

# The German Constitutional Court's decision on OMT: Have markets misunderstood?¹

**Helmut Siekmann and Volker Wieland**

Institute for Monetary and Financial Stability, Goethe University of Frankfurt

The European Central Bank's announcement of the Outright Monetary Transactions (OMT) program in summer 2012 is widely credited, not least by the ECB itself, as a key factor in the subsequent decline of sovereign risk premia in the Eurozone. Following the February 2014 decision by the German Constitutional Court on the OMT commentators have declared the program "effectively dead". Nevertheless, financial markets seemingly ignored the decision and sovereign risk premia of Eurozone crisis countries have continued to decline. This note reviews the legal issues underlying the German Court's decision and the respective responsibilities of the European Court of Justice. It explores whether likely outcomes of the judicial process would support the benign market reaction to the German Court's announcement.

## 1. The Bank, the Court and the Markets

ECB President Mario Draghi's "whatever it takes" speech on 26 July 2012 and the subsequent unveiling of a new sovereign debt purchase program, the Outright Monetary Transactions (OMT), on 2 August and 6 September of the same year have been widely credited as key drivers of the decline in sovereign risk premia since the middle of 2012.<sup>2</sup> Altavilla et al (2014), for example, estimate that the OMT announcements decreased the Italian and Spanish two-year government bond yields by about two percentage points. By June 2013, when asked at the ECB press conference about the upcoming hearings on the OMT held by the German Constitutional Court in Karlsruhe,<sup>3</sup> Mario Draghi himself responded: "When we all look back at what OMT has produced, frankly

when you look at the data, it's really very hard not to state that OMT has been probably the most successful monetary policy measure undertaken in recent time. ... OMT has brought stability, not only to the markets in Europe but also to the markets worldwide."

However, when the German Constitutional Court announced on 7 February 2014 that it did not consider the ECB's OMT announcement consistent with EU primary law, financial markets did not even blink. In fact, sovereign risk premia of Eurozone crisis countries continued to decline steadily throughout 2014 (Figure 1).

Initially, many market participants may have thought that the referral of questions concerning this case to the European Court of Justice meant that it would be assured that the European Court would ultimately rule in favor of the OMT. Yet, commentators quickly pointed out that the German Constitutional Court reserved its own judgment and pronounced the OMT program "effectively dead".<sup>4</sup>

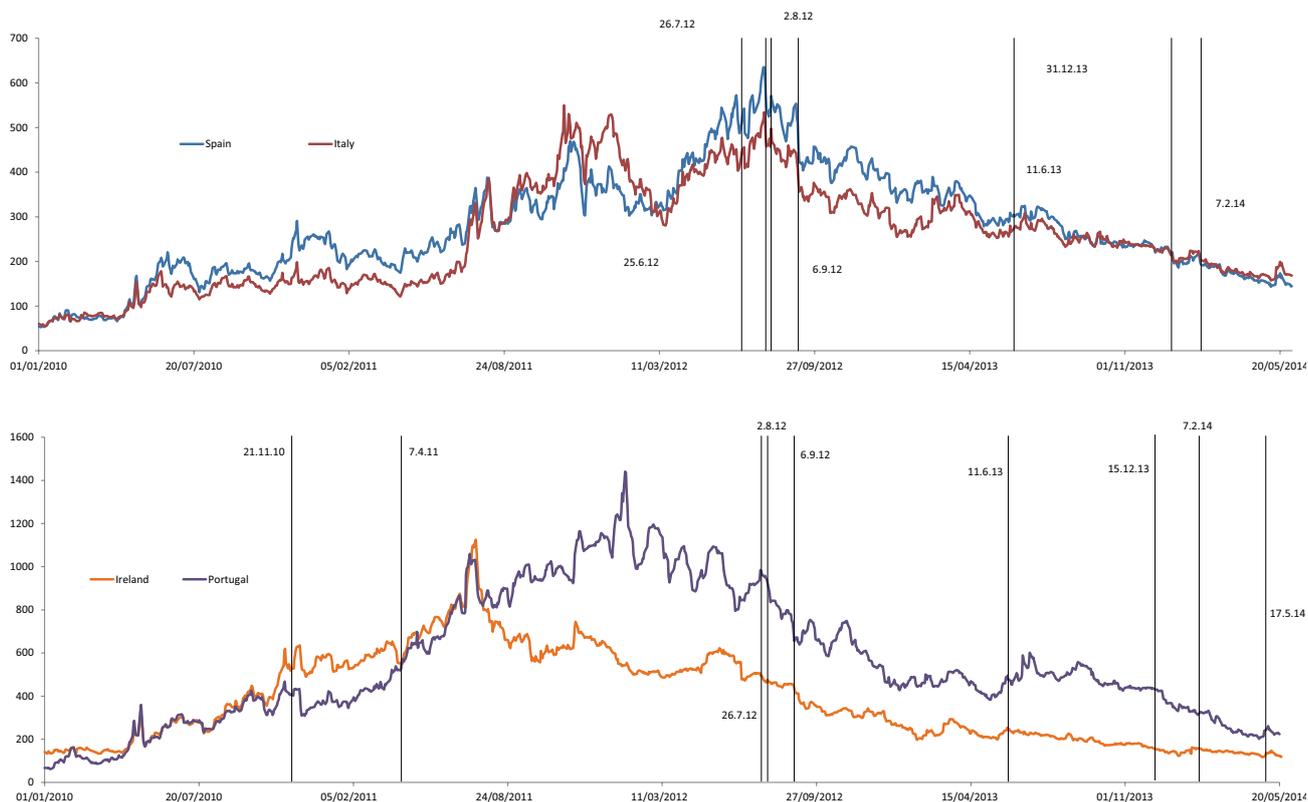
How could the benign behavior of sovereign risk premia for Eurozone crisis countries then be reconciled with the Court's decision on OMT?

Of course, there are many other factors that are potentially influencing sovereign risk premia. One explanation could simply be that the progress achieved in terms of economic fundamentals due to fiscal consolidation and structural reforms has been sufficient to justify the lower sovereign risk premia even with the OMT "effectively dead". Indeed, Ireland successfully completed its program with the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) in December 2013. Spain also exited its financial assistance program in that month. And Portugal's performance had been so positive that by February 2014 it was fairly likely that it would successfully complete its EFSF/ESM program.

1 The authors would like to thank Tobias Tröger, Michael Binder, Harry Schmidt and Vikrant Vig for useful discussions. All remaining errors are the authors' sole responsibility.  
2 Supportive empirical analysis has been provided by Altavilla et al (2014) and De Grauwe and Ji (2014), for example.  
3 For an analysis of the legal matters at stake at the time of the hearings conducted by the German Court see, for example, Siekmann and Wieland (2013a) and (2013b).

4 See for example, Fratzscher (2014) and Münchau (2014).

Figure I. Ten-year sovereign debt spreads versus Germany



Notes: the following dates are indicated in format day/month/year by vertical bars in the panels: 21.11.10 Ireland announced request for EFSF/ESM support, 7.4.11 Portugal announced request for EFSF/ESM support, 25.6.12 Spain announced request of ESM financial assistance, 26.7.12 Mario Draghi's "whatever it takes" speech, 2.8.12 ECB announces OMT program, 6.9.12 ECB publishes technical details of OMT program, 11.6.13 Constitutional Court hearings on OMT, 15.12.13 Ireland exits ESM program, 7.2.14 OMT Ruling of German Court, 17.5.14 Portugal exits ESM program.

Portugal then exited the program in May 2014.<sup>5</sup> These countries have undergone major adjustment programs. As a result, competitiveness has improved, exports have increased, private indebtedness has improved, public deficits have declined and government debt-to-GDP ratios have begun to stabilise. Italy has not needed ESM support. It has achieved a primary fiscal surplus and succeeded in rolling over its large outstanding debt at relatively low cost. Thus, one might conclude that the continued decline in sovereign risk premia following the announcement of the Federal Constitutional Court of Germany was the result of a rational response of financial market participants to improved economic fundamentals.

Nevertheless, it is easy to make the case that the situation remains very fragile and the Eurozone sovereign debt crisis is far from over.<sup>6</sup> Unemployment in crisis countries is very high and economic activity fairly low compared to the levels before the crisis. Italian GDP in fact remains

furtherst below the level reached before the start of the global financial crisis among the four countries mentioned so far. Only Greek GDP is even more distant from the level reported for 2007. While government debt-to-GDP ratios are stabilising, they are doing so at high levels. Hence, these countries remain vulnerable. From this perspective, some observers might simply take the fact that financial market participants have ignored the German Constitutional Court's negative assessment of OMT as another indication of their lack of rationality.

In the remainder of this note we aim to explore in more detail the legal implications of the German Court's announcement regarding OMT, the respective responsibilities of the German and the European Court and the possible outcomes of this judicial process. We also aim to assess to what extent these outcomes would support the lack of a reaction of sovereign risk premia to the German Court's announcement.

## 2. Key features of the ECB's OMT announcement

On 2 August 2012, Mario Draghi expressed the ECB's concerns that the exceptionally high risk premia embodied in sovereign bond prices in several Eurozone member countries were hindering the transmission of monetary policy. Specifically,

<sup>5</sup> The restructuring of Portugal's Banco Espírito Santo on 3 August 2014, however, required a recapitalisation on the scale of 4.4 bln. To this end, the Portuguese government drew on some 6.4 bln leftovers from the IMF/EU bailout funds that were specifically earmarked to banks' assistance.

<sup>6</sup> De Grauwe and Jin (2014), for example, claim that their analysis indicates that "most of this decline in government bond premia is due to the positive market sentiments that OMT has triggered, and is not related to underlying economic fundamentals such as debt-to-GDP ratios or external debt positions".

risk premia driven by fears of the reversibility of the euro as the currency of these countries were unacceptable to the ECB.

While emphasising that governments would need to push ahead with fiscal consolidation, structural reform and European institution-building in order for those risk premia to disappear, Draghi also called on them to request support by the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) in the bond market when exceptional financial circumstances and risks to financial stability exist. In those circumstances, the ECB would then be willing to buy sovereign bonds in the quantity needed to reduce the above-mentioned risk premia.

Clearly, such interventions could be very large and many commentators treated the ECB announcement as a promise of unlimited ECB intervention in government debt markets. Importantly, the ECB stated that it would forego seniority status and its holdings of these sovereign bonds would be subject to the same losses as privately-held bonds in the event of a sovereign default.

The ECB was well aware of the danger that monetary policy might come to be seen as subordinated to fiscal concerns. For this reason, the ECB made clear that such interventions would be subject to the conditionality imposed on the respective government by the EFSF/ESM.

The technical features of the OMT were described in the ECB Press Release of 6 September 2012 that is also found in Appendix 1 to this paper.

### 3. The German Constitutional Court's decision in February 2014

On 7 February 2014 the German Federal Constitutional Court (GFCC) announced the following (for the full press release see Appendix 2):

- i. the charges concerning the OMT Decision of the ECB of 6 September 2012 are separated from the other matters (concerning the amendment of Art. 136 TFEU, establishing the permanent support mechanism ESM, and the “fiscal compact”);
- ii. the proceedings concerning the OMT Decision are suspended and several questions are referred to the European Court of Justice (ECJ) for a preliminary ruling;
- iii. a final decision on the part of the case which is not suspended will be pronounced on Tuesday 18 March 2014.

And in fact, this latter decision has been handed down with all remaining complaints being dismissed.

The questions presented to the ECJ deal with the problem whether the OMT is consistent with EU primary law. In view of the German Court the OMT may well exceed the mandate given to the ECB which is limited to monetary policy. It lists a number of important reasons why the OMT may interfere with economic policy reserved to Member States and why the OMT may violate the prohibition of monetary financing of the EU or its Member States. The key argument used by the ECB to justify its actions “disruption of the monetary policy transmission mechanism” was rejected by the Court as being irrelevant.

From this perspective, the OMT may have to be considered as “ultra vires” (i.e. outside the competences given to the EU and the ECB in line with the EU treaties and thus outside democratic legitimation) and could constitute a violation of German constitutional law. However, the GFCC also delineated an alternative interpretation of OMT that it would consider consistent with EU primary law. This interpretation involves a range of constraints and limitations. The Court had concluded from the statements of the ECB's representatives presented in the hearings in June 2013 that the objectives of OMT could be achieved within such constraints.

### 4. German Constitutional Court versus European Court of Justice: Who is going to have the last word?

The tasks of the ECJ and the GFCC are well defined: The ECJ shall ensure that in the interpretation and application of the Treaties the law is observed whereas the GFCC is installed as the “guardian” of the German Federal Constitution, the “Basic Law” (*Grundgesetz*). The domain of the ECJ is the enforcement of EU law; the domain of the GFCC the compliance with the Basic Law. In particular, the GFCC has the power to control whether a statute is in accordance with the constitution. Its competences are, however, limited to acts of German authorities and do not include the control of institutions and organs of the EU. Although no formal hierarchy has been established between the ECJ and the national courts, the described distribution of competences in conjunction with the primacy of application of Union law would give the word of the European Court clearly greater weight. As a consequence, OMT and all other actions of the ECB would not fall into the jurisdiction of the German Court.

While this demarcation of powers is clear in theory, it has been blurred in practice by the judicature of the GFCC. In a series of decisions the Court has held that acts of institutions and agencies of the European Union have a binding effect in the Federal Republic of Germany only within certain limits. It has reserved the right to review whether these acts are based on manifest transgressions of powers or affect the area of constitutional identity, which cannot be transferred. If such an infraction is manifest and entails a structurally significant shift in the allocation of powers to the detriment of the Member States it would have to be judged as a violation of German constitutional law as it were not covered by the legislative Acts of Assent to the Treaties conferring powers on the EU. In addition, the protection of the core content of the Basic Law ("identity") is considered a task of the Federal Constitutional Court alone.

The Court concedes, however, that these reserved powers of control have to "be exercised only in a manner that is cautious and friendly towards European law." This means for the *ultra vires* review at hand that the Federal Constitutional Court must in principle comply with the rulings of the Court of Justice as a binding interpretation of Union law. But the GFCC "will take the interpretation which the Court of Justice gives in a preliminary ruling" only as a basis. In their „cooperative relationship“, it attributes to the Court of Justice the interpretation of the act. On the other hand, it shall be the GFCC which „determines the inviolable core content of the constitutional identity, and reviews whether the act interferes with this core“. By this, the German Court claims to have the "last word" in extreme cases.

According to the opinion of the GFCC, a manifest and structurally significant transgression of powers would have to be assumed if the European Central Bank acted beyond its monetary policy mandate or if the prohibition of monetary financing of government budgets was violated by the OMT program. Additionally, the GFCC has reserved the right to determine whether the OMT - even after an interpretation by the ECJ taking into account the concerns of the German Court - infringes the inviolable core content of the constitutional identity. Such a "last word" of the German Court could possibly lead to an open conflict among the judicial institutions.

The GFCC's decisions are binding for all German authorities. They have the virtue of law. Thus, the German government and the Bundesbank would be obliged to comply with the decisions of the Court. If not, legal actions against them could ensue. As a consequence the Bundesbank would be prohibited to participate in the OMT, in case the GFCC comes finally to the conclusion, after receiving answers from the ECJ, that the OMT violates the core

content of the constitutional identity; regardless of what the European Court pronounces about the conformity with EU-law.

In case the ECJ were to decide that OMT conforms to EU law and the Bundesbank would not implement Euro system policy appropriately, the ECB could sue the Bundesbank in a specific procedure before the ECJ laid down in the Statute of the ESCB and the ECB.

## 5. Key considerations of the German Court concerning the OMT

### 5.1. Transgression of mandate

The GFCC points out that the mandate of the ECB is limited to monetary policy, while other economic policies are reserved to Member States. According to its assessment, already the OMT decision – not to speak of its implementation - interferes with Member States' competences in economic policy. Reasons for this assessment are the following:

- i. with OMT the ECB aims to neutralise risk premia on the debt of certain sovereigns which are market results;
- ii. an approach that differentiates between Member States does not fit with the monetary decision-making framework for a monetary union;
- iii. the linkage to the conditionality of an ESM program of the Member States indicates that it reaches into the realm of economic policies reserved to Member States;
- iv. that the purchase of government debt as outlined in the OMT exceeds the support of the general economic policies in the European Union that the European System of Central Banks is allowed to pursue. The reason being the ECB would make an independent economic evaluation that could imply removing the support when conditions are not met.

### 5.2. Violation of prohibition of monetary financing of budgets

The GFCC expresses a broad interpretation of the prohibition of monetary financing of budgets. It holds that the (explicit) interdiction of direct purchase of government debt on the primary market also applies to functionally equivalent measures that are simply intended to circumvent that prohibition. In this context, it also views the total or partial forgiveness, i.e. acceptance

of haircuts on sovereign debt, as in-admissible monetary financing. It is functionally equivalent to just handing over resources up-front.

### 5.3. Justification

The Court also rejected the objective used by the ECB to justify the OMT Decision “to correct a disruption of the monetary policy transmission mechanism” as irrelevant. It could neither change the transgression of the European Central Bank’s mandate, nor the violation of the prohibition of monetary financing of the budget. The main argument is that it would amount to granting plain power to the European Central Bank to remedy any deterioration of the credit rating of a Eurozone Member State. Furthermore it also “seems irrelevant” to the Court that the ECB only intends to assume a disruption to the monetary policy transmission mechanism if the interest rate charged from a Member State of the euro currency area were “irrational”. To its view it would be an almost “arbitrary interference with market activity” to single out individual causes as irrational. Thus, the distinction between “rational and irrational” ultimately appears to be “meaningless in this context”.

### 5.4. Alternative interpretation of OMT in conformity with Union law

The GFCC offers an alternative interpretation of OMT that it would consider consistent with EU primary law. This would be the case if the OMT would not subvert the conditionality of EFSF and ESM rescue programs and if it would only be of a supportive character for EU policies. Specifically, in the GFCC’s view, the following limitation for the OMT would be essential:

- i. no acceptance of possible haircuts on Member States’ debt;
- ii. no purchases of selected Member States’ debt up to unlimited amounts;
- iii. avoiding interference with the price-formation on the market as much as possible.

In this regard, the detailed explanations issued by the GFCC include an interesting reference to the testimony of ECB representatives during the hearings of the GFCC in June 2013. Specifically, the explanations to the framework of the OMT (limited purchase volume, no participation in haircut, intervals between issuance of debt and ECB purchase, not held to maturity) by the ECB representatives would indicate that the GFCC’s “alternative interpretation of an OMT that would be consistent with EU primary law” would still achieve the objective of the ECB’s OMT announcement.

## 6. Outlook

### 6.1. Potential outcome of the struggle of the courts

At first sight, the German Court has demonstrated respect for the distribution of powers in the multilevel system of the European Union and specifically for the European Court of Justice. Some legal scholars, however, have questioned this view (see Heun 2014, Thiele 2014). They claim a closer look reveals that the decision does in fact not respect the primacy of application of Union law (*Anwendungsvorrang*) and its interpretation by the ECJ as the GFCC has reserved the right to review whether an act has interfered with the inviolable core content of the constitutional identity – even after a “friendly” interpretation of the OMT by the ECJ.

The reputation of both courts would suffer from a conflict. The judges of both institutions know each other and meet often in a variety of settings. Note also, the President of the ECJ, Vasilios Skouris, a Greek national, speaks German, studied law in Germany, and was professor of law in Germany. Though, the courts may well disagree, they certainly understand where each is coming from in its analysis.

The German court referred key questions to the ECJ while at the same time unmistakably signaling its own judgment of the facts. Furthermore, by not asking for an expedited procedure the GFCC left room for waiting with a final decision till the economic situation in the Eurozone has improved. This way, the crisis need not influence unduly either Court’s decision on the lawfulness of the OMT.

If the ECJ were to completely ignore the GFCC’s analysis and the arguments presented without providing substantially new arguments or evidence, the GFCC could consider itself well-justified to rule that the OMT are beyond the ECB’s mandate and forbid German authorities to support them.

In the meantime the final decision on the rest of the proceedings has been pronounced: The GFCC judged the insertion of the new paragraph 3 in Article 136 TFEU opening the door for permanent support facilities by Member States, the Treaty establishing the European Stability Mechanism (ESM), and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (new fiscal compact) as consistent with the Basic Law without reservation. In this manner, the Court has again demonstrated its principally friendly attitude towards European integration. In constant jurisdiction it has never halted a step towards more integration but has only provided

a voice for concerns about flaws associated with those steps, for example deficits in democratic legitimation, in particular in budgetary matters.

All aspects considered, the ECJ has an incentive to adopt at least some of the limitations held essential by the GFCC. However, it could announce its own interpretation of an OMT that would incorporate a subset of the criteria under 3.4 but not all of them. The GFCC might then find it rather difficult to reject such a “compromise interpretation”. What to take and what to drop would likely depend on which aspect the ECB would consider most important in order to achieve the objective it had in mind for the OMT.

## 6.2. Implications for market perceptions of OMT effectiveness

The above analysis of the possible outcomes of the judicial process involving GFCC and ECJ suggests no simple conclusion. Neither can the ECJ simply ensure the continued effectiveness of the ECB's OMT, nor is it necessarily effectively dead.

First, the ECJ may simply delay any decision until the Eurozone economies are finally out of the crisis. As long as no new shock pushes these economies back to the brink, the low level of risk premia might not be disturbed.

More importantly, a “compromise interpretation” may be possible. Already during the period leading up to the June 2013 hearings of the Constitutional Court the ECB made clear that the OMT is not literally unlimited. Thus, some more formal limits need not destroy its effectiveness. After all, the real resources at the disposal of the ECB in terms of real income it can raise are quite limited in any case. Furthermore, even nominal monetary expansion would eventually have to be curtailed, once it causes inflation to rise significantly above the ECB's objective of close to 2 percent.

The ECB's decision that it would forego seniority status was certainly a crucial feature of the OMT announcement. It had become clear during the process leading up to the write-down of Greek sovereign debt, the so-called Private Sector Involvement (PSI) finalised in February 2012, that sovereign debt purchases by the ECB under its SMP program would not stabilise prices. Rather, because the ECB maintained seniority status, they would reduce the amount of privately-held paper and increase the likely haircut imposed on them.

If the ECJ were to rule that foregoing ECB seniority status on its sovereign debt holdings resulting from OMT purchases were consistent with EU primary law, the GFCC would face a difficult decision as it clearly criticised this aspect of the OMT program. Even so, one could envision adjustments to the

OMT program that would keep it effective. For example, it might be decided that a certain extent of losses on ECB holdings were to be covered by guarantees from the ESM. Hence, the OMT could still function as a leveraging of the ESM's resources.

In sum, the fact that sovereign risk premia have continued to decline after the GFCC's critical statements on OMT need not be taken as a sign that market participants irrationally refuse to accept that the OMT program is “effectively dead”.

## References

- Altavilla, Carlo, Domenico Giannone and Michele Lenza (2014), "The Financial and Macroeconomic Effects of the OMT Announcements", CSEF Working Paper 352, January 2014.
- De Grauwe, Paul and Yuemei Ji (2014), "Disappearing government bond spreads in the euro zone – Back to normal?", CEPS Working Document 396, May 2014.
- Heun, Werner (2014), Eine verfassungswidrige Verfassungsgerichtsentscheidung – der Vorlagebeschluss des BVerfG vom 14.1. 2014, *Juristenzeitung (JZ)*, pp 331-337.
- Fratzsch, Marcel (2014), "Germany's Pyrrhic Victory", Project Syndicate, February 10, 2014.
- Münchau, Wolfgang (2014), "Germany's Constitutional Court has Strengthened the Sceptics", *Financial Times*, February 9, 2014.
- Siekmann, Helmut and Volker Wieland (2013a), "The European Central Bank's Outright Monetary Transactions and the Federal Constitutional Court of Germany", IMFS Working Paper 71, June 2013.
- Siekmann, Helmut and Volker Wieland (2013b), The Question before the Court, *The Economist - Free-Exchange*, June 18, 2013.
- Thiele, Alexander (2014), Friendly or Unfriendly Act? The "Historic" Referral of the Constitutional Court to the ECJ Regarding the ECB's OMT Program, *German Law Journal* 15, pp, 241-264.

## Appendix I: ECB Press Release of 6 September 2012 - Technical features of Outright Monetary Transactions

As announced on 2 August 2012, the Governing Council of the European Central Bank (ECB) has today taken decisions on a number of technical features regarding the Eurosystem's outright transactions in secondary sovereign bond markets that aim at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy. These will be known as Outright Monetary Transactions (OMTs) and will be conducted within the following framework:

### Conditionality

A necessary condition for Outright Monetary Transactions is strict and effective conditionality attached to an appropriate European Financial Stability Facility/European Stability Mechanism (EFSF/ESM) programme. Such programmes can take the form of a full EFSF/ESM macroeconomic adjustment programme or a precautionary programme (Enhanced Conditions Credit Line), provided that they include the possibility of EFSF/ESM primary market purchases. The involvement of the IMF shall also be sought for the design of the country-specific conditionality and the monitoring of such a programme.

The Governing Council will consider Outright Monetary Transactions to the extent that they are warranted from a monetary policy perspective as long as programme conditionality is fully respected, and terminate them once their objectives are achieved or when there is non-compliance with the macroeconomic adjustment or precautionary programme.

Following a thorough assessment, the Governing Council will decide on the start, continuation and suspension of Outright Monetary Transactions in full discretion and acting in accordance with its monetary policy mandate.

### Coverage

Outright Monetary Transactions will be considered for future cases of EFSF/ESM macroeconomic adjustment programmes or precautionary programmes as specified above. They may also be considered for Member States currently under a macroeconomic adjustment programme when they will be regaining bond market access.

Transactions will be focused on the shorter part of the yield curve, and in particular on sovereign bonds with a maturity of between one and three years.

No ex ante quantitative limits are set on the size of Outright Monetary Transactions.

### Creditor treatment

The Eurosystem intends to clarify in the legal act concerning Outright Monetary Transactions that it accepts the same (pari passu) treatment as private or other creditors with respect to bonds issued by Eurozone countries and purchased by the Eurosystem through Outright Monetary Transactions, in accordance with the terms of such bonds.

### Sterilisation

The liquidity created through Outright Monetary Transactions will be fully sterilised.

### Transparency

Aggregate Outright Monetary Transaction holdings and their market values will be published on a weekly basis. Publication of the average duration of Outright Monetary Transaction holdings and the breakdown by country will take place on a monthly basis.

### Securities Markets Programme

Following today's decision on Outright Monetary Transactions, the Securities Markets Programme (SMP) is herewith terminated. The liquidity injected through the SMP will continue to be absorbed as in the past, and the existing securities in the SMP portfolio will be held to maturity.

## Appendix II: Federal Constitutional Court, Press release no. 9/2014 of 7 February 2014, Orders of 17 December 2013 and of 14 January 2014: Principal Proceedings ESM/ECB: Pronouncement of the Judgment and Referral for a Preliminary Ruling to the Court of Justice of the European Union

Based on the oral hearing of 11 and 12 June 2013 (see press releases no. 29/2013 of 19 April 2013 and no. 36/2013 of 14 May 2013), on Tuesday 18 March 2014, 10:00 am in the Courtroom of the Federal Constitutional Court, "Waldstadt" seat, Rintheimer Querallee 11, 76131 Karlsruhe the Second Senate of the Federal Constitutional Court will pronounce its judgment on the subjects of the proceedings that relate to the establishment of the European Stability Mechanism (ESM) and the Treaty of 2 March 2012 on Stability, Coordination

and Governance in the Economic and Monetary Union (Fiscal Compact). The conditions for accreditation will be announced at a later stage; currently, no accreditations are possible.

The Senate has separated the matters that relate to the OMT Decision of the Governing Council of the European Central Bank of 6 September 2012, stayed these proceedings and referred several questions to the Court of Justice of the European Union for a preliminary ruling. The subject of the questions referred for a preliminary ruling is in particular whether the OMT Decision is compatible with the primary law of the European Union. In the view of the Senate, there are important reasons to assume that it exceeds the European Central Bank's monetary policy mandate and thus infringes the powers of the Member States, and that it violates the prohibition of monetary financing of the budget. While the Senate is thus inclined to regard the OMT Decision as an *ultra vires* act, it also considers it possible that if the OMT Decision were interpreted restrictively in the light of the Treaties, conformity with primary law could be achieved. The Senate decided with 6:2 votes; Justice Lübbe-Wolff and Justice Gerhardt both delivered a separate opinion.

#### *Facts of the Cases:*

In a reasonable assessment of their applications, the complainants and the applicant challenge, first, the participation of the German Bundesbank in the implementation of the Decision of the Governing Council of the European Central Bank of 6 September 2012 on Technical Features of Outright Monetary Transactions (OMT Decision), and secondly, that the German Federal Government and the German Bundestag failed to act regarding this Decision. The OMT Decision envisages that the European System of Central Banks can purchase government bonds of selected Member States up to an unlimited amount if, and as long as, these Member States, at the same time, participate in a reform programme as agreed upon with the European Financial Stability Facility or the European Stability Mechanism. The stated aim of the Outright Monetary Transactions is to safeguard an appropriate monetary policy transmission and the consistency or “singleness” of the monetary policy. The OMT Decision has not yet been put into effect.

#### *Essential Considerations of the Senate:*

1. According to the established case-law of the Federal Constitutional Court, the Court's powers of review cover the examination of whether acts of European institutions and agencies are based on manifest transgressions of powers or affect the area of constitutional identity of the Basic Law, which cannot be

transferred and is protected by Art. 79 sec. 3 of the Basic Law (Grundgesetz – GG).

2. If the OMT Decision violated the European Central Bank's monetary policy mandate or the prohibition of monetary financing of the budget, this would have to be considered an *ultra vires* act.

- a. Pursuant to the Federal Constitutional Court's Honeywell decision (BVerfGE 126, 286), such an *ultra vires* act requires a sufficiently qualified violation. This means that the act of authority of the European Union must 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.

- b. The mandate of the European Central Bank is limited in the Treaties to the field of monetary policy (Art. 119 and 127 et seq. TFEU, Art. 17 et seq. ESCB Statute). It is not authorised to pursue its own economic policy but may only support the general economic policies in the Union (Art. 119 sec. 2, Art. 127 sec. 1 sentence 2 TFEU; Art. 2 sentence 2 ESCB Statute). If one assumes – subject to the interpretation by the Court of Justice of the European Union – that the OMT Decision is to be qualified as an independent act of economic policy, it clearly violates this distribution of powers. Such a shifting of powers would also be structurally significant, because the OMT Decision could be superimposed onto assistance measures which are part of the “Euro rescue policy” and which belong to the core aspects of the Member States' economic policy responsibilities (cf. Art. 136 sec. 3 TFEU). Moreover, the Outright Monetary Transactions can lead to a considerable redistribution between the Member States, and can thus gain effects of a system of fiscal redistribution, which is not entailed by the European Treaties.

- c. Should the OMT Decision violate the prohibition of monetary financing of the budget (Art. 123 TFEU), this, too, would have to be considered a manifest and structurally significant transgression of powers. The violation would be manifest because primary law stipulates an explicit prohibition of monetary financing of the budget and thus unequivocally excludes such powers of the European Central Bank. The violation would also be structurally

significant, because the prohibition of monetary financing of the budget is one of the fundamental rules for the design of the Monetary Union as a “community of stability”. Apart from this, it safeguards the overall budgetary responsibility of the German Bundestag.

3. The existence of an ultra vires act as understood above creates an obligation of German authorities to refrain from implementing it and a duty to challenge it. These duties can be enforced before the Constitutional Court at least insofar as they refer to constitutional organs.

a. It is derived from the responsibility with respect to integration that the German Bundestag and the Federal Government are obliged to safeguard compliance with the integration programme and, in case of manifest and structurally significant transgressions of powers by European Union organs, to actively pursue the goal to reach compliance with the integration programme. They can retroactively legitimise the assumption of powers by initiating a corresponding change of primary law, and by formally transferring the exercised sovereign powers in proceedings pursuant to Art. 23 sec. 1 sentences 2 and 3 GG. However, insofar as this is not feasible or wanted, they are generally obliged within their respective powers, to pursue the reversal of acts that are not covered by the integration programme, with legal or political means, and – as long as the acts continue to have effect – to take adequate precautions to ensure that the domestic effects remain as limited as possible.

b. A violation of these duties violates individual rights of the voters that can be asserted with a constitutional complaint. According to the established case-law of the Senate, Art. 38 sec. 1 sentence 1 GG is violated if the right to vote is in danger of being rendered ineffective in an area that is essential for the political self-determination of the people. On the other hand, Art. 38 sec. 1 sentence 1 GG does not entail a right to have the legality of decisions taken by a democratic majority reviewed by the Federal Constitutional Court.

Vis-à-vis manifest and structurally significant transgressions of the mandate by the European institutions, the safeguard provided by Art. 38 sec. 1 sentence 1 GG also consists of a

procedural element: In order to safeguard their democratic influence in the process of European integration, citizens who are entitled to vote generally have a right to have a transfer of sovereign powers only take place in the ways envisaged, which are undermined when there is a unilateral usurpation of powers. A citizen can therefore demand that the Bundestag and the Federal Government actively deal with the question of how the distribution of powers can be restored, and that they decide which options they want to use to pursue this goal. An ultra vires act can further be the object of Organstreit proceedings [proceedings relating to disputes between constitutional organs].

4. Subject to the interpretation by the Court of Justice of the European Union, the Federal Constitutional Court considers the OMT Decision incompatible with primary law; another assessment could, however, be warranted if the OMT Decision could be interpreted in conformity with primary law.

a. The OMT Decision does not appear to be covered by the mandate of the European Central Bank. The monetary policy is to be distinguished according to the wording, structure, and purpose of the Treaties from (in particular) the economic policy, which primarily falls into the responsibility of the Member States. Relevant to the delimitation are the immediate objective of an act, which is to be determined objectively, the instruments envisaged to achieve the objective, and its link to other provisions.

The classification of the OMT Decision as an act of economic policy is supported by its immediate objective, which is to neutralise spreads on government bonds of selected Member States of the euro currency area. According to the European Central Bank, these spreads are partly based on fear of investors of a reversibility of the euro; however, according to the Bundesbank, such interest rate spreads only reflect the scepticism of market participants that individual Member States will show sufficient budgetary discipline to stay permanently solvent.

The purchase of government bonds from selected Member States only is a further indication of the OMT Decision being an act of economic policy because the monetary policy framework of the European System of Central Banks does generally not have an approach which

would differentiate between individual Member States. The parallelism of the OMT with assistance programmes of the EFSF or the ESM and the risk of undermining their objectives and requirements confirm this assessment. The purchase of government bonds to provide relief to individual Member States that is envisaged by the OMT Decision appears, in this context, as the functional equivalent to an assistance measure of the above-mentioned institutions – albeit without their parliamentary legitimation and monitoring.

- b. Art. 123 sec. 1 TFEU prohibits the European Central Bank from purchasing government bonds directly from the emitting Member States. It seems obvious that this prohibition may not be circumvented by functionally equivalent measures. The above-mentioned aspects, namely the neutralisation of interest rate spreads, selectivity of purchases, and the parallelism with EFSF and ESM assistance programmes indicate that the OMT Decision aims at a prohibited circumvention of Art. 123 sec. 1 TFEU. The following aspects can be added: The willingness to participate in a debt cut with regard to the bonds to be purchased; the increased risk; the option to keep the purchased government bonds to maturity; the interference with the price formation on the market, and the encouragement, coming from the ECB's Governing Council, of market participants to purchase the bonds in question on the primary market.
- c. In the view of the Federal Constitutional Court, the objective mentioned by the European Central Bank to justify the OMT Decision, namely to correct a disruption to the monetary policy transmission mechanism, cannot change this assessment. The fact that the purchase of government bonds can, under certain conditions, also help to support the monetary policy objectives of the European System of Central Banks does not turn the OMT Decision itself into an act of monetary policy. If purchasing of government bonds were admissible every time the monetary policy transmission mechanism is disrupted, it would amount to granting the European Central Bank the power to remedy any deterioration of the credit rating of a euro Member State through the purchase of that state's government bonds. This would largely

suspend the prohibition of monetary financing of the budget.

- d. In the view of the Federal Constitutional Court, the OMT Decision might not be objectionable if it could be interpreted or limited in its validity in conformity with primary law in such a way that it would not undermine the conditionality of the assistance programmes of the EFSF and the ESM, and would indeed only be of a supportive nature with regard to the economic policies in the Union. In light of Art. 123 TFEU, this would probably require that the acceptance of a debt cut must be excluded, that government bonds of selected Member States are not purchased up to unlimited amounts, and that interferences with price formation on the market are to be avoided where possible. Statements by the representatives of the European Central Bank in the course of the proceedings and the oral hearing before the Senate suggest that such an interpretation in conformity with primary law would most likely be compatible with the meaning and purpose of the OMT Decision.
5. Whether the OMT Decision and its implementation could also violate the constitutional identity of the Basic Law is currently not clearly foreseeable and depends, among other factors, on the content and scope of the OMT Decision as interpreted in conformity with primary law.

*Separate Opinion of Justice Lübbe-Wolff:*

In an effort to secure the rule of law, a court may happen to exceed judicial competence. In my view, this has occurred here. The motions should have been rejected as inadmissible. How Bundestag and Federal Government are to react to a violation, martial or non-martial, of German sovereign rights is a question that cannot reasonably be answered by rules making certain predetermined positive actions mandatory. Selecting from the variety of possible reactions, which range from expressions of disapproval to an exit from the Monetary Union, can only be a matter of political discretion. Accordingly, it comes as no surprise that no such rules are detectable either in the text of the Constitution or in the case-law interpreting it.

The assumption that under specified conditions not only acts of German federal organs which positively restrict sovereign rights, but also mere inaction in the face of qualified transgressions on the part of the European Union can be challenged on the basis of Art. 38 sec. 1 GG departs from earlier case-law, just recently corroborated, according to

which parliamentary or governmental inaction is contestable in constitutional complaint proceedings only if the complainant can rely on an explicit constitutional mandate substantially specifying the content and reach of the alleged duty to act. With respect to *Organstreit* challenges of inaction, too, the Senate has just recently repeated that they are admissible only if directed against a specific omission, i.e. against the omission of a specific action which can arguably be presented as constitutionally imperative. Moreover, the notion that a mere omission of certain governmental behaviour on the Union level can be a proper object of constitutional complaint would seem to stand in contrast to recent case-law according to which even positive acts of governmental cooperation in EU decisions or in intergovernmental decisions related to the Union will not be examined.

*Separate Opinion of Justice Gerhardt:*

I hold that the constitutional complaints and the application in the *Organstreit* proceedings, in so far as they relate to the OMT Decision, are inadmissible. The Senate's decision extends the possibilities of the individual to initiate via Art. 38 sec. 1 GG – without connection to a substantive fundamental right – a review of the acts of Union institutions by the Constitutional Court. By admitting such an *ultra vires* review, the door is opened to a general right to have the laws enforced (*allgemeiner Gesetzesvollziehungsanspruch*), which the Basic Law does not contain.

The responsibility with respect to integration (*Integrationsverantwortung*) of the German constitutional organs exists vis-à-vis the general public, and yields nothing for the construction of a subjective right of any person entitled to vote to have constitutional organs take action. With regard to the question of whether there exists a qualified *ultra vires* act, the Federal Government and the Bundestag must have a margin of appreciation and discretion, which the citizen needs to accept. The decision is based on the assumption that a transgression of powers can also be manifest if it is preceded by a lengthy clarification process. This case shows in abundant clarity how difficult it is to handle the criterion “manifest”. Monetary and economic policies relate to each other and cannot be strictly separated.

In an overall assessment, it seems to me that the claim, that the objective of the OMT Decision is first and foremost the re-establishment of the monetary transmission mechanism, cannot be contradicted with the unequivocalness to be required.

That, with the help of the Federal Constitutional Court, an individual may steer the Bundestag's right of initiative into a specific direction, does not fit into the constitutional framework of

parliamentary work. The citizens can influence the way and objectives of the political process through petitions, the political parties and Members of Parliament, and in particular through the media. The Bundestag could readily have criticised the OMT Decision by political means, threatened, if necessary, to bring proceedings for annulment before the Court of Justice of the European Union, waited for the reactions of the European Central Bank and the financial markets and then taken further steps. The fact that it did none of this does not indicate a democratic deficit, but is an expression of its majority decision for a certain policy when handling the sovereign debt crisis in the euro currency area.

**Professor Helmut Siekmann** holds the Endowed Chair of Money, Currency and Central Bank Law at Goethe University Frankfurt. He is Deputy Managing Director of the Institute for Monetary and Financial Stability (IMFS) and previously served as its Founding Managing Director.

Professor Siekmann received his doctor juris and his postdoctoral degree from the University of Cologne. He also earned a degree in Economics from the University of Bonn. Furthermore, he was awarded an honorary doctor's degree by the University Paris-Dauphine.

His main field of work is the stability of financial markets, financial institutions and public finances. His research is focused on all aspects of government finances, the institutional framework of the European System of Central Banks, the European provisions to secure stable government finances, the stabilization mechanisms in time of crisis, and the supervision and control of financial markets.

In addition to his academic work, Professor Siekmann contributed to numerous legislative projects on national and supranational level. He worked as counsel to constitutional bodies and represented them in constitutional courts.

Professor Siekmann has been visiting professor at several foreign universities like Saint Louis University in St. Louis, the University of Orléans, Paris-Dauphine, Luxembourg, and Donau University Krems.

**Volker Wieland** is Managing Director of the Institute for Monetary and Financial Stability (IMFS) at Goethe University Frankfurt where he also holds the Endowed Chair of Monetary Economics. From 2000 to 2012, he was Professor of Monetary Theory and Policy at Goethe University.

He is member of the German Council of Economic Experts and the Scientific Advisory Council of the Federal Ministry of Finance and also belongs to the Kronberger Kreis that is the Scientific Council of the Market Economy Foundation. Furthermore, he is a Research Fellow at the Center for Economic Policy Research (CEPR).

In 1995, Volker Wieland received a Ph.D. in Economics from Stanford University. Before joining Goethe University, Volker Wieland was a senior economist at the Board of Governors of the Federal Reserve System in Washington, DC. In 2008 he was awarded the Willem Duisenberg Research Fellowship by the European Central Bank.

His research interests include monetary and fiscal policy, business cycles and macroeconomic models, learning and economic dynamics as well as numerical methods in macroeconomics. His work has been published in leading economic journals such as the *American Economic Review*, the *Journal of Monetary Economics*, the *Journal of the European Economic Association*, the *European Economic Review* and the *Journal of Economic Dynamics and Control*. Professor Wieland has also served as Managing Editor of the *Journal of Economic Dynamics and Control* and remains a member of the JEDC Advisory Board. Besides, he served on the Advisory Council of the Society for Computational Economics from 1998 to 2006, as an Associate Editor of the *European Economic Review* (2001 to 2004) and as a Member of the Referee Panel of *Economic Policy* (2004 to 2006).

The **Centre for Economic Policy Research**, founded in 1983, is a network of over 800 researchers based mainly in universities throughout Europe, who collaborate through the Centre in research and its dissemination. The Centre's goal is to promote research excellence and policy relevance in European economics. Because it draws on such a large network of researchers, CEPR is able to produce a wide range of research which not only addresses key policy issues, but also reflects a broad spectrum of individual viewpoints and perspectives. CEPR has made key contributions to a wide range of European and global policy issues for almost three decades. CEPR research may include views on policy, but the Executive Committee of the Centre does not give prior review to its publications, and the Centre takes no institutional policy positions. The opinions expressed in this paper are those of the author and not necessarily those of the Centre for Economic Policy Research.