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Monetary Policy, and the End of Rational
Legal Reasoning**

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Squaring the Circle: The Court of Justice, Monetary Policy, and the End of Rational Legal Reasoning

Carsten Gerner-Beuerle¹ and Esin Küçük²

ABSTRACT

Few decisions of the Court of Justice of the EU have provoked more diverse, and more critical, reactions than its two decisions on the legality of the ECB's asset purchase programmes, *Gauweiler* and *Weiss*. Few are of greater importance, given that unprecedented exogenous shocks are likely to require continued interventions by the ECB to stabilise the Eurozone for some time to come. In spite of an extensive literature, there is no established view on whether the ECB's asset purchase programmes are legal. We argue that it is possible rationally to disagree about many of the concepts at issue in the two cases. We therefore propose to test the decisions solely against the benchmarks of consistency and coherence and show that they meet neither benchmark. The article explores the reasons for the Court's failure to deliver rationally defensible judgments and discusses implications for the further development of the legal framework governing unconventional monetary policy measures.

Keywords: *Gauweiler*; *Weiss*; monetary policy; monetary financing; asset purchase programmes; proportionality

1. Introduction

Of the many controversial judgments of the Court of Justice of the EU, few have been more controversial than its two decisions on the limits of monetary policy in the European Union, *Gauweiler* and *Weiss*. The decisions concern the legality of two asset purchase programmes of the European Central Bank (ECB), called outright monetary transactions (OMT) and the

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public sector asset purchase programme (PSPP).³ The two cases take us, in several respects, into uncharted waters. They are the first decisions to offer a comprehensive analysis of the legality of unconventional monetary policy measures in light of the ECB's monetary policy mandate and the prohibition of monetary financing.⁴ They are the first two (and so far, the only) cases referred to the Court of Justice by the German Federal Constitutional Court (FCC) under Article 267 TFEU.⁵ One of them, Weiss, is the first decision to be denied binding force in Germany for the reason that the Court of Justice had exceeded its judicial mandate and acted *ultra vires*.⁶

The decisions have provoked sharply contrasting reactions. In the opinion of the FCC, the Court's judgment in Gauweiler met 'with serious objections'⁷ and its reasoning in Weiss was 'simply not comprehensible',⁸ 'objectively arbitrary'⁹ and 'no longer tenable from a methodological perspective'.¹⁰ Commentators claimed that Gauweiler and Weiss represented a renunciation of a rules-based conception of Economic and Monetary Union in favour of non-democratically legitimated emergency rule and the willingness of the Court to do whatever it took to save the Euro,¹¹ but also that they were 'sober and level-headed'¹² and embraced an appropriate standard of review that safeguarded the independence of the ECB.¹³

Whether the decisions are indeed 'methodologically untenable' and 'objectively arbitrary', and whether they provide for an appropriate standard of review that is able to legitimise the ECB's asset purchase programmes, is of critical importance for the future of European

³ Case C-C-62/14 Gauweiler and Others v Deutscher Bundestag [2015] EU:C:2015:400; Case C-493/17 Weiss and Others [2018] EU:C:2018:1000. The third important judgment on monetary union is Case C-370/12 Thomas Pringle v Ireland [2012] ECLI:EU:C:2012:756 regarding the European Stability Mechanism (ESM). In Pringle, the Court of Justice developed many of the principles that were applied in Gauweiler and Weiss, and we will refer to the decision where necessary.

⁴ TFEU, Arts 119, 123(1), 127.

⁵ BVerfGE 134, 366, 2 BvR 2728/13 (OMT referral); BVerfGE 146, 216, 2 BvR 859/15 (PSPP referral).

⁶ Bundesverfassungsgericht [German Federal Constitutional Court], 2 BvR 859/15 (FCC judgment on PSPP), para 163. In its judgment on OMT, the FCC had expressed serious concerns about the interpretation of the Treaty by the Court of Justice, but ultimately held that the interpretation was 'at least tenable' and remained within the mandate of the Court, BVerfGE 142, 123, 2 BvR 2728/13 (FCC judgment on OMT), paras 176-177. Weiss is not the first decision that was declared *ultra vires* by any national court in the EU. The first two such instances were a judgment of the Czech Constitutional Court of 31 January 2012, Pl. ÚS 5/12 (Landtovà) and a judgment of the Danish Supreme Court of 6 December 2016, Case no. 15/2014 (Ajos).

⁷ FCC judgment on OMT (n 6), para 181.

⁸ FCC judgment on PSPP (n 6), para 118.

⁹ *ibid.*

¹⁰ *ibid* para 119.

¹¹ Mark Dawson and Ana Bobić, 'Quantitative Easing at the Court of Justice – Doing whatever it takes to save the euro: Weiss and Others' (2019) 56 CML Rev. 1005, 1040; Alicia Hinarejos, 'Gauweiler and the Outright Monetary Transactions Programme: The Mandate of the European Central Bank and the Changing Nature of Economic and Monetary Union' (2015) 11 EuConst 563, 575; Nicole Scicluna, 'Integration through the disintegration of law? The ECB and EU constitutionalism in the crisis' (2018) 25 Journal of European Public Policy 1874, 1881-1883. An in-depth treatment of all stages of the development of the case law on monetary union can be found in several special issues of the German Law Journal: Pringle in vol. 14(1) (2013); the preliminary reference of the FCC in Gauweiler in vol. 15(2) (2014); the Gauweiler judgment of the Court of Justice in vol. 16(4) (2015); and most recently the FCC's judgment in Weiss in vol. 21(5) (2020).

¹² Mehrdad Payandeh, 'The OMT Judgment of the German Federal Constitutional Court' (2017) 13 EuConst 400, 404.

¹³ Annelieke AM Mooij, 'The Weiss judgment: The Court's further clarification of the ECB's legal framework' (2019) 26 MJ 449, 465.

monetary union at a time when unprecedented exogenous shocks are likely to require repeated interventions by the ECB, such as, most recently, its large-scale pandemic emergency purchase programme (PEPP).¹⁴ Rather than offering yet another view on the ‘right’ interpretation of the Treaty, this article will assess the decisions of the Court of Justice on the Court’s own terms. It is our goal to determine whether the decisions are rationally defensible, premised on the interpretation of the Treaty advanced by the Court in Gauweiler and Weiss and the Court’s understanding of the explicit or implied objectives of the provisions on monetary union.

We adopt this approach because Gauweiler and Weiss are, arguably, ‘hard cases’, not only because of their political dimension, but also because the relevant Treaty provisions use terms that are neither defined in the Treaty, nor associated with a clearly delineated meaning, such as ‘monetary policy’.¹⁵ In such cases, courts often appeal to legal principles of a higher order to resolve an interpretive conflict.¹⁶ However, higher-order principles, owing to their generality, will also often be open to different interpretations or in conflict with one another.¹⁷ For example, in the present context, there is a tension between the preservation of financial stability in the Eurozone, which may require a form of fiscal transfer system to address the asymmetric impact of economic shocks on Member State finances, and budgetary autonomy of the Member States, which militates against transfer payments.¹⁸ Where it is possible rationally to disagree about the most appropriate resolution of a conflict over the interpretation of a principle, or between two principles, it may be more useful to assess proposed solutions in light of their consistency and coherence, rather than by attempting to identify the ‘correct’ answer to the conflict. This is the approach we take to analysing whether the Court’s decisions are rationally defensible.¹⁹

Consistency, as we use the term, refers to the non-contradictory formulation and application of legal rules and principles. A norm should be given the same meaning across and within cases, with the consequence that cases that differ factually along a relevant dimension should be treated differently and cases that do not differ along that dimension should be treated alike,

¹⁴ Decision (EU) 2020/440 of the ECB on a temporary pandemic emergency purchase programme (ECB/2020/17), amended by Decision (EU) 2020/1143 of the ECB of 28 July 2020 (ECB/2020/36), which enlarged the overall envelop of the programme from €750bn to €1,350bn.

¹⁵ TFEU, Art 119(2).

¹⁶ The account of first and second-order conflicts in this paragraph draws on Neil MacCormick, ‘The Limits of Rationality in Legal Reasoning’ in Neil MacCormick and Ota Weinberger, *An Institutional Theory of Law* (Reidel 1986), 189, 203-205. MacCormick’s conceptual framework has been applied to the legal reasoning of the Court of Justice by Joxerramon Bengoetxea, *The Legal Reasoning of the European Court of Justice* (Clarendon Press 1993), 168-172, 224-225.

¹⁷ MacCormick (n 16) 203.

¹⁸ The Court of Justice, in Pringle (n 3) para 135, ascribed ‘a higher objective, namely maintaining the financial stability of the monetary union’ to Art 125 TFEU. It accordingly held that ‘the activation of financial assistance by means of a stability mechanism such as the ESM’ was compatible with Art 125 if it was ‘indispensable for the safeguarding of the financial stability of the euro area as a whole’, *ibid* para 136. The FCC, on the other hand, in its OMT referral to the Court of Justice (n 5) para 102, emphasised the importance of the budgetary autonomy of the German parliament, which would be violated if the EU institutions ‘created a mechanism [amounting] to an assumption of liability for decisions of third parties which entail[ed] consequences that [were] difficult to calculate’.

¹⁹ This understanding of rationality is informed by MacCormick (n 16) 193, 203-204. A similar approach has been adopted by Bengoetxea (n 16) 10-12 and *passim*.

all else being equal.²⁰ A legal solution to a particular social conflict is coherent if the rules that apply to the conflict contribute to the attainment of the higher-order principle that guides a regulation of the relevant issues.²¹ For example, if the preservation of sound public finances is seen as the main objective of the prohibition of monetary financing pursuant to Article 123(1) TFEU (as it is in the opinion of the Court of Justice), an interpretation of Article 123(1) TFEU that requires monetary policy measures to exhibit certain technical features is incoherent if these features do not in fact contribute to the preservation of sound public finances.

We make three contributions. First, while there is considerable disagreement about many of the questions at issue in *Gauweiler and Weiss*, which are heavily infused with political considerations about the goals of monetary policy and the permissibility of redistributive measures that help to absorb asymmetric demand shocks, we presume that there is broad agreement, in all Member States, about the importance of consistency and coherence in the adjudication of these matters. Decisions of the Court of Justice on politically sensitive matters that have a differential impact on Member State interests can only hope to meet with broad acceptance if they are based on a foundation of unquestionable consistency and coherence. We explore whether this foundation is existent. If it is not, as we will conclude, the first step is to develop the case law further and eliminate inconsistency and incoherence. Once it is existent, the debate can turn to assessing whether the rules developed by the Court of Justice are appropriate in light of other considerations.

Second, focussing solely on consistency and coherence lays bare ambiguities in *Gauweiler and Weiss* that have received no attention to date, because the focus in the literature is typically on overarching, politically charged questions, such as the role of the ECB in European monetary union, or on the conflict between the Court of Justice and the FCC. In particular, we argue that the term ‘indirect effects’ is key to understanding how the Court construes the mandate of the ECB. Taking the Court’s discussion of indirect effects seriously calls into question not only whether *Gauweiler* should have been decided as it was decided, but also whether the main point of criticism of the FCC in its judgment in *Weiss*—that the

²⁰ Our definition of consistency is based loosely on Neil MacCormick, *Legal Reasoning and Legal Theory* (OUP 1994) 106.

²¹ *ibid* 106-107, 152-157. We can sidestep difficult conceptual problems surrounding the concept of coherence, for example the question whether overarching, global principles can give coherence to a legal system as a whole, such as the idea of integration as a guiding principle of the jurisprudence of the Court of Justice, Joxerramon Bengoetxea, Leonor Moral Soriano and Neil McCormick, ‘Integration and Integrity in the Legal Reasoning of the European Court of Justice’ in Gráinne de Búrca and J.H.H. Weiler, *The European Court of Justice* (OUP 2001), 43, 47, 82-85. For a critique of this understanding of coherence, see Barbara Baum Levenbook, ‘The Role of Coherence in Legal Reasoning’ (1984) 3 *Law and Philosophy* 355. We are also not concerned with conceptual questions regarding the relationship between two or more higher-order principles, see e.g. the Court of Justice in *Pringle* (n 3) para 135, who associates two objectives with Art 125 TFEU, the preservation of sound public finances and financial stability, with the latter being the higher-level objective. On this aspect of *Pringle*, see Kaarlo Tuori and Klaus Tuori, *The Eurozone Crisis: A Constitutional Analysis* (CUP 2014), 120-136, who speak of the ‘two-order telos’ of Art 125. For our purposes, it is sufficient to simply take the higher-order principles identified by the Court in *Gauweiler and Weiss*, and the order of priority stipulated by the Court, as given and analyse whether the applicable provisions are interpreted in a coherent way in light of these principles.

ECB's mandate should have been construed restrictively in light of the principle of proportionality—is justified.

Third, we show how inconsistencies and incoherence in the case law of the Court of Justice can be traced back to two constraints under which the Court decided *Gauweiler*: the risk that the Eurozone might have disintegrated during the sovereign debt crisis without the OMT programme and the threat of a judicial conflict with the FCC. Without certain points of inconsistency and incoherence, OMT would have been impermissible and the Court's holding would have been diametrically opposed to the reference of the FCC. These defects in the Court's reasoning spilled over into *Weiss* and may have contributed to the FCC's decision to declare that judgment *ultra vires* (although, as we will see, the FCC's criticism concerned other parts of the Court's decisions).

Our analysis proceeds as follows. Section 2 gives a brief overview of the questions at issue in *Gauweiler* and *Weiss*. Sections 3 and 4 form the core of this article. Through our methodological lens of consistency and coherence, we first analyse the reasons given by the Court of Justice to justify that OMT and the PSPP fall within the monetary policy mandate of the ECB, and the reasons by the FCC why the PSPP (but not OMT) exceeds the ECB's mandate. We then examine whether the Court's view that the two asset purchase programmes do not constitute monetary financing is rationally defensible. Section 5 traces the origins of inconsistency and incoherence back to the sovereign debt crisis and the reference of the FCC in *Gauweiler*. Section 6 concludes with some comments on the implications of our analysis for the further development of the legal framework governing unconventional monetary policy measures, including the PEPP.

2. Background

The proceedings in *Gauweiler* and *Weiss* revolved around two foundational features of the constitutional architecture of European monetary union: the competence of the ECB and the European System of Central Banks (ESCB) in the area of monetary policy²² and the prohibition of monetary financing.²³ The proceedings have been described in detail in the literature, and there is no need to reproduce these accounts here.²⁴ Instead, we will focus on the characteristics, operation, and economic importance of the measures challenged in the two cases—the two decisions of the ECB announcing outright monetary transactions and

²² TFEU, Arts 119 and 127.

²³ TFEU, Art 123(1).

²⁴ From the voluminous literature, see on *Gauweiler*, among others: Dariusz Adamski, 'Economic constitution of the euro area after the *Gauweiler* preliminary ruling' (2015) 52 CML Rev. 1451; Vestert Borger, 'Outright Monetary Transactions and the Stability Mandate of the ECB: *Gauweiler*' (2016) 53 CML Rev. 139; Hinarejos (n 11); Takis Tridimas and Napoleon Xanthoulis, 'A Legal Analysis of the *Gauweiler* Case: Between Monetary Policy and Constitutional Conflict' (2016) 23 MJ 17; and on *Weiss*, among others: Dawson and Bobić (n 11); Mooij (n 13).

public sector asset purchases²⁵—insofar as this is relevant to our critique of the legal reasoning of the Court of Justice.

Outright monetary transactions involve the purchase of government bonds of selected Member States in the secondary market with the aim of ‘safeguarding an appropriate monetary policy transmission’.²⁶ The ECB’s intervention is subject to no ex ante quantitative limits, but conditional on the participation of the Member States concerned in an EFSF or ESM macroeconomic adjustment programme that requires the implementation of macroeconomic reforms prepared and supervised by the European Commission in liaison with the ECB and IMF.²⁷ Until today, the ECB has carried out no transactions under its OMT programme.

The PSPP was adopted to respond to a ‘materially increased ... downside risk to the medium-term outlook on price developments,’ which, in the words of the ECB, ‘jeopardis[ed] the achievement of the ECB’s primary objective of maintaining price stability.’²⁸ Just as OMT, the PSPP involves the purchase of government bonds in the secondary market. In contrast to OMT, the ECB and the national central banks purchase the bonds of all Eurozone Member States largely in proportion to the ECB’s capital key (with the exception of Member States whose bonds are not eligible for purchase²⁹) and conditionality does not apply.³⁰ The PSPP was initially carried out between March 2015 and December 2018 and restarted in November 2019. As of August 2020, cumulative net purchases (purchases minus redemptions) under the PSPP amounted to €2.4tn.³¹

It is the stated aim of both OMT and the PSPP to address tensions in financial markets that, according to the ECB, were hampering the effective transmission of monetary policy and credit provision to the economy.³² Thus, the programmes ostensibly pursue monetary policy goals. They are qualified by the ECB as non-standard monetary policy measures that are deployed when conventional policy instruments fail to produce their intended effects.³³

²⁵ ECB Press Release, Technical features of Outright Monetary Transactions, 6 September 2012; Decision (EU) 2015/774 of the ECB on a secondary markets public sector asset purchase programme (ECB/2015/10), recast as Decision (EU) 2020/188 of the ECB on a secondary markets public sector asset purchase programme (ECB/2020/9).

²⁶ ECB Press Release (n 25).

²⁷ *ibid.*

²⁸ Decision (EU) 2015/774 (n 25), recital 3.

²⁹ Art 3 Decision (EU) 2020/188 (n 25) sets out eligibility criteria for government bonds that can be purchased under the PSPP. In particular, bonds must be of investment grade.

³⁰ Decision (EU) 2020/188 (n 25), Art 6.

³¹ Data from <https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html>.

³² Decision (EU) 2015/774 (n 25), recital 2; Decision (EU) 2020/188 (n 25), recital 2. If a change in central bank interest rates alone is insufficient to affect money market rates and, through them, lending and deposit rates and inflation, or policy rates have reached their lower bound, asset purchases can support the transmission of a central bank’s monetary policy stance by reducing the risk of future interest rate changes associated with bonds (so-called duration risk) and strengthening the capital position of banks holding sovereign bonds, Philippe Andrade, Johannes Breckenfelder, Fiorella De Fiore, Peter Karadi and Oreste Tristani, ‘The ECB’s asset purchase programme: an early assessment’ (2016) ECB Working Paper No 1956, 3.

³³ Conventional policy instruments are open market operations, standing facilities and reserve requirements for credit institutions, Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank, Arts 18, 19. Open market operations are typically carried out in the form of reverse transactions (repurchase agreements or collateralised loans), but the ESCB has further instruments at its disposal and can, for

However, there is widespread agreement that the OMT programme contributed critically to containing the Eurozone crisis at its height in 2012, when Mario Draghi made his famous statement that the ECB would ‘do whatever it takes to preserve the euro’,³⁴ followed by a more formal announcement of the OMT programme a few months later.³⁵ The announcement as such was sufficient to calm markets and reduce sovereign bond spreads in the Eurozone to levels that did not call into question the ability of individual Member States to refinance their debt.³⁶

The legal challenges against OMT and the PSPP were based on similar arguments. The applicants in the main proceedings submitted that the bond purchase programmes exceeded the powers of the ESCB pursuant to Articles 119(2), 127 TFEU and violated the prohibition of monetary financing pursuant to Article 123(1) TFEU.³⁷ They exceeded the powers of the ESCB because they had ‘a direct impact on the financing sources of ... Member States’³⁸ and, in the case of OMT, their ‘true objective’ was ‘to “save the euro”’.³⁹ These were economic policy goals that fell within the exclusive remit of the Member States.⁴⁰ Furthermore, the applicants contended that the programmes circumvented the prohibition laid down in Article 123(1) TFEU, because purchases under OMT and the PSPP were, in their economic effects and the incentives they created for Member States to adjust their budgetary policies, equivalent to direct purchases of government bonds in the primary market.⁴¹ The Court of Justice held that OMT and the PSPP complied with the Treaty in all respects. The FCC accepted the Court’s assessment of OMT (however, not without expressing grave reservations and reiterating that OMT was only permissible if it was subject to strict limits⁴²). It also concluded that the PSPP did not ‘manifestly’ circumvent the prohibition of monetary financing.⁴³ However, it held that the ECB had exceeded its monetary policy mandate, because it had failed to balance the monetary policy objectives pursued with the PSPP against

example, engage in the outright purchase or sale of assets to pursue monetary policy goals. The different categories of open market operations and the instruments used for each category are laid down in Art 5 Guideline (EU) 2015/510 of the ECB on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (recast).

³⁴ Mario Draghi, President of the European Central Bank, speech at the Global Investment Conference in London, 26 July 2012. He made similar remarks at the press conference where the OMT decision was announced, ECB, Introductory statement to the press conference of 6 September 2012. Transcripts of both speeches are available at <https://www.ecb.europa.eu/press/html/index.en.html>.

³⁵ ECB Press Release (n 25). For an overview of existing research concerning the EU’s response to the Eurozone crisis, see Tal Sadeh, ‘How did the euro area survive the crisis?’ (2019) 42 *West European Politics* 201

³⁶ Carsten Gerner-Beuerle, Esin Küçük, and Edmund Schuster, ‘Law Meets Economics in the German Federal Constitutional Court: Outright Monetary Transactions on Trial’ (2014) 15 *German L.J.* 281, 298-301.

³⁷ Opinion of AG Cruz Villalón in Case C-C-62/14 Gauweiler and Others EU:C:2015:400, paras 94, 206; Opinion of AG Wathelet in Case C-493/17 Weiss and Others EU:C:2018:1000, para 25.

³⁸ Gauweiler, Opinion of AG Cruz Villalón (n 37) para 94. Similar concerns were raised in Weiss (n 3) para 16 (third question referred by the German Federal Constitutional Court).

³⁹ Gauweiler, Opinion of AG Cruz Villalón (n 37) para 95.

⁴⁰ TFEU, Art 120.

⁴¹ Gauweiler, Opinion of AG Cruz Villalón (n 37) paras 205-208; Weiss, Opinion of AG Wathelet (n 37) para 54.

⁴² We will discuss these limits Section 5.

⁴³ FCC judgment on PSPP (n 6), paras 197-217.

the economic policy effects of the asset purchases.⁴⁴ We will deal with these two points—competence and the prohibition of monetary financing—in the next two sections.

3. Monetary Policy Mandate

The EU has exclusive competence to conduct a single monetary policy for the Member States whose currency is the euro, while economic policy falls within the competence of the Member States.⁴⁵ Pursuant to Articles 119(2), 127 TFEU, the primary objective of the EU's monetary policy is the maintenance of price stability. Other than this reference, the Treaty contains no description of what monetary policy involves. In both *Gauweiler* and *Weiss*, the question therefore arose how to delimit the ECB's mandate and distinguish monetary from economic policy. We will discuss first the formula developed by the Court of Justice and then the alternative approach of the FCC, which rejected the Court's interpretation as methodologically untenable.

3.1. *Inconsistency, part 1: The Court's direct/indirect effects test*

Since *Pringle*, the Court of Justice has used a two-pronged test to distinguish between monetary and economic policy. It asks, first, whether the ECB pursues an objective that belongs to monetary or economic policy and, second, whether the instrument used to achieve that objective can be qualified as a monetary or an economic policy instrument.⁴⁶ The second part of this test is easy to apply, since the monetary policy instruments that are at the ECB's disposal are enumerated in the Protocol on the ESCB and the ECB. One type of monetary policy instrument are open market operations, which are carried out, among other means, by buying and selling marketable instruments in financial markets.⁴⁷ Both OMT and the PSPP fall squarely within this definition.⁴⁸

The first part of the ECB's test is more problematic. The purported goals of both OMT and the PSPP are standard monetary policy objectives: repairing the monetary policy transmission mechanism and safeguarding the singleness of the ECB's monetary policy.⁴⁹ A functioning monetary policy transmission mechanism is a precondition for benchmark interest rate decisions to influence inflation and hence the ECB's ability to achieve its primary objective

⁴⁴ *ibid* paras 167-177.

⁴⁵ Art 3(1)(c) TEU.

⁴⁶ *Pringle* (n 3) para 55; *Gauweiler* (n 3) para 46; *Weiss* (n 3) para 53.

⁴⁷ Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank, Art 18.1.

⁴⁸ *Gauweiler* (n 3) para 54; *Weiss* (n 3) para 69. The selectivity and conditionality of OMT (see text to nn 26-27 above) made no difference in this context. The Court argued that the TFEU and the Protocol on the ESCB and the ECB did not require open market operations to be carried out in all Eurozone Member States, and conditionality simply served to ensure that the ESCB's purchases did not give rise to moral hazard and imperilled the economic policies of the Member States, *Gauweiler* (n 3) paras 55-61.

⁴⁹ ECB Press Release (n 25); Decision (EU) 2015/774 (n 25) recitals 2-4; Decision (EU) 2020/188 (n 25), recitals 2, 10. See also the text to nn 26, 28, and 32 above.

of maintaining price stability.⁵⁰ Furthermore, Article 119(2) TFEU provides that the Eurozone shall have ‘a single monetary policy’, which is not the case if monetary policy decisions are ineffective in a part of the Eurozone because of a disruption to the transmission mechanism. This much was not disputed in *Gauweiler and Weiss*. In response to the submissions of the applicants in the main proceedings, the Court of Justice then added a second step to the analysis that went beyond the stated goals of the measures and inquired into their effects. This second layer of analysis can be seen as an objective corrective to a test that necessarily has to rely on the published rationale behind a measure and, hence, is largely subjective.⁵¹ The Court held that a measure whose stated aim concerned the promotion of the monetary policy objectives of Articles 119(2) and 127(1) TFEU was not equivalent to an economic policy measure ‘for the sole reason that it may have indirect effects that can also be sought in the context of economic policy’.⁵² The effect of OMT on financial stability and the impact of the PSPP on refinancing conditions of Eurozone governments were, in the opinion of the Court, examples of indirect economic policy effects.⁵³

From the discussion of indirect effects in *Gauweiler and Weiss*, it is not easy to understand how the Court’s test is intended to operate.⁵⁴ Some passages especially in *Weiss*, which contains the most detailed examination of indirect effects,⁵⁵ seem contradictory. For example, the Court acknowledged that the PSPP was capable of having an impact on the balance sheets of commercial banks that sold government bonds to the ESCB and that such an effect might also be sought through economic policy measures.⁵⁶ In the following paragraphs, it then dismissed the argument that this effect called the monetary policy nature of the PSPP into question, because indirect effects had ‘no consequences for the purposes of classification of the measures at issue’.⁵⁷ Taken literally, the Court’s example is perplexing. Asset purchases by the ESCB have, by definition, a direct impact on the balance sheets of the sellers (and their refinancing conditions) by replacing one asset (government bonds) with another (cash). On the other hand, the one effect that falls undoubtedly within the area of monetary policy—the impact of asset purchases on price stability—is clearly an indirect effect. The ECB has no direct influence over inflation and instead affects price levels through various economic

⁵⁰ The monetary policy transmission mechanism will be discussed in more detail presently in the text.

⁵¹ In analysing the objectives of OMT and the PSPP, the Court indeed relied exclusively on the press release and the ECB decision setting out the aims of the two programmes, and discussed whether these aims were consistent with the objectives of monetary policy as formulated in Arts 119(2) and 127(1) TFEU, *Gauweiler* (n 3) paras 47-50; *Weiss* (n 3) paras 54-57.

⁵² *Weiss* (n 3) para 61. Similar *Gauweiler* (n 3) para 52. Likewise, an economic policy measure ‘cannot be treated as equivalent to a monetary policy measure for the sole reason that it may have indirect effects on [a monetary policy objective such as] the stability of the euro’, *Pringle* (n 3) para 56.

⁵³ *Gauweiler* (n 3) paras 51-52; *Weiss* (n 3) paras 63-64.

⁵⁴ In spite of their importance for a distinction between economic and monetary policy, the Court’s considerations of the effects of asset purchases in *Gauweiler and Weiss* have not received much attention in the literature. An exception is Armin Steinbach, ‘Effect-based analysis in the court’s jurisprudence on the euro crisis’ (2017) 42 E.L. Rev. 254.

⁵⁵ *Weiss* (n 3) paras 58-67.

⁵⁶ *ibid* para 59.

⁵⁷ *ibid* para 63.

channels. As the Court of Justice emphasised in both *Gauweiler* and *Weiss*, such economic effects are a precondition for the ECB's policy decisions to achieve their ultimate objective.⁵⁸

One possible interpretation of the Court's comments on indirect effects is this: All effects other than those that have an impact on the singleness of European monetary policy and price stability (the monetary policy objectives laid down in Articles 119(2) and 127(1) TFEU) are by definition indirect effects. However, this interpretation would distort the ordinary meaning of 'direct' and 'indirect'. If this is what the Court had meant, it would have been more natural to speak simply of 'effects'. It would also render the effects-based considerations in *Gauweiler* and *Weiss* largely redundant. Provided a measure's purported goal belonged to monetary policy and it had some (direct or indirect) effects on monetary policy objectives, it would qualify as a monetary policy measure. Indirect effects on price stability are, however, widespread when economic policy decisions are taken.⁵⁹ A test that did not assess the direct (or alternatively the predominant⁶⁰) effects of a measure would make any objective differentiation between monetary and economic policy therefore largely impossible.

More convincing is an alternative interpretation that is based on the ordinary meaning of 'direct' and 'indirect' and distinguishes between monetary and economic policy effects by asking whether an effect is a necessary part of the transmission of a monetary policy decision. This interpretation would lead to a clear demarcation of monetary policy and allow us to make sense of the Court's examples in *Weiss*. Secondary market asset purchases have an impact on a bank's balance sheet and refinancing conditions. Even though these effects are economic in nature, they do not result in a qualification of asset purchase programmes as economic policy instruments, because they contribute directly to the transmission of monetary policy decisions. Or, to put it differently: the direct effects of such a measure belong to monetary policy because they are part of the monetary policy transmission mechanism. The impact that secondary market asset purchases have on the refinancing conditions of Eurozone governments also do not render the measure an economic policy measure, because these are indirect economic effects.

However, it is questionable whether the direct/indirect effects test, thus understood, can justify the conclusion that both OMT and the PSPP are monetary policy measures. Both purchase programmes were intended to, and did, address disruptions to the monetary policy transmission mechanism, and both had some effects on goals belonging to economic policy. However, the similarities end there. In order to investigate the precise effects of the two programmes and their differences, a brief description of the monetary policy transmission mechanism may be useful. Monetary policy decisions are transmitted to the economy in several steps. Simplifying considerably, a central bank sets the interest rates under its control,

⁵⁸ *Gauweiler* (n 3) para 108; *Weiss* (n 3) paras 64-67.

⁵⁹ See, e.g., Klaus Weyerstrass, Johannes Jaenicke, Reinhard Neck, Gottfried Haber, Bas van Aarle, Koen Schoors, Niko Gobbin and Peter Claeys, 'Economic Spillover and Policy Coordination in the Euro Area' (2006) European Economy Economic Paper No 246 (showing that, for example, measures contributing to fiscal consolidation and structural reform—both clearly outside of the mandate of the ECB—have effects on interest rates and, through them, price levels).

⁶⁰ An assessment of the predominant effects of a policy measure is effectively what the FCC suggests through its lens of proportionality, see the discussion in Section 3.2.

in the Eurozone in particular the rates on the main refinancing operations (the rate at which the central bank provides short-term liquidity to financial institutions), the deposit facility (the rate at which banks can make overnight deposits with the Eurosystem), and the marginal lending facility (the rate at which banks can borrow money overnight from the Eurosystem). These rates affect the refinancing costs of financial institutions in the money market and, through these, the rates at which banks lend to, and accept deposits from, their customers. The latter rates, in turn, influence asset prices and saving, consumption, and investment decisions of households and firms. Finally, the behaviour of households and firms affects supply and demand in the markets for goods and services and shifts prices in these markets accordingly.

At the time of the OMT decision, the Governing Council of the ECB considered the Eurozone to be in a ‘bad equilibrium’ where concerns about the solvency of some Member States and the continued viability of monetary union had driven interest rates on government bonds up. This made it more costly for Member States to refinance their debts, thus creating the risk that a liquidity crisis would degenerate into a solvency crisis, irrespective of the question whether the initial concerns (fully) justified the spike in interest rates.⁶¹ The monetary policy transmission mechanism was disrupted because financial institutions in the affected Member States were effectively excluded from international capital and money markets as the macroeconomic environment deteriorated.⁶² The ECB’s intervention was intended to eliminate the risk premia that reflected the threat that a liquidity crisis might develop into a self-fulfilling solvency crisis.⁶³ The bank did so by offering to buy potentially unlimited amounts of government bonds from solvent issuers,⁶⁴ thus performing a de facto role of lender of last resort for national governments to resolve liquidity (but not solvency) crises.⁶⁵

⁶¹ Mario Draghi, press conference of 6 September 2012 (n 34). For a formal model, see Paul De Grauwe and Yuemei Ji, ‘Self-fulfilling crises in the Eurozone: An empirical test’ (2013) 34 *Journal of International Money and Finance* 15, 33-35.

⁶² See, for example, Yannis Stournaras, ‘The impact of the Greek sovereign crisis on the banking sector – challenges to financial stability and policy responses by the Bank of Greece’, keynote speech, at the London Business School Greek Alumni Association and Stanford Club of Greece event ‘Breaking the Bottlenecks – Steps towards Sustainable Growth’, 8 June 2016, p 2, available at www.bis.org/review/r160628a.htm.

⁶³ In the words of Mario Draghi at the press conference of 6 September 2012 (n 34), the ECB sought to ‘break’ the self-fulfilling expectations of the impending insolvency of Eurozone states and a disintegration of the Eurozone.

⁶⁴ OMT is conditional on the relevant Member State receiving EFSF/ESM assistance (ECB Press Release (n 25)), and such assistance is only granted when the public debt of the recipient state is sustainable. Pursuant to the ESM Treaty, Art 13(1)(b), the Commission conducts a debt sustainability analysis together with the IMF before financial assistance is granted. If the debt sustainability analysis reveals that a country could be insolvent, the recipient state is required to negotiate a comprehensive plan with its private creditors to restore debt sustainability, European Commission, European Stability Mechanism (ESM) – Q&A, MEMO/10/636.

⁶⁵ Paul De Grauwe, *Economics of Monetary Union* (OUP, 12th edn 2018), 133-134; Kun Hu, ‘The Institutional Innovation of the Lender of Last Resort Facility in the Eurozone’ (2014) 36 *Journal of European Integration* 627. While OMT effectively enables the ECB to perform lender-of-last-resort functions for the member states of the Eurozone, the Maastricht Treaty that established monetary union did not provide for a lender of last resort, and some of the provisions on monetary union, such as those discussed here, call into question whether lender-of-last-resort activities are covered by the Treaty. See Borger (n 24) 148-152 and 184-185 for an overview of the legal issues.

In contrast, the PSPP was adopted because the ECB's standard monetary policy tools had been exhausted. At the time of the initial commencement of the purchase programme in March 2015 and when it was restarted in November 2019, the rates on the main refinancing operations and the marginal lending facility were close to or at their zero bound, and the deposit facility rate was negative.⁶⁶ Nevertheless, inflation remained significantly below the central bank's target of close to 2%.⁶⁷ The bond purchase programme was initiated because, among other reasons, the ECB was of the view that the adopted monetary policy measures had resulted in a 'lower than expected monetary stimulus' and there was no room to loosen monetary policy further by using traditional tools.⁶⁸ By purchasing government bonds from private institutions in the secondary market, the programme was intended to 'induc[e] financial intermediaries to increase their provision of liquidity to the interbank market and credit to the euro area economy'.⁶⁹

It is clear from this description that OMT and the PSPP are qualitatively very different measures that have different direct and indirect effects. The (intended and actual) direct effect of OMT was the resolution of a liquidity crisis that imperilled the solvency of financial institutions, governments, and more generally financial stability.⁷⁰ As a consequence of the resolution of the liquidity crisis and the restoration of an equilibrium in the money market that was not distorted by self-fulfilling expectations (and hence as an indirect effect of OMT), the ECB's intervention ensured that benchmark interest rate decisions would influence the money market and would be transmitted further to the real economy.⁷¹ The PSPP, on the other hand, operates directly at the second stage of the transmission mechanism by increasing demand for government bonds and hence lowering refinancing costs for financial institutions, which can then be passed on to the institutions' customers. The Court's direct/indirect-effects distinction, therefore, if it is understood as we suggest here, provides a satisfactory explanation for the classification of the PSPP, but not OMT, as a monetary policy measure.⁷²

⁶⁶ The key interest rates are published on the website of the ECB, www.ecb.europa.eu/stats (follow hyperlinks 'ECB/Eurosystem policy and exchange rates' and 'Official interest rates').

⁶⁷ When the programme was initially announced and when it was restarted, in January 2015 and September 2019, inflation was -0.6% and 0.8%, respectively. Data are from <https://sdw.ecb.europa.eu>.

⁶⁸ Decision (EU) 2015/774 (n 25) recital 3; Decision (EU) 2020/188 (n 25), recital 6.

⁶⁹ Decision (EU) 2015/774 (n 25) recital 4.

⁷⁰ Members of the Executive Board of the ECB acknowledged that the ECB saw the OMT decision as a tool to prevent a breakup of the Eurozone and contribute to a resolution of the sovereign debt crisis, Peter Praet, The ECB and its role as lender of last resort during the crisis, speech at the Committee on Capital Markets Regulation conference, 'The Lender of Last Resort – an international perspective', 10 February 2016, available at www.ecb.europa.eu/press/key/date/2016. See in particular fn. 2 of the transcript of the speech.

⁷¹ Indeed, AG Cruz Villalón said as much in his opinion in Gauweiler. He explained that unblocking the monetary policy transmission channels was the 'indirect aim' of the OMT programme, and reducing the interest rates required of certain Member States to 'normal levels' its 'immediate objective', Opinion of AG Cruz Villalón (n 37) para 259.

⁷² The outcome in the two cases would, of course, be consistent if the first possible interpretation of the direct/indirect-effects distinction, described in the text to nn 59-60 above, was adopted. However, as we discuss there, this interpretation is unconvincing.

3.2. *Incoherence, part 1, and inconsistency, part 2: The FCC's proportionality test*

The German Federal Constitutional Court suggested an alternative type of effects-based test to delimit monetary policy on objective grounds. It held in its judgment in *Weiss* that a measure that was ostensibly adopted to pursue a monetary policy objective exceeded the ECB's mandate if the economic and social policy effects resulting from the measure, for example its effects on 'public debt, personal savings, pension and retirement schemes, real estate prices and the [preservation] of economically unviable companies', were disproportionate to the monetary policy goal.⁷³ Since *Gauweiler*, the Court of Justice has also held that a bond-buying programme can only be adopted and implemented if it is proportionate.⁷⁴ However, the FCC's proposed proportionality test deviates from that of the Court of Justice in two important respects. First, in *Gauweiler* and *Weiss*, the proportionality principle was used to constrain the exercise of an existing power,⁷⁵ whereas it served to distinguish between monetary and economic policy in the FCC's judgment.⁷⁶ A measure that affects considerations disproportionately that fall within the area of economic policy becomes an economic policy measure, even if it (ostensibly or actually) pursues monetary policy objectives. Second, according to the Court of Justice, a monetary policy measure is proportionate if it is suitable to attain its objective, does not go manifestly beyond what is necessary to achieve it, and does not entail any consequences that are manifestly disproportionate to the objective.⁷⁷ The FCC's proportionality test is more stringent and involves a 'full judicial review', although the FCC does not explain what this means in the present context, or how the suggested proportionality test would make allowance for the technical nature of the ECB's actions and the limited expertise of courts in monetary and economic policy matters.⁷⁸

Without a detailed empirical analysis of the effects of OMT and the PSPP on the economic policy considerations mentioned by the FCC, it is impossible to form a clear view on whether the two programmes fall within monetary policy according to the FCC's test. The ECB regularly assesses the macroeconomic impact of its policy decisions,⁷⁹ but not all relevant assessments are publicly available. Presumably, an analysis of the ECB's asset purchases under a proportionality test would yield similar results to the direct/indirect effects test, in particular with regard to OMT. Given that there exists evidence that associates the announcement of OMT with a substantial decrease in sovereign bond yields in the Eurozone, which played a critical role in mitigating the Eurozone crisis, the financial stability implications of OMT would feature prominently in any balancing exercise.⁸⁰ Hence, an

⁷³ FCC judgment on PSPP (n 6) para 139.

⁷⁴ *Gauweiler* (n 3) para 66; *Weiss* (n 3) para 71.

⁷⁵ This is clear from *Gauweiler* (n 3) para 66 and *Weiss* (n 3) para 71, stating that 'a bond-buying programme forming part of monetary policy' must comply with the principle of proportionality (emphasis added).

⁷⁶ FCC judgment on PSPP (n 6) paras 127, 139-143.

⁷⁷ *Gauweiler* (n 3) para 66-92; *Weiss* (n 3) paras 71-100.

⁷⁸ FCC judgment on PSPP (n 6) para 143.

⁷⁹ For two examples concerning the PSPP, see Andrade et al (n 32); Fabian Eser, Wolfgang Lemke, Ken Nyholm, Sören Radde and Andreea Liliana Vladu, 'Tracing the impact of the ECB's asset purchase programme on the yield curve' (2019) ECB Working Paper No 2293.

⁸⁰ Carlo Altavilla, Domenico Giannone and Michele Lenza, 'The Financial and Macroeconomic Effects of the OMT Announcements' (2016) 12 *International Journal of Central Banking* 29; Paul De Grauwe and Yuemei Ji,

application of the FCC's proportionality test would most likely not have preserved the consistency of the case law of the Court of Justice, premised on an outcome of *Gauweiler* and *Weiss* as in the original cases.

A number of arguments could be made against the FCC's proportionality test and in favour of the direct/indirect effects test of the Court of Justice, as we interpret it.⁸¹ First, the FCC relies on proportionality to give substance to the principle of conferral. In the opinion of the FCC, the principle of conferral would be rendered 'meaningless' if the ECB's adherence to its monetary policy mandate could not be reviewed fully in light of the principle of proportionality.⁸² It is true that the three principles enshrined in Art 5 TEU—conferral, subsidiarity and proportionality—cannot be separated with perfect clarity.⁸³ Proportionality may require a restrictive interpretation of the scope of an existing competence.⁸⁴ However, the FCC's approach is different. It does not determine the limits of a competence conferred on the Union in an abstract manner but introduces a form of state-dependent definition of the ECB's monetary policy mandate. The scope of the Union's competence in monetary policy matters will expand or shrink depending on the state of the economy and the behaviour of economic actors, for example the savings rate and the preference to hold cash or invest in equity compared with an investment in debt instruments. The approach of the Court of Justice, in contrast, maps on to the distinction in Article 5(1) TEU between the 'limits' of Union competences, which are governed by the principle of conferral, and the 'use' of Union competences, which is governed by the principles of subsidiarity and proportionality.⁸⁵

Second, this difference in approach has manifest practical consequences. Any policy decision of the ECB, including a decision belonging to its standard monetary policy tools, for example the setting of a benchmark interest rate, could be challenged on the ground that certain economic effects of the decision had not been considered, or had not been accorded sufficient weight, and would have to be qualified as falling within economic policy if its effects on the real economy were disproportionate. Courts would be required to form a view on questions of

'Correcting for the Eurozone Design Failures: The Role of the ECB' (2015) 37 *Journal of European Integration* 739; Jannik Jäger and Theodor Grigoriadis, 'The effectiveness of the ECB's unconventional monetary policy: Comparative evidence from crisis and non-crisis Euro-area countries' (2017) 78 *Journal of International Money and Finance* 21.

⁸¹ The approach of the FCC has met with overwhelming criticism by commentators. For a summary of initial reactions, mostly published in blogposts, see Annegret Engel, Julian Nowag and Xavier Groussot, 'Is This Completely M.A.D.? Three Views on the Ruling of the German FCC on 5th May 2020' (2020) 3 *Nordic Journal of European Law* 128, 134-139. A more in-depth analysis is offered by the contributions to the special issue of the *German Law Journal* in vol. 21(5) (2020): Special Collection on European Constitutional Pluralism and the PSPP Judgment.

⁸² FCC judgment on PSPP (n 6) para 123.

⁸³ This is particularly true for subsidiarity and proportionality, see, e.g., Robert Schütze, 'Subsidiarity after Lisbon: reinforcing the safeguards of federalism?' (2009) 68 *Cambridge L.J.* 525, 532-533, but it is plausible to argue that the obligation to act proportionately also influences the interpretation of the Union's competences.

⁸⁴ Herwig C. H. Hofmann, Gerard C. Rowe and Alexander Türk, *Administrative Law and Policy of the European Union* (OUP 2011) 129; Takis Tridimas, *The General Principles of EU Law* (2nd ed., OUP 2006), 176.

⁸⁵ See n 75 above. The view that the principles of conferral and proportionality address two analytically separate (even if not entirely independent) questions is widely shared. The former determines whether the Union can act, and the latter how it should act within its competences. See, for example, Christian Calliess in Christian Calliess and Matthias Ruffert (eds.), *EUV/AEUV* (5th ed., C.H. Beck 2016), Art. 5 EUV para 5; Tridimas (n 84) 176; Stephen Weatherill, *The Internal Market as a Legal Concept* (OUP 2017), 175-176.

a technical and evaluative nature that required special expertise. While it is undisputed, including by the FCC, that the ECB enjoys a margin of appreciation when it assesses the consequences of monetary policy decisions,⁸⁶ the judicial review standard required by the FCC involves a more intensive review than the largely procedural⁸⁷ ‘manifest error of assessment’ standard of the Court of Justice.⁸⁸ Even if courts generally appreciate the need to afford the ECB discretion, there will be a risk that different perspectives regarding the weighting of the interests at stake will make the outcome of litigation more unpredictable. This is likely to become a factor in the decision-making process of the ECB and impinge on the bank’s independence.⁸⁹ In addition, it may cast doubt on the legality of actions that fall within the core area of the ECB’s mandate and undermine the legitimacy of its monetary policy in those parts of the Union where people disagree with how the ECB balances conflicting economic interests.

Third, the direct/indirect effects test leads to a clearer dividing line between monetary and economic policy and a more objective approach to delimiting the ECB’s monetary policy mandate than the FCC’s proportionality test. The FCC envisages a two-step process. The consequences of monetary policy decisions must be ‘assessed’ and then ‘weighed’.⁹⁰ Presumably, ‘assessing’ means quantifying. Any quantification of the effects of a monetary policy decision on an intermediate or ultimate target variable, for example asset purchases on yields, involves complex macroeconomic modelling, which is influenced by the assumptions made and the empirical methods used. It is, therefore, not free from subjective choices. This holds even more so for the weighting of the affected interests and the balancing of economic and monetary policy consequences. There is no framework to standardise the effects on different interests (provided they can be quantified in the first place). It is therefore unclear how, say, the risk of deflation can be balanced against the ‘economic and social impact’ of rising real estate and stock market prices.⁹¹ Consequently, it is by no means evident that the FCC’s proportionality test reinforces the principle of conferral as much as the FCC seems to think, and indeed more so than the direct/indirect effects test, or in a more principled way.

However, we acknowledge that it is possible rationally to disagree about these points.⁹² In particular, it is important to be conscious of the fact that the Court of Justice applies review

⁸⁶ FCC judgment on PSPP (n 6) para 141.

⁸⁷ See Mark Dawson, Adina Maricut-Akbik and Ana Bobić, ‘Reconciling Independence and accountability at the European Central Bank: The false promise of Proceduralism’ (2019) 25 *Eur. Law J.* 75, 88-91.

⁸⁸ See text to n 78 above.

⁸⁹ A detailed discussion of the independence of the ECB, and the tension between independence and accountability, is beyond the scope of this article. These issues have been examined comprehensively in the literature, see, for example, Deirdre Curtin, “‘Accountable Independence’ of the European Central Bank: Seeing the Logics of Transparency’ (2017) 23 *Eur. Law J.* 28; Dawson, Maricut-Akbik and Bobić (n 87); Matthias Goldmann, ‘Adjudicating economics? Central bank independence and the appropriate standard of judicial review’ (2014) 15 *German L.J.* 265; Otmar Issing, Vitor Gaspar, Ignazio Angeloni and Oreste Tristani, *Monetary Policy in the Euro Area* (CUP 2001), 128-143. The importance of the independence of the ESCB and ECB has also been affirmed by the Court of Justice, *Joined Cases C-202/18 and C-238/18 Rimšēvičs* ECLI:EU:C:2019:139.

⁹⁰ FCC judgment on PSPP (n 6) para 143.

⁹¹ The FCC requires these and other types of economic effect to be considered, see *ibid* paras 139, 170-175.

⁹² For a (qualified) defence of the proportionality test as formulated by the FCC in *Weiss*, see, for example, Matthias Goldmann, ‘The European Economic Constitution after the PSPP Judgment: Towards Integrative

standards of different intensity depending on the context. The clearest difference exists between the review of measures of the Union and national measures. In the former case, the Court is generally reluctant to intervene, unless the measure is manifestly inappropriate or the result of a manifest error or misuse of power.⁹³ In the latter case, the Court is more demanding and requires a showing that there is no less restrictive alternative.⁹⁴ Further differentiations in the standard of review are a function of the nature of the right or interest invoked by the applicant, the policy area, and the relative expertise of the Court compared with that of the decision-making body.⁹⁵ The review standard applied to the ECB is, arguably, at the low-intensity end of a spectrum that has been said to range from very deferential to rigorous.⁹⁶ The FCC's holding in *Weiss* has to be read primarily as a challenge to these perceived double standards, which, in the absence of other effective checks, leave it largely to the ECB to determine its mandate,⁹⁷ rather than as an attempt to impose a 'German understanding of proportionality'⁹⁸ on the rest of the EU.⁹⁹

In the spirit of the general line of inquiry pursued in this article, we will therefore only probe the FCC's conclusion that the Court of Justice acted *ultra vires* from the perspective of whether it is rationally defensible. We will approach the FCC's assertion that the decision in *Weiss* was methodologically untenable from two angles. We will first examine the FCC's response to the test developed by the Court of Justice to distinguish between monetary and economic policy, and we will then ask whether the FCC applied its precedent in *Gauweiler* consistently in *Weiss*.

The FCC argued that the Court of Justice, in ascertaining whether a measure fell within the area of monetary policy:

Liberalism?' (2020) 21 *German L.J.* 1058, 1073-1075; Sven Simon and Hannes Rathke, "'Simply not comprehensible.' Why?" (2020) 21 *German L.J.* 950, 951-953.

⁹³ Paul Craig, *EU Administrative Law* (2nd ed., OUP 2012), 592-600; Hofmann, Rowe and Türk (n 84) 129-134; Tridimas (n 84) 142-149, 177-183.

⁹⁴ Craig (n 93) 617-628; Tridimas (n 84) 138, 209-220.

⁹⁵ Gráinne de Búrca, 'The Principle of Proportionality and its Application in EC Law' (1993) 13 *YBEL* 105, 111.

⁹⁶ *ibid* 111. Low intensity proportionality review is particularly prevalent in cases where EU institutions make discretionary policy choices, Craig (n 93) 592-600.

⁹⁷ For a similar view, see Dieter Grimm, 'A Long Time Coming' (2020) 21 *German L.J.* 944, 948; Simon and Rathke (n 92) 953. It should be emphasised that we only explore what motivated the FCC to challenge the proportionality test of the Court of Justice. We do not dispute that there are good reasons why national legislation that impinges, for example, on the free movement rights under the TFEU should be subject to stricter scrutiny than discretionary policy choices of EU institutions, see Craig (n 93) 600-601, 629-631.

⁹⁸ Engel, Nowag and Groussot (n 81) 136.

⁹⁹ The FCC takes issue with the fact that the Court of Justice often performs a relatively detailed assessment of the actual economic effects of a challenged measure when it carries out a proportionality review, whereas neither *Gauweiler* nor *Weiss* contain such an assessment, FCC judgment on PSPP (n 6) para 143. The FCC then produces a long list of references to decisions of the Court of Justice that commingles review standards from different contexts in order to substantiate the claim that the Court's review intensity with respect to actions of the ECB is unusually low, *ibid* paras 146-152. We are grateful to Damian Chalmers for pointing this out. For this reason, the direction of some of the initial, often strident criticism of the FCC's judgment in *Weiss*, which focused on the court's 'German understanding of proportionality', detracted from the true shortcomings of the decision, see Engel, Nowag and Groussot (n 81) 136 for examples and references.

accepts the proclaimed objectives of the ECB as fact without further scrutiny and without regard to foreseeable and/or intended—perhaps even primarily so—consequences of the [measure] in the areas of economic and fiscal policy, the possibility of which the ECB at the very least knowingly accepted; in doing so, the CJEU allows the ESCB to decide autonomously on the scope of the competences conferred upon it by the Member States ... [and declares] asset purchases [as valid] even in cases where the purported monetary policy objective is possibly only invoked to disguise what essentially constitutes an economic and fiscal policy agenda.¹⁰⁰

This is a reading of the Court’s approach that ignores the ordinary meaning of the term ‘indirect effects’ as used in *Gauweiler and Weiss*.¹⁰¹ It is true that the Court of Justice did not balance the (direct or indirect) economic policy effects of the PSPP against the objectives of the programme at the third stage of the proportionality test, as demanded by the FCC. However, it is not true that the Court of Justice, by not doing so, failed to accord ‘foreseeable and/or intended ... consequences of [a measure of the ECB] in the areas of economic and fiscal policy’ any relevance. As discussed in the previous section, a reading of *Gauweiler and Weiss* that gives due weight to the ordinary meaning of ‘indirect effects’ implies that direct effects (and certainly direct effects that are foreseeable and intended) change the character of a measure as monetary or economic policy. The difference to the FCC’s test is simply that the delimitation operates along a different dimension: direct versus indirect effects as opposed to a weighting of the different effects.¹⁰²

The FCC’s view seems to stem from its disagreement with the Court’s treatment of ‘foreseeable consequences’. Criticising *Gauweiler*, the FCC had submitted in its reference in *Weiss* that the effects of a measure that purportedly pursued a monetary policy objective could not be regarded as indirect if they were ‘foreseeable with certainty’ and hence either ‘intended or knowingly accepted’ by the ECB.¹⁰³ From the FCC’s perspective, this is convincing, since the FCC argues in favour of a comprehensive balancing of monetary and economic consequences, but does not automatically regard a measure as impermissible if (direct or indirect) consequences for economic policy exist.¹⁰⁴ The Court of Justice rejected this wide interpretation, because for the Court, the existence of foreseeable economic policy effects (which, according to the FCC, had to be regarded as direct effects because they were foreseeable and knowingly accepted) would otherwise preclude the ESCB from implementing the measure.¹⁰⁵ From the Court’s perspective, a broad interpretation of ‘direct effects’ would have thus made it impossible for the ESCB to pursue its monetary policy mandate, which required it to act on economic conditions to influence price levels.¹⁰⁶ The

¹⁰⁰ FCC judgment on PSPP (n 6) paras 136-137.

¹⁰¹ See the two paragraphs starting with the text to nn 59-60 in Section 3.1.

¹⁰² This interpretation of *Weiss* is, thus, the answer to the question posed by some voices in the literature ‘why the CJEU did not seek to analyze whether the monetary policy measures were appropriate given the effects on economic policy’, *Simon and Rathke* (n 92) 954.

¹⁰³ PSPP referral (n 5) para 119; FCC judgment on PSPP (n 6) para 135.

¹⁰⁴ See the description of the FCC’s proportionality test above, text to nn 73-78.

¹⁰⁵ *Weiss* (n 3) para 67.

¹⁰⁶ *ibid.*

FCC and the Court of Justice are, therefore, talking past each other. The passage of the FCC's judgment rejecting the Court's argument that certain effects (namely, indirect effects) may be disregarded even if they are foreseeable and knowingly accepted (which is the passage we reproduced in parts above¹⁰⁷) quotes selectively one paragraph from the Court's decision in Weiss, where the Court spoke of 'effects', rather than distinguishing between direct and indirect effects.¹⁰⁸ The FCC then concludes that the Court of Justice disregards the economic policy effects of the PSPP altogether.¹⁰⁹ However, the quoted paragraph is a continuation of the Court's discussion of indirect effects and applies only to them.¹¹⁰ The FCC's central point of criticism is therefore a non sequitur.

Second, neither the direct/indirect effects test nor the Court's limited proportionality review of acts of the ECB are new features of the judgment in Weiss. In Gauweiler, the Court of Justice followed an identical methodology to distinguish between monetary and economic policy. It interpreted the term 'monetary policy' according to the two-pronged test set out in the previous section and, once it had established that OMT was to be qualified as a monetary policy measure, examined the proportionality of the measure.¹¹¹ Furthermore, the Court's lenient standard of review, under which the ECB is afforded broad discretion because of the 'technical nature' of its assessment and the 'forecasts and complex assessments' that it involves,¹¹² reflects the Court's application of the proportionality principle in similar circumstances.¹¹³ In its judgment on OMT, the FCC regarded this methodological approach as 'tenable and correspond[ing] to the established case law of the Court of Justice',¹¹⁴ even though the Court used proportionality 'at the level of the exercise of competences',¹¹⁵ and ignored economic policy considerations in its analysis of the proportionality of OMT. It is difficult to understand why the same approach was qualified as not 'tenable from a methodological perspective' and 'objectively arbitrary' in the FCC's PSPP judgment.¹¹⁶ The FCC's judgment is thus methodologically problematic itself and can be challenged for reasons of both using an incorrect premise and being inconsistent with the FCC's own precedent.

4. Prohibition of Monetary Financing

Article 123(1) TFEU prohibits the ECB and the national central banks from granting credit facilities to the Member States or purchasing debt instruments directly from them on the

¹⁰⁷ FCC judgment on PSPP (n 6) para 137.

¹⁰⁸ Weiss (n 3) para 67.

¹⁰⁹ FCC judgment on PSPP (n 6) para 138.

¹¹⁰ The Court of Justice rejected the FCC's submission that foreseeable effects could not be qualified as 'indirect' in para 62 of its decision in Weiss. It then gave two reasons why an effect was not 'direct' for the sole reason that it was foreseeable, the first discussed in para 63 and the second in paras 64-67.

¹¹¹ Gauweiler (n 3) paras 46-65 (delimitation of monetary policy) and 66-92 (proportionality).

¹¹² *ibid* para 68.

¹¹³ See the references in n 96 above.

¹¹⁴ FCC judgment on OMT (n 6) para 177.

¹¹⁵ *ibid* para 179.

¹¹⁶ FCC judgment on PSPP (n 6) paras 118, 119.

primary market. The prohibition of monetary financing seeks to ensure that financial markets price government debt accurately and penalise excessive deficits, thus giving Member States an incentive to follow a sound budgetary policy.¹¹⁷ The risk that the market price of government debt is distorted, of course, exists not only if the ESCB purchases government bonds on the primary market, but also if it does so on the secondary market. It is empirically well documented that the announcement of an asset purchase programme leads to a decline in the yields on government bonds.¹¹⁸ Indeed, this is necessary for asset purchase programmes to have an effect on the ultimate target variable or variables, notably inflation.¹¹⁹ The literature has identified several transmission channels of secondary market asset purchases to interest rates.¹²⁰ To give just one intuitive example, a government bond purchase programme decreases the supply of the purchased securities in the secondary market and replaces them with short-term, risk-free bank reserves (i.e. cash). According to basic macroeconomic theory, an increase in the demand for cash must go hand in hand with a decrease in the interest rate on (or an increase in the price of) alternative essentially risk-free assets.¹²¹ The reason is that investors have different attitudes towards the interest rate risk associated with assets with longer maturities. As the amount of securities with a higher duration risk decreases, those who are comparatively more willing to bear the relevant risk will decide to invest or remain invested, thus exerting a downward pressure on the risk premium required by the market.¹²² Since an increase of bond prices in the secondary market gives an incentive to invest in the primary market, yields decrease and governments have lower financing costs.

Given that primary and secondary market purchases have similar effects, a literal interpretation of Article 123 TFEU that prohibited only primary market interventions would be unconvincing, and the Court of Justice has indeed not adopted such a narrow approach. According to the Court, any intervention in sovereign debt markets by the ECB must come with ‘sufficient safeguards’ that prevent moral hazard and ensure that Member States do not deviate from a sound budgetary policy.¹²³ In its OMT decision, the ECB was well aware of the link between asset purchases that resulted in more favourable financing conditions for Member States and the existence (or the risk) of ‘policy mistakes’, as Mario Draghi put it in the press conference announcing the OMT decision, which imperilled the sustainability of public finances.¹²⁴ The ECB therefore made outright monetary transactions conditional on the participation of the Member State(s) concerned in an EFSF/ESM macroeconomic adjustment programme or precautionary programme and on full compliance with the conditionality

¹¹⁷ Gauweiler (n 3) para 100; Weiss (n 3) para 107.

¹¹⁸ For a discussion of the literature and empirical evidence, see Jens H.E. Christensen and Signe Krogstrup, ‘Transmission of Quantitative Easing: The Role of Central Bank Reserves’ (2019) 129 *Economic Journal* 249.

¹¹⁹ Gauweiler (n 3) paras 108, 110; Weiss (n 3) para 130.

¹²⁰ Christensen and Krogstrup (n 118) 249-250; Arvind Krishnamurthy and Annette Vissing-Jorgensen, ‘The Effects of Quantitative Easing on Long-term Interest Rates: Channels and Implications for Policy’ (2011) *Brookings Papers on Economic Activity* 215, 218-225.

¹²¹ See, for example, James Tobin, ‘Liquidity Preference as Behavior Towards Risk’ (1958) 25 *Rev. Econ. Stud.* 65, 67-70.

¹²² Joseph Gagnon, Matthew Raskin, Julie Remache and Brian Sack, ‘The Financial Market Effects of the Federal Reserve’s Large-Scale Asset Purchases’ (2011) 7 *International Journal of Central Banking* 3, 7.

¹²³ Gauweiler (n 3) paras 100-102; Weiss (n 3) para 107.

¹²⁴ Mario Draghi, press conference of 6 September 2012 (n 34). See also the arguments of the ECB in Gauweiler, Opinion of AG Cruz Villalón (n 37) para 141.

attached to such a programme.¹²⁵ We will first describe the link between conditionality and the prevention of moral hazard, before we analyse the Court's approach to interpreting Article 123(1) TFEU in greater detail in the following section.

4.1. *The ECB's approach: Conditionality*

All forms of financial assistance by the ESM (and previously the ESFS) must be subject to strict conditionality, which ranges from a macro-economic adjustment programme if stability support is provided by way of a loan to more specific eligibility criteria.¹²⁶ The precise conditions are agreed between the Commission, ECB, IMF and the recipient Member State and laid down in a memorandum of understanding.¹²⁷ They include fiscal conditions intended to ensure the sustainability of the beneficiary Member State's debt, for example the requirement to achieve a specified primary surplus and adopt clearly defined structural policies to meet agreed fiscal targets.¹²⁸ The fiscal policy choices of beneficiary Member States are, accordingly, constrained. In particular, if the memorandum of understanding imposes numerical limits on budgetary aggregates, such as the primary deficit, it is easy to monitor whether a Member State adheres to a sound budgetary policy. Thus, once conditionality is in place, moral hazard is all but eliminated. This explains why the ECB insisted on conditionality in its OMT decision and the Court of Justice held in *Gauweiler* that conditionality 'preclude[d] the possibility of [OMT] ... acting as an incentive ... to dispense with fiscal consolidation'.¹²⁹

In a different context, the legality of the ESM, it has been pointed out that conditionality cannot guarantee that a Member State will not act irresponsibly in anticipation of receiving financial assistance.¹³⁰ The availability of financial assistance, the argument goes, may prompt Member States to leave the path of fiscal prudence before a macro-economic adjustment programme commences and any constraints on fiscal policy apply. Whether this is a serious risk depends on the political cost that is involved in surrendering fiscal autonomy, which can be substantial, as the Greek example has shown, and the extent to which decision-makers factor the cost in when they make fiscal policy choices. More importantly, the moral hazard at issue here is different from that created by the ESM. Under the OMT programme, the ECB does not hold out the possibility of a bailout. Rather, the announcement of OMT removed the risk of a self-fulfilling solvency crisis and thus allowed Member States¹³¹ to finance their expenditure at a lower cost than would otherwise have been possible. Increasing expenditure because of lower financing costs does not threaten a sound budgetary position, provided the increase in expenditure reflects the savings from lower interest payments, and

¹²⁵ ECB Press Release (n 25).

¹²⁶ ESM Treaty, Arts 12(1), 16(2) (ESM loans), 17(2) (primary market support facility), 18(3) (secondary market support facility).

¹²⁷ *ibid* Art 13(3).

¹²⁸ See, for example, the Memorandum of Understanding between the Commission and Greece, August 2015, pp 6-17.

¹²⁹ *Gauweiler* (n 3) para 120.

¹³⁰ Paul Craig, 'Pringle: Legal Reasoning, Text, Purpose and Teleology' (2013) 20 MJ 3, 8-9.

¹³¹ Especially those who find themselves in a bad equilibrium, see text to n 61 above.

may indeed be the welfare-maximising course of action. Once OMT is implemented and the ESCB commences its bond-buying programme, a macro-economic adjustment programme must be in place, thus again containing moral hazard.

Consequently, conditionality plays a key role in ensuring that secondary market purchases do not jeopardise the objective of Article 123(1) TFEU. However, surprisingly, the Court of Justice mentioned conditionality in *Gauweiler* only in passing towards the end of its judgment, after it discussed other safeguards that feature less prominently in the design of OMT at considerable length.¹³² We will explore a possible explanation for this skewed emphasis later, but first we turn to the other safeguards that the Court of Justice considered in *Gauweiler* and *Weiss*.

4.2. *Incoherence, part 2: The Court's equivalence/sufficient safeguards test*

According to the Court of Justice, secondary market asset purchases are incompatible with the prohibition of monetary financing if they are carried out ‘under conditions which would, in practice, mean that [they have] an effect equivalent to that of a direct purchase of government bonds from ... the Member States, thereby undermining the effectiveness of the prohibition in Article 123(1) TFEU.’¹³³ The latter point—not undermining the effectiveness of the prohibition of monetary financing—requires, in the view of the Court, that safeguards are built into ECB interventions in government debt markets that limit the impact of asset purchases on Member State incentives.¹³⁴ This two-pronged test has become the general standard against which the compatibility of an asset purchase programme with Article 123(1) is assessed. We shall examine both prongs in turn.

When the Court speaks of ‘equivalent effects’, it seems to have a test in mind that examines whether secondary market purchases have identical, rather than merely similar, effects to primary market purchases. The Court has held that secondary market transactions are equivalent to primary market transactions ‘if the potential purchasers of government bonds on the primary market knew for certain that the ESCB was going to purchase those bonds within a certain period and under conditions allowing those market operators to act, *de facto*, as intermediaries for the ESCB’.¹³⁵ Requiring certainty establishes a threshold that will virtually never be met. Even in the unrealistic scenario that the ESCB committed to purchasing all bonds of a certain issue that were identifiable (thus, all bonds with the same ISIN), sales would presumably only be made under conditions resembling the transactions of an intermediary if the risk that the market price changed between the purchase and sale by the ESCB’s counterparty was minimal. For this to be the case, the ESCB would need to purchase the bonds immediately after they were issued. OMT passed the test easily, because the ECB intended to observe a minimum period before purchasing bonds on the secondary market and

¹³² The discussion of Art 123(1) TFEU begins in para 93 of *Gauweiler*, and conditionality is only mentioned in one paragraph (para 120).

¹³³ *Gauweiler* (n 3) para 97. Similar *Weiss* (n 3) para 106.

¹³⁴ *Gauweiler* (n 3) para 102; *Weiss* (n 3) para 107.

¹³⁵ *Gauweiler* (n 3) para 104; *Weiss* (n 3) para 110.

to refrain from making any prior announcement of either the decision to carry out purchases or their volume.¹³⁶ In contrast, the main features of the PSPP, in particular the monthly volume of purchases, the duration of the programme, and the allocation of asset purchases between the national central banks, are announced in advance. However, the observance of a ‘blackout period’ before any intervention in the secondary market, the possibility to deviate, within certain parameters, from the monthly purchase guidance, and a 33% cap on purchases of both a particular bond issue and all of the outstanding securities of a government meant, in the opinion of the Court, that private market participants could not foresee with certainty whether the ESCB would purchase bonds acquired by them in the primary market.¹³⁷ It is evident that certainty is lacking under these conditions. If we accept the narrow definition of ‘equivalent effects’ set out in *Gauweiler and Weiss*, purchasers of government bonds in the primary market cannot be regarded as *de facto* intermediaries for the ESCB in either case, since they bear the risk of price changes until they actually sell to the ESCB.

Irrespective of its limited practical relevance, it is questionable whether this prong of the Court’s test performs a useful function. The position of private market participants as ‘*de facto* intermediaries for the ESCB’ has little bearing on the incentives of Member States to increase or reduce their borrowing, and hence on the goal of the prohibition of monetary financing. As explained, purchases on the secondary market lead to a general lowering of yields on government bonds. Whether the ESCB’s secondary market purchases have identical (or similar) effects to transactions on the primary market depends, from the perspective of the borrower, not on the certainty with which an individual purchaser can resell bonds to the ESCB, but on the volume of the intervention compared with a hypothetical direct intervention in the primary market.

The second prong of the Court’s test concerns this last point. In *Gauweiler and Weiss*, the Court identified a number of safeguards that, in the Court’s opinion, ensured that the asset purchase programmes did not ‘lessen the impetus of the Member States concerned to follow a sound budgetary policy.’¹³⁸ First, purchases were only conducted to the extent necessary for the maintenance of price stability (PSPP) or to unblock the monetary policy transmission mechanism (OMT) and were then expected to cease.¹³⁹ This meant, the Court argued, that Member States could not ‘rely on the certainty that the ESCB will at a future point purchase their government bonds on secondary markets’ and the purchase programmes could not be used to eliminate spreads in interest rates between Member States irrespective of any fiscal differences.¹⁴⁰ Both points are, of course, correct, but they are, arguably, irrelevant to the objective of ensuring a sound budgetary policy. Even a temporary purchase of government bonds reduces yields and hence financing costs for Member States. This shifts a government’s budget constraint, and, assuming that the government seeks to maximise the provision of public goods subject to its budget constraint, it will spend more. Thus, monetary financing of public expenditure occurs. As the Court acknowledged in *Gauweiler and Weiss*,

¹³⁶ *Gauweiler* (n 3) para 106.

¹³⁷ *Weiss* (n 3) paras 113-125.

¹³⁸ *Gauweiler* (n 3) para 109.

¹³⁹ *Gauweiler* (n 3) para 112; *Weiss* (n 3) paras 133-134.

¹⁴⁰ *Gauweiler* (n 3) para 113. Similar *Weiss* (n 3) para 132.

this effect is inherent in all public sector asset purchase programmes, which are explicitly permitted by the statute of the ESCB and the ECB.¹⁴¹ Whether government finances become less sustainable as a result is a different question that depends on the government's fiscal policy after the end of the stimulus package and not the 'certainty' that the purchase programme will continue indefinitely or the elimination of spreads between Member States. It is easy to see that this is the case by considering a government's intertemporal budget constraint, which models the government's debt dynamics (change in debt) as a function of expenditure, tax revenue and interest payments. Over the duration of an asset purchase programme, the budget deficit remains constant (change in debt is zero) if an increase in expenditure can be financed out of cheaper debt (lower interest payments).¹⁴² After a central bank's intervention has ended, the budget deficit, of course, only remains constant if expenditure is again reduced. Without any safeguards, it is perhaps unrealistic to expect that this will happen, given the particularities of the political economy of debt.¹⁴³ However, the structure of an asset purchase programme has nothing to do with this problem. Rather, the necessary safeguards must be in the form of fiscal rules or other controls over fiscal policy.¹⁴⁴

Second, the ECB's asset purchase programmes were limited in size.¹⁴⁵ Central banks typically announce the amount of sovereign debt they intend to purchase in a quantitative easing programme each month in advance in order to condition the market. The ECB's PSPP decision is no exception.¹⁴⁶ Furthermore, asset purchases under the PSPP are allocated among the Member States according to a pre-determined ratio, based on the key for subscriptions to the ECB's capital (rather than the level of debt of a Member State).¹⁴⁷ The Court of Justice argued that Member States, consequently, had no incentive to increase government debt in response to the implementation of the PSPP, which would only result in a comparatively smaller proportion of a state's bonds being purchased by the ESCB.¹⁴⁸ The OMT programme, in contrast, operates with no ex ante quantitative limits. However, the Court held that OMT was de facto limited in size, since bonds were only eligible for purchase if the issuing Member State underwent a structural adjustment programme and the ESCB was able to sell the purchased bonds at any time.¹⁴⁹

Again, it is not clear why these aspects of the bank's asset purchase programmes should be relevant to the question of how moral hazard can be contained. The size of OMT is only limited at the level of the Eurozone as a whole, but not at the level of an individual state.¹⁵⁰ Limitations that exist at the level of an individual state, as under the PSPP, limit asset price distortions, but do not ensure that the Member State concerned will follow a sound budgetary

¹⁴¹ See nn 47-48, 119 above and accompanying text.

¹⁴² For a more formal model, see Wendy Carlin and David Soskice, *Macroeconomics: Institutions, Instability and the Financial System* (OUP 2015), 518-519.

¹⁴³ On this point, see *ibid* 535-537.

¹⁴⁴ *ibid* 537-541. Steinbach (n 54) 268 comes to a similar conclusion.

¹⁴⁵ Gauweiler (n 3) para 116; Weiss (n 3) paras 139-141.

¹⁴⁶ See, initially, Decision (EU) 2015/774 (n 25) recital 7.

¹⁴⁷ *ibid* Art 6(2).

¹⁴⁸ Weiss (n 3) para 140.

¹⁴⁹ Gauweiler (n 3) paras 116-117.

¹⁵⁰ Apart from the fact that the ECB declared that it would focus on bonds with shorter maturities, ECB Press Release (n 25).

policy. As explained, any meaningful secondary market intervention will, by definition, have an impact on government bond yields and hence provide an incentive to increase government expenditure. Moral hazard that arises as a consequence of an asset purchase programme can be controlled through appropriate fiscal rules, but not through volume limits on asset purchases or by allocating purchases within the Eurosystem according to a key that is independent of debt levels. Likewise, the resale of bonds by the ESCB in the secondary market does not change the fact that the initial purchase may contribute to the financing of government expenditure. This may create commitments on the part of the Member State that cannot be reversed easily when the ESCB's intervention ends and hence may initiate an upward trend in the government's debt ratio. Whether the knowledge that the ESCB is able to sell purchased bonds constitutes an effective deterrent that prevents the beneficiary Member State from undertaking such commitments in the first place may be doubted.

Third, asset purchases were restricted to bonds that were either of investment grade¹⁵¹ or issued by a country subject to a financial assistance programme, notably an EFSF/ESM adjustment programme.¹⁵² We have argued above that a structural adjustment programme is an appropriate measure to safeguard against a circumvention of Article 123(1) TFEU, since it establishes fiscal rules and imposes other fiscal constraints on a Member State with the goal of safeguarding or restoring the sustainability of the Member State's public debt.¹⁵³ Whether the risk that a credit rating agency downgrades government debt to below investment grade is sufficient to incentivise a Member State to follow a sound budgetary policy is more difficult to assess. Credit rating agencies will rate an issuer as investment grade only if the issuer has the capacity to meet its financial commitments and respond adequately to adverse economic shocks.¹⁵⁴ A fiscal policy that seeks to deliver sustainable public finances and allows the government to respond effectively to economic shocks may be called 'sound' within the meaning of Gauweiler and Weiss. In principle, distinguishing between investment grade and non-investment grade securities is, therefore, an appropriate criterion that promotes the objective of Article 123(1) TFEU.

However, two objections may be made to this preliminary conclusion. First, credit ratings are a function of the combined consideration of a variety of institutional, economic, fiscal and monetary variables.¹⁵⁵ The effect of changes along one dimension— in the present context fiscal conditions—on the rating outcome is, therefore, attenuated and possibly offset by changes along other dimensions. In theory, this does not call into question the suitability of credit ratings to assess the effect that fiscal policy adjustments have on a country's public debt sustainability and resilience to economic shocks. This is evident for variables that have a direct impact on debt levels and debt sustainability, for example the ratio of government debt

¹⁵¹ Decision (EU) 2020/188 (n 25), Art 3(2). The Decision requires Credit Quality Step 3 in the Eurosystem's harmonised rating scale, which is equivalent to investment grade, see ECB Monthly Bulletin April 2014, p 30.

¹⁵² Gauweiler (n 3) para 120; Weiss (n 3) para 142.

¹⁵³ Text to nn 126-131.

¹⁵⁴ See, for example, S&P Global Ratings Definitions (2017), p 5; S&P Sovereign Rating Methodology (2017), p 3.

¹⁵⁵ S&P Sovereign Rating Methodology (2017), pp 2-5.

to GDP or economic growth.¹⁵⁶ It is reasonable to assume that an asset purchase programme does not change a government's incentives with regard to fiscal policy if an increase in the debt-to-GDP ratio is offset by a more positive assessment of an issuer's economy and growth prospects. The increase in the debt-to-GDP ratio might have been triggered by the asset purchase programme or the improved growth forecast (or both), but the situation of the country has not changed in comparison with a scenario where the government had not borrowed more, but the economy had also not improved. The same line of reasoning holds for 'softer' variables, for example the accountability of government institutions and the absence of corruption.¹⁵⁷ Again, if an increase in borrowing is offset by an improvement in the institutional environment, it is justified to regard an asset purchase programme as not jeopardising the aim of Article 123(1) TFEU, since better institutions make it more likely that the government will manage its debt more competently and prudently. However, the problem with such 'softer' measures, and more generally with the drawing up of a matrix of variables and their interactions to determine a country's credit rating,¹⁵⁸ is that they introduce a considerable amount of noise. Inevitably, a certain degree of subjectivity is involved in defining and weighting the relevant variables and assessing a country's situation. Thus, it is possible that a country's creditworthiness deteriorates as a consequence of a monetary policy measure, without this being reflected in a corresponding decrease in the country's credit rating.

The second objection is that credit ratings operate retroactively. It is therefore questionable whether the threat of a potential downgrade is enough to incentivise a Member State not to deviate from a sound budgetary policy when presented with a monetary policy intervention that creates favourable financing conditions. As discussed, credit ratings are partially subjective. Therefore, a downgrade cannot be predicted with certainty and its deterrent effects must be discounted accordingly. Furthermore, those who make fiscal policy decision may rationally decide to accept the risk that the government's credit rating could be downgraded in order to be able to pursue economic policy goals that are regarded as taking priority over fiscal reticence.

While the risk of a credit rating downgrade will, therefore, not always be effective, it is important to note that the investment-grade requirement does not operate in a legal vacuum. We have argued above that some control over a Member State's fiscal policy decisions after the termination of an asset purchase programme is essential to prevent the goal of Article 123(1) TFEU from being compromised. Such a control mechanism exists in the EU in the form of the Stability and Growth Pact (SGP) and the Fiscal Compact.¹⁵⁹ The SGP has

¹⁵⁶ For an example of the methodology that credit rating agencies typically use to assess a sovereign borrower's economic situation, see *ibid* pp 9-12.

¹⁵⁷ Such institutional variables are discussed and defined *ibid* on pp 5-9.

¹⁵⁸ See *ibid* p 4.

¹⁵⁹ The SGP is composed of several measures of primary and secondary EU law: Arts 121, 126, 136 TFEU, Protocol (No 12) on the Excessive Deficit Procedure annexed to the TFEU, [2008] OJ C 115/279, and the 'Six-pack' and 'Two-pack' packages of regulations and directives. For a full list, see https://ec.europa.eu/info/business-economy-euro_en (follow hyperlinks 'EU Economic governance: monitoring, prevention, correction' and 'Legal basis of the Stability and Growth Pact'). The European Fiscal Compact refers

introduced a process of budgetary surveillance and coordinated formulation of the Member States' annual budgets and economic policies.¹⁶⁰ As part of this process, Member States are required to set a medium-term objective for their budgetary position that should be close to balance.¹⁶¹ For signatories of the Fiscal Compact, the structural deficit is limited to 0.5% of GDP, unless debt is significantly below 60% of GDP.¹⁶² Member States that are at their medium-term objective must ensure that government expenditure does not grow more than predicted GDP growth, and Member States that are below their medium-term objective must formulate an adjustment path that includes a rate of expenditure growth below predicted GDP growth.¹⁶³ The Council and Commission monitor compliance with the SGP and can issue warnings, recommend policy changes, and, as a last resort, impose sanctions on Member States.¹⁶⁴ In addition, the SGP contains a corrective arm, also known as the excessive deficit procedure, which is triggered if a Member State exceeds a structural deficit of 3% of GDP or a government-debt-to-GDP ratio of 60%.¹⁶⁵ The Commission and Council will then recommend adjustments to correct the fiscal imbalances and, if the Member State concerned does not take effective action, step up the excessive deficit procedure, potentially leading to the imposition of fines.¹⁶⁶ After the SGP was initially criticised for a lack of enforcement, the excessive deficit procedure was made more automatic and surveillance and coordination were strengthened with the adoption of the so-called 'Six-pack' in 2011.¹⁶⁷ Recent empirical findings indicate that the SGP significantly shapes fiscal policy in the Eurozone and gives an impetus for fiscal consolidation.¹⁶⁸ It does not seem incoherent to argue, as did the Court of Justice in *Weiss*, that the threat posed by a potential credit rating downgrade, in an environment where fiscal policy choices of Member States are already constrained, provides a sufficient safeguard against the moral hazard otherwise caused by an asset purchase programme.

to Art 3 Treaty on Stability, Coordination and Governance (TSCG), which requires the signatory states to maintain a balanced budget.

¹⁶⁰ For a description of the process, see European Commission, *Vade Mecum on the Stability and Growth Pact*, European Economy Institutional Paper 101, April 2019, 74-86.

¹⁶¹ Art 2a Council Regulation (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, [1997] OJ L 209/1, as amended by Council Regulation (EC) No 1055/2005, [2005] OJ L 174/1, and Regulation (EU) No 1175/2011, [2011] OJ L 306/12, requires Member States to specify a medium-term budgetary objective within a range of -1% of GDP and surplus.

¹⁶² Art 3 TSCG.

¹⁶³ Art 5(1) Council Regulation (EC) 1466/97. See also European Commission (n 160) 7-32 for the methodology underpinning the calculation of the medium-term budgetary objective and the determination of an appropriate adjustment path.

¹⁶⁴ Art 121(4) TFEU; Regulation (EU) No 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, [2011] OJ L 306/1.

¹⁶⁵ Art 1 Protocol (No 12) on the Excessive Deficit Procedure.

¹⁶⁶ Art 126 TFEU.

¹⁶⁷ See n 159 above for references to the Six-pack. Importantly, sanctions recommended by the Commission under the excessive deficit procedure are now considered adopted unless the Council decides by a qualified majority to reject the Commission's recommendation (reverse qualified majority voting pursuant to Arts. 4-6 Regulation (EU) No 1173/2011).

¹⁶⁸ Friedrich Heinemann, Marc-Daniel Moessinger, and Mustafa Yeter, 'Do fiscal rules constrain fiscal policy? A meta-regression-analysis' (2018) 51 *European Journal of Political Economy* 69 (finding a constraining effect of budget rules on fiscal aggregates, but also a publication bias that calls the statistical significance of the findings into question); Jasper De Jong and Niels Gilbert, 'Fiscal discipline in EMU? Testing the effectiveness of the Excessive Deficit Procedure' (2020) 61 *European Journal of Political Economy* 101822 (finding that EDP recommendations have led to additional fiscal consolidation).

5. Rational Legal Reasoning, Economic Exigency and Judicial Dialogue

We now turn to the question why Gauweiler and Weiss, two decisions that are of critical importance to the operation of European monetary union, do not meet, even on the Court's own terms, basic requirements of consistency and coherence. We offer two tentative, albeit intuitive, explanations. The points of inconsistency and incoherence that we have identified in the previous sections can be related, first, to the crucial role that OMT played in mitigating the risk of a breakup of the Eurozone and, second, to the perceived need to avoid open judicial conflict with the FCC.

We have shown that the direct/indirect effects test, as we interpret it, has been applied inconsistently in Gauweiler and Weiss. In contrast to what the FCC alleged in its judgment in Weiss, the test delimits the monetary policy mandate of the ECB on objective grounds and provides a rational basis for the conclusion that the PSPP is a monetary policy measure. The OMT programme, on the other hand, has a direct impact on financial stability, which is a matter of economic policy. When the ECB made its OMT announcement at the height of the Eurozone crisis in 2012, no alternative, comparably effective mechanism existed to protect Member States and the banking sector against the risk of a self-fulfilling solvency crisis.¹⁶⁹ The Eurozone did not have a lender of last resort (and still does not have one as a matter of law¹⁷⁰), even though it is widely accepted that a lender of last resort is an integral part of a resilient monetary union.¹⁷¹ In addition, mechanisms to deal with asymmetric shocks that affect the fiscal position of some Member States more than others, for example transfer payments or the use of common debt instruments to refinance Member States that experience a liquidity crisis, were, and still are,¹⁷² underdeveloped.¹⁷³ The Court's decision not to invalidate OMT can be seen as an acknowledgment of this economic reality.

¹⁶⁹ On the self-fulfilling nature of the solvency crises faced by some Member States in 2012, see the text to nn 61-65 above.

¹⁷⁰ Proposals to transform the ESM into a European Monetary Fund that would function as a lender of last resort (Proposal for a Council Regulation on the establishment of the European Monetary Fund, COM(2017) 827 final) have met with considerable political opposition in some Member States, European Parliamentary Research Service, Briefing: Establishment of a European monetary fund (EMF) (2019), p 3.

¹⁷¹ Richard Baldwin and Francesco Giavazzi, 'Introduction' in Richard Baldwin and Francesco Giavazzi (eds.), *The Eurozone Crisis: A Consensus View of the Causes and a Few Possible Remedies* (CEPR Press 2015), 18, 20; Paul De Grauwe, 'Design failures of the Eurozone' in Baldwin and Giavazzi (eds.), *ibid* 99, 103-105; Daniel Gros, 'The Eurozone crisis and foreign debt' in Baldwin and Giavazzi (eds.), *ibid* 121, 126-127.

¹⁷² The EU budget is partly used to promote economic cohesion and growth, but it is small in comparison with the budgets of national governments, Nadine Leiner-Killinger and Carolin Nerlich, 'Fiscal rules in the euro area and lessons from other monetary unions', *ECB Economic Bulletin* 3/2019, p 76. The recovery fund agreed at the EU's budget summit of July 2020 to assist Member States in dealing with the consequences of the COVID-19 pandemic has considerable financial firepower and, importantly, authorises the Union to issue bonds in order to raise the necessary funds on capital markets. However, the Commission's borrowing powers will expire in 2026 and the plan to grant the EU sufficient taxing powers to bolster its own resources in the long term remains aspirational, European Council, Special meeting of the European Council of 17-21 July 2020 – Conclusions, EUCO 10/20, para A29. Ambitious revisions of the constitutional architecture of European monetary union that would strengthen risk sharing within the Eurozone, such as a reform package proposed by the Commission in 2017 (Communication from the Commission to the Institutions, Further steps towards completing Europe's economic and monetary union: A roadmap, COM(2017) 821 final), have, so far, all faltered.

The threat of open judicial conflict with the FCC has affected the Court's approach to the second main legal issue in *Gauweiler and Weiss*: whether OMT and the PSPP constitute prohibited monetary financing. This question is governed by what we have called the Court's equivalence/sufficient safeguards test. The content of this test can be traced back to the FCC's reference in *Gauweiler*. We will show that the conditions for compliance with Article 123(1) TFEU that were set out by the FCC in *Gauweiler* were adopted by the Court of Justice without modifications where they did not threaten the effectiveness of OMT, even if they constituted irrelevant safeguards against moral hazard, and with modifications where they threatened the programme's effectiveness. The incoherence that thus found a way into the Court's test in *Gauweiler* spilled over into *Weiss*, where the equivalence/sufficient safeguards test was applied without further alterations. However, the Court's incoherent reasoning did, for the most part, succeed in averting a judicial conflict, since the FCC accepted that neither OMT nor the PSPP violated the prohibition of monetary financing.¹⁷⁴ Whether it will also avert a judicial conflict when the two courts are asked to decide on the PEPP is a different question, which we will address towards the end of this section.

In its reference in *Gauweiler*, the FCC held that an asset purchase programme violated the prohibition of monetary financing, unless the volume of the programme was limited, interest rate spreads were not neutralised, purchases did not interfere more than necessary with the process of price formation, in particular because the Eurosystem observed a blackout period before it purchased bonds on the secondary market, bonds were not held until maturity, and the ESCB did not participate in a debt cut.¹⁷⁵ This interpretation of EU law was held out as authoritative, and the FCC made it clear that it would not accept any interpretation that did not remain within the limits drawn in its decision.¹⁷⁶

The first prong of the Court's equivalence/sufficient safeguards test, the requirement that secondary market transactions must not be equivalent to primary market transactions, takes account of the FCC's concern that bond purchases do not interfere with the price mechanism. The second prong, the existence of safeguards that ensure that Member States adopt a sound budgetary policy, deals with the other conditions established by the FCC. The Court of Justice agreed, in principle, that the volume of bond purchases had to be limited, interest rate spreads should not be eliminated, and the risk that Member States deviated from a prudent budgetary policy had to be mitigated by the fact that the ESCB had the option of selling bonds before maturity.¹⁷⁷ We have argued above that all of these limitations are irrelevant if

¹⁷³ For these reasons, the Eurozone has been called an incomplete monetary union, De Grauwe (n 65) 17-19, 103-120; Alicia Hinarejos, 'Fiscal federalism in the European Union: Evolution and future choices for EMU' (2013) 50 CML Rev. 1621, 1623-1624.

¹⁷⁴ The FCC accepted the Court's interpretation of Article 123(1) TFEU specifically because of the safeguards that the Court of Justice had held were required to prevent a circumvention of the prohibition of monetary financing, FCC judgment on PSPP (n 6) paras 180, 216-217. On the condition that the ECB supplied a proportionality assessment that demonstrated that the monetary policy objectives of the programme were not disproportionate to its economic and fiscal policy effects, the FCC did not enjoin the German central bank from participating in the PSPP, *ibid* paras 176-179, 235.

¹⁷⁵ OMT referral (n 5) paras 87-94, 100. In the PSPP referral, the FCC stipulated slightly modified conditions in light of the Court of Justice's judgment in *Gauweiler*, PSPP referral (n 5) para 78.

¹⁷⁶ OMT referral (n 5) para 99.

¹⁷⁷ *Gauweiler* (n 3) paras 113 (interest rate spreads), 116 (volume limitations), 117-118 (selling before maturity).

the issue at hand is conceptualised as the prevention of moral hazard (on which both the Court of Justice and the FCC agree).

Two of the conditions weaken the effectiveness of OMT.¹⁷⁸ The risk of a self-fulfilling liquidity crisis would have remained acute if the volume of OMT purchases had been limited *ex ante*. In this case, the Eurosystem would not have been able to function as a *de facto* lender of last resort, since it would not have been in a position to supply any amount of liquidity needed.¹⁷⁹ Likewise, the obligation not to hold bonds until maturity would have made it clear to the market that liquidity support would be withdrawn within a foreseeable period of time. Without explicitly rejecting these two conditions as unsuitable, the Court of Justice carefully modified them so that they were largely deprived of substance. The Court argued that the volume of the OMT programme was ‘*de facto*’ limited, since transactions were restricted to bonds with a targeted maturity of between one and three years, even though *ex ante* limits were not expressed in absolute terms.¹⁸⁰ Furthermore, it held that the ECB had the option of holding bonds until maturity, but it did not impose a positive obligation to sell on the ECB¹⁸¹ (although it conceded that bonds should only be held until maturity if this ‘[was] necessary to achieve the objectives sought’¹⁸²).

These modifications go against the explicit requirements imposed by the FCC.¹⁸³ Nevertheless, when Gauweiler returned to the FCC, the German court was prepared to follow the approach of the Court of Justice. It submitted that the Court of Justice had ‘essentially performed the restrictive interpretation of the [ECB’s OMT] decision that the [FCC] had suggested was possible’.¹⁸⁴ However, the FCC was, of course, well aware that the conditions

¹⁷⁸ A third condition, in which the Court of Justice did not acquiesce, the prohibition of the Eurosystem to participate in a debt cut, also impairs the effectiveness of OMT. Private investors would become junior debt holders if a senior tranche of public debt existed and could be expected to require a higher interest rate as a consequence, Sven Steinkamp and Frank Westermann, ‘The role of creditor seniority in Europe’s sovereign debt crisis’ (2014) 29 *Economic Policy* 495. The Court of Justice disagreed explicitly with the FCC on this point and argued that the possibility of a debt cut was a risk inherent in all open market operations, Gauweiler (n 3) para 126.

¹⁷⁹ The ability of central banks to provide liquidity support is in practice always limited. A central bank that made excessive use of its authority to issue money would impair its ability to control inflation and would potentially need support for its balance sheet by the treasury, Marco Del Negro and Christopher A. Sims, ‘When does a central bank’s balance sheet require fiscal support?’ (2015) 73 *J. Monet. Econ.* 1, 5-6. This is particularly true for the ECB, which is committed to an inflation target of close to 2% and not backed by the taxing power of a strong state, see Charles Goodhart, ‘Myths about the Lender of Last Resort’ (1999) 2 *Int. Finance* 339, 351-352. Nevertheless, it has been estimated that the loss absorbing capacity of the ECB, even on the assumption that it adheres strictly to its price stability mandate, is sufficient to deal with a general liquidity crisis involving both private and public borrowers throughout the Eurozone, Willem Buiter and Ebrahim Rahbari, ‘The European Central Bank as Lender of Last Resort for Sovereigns in the Eurozone’ (2012) 50 *JCMS* 6, 32-33.

¹⁸⁰ Gauweiler (n 3) para 116. This is clearly not what the FCC had required. In the Gauweiler reference, it had emphasised that ‘[t]he “factual” limitation of the volume of bond purchases by the amount of the government bonds issued already in the currently scheduled maturity spectrum of one to three years ... is not likely to sufficiently ensure an adequate quantitative limitation’, OMT referral (n 5) para 83.

¹⁸¹ Gauweiler (n 3) paras 117-118. The FCC had wanted to go further. It had argued in the Gauweiler reference that ‘if a substantial amount of the government bonds issued by selected Member States [were] permanently removed from the market, ... [t]he Eurosystem would ... not only prevent an unbiased price determination; it would also contribute to the financing of the respective [Member State] budgets’, OMT referral (n 5) para 90.

¹⁸² Gauweiler (n 3) para 118.

¹⁸³ See the quotes from the FCC’s Gauweiler reference in nn 180-181 above.

¹⁸⁴ FCC judgment on OMT (n 6) para 190.

developed by the Court of Justice fell short of what it had required in its reference in no uncertain terms.¹⁸⁵ It is therefore unsurprising that the conflict between the two courts about the reach of Article 123(1) TFEU carried over into the litigation over the PSPP, even though Weiss should have been an easier case.¹⁸⁶ Not entirely unreasonably, the FCC criticised the Court of Justice for rendering some of the FCC's criteria from its references in Gauweiler and Weiss 'practically meaningless'.¹⁸⁷ It pushed back against the flexibility built into the equivalence/sufficient safeguards test of the Court of Justice, which involves a consideration of several factors, without any one factor being dispositive. In particular, in its judgment in Weiss, the FCC held that two conditions were indispensable for an asset purchase programme to be legal: a purchase limit of 33% per ISIN and issuer and the requirement that purchased securities are of investment grade.¹⁸⁸ Thus, the FCC again laid down firm limits that seemingly tie its hands, and are intended to tie the hands of the Court of Justice, in future litigation.

It is likely that these limits will have to be considered by the Court of Justice in proceedings over the legality of the ECB's pandemic emergency purchase programme, which have been opened in the German Federal Constitutional Court.¹⁸⁹ The PEPP does not fulfil either of the two conditions mentioned in the previous paragraph that are held out as mandatory by the FCC.¹⁹⁰ If the FCC applies its own criteria consistently, the PEPP should accordingly be declared *ultra vires*, unless the court considers that the extraordinary circumstances under which the PEPP was adopted warrant a more flexible approach.¹⁹¹

The standards developed by the Court of Justice are more open-ended. The direct/indirect effects test places the PEPP within the ECB's monetary policy mandate, since it is intended to counteract 'severe downside risks to the ... inflation outlook'¹⁹² and operates directly at the

¹⁸⁵ This is clear from the language that the FCC used. It stated that the OMT decision, as interpreted by the Court of Justice, 'essentially' or 'largely' met the requirements established by the FCC, *ibid* paras 190, 193.

¹⁸⁶ In contrast to OMT, purchases under the PSPP are non-selective, *ex ante* limited in size, and allocated pursuant to the ECB's capital key, see text to n 137 above and Decision (EU) 2020/188 (n 25), Arts 5-6.

¹⁸⁷ FCC judgment on PSPP (n 6) para 197. It has been speculated in the literature that the FCC's decision to declare Weiss *ultra vires* was as much a reaction to the refusal of the Court of Justice to accept the FCC's arguments in Gauweiler, as it was to the perceived failure to conduct a thorough proportionality review in Weiss, see Franz C. Mayer, 'To Boldly Go Where No Court Has Gone Before: The German Federal Constitutional Court's *ultra vires* Decision of May 5, 2020' (2020) 21 German L.J. 1116, 1125; Niels Petersen, 'Karlsruhe's Lochner Moment? A Rational Choice Perspective on the German Federal Constitutional Court's Relationship to the CJEU After the PSPP Decision' (2020) 21 German L.J. 995, 1003.

¹⁸⁸ FCC judgment on PSPP (n 6) paras 202, 208.

¹⁸⁹ AfD-Fraktion im Deutschen Bundestag, Boehringer: AfD-Fraktion hat Organklage gegen das EZB-Anleihekaufprogramm PEPP eingereicht [AfD group in the Federal Parliament files a complaint challenging the ECB bond purchase programme PEPP], press release of 28 August 2020.

¹⁹⁰ Decision (EU) 2020/440 (n 14) Art 3 waives the requirement that debt securities issued by Greece must be of investment grade. Art 4 provides that '[p]urchases shall be carried out under the PEPP to the extent deemed necessary and proportionate to counter the threats posed by the extraordinary economic and market conditions on the ability of the Eurosystem to fulfil its mandate.' There is thus no purchase limit per ISIN or issuer.

¹⁹¹ This is also the view of Grégory Claeys, 'The ECB in the COVID-19 Crisis: Whatever it Takes, within its Mandate' in *The ECB's Mandate: Perspectives on General Economic Policies*, study requested by the ECON Committee of the European Parliament, June 2020, 115, 131; Annamaria Viterbo, 'The PSPP Judgment of the German Federal Constitutional Court: Throwing Sand in the Wheels of the European Central Bank' (2020) 5 *European Papers* 671, 681-683.

¹⁹² Decision (EU) 2020/440 (n 14) recital 4.

second stage of the monetary policy transmission mechanism.¹⁹³ In order to comply with the prohibition of monetary financing, secondary market purchasers must not act as de facto intermediaries for the ESCB and sufficient safeguards must exist to ensure that Member States will follow a sound budgetary policy. As mentioned, in contrast to the FCC's mandatory conditions, the test of the Court of Justice has a degree of built-in flexibility. Secondary market purchasers are de facto intermediaries for the ESCB if they can foresee with certainty that the ESCB will purchase bonds acquired by them in the primary market.¹⁹⁴ A percentage cap on purchases is one of several criteria that the Court uses to assess foreseeability. Under the PEPP, the ECB follows a 'flexible approach to the composition of purchases',¹⁹⁵ and, similar to the PSPP, it can be assumed that the ESCB will not intervene immediately after a bond issue.¹⁹⁶ Under these conditions, the high threshold of certainty is not met.

Likewise, whether sufficient safeguards exist depends on a consideration of a totality of the circumstances. In *Gauweiler and Weiss*, the Court highlighted three factors that were decisive. Purchases would only be carried out to the extent necessary to achieve the goals of the programmes, the overall size of the programmes was (de facto) limited, and purchased bonds had to be of investment grade. The decision establishing the PEPP replicates the first two criteria,¹⁹⁷ but allows the purchase of government bonds of one Member State, Greece, even if the bonds are below investment grade.¹⁹⁸ However, safeguards exist that allow continued monitoring of the fiscal policy of the Greek government and the implementation of prior commitments to structural reform.¹⁹⁹ While this so-called enhanced surveillance framework²⁰⁰ imposes less rigid constraints on a Member State's fiscal autonomy than a macro-economic adjustment programme,²⁰¹ it grants the ECB, Commission and Council enhanced powers in comparison with those under the SGP to review developments in the Member State concerned and recommend precautionary corrective measures or require the preparation of a draft macro-economic adjustment programme.²⁰² Considering that the ECB can, therefore, monitor in a targeted manner how government bond market interventions affect fiscal policy choices and that this is just one of several safeguards built into the PEPP, there are good reasons to conclude that the PEPP will pass the Court's equivalence/sufficient

¹⁹³ It is thus, in this regard, comparable to the PSPP, see our discussion in the text to nn 58-71.

¹⁹⁴ Text to n 137 above.

¹⁹⁵ Decision (EU) 2020/440 (n 14) recital 5. Art 5 contains further details.

¹⁹⁶ Annelieke A.M. Mooij, 'The legality of the European Central Bank's Pandemic Emergency Purchase Programme', BRIDGE Network - Working Paper 5, 2020, <https://ssrn.com/abstract=3677152>, p 12.

¹⁹⁷ Decision (EU) 2020/440 (n 14) Arts 1 (overall limit) and 4 (necessity).

¹⁹⁸ *ibid* Art 3.

¹⁹⁹ *ibid* recital 7. For a report on the nature of these commitments and their implementation, see European Commission, Enhanced Surveillance Report – Greece, European Economy Institutional Paper 127, May 2020.

²⁰⁰ The enhanced surveillance framework is laid down in Regulation (EU) No 472/2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, [2013] OJ L140/1, Art 3.

²⁰¹ See the text to nn 126-128 above.

²⁰² Regulation (EU) No 472/2013, Arts 3, 14.

safeguards test.²⁰³ If this is correct, the FCC and the Court of Justice are again on a collision course, assuming a consistent application of their respective tests.

6. Conclusion

It was the goal of this article to test the case law of the Court of Justice on unconventional monetary policy measures—its decisions in *Gauweiler* and *Weiss*—against the low benchmarks of consistency and coherence. We have shown that the decisions meet neither benchmark. The conclusions that the Court reaches are, perhaps, understandable in light of the economic exigencies that threatened the very survival of the Eurozone and the concurrent threat of open conflict with the German Federal Constitutional Court (which has indeed now materialised). Nevertheless, the deficiencies in the Court’s legal reasoning imperil the legitimacy of both its own rulings and the ECB’s unconventional monetary policy measures. Arguably, the controversies surrounding the two decisions, and the FCC’s ultimate rejection of the Court’s authority in *Weiss*, can be explained not only with disagreements about the goals of monetary policy and the redistributive effects of asset purchase programmes, but also with the fact that *Gauweiler* and *Weiss* are, at a basic level of rational legal reasoning, unconvincing.

We do not make suggestions for the role that the ECB should play in the evolution of monetary union towards a more complete currency union, or for a new constitutional settlement between the Court of Justice and the FCC.²⁰⁴ Rather, our contribution is more modest. We submit that, as a first step, it is essential for both the Court of Justice and the FCC to develop the doctrines analysed in this article further and produce a consistent and coherent set of rules governing policy interventions by the ECB. Only on this basis can a conversation develop about the appropriateness of the rules in light of different policy preferences. This opportunity will arise in the pending proceedings over the PEPP. As discussed, there are good reasons to conclude that the tests of the Court of Justice and the FCC will lead to different outcomes when applied to the PEPP. The two courts, thus, have a choice between three courses of action. They could apply their respective doctrines

²⁰³ Most commentators come to similar conclusions, see Matthias Goldmann, ‘Borrowing Time. The ECB’s Pandemic Emergency Purchase Programme’, *VerfBlog*, 27 March 2020, <https://doi.org/10.17176/20200328-002904-0>; Sebastian Grund, ‘Legal, compliant and suitable: The ECB’s Pandemic Emergency Purchase Programme (PEPP)’, *Hertie School Jacques Delors Centre Policy Brief*, 25 March 2020; Mooij (n 196); Viterbo (n 191) 675-678, 680-681. Mark Dawson and Ana Bobić, ‘COVID-19 and the European Central Bank: The Legal Foundations of EMU as the Next Victim?’, *VerfBlog*, 27 March 2020, <https://doi.org/10.17176/20200327-122939-0>, on the other hand, express doubts about the legality of the PEPP. They argue that, because of the PEPP’s volume, there was a high probability that bonds would be purchased by the ESCB, and the PEPP did not contain any reference to conditionality. However, the equivalence/sufficient safeguards test of the Court of Justice requires certainty, not a high probability. In addition, the necessary safeguards may, but do not have to, stem from conditionality under an assistance programme.

²⁰⁴ Such suggestions abound in the literature. For a few examples, see Matthias Goldmann, ‘Constitutional Pluralism as Mutually Assured Discretion: The Court of Justice, the German Federal Constitutional Court, and the ECB’ (2016) 23 *MJ* 119; Vlad Perju, ‘Against Bidimensional Supremacy in EU Constitutionalism’ (2020) 21 *German L.J.* 1006; Franz Schorkopf, ‘Value Constitutionalism in the European Union’ (2020) 21 *German L.J.* 956.

consistently and disagree on the legality of the PEPP, possibly resulting in a second act of open defiance of the primacy of EU law by the FCC. They could agree on the legality of the PEPP (or the lack thereof), ostensibly by applying the legal rules established in Gauweiler and Weiss, but in reality introducing further inconsistencies. Or they could carefully alter their positions and remove existing inconsistencies and incoherence. For the long-term success of a rules-based monetary union, it is clear which option is preferable.