Will this affect the implementation of QE?

In our opinion: no. By assessing the implications of the judgment on OMT for Quantitative Easing (QE) it should be remembered that the rationale behind the two programs is different.

- The OMT was aimed at removing the “irrational” risk premia for some sovereign bonds stemming from an overall euro area break-up scenario.

¹ Changing the ESM Treaty would require unanimous ratification. Whether the change of the role of the ECB as a minor amendment would require a referendum in selected countries, e.g. Ireland cannot yet be fully assessed.



This led the GCC to ask whether the program, rather than being a monetary policy measure to smooth the monetary transmission channel, is in fact an economic policy measure which would fall outside the scope of the ECB's mandate.

- Public QE aims at meeting the ECB medium-term inflation target and hence anchoring inflation-expectations. Even after taking into account the conditions set out by the ECJ, there seems to be no evidence to prevent a QE program aimed at loosening monetary policy across the euro area.

Irrespective of that, there would be a debate in Germany on the possible implications of the OMT judgment on QE depending on how the GCC will take up the case in the next months.

5 How will the current proceedings continue?

The case will now go back to the GCC which has originally opened the preliminary ruling procedure at the ECJ. While the GCC in principle should be bound to an ECJ interpretation of the EU Treaties, the GCC has expressly reserved the right to form its own views, we regard an outright rejection of the ECJ's judgment as rather unlikely – not least because the GCC itself has addressed the preliminary ruling procedure to the ECJ.

Nevertheless, the GCC could leave open certain aspects in their judgment and deliberately create new starting points for subsequent constitutional complaints – not least because the Jury in itself did not fully concur with the request for preliminary ruling that it had sent to the ECJ back in 2014 (two dissenting votes). In any case, this would further define and clarify future boundaries between German constitutional and European law.

6 Will this be the last legal proceeding against the ECB's bond purchasing programs?

In our opinion: definitely not. It can be taken for granted that the plaintiffs will launch further complaints in the context of the ECB's non-conventional policy. Besides challenging the details of Tuesday's decision on implementing the OMT-program, there will likely be various new constitutional complaints addressing the ECB's current QE Programme. According to recent press reports, several prominent German entrepreneurs are about to submit a constitutional complaint addressing the current QE-program – once the GCC has held its judgment on OMT in the second half of the year.

In any case, the GCC will remain a crucial institution determining Germany's role in the Euro area. As both politics and the Court are fully aware of that *Responsibility for European Integration* (Integrationsverantwortung), a responsible and constructive stance of the Court can be expected for the next years.

We thank Julius Elting for contributing with valuable research to this report.



Appendix 1

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