

**Innovative ways out of the crisis: can gold be used as collateral by EU Member States?**

1. Introduction

a) *Background to this memorandum*

With the combined sovereign debt and banking crises of the European Union ('EU') going on for three years now, innovative methods to address the crisis may be called for. One such method, hinted at by the European Commission in its consultation on the joint issue of bonds by Member States<sup>1</sup>, concerns the use of gold as collateral for the issue of public debt. The idea would be that EU Member States make use of the gold in their official foreign reserves to return to the markets, or to access the markets, on more favourable terms than hitherto. The Commission aired the idea in the context of joint issuance of bonds. The World Gold Council ('WGC') came with suggestions for individual Member States to do so already. The WGC requested my opinion on the legality under EU law of the use of gold as collateral for bonds issued by a Member State. This memorandum sets out the main lines of reasoning followed in my response to this request. It solely relates to EU law, as it now stands, in regard to the status of gold as an official foreign reserve asset. It discusses the legality of the use of such gold as collateral in the context of the organisation of the financing needs of governments of the EU Member States that have adopted the euro ('participating Member States'). More technical-legal issues of the use of gold currently on the balance sheets of the Eurosystem, such as consequences for monetary income distribution or profit and loss within the Eurosystem, are not discussed. Nor does this memorandum address accounting issues involved in such a gold-backed bond scheme. Further legal issues which may be relevant in the context of such transactions, such as *pari passu* clauses, and the issue of creditor seniority, are not discussed here either, nor is applicable national law.

b) *EMU law is in flux*

The law on the Economic and Monetary Union ('EMU') is in flux: since the beginning of the financial crisis and of the sovereign debt *cum* banking crisis, many legal acts have been adopted to prevent a recurrence of the crisis, to strengthen regulation<sup>2</sup> and supervision of the financial sector<sup>3</sup>, to strengthen

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<sup>1</sup> Green Paper on the feasibility of introducing Stability Bonds, COM(2011) 818 final, 23 November 2011, at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:DKEY=627611:EN:NOT> (accessed 10 October 2012).

<sup>2</sup> In compliance with G20 and Basle Committee on Banking Supervision proposals ('Basle-III'; see: <http://www.bis.org/bcbs/> (accessed 28 October 2012)), the EU adopted strengthened regulatory capital requirements. The implementation of 'Basle-III' is the subject of two legislative proposals currently pending, the so-called 'CRD IV' package, with "CRD" standing for Capital Requirements Directive: a Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, and a Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, both to be found at: [http://ec.europa.eu/internal\\_market/bank/regcapital/new\\_proposals\\_en.htm](http://ec.europa.eu/internal_market/bank/regcapital/new_proposals_en.htm) (accessed 28 October 2012). Further legislative and regulatory strengthening concerns deposit insurance, crisis management, the regulation of Credit Rating Agencies ('CRAs') and a host of other initiatives that go beyond the confines of the present memorandum. See: [http://ec.europa.eu/internal\\_market/top\\_layer/financial\\_capital/index\\_en.htm](http://ec.europa.eu/internal_market/top_layer/financial_capital/index_en.htm)

economic governance in the EU and in the euro area, and to make fiscal discipline provisions and their enforcement much stricter than before<sup>4</sup>. Also, novel approaches have been taken to stem the crisis, with a combination of a temporary Union financial facility<sup>5</sup> with a temporary intergovernmental financial facility<sup>6</sup> established in 2010, followed by a permanent financial facility on the basis of a separate treaty<sup>7</sup>. This latter route was also followed for the strengthening of budgetary rules and of euro area governance in the so-called Fiscal Compact Treaty<sup>8</sup>. As these novel methods of trying to address the situation show, the present crisis calls for unprecedented measures<sup>9</sup> and focuses the

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(accessed 28 October 2012).

<sup>3</sup> A European System of Financial Supervisors ('ESFS') was established and became operational in January 2011. It consists of three supervisory authorities, the European Banking Authority ('EBA', established by Regulation No. 1093/2010; see: <http://www.eba.europa.eu> (accessed 28 October 2012)), the European Securities and Markets Authority ('ESMA', established by Regulation No. 1095/2010, see: <http://www.esma.europa.eu> (accessed 28 October 2012)) and the European Insurance and Occupational Pensions Authority ('EIOPA', established by Regulation No. 1096/2010, see: <https://eiopa.europa.eu/> (accessed 28 October 2012)), plus the European Systemic Risk Board ('ESRB'; see: <http://www.esrb.europa.eu> (accessed 28 October 2012)). In addition to the regulations establishing these Authorities, the regulations concerning the ESRB (Nos. 1092 and 1093/2010) encompass the conferral of specific tasks upon the European Central Bank ('ECB') pursuant to Article 127 (6) Treaty on the Functioning of the European Union ('TFEU'). The latter Treaty provision is the basis for the recent Commission proposals for the establishment of a Single Supervisory Mechanism ('SSM'), the first step towards full 'banking union' in the euro area. The legal acts establishing the four entities that make up the ESFS were published in the Official Journal of the European Union ('OJ') L 331, 15 December 2010. The Commission's proposals on the SSM can be found at: [http://ec.europa.eu/internal\\_market/finances/committees/index\\_en.htm](http://ec.europa.eu/internal_market/finances/committees/index_en.htm) (accessed 28 October 2012).

<sup>4</sup> The strengthening of economic governance and the increased acumen with which the budgetary rules of Article 121 TFEU's Excessive deficit Procedure ('EDP') and the Stability and Growth Pact ('SGP') are applied largely follow the adoption of the so-called 'six-pack'. It consists of the following legal acts, collectively published in Official Journal of the European Union No. L 306, 23 November 2011:

1. Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area;
2. Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area;
3. Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies;
4. Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances;
5. Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure;
6. Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.

See: [http://ec.europa.eu/economy\\_finance/economic\\_governance/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/index_en.htm) (accessed 28 October 2012).

<sup>5</sup> The European Financial Stability Mechanism ('EFSM'). See Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism, OJ L L 118/1, 12 May 2010. See, also: [http://ec.europa.eu/economy\\_finance/eu\\_borrower/efsm/index\\_en.htm](http://ec.europa.eu/economy_finance/eu_borrower/efsm/index_en.htm) (accessed 31 October 2012).

<sup>6</sup> The European Financial Stability Facility ('EFSF'). See the EFSF Framework Agreement and the EFSF's Articles of Incorporation at <http://www.efsf.europa.eu/about/legal-documents/index.htm> (accessed 31 October 2012).

<sup>7</sup> The European Stability Mechanism ('ESM'). See the Treaty establishing the European Stability Mechanism at: [http://ec.europa.eu/economy\\_finance/economic\\_governance/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/index_en.htm) (accessed 31 October 2012).

<sup>8</sup> Officially, Treaty on Stability, Coordination and Governance in the Economic and Monetary Union ('TSCG'), see: <http://european-council.europa.eu/eurozone-governance/treaty-on-stability> (accessed 31 October 2012).

<sup>9</sup> Like other central banks in the world, the ECB has had to introduce non-standard measures to address the financial crisis. Notably, it introduced the Securities Markets Programme (Decision of the European Central Bank of 14 May 2010 establishing a securities markets programme (ECB/2010/5), OJ OJ L 124/8, 20 May 2010), the Covered Bond Purchase Programme and the longer-term refinancing operations ('LTROs'). For an

attention of policymakers and central bankers alike. The issue of gold-backed bonds is novel under EMU law: since the beginning of EMU, Member States have not used gold as collateral in the context of the issue of bonds. Thus, interpreting EU law on this issue cannot give certainty. Yet, comfort can be given on a reasonable interpretation of the law and a reasonable application of the law to new circumstances that have emerged since the crisis. This is what this memorandum seeks to do.

*c) Structure of this memorandum*

This memorandum is structured as follows. Following this introduction, eight sections discuss the various legal issues involved. After describing the law on the holding and managing of official foreign reserves in the euro area (section 2), I present an overview of EU law issues relevant for ‘gold bonds’ issuance (section 3). These issues are then discussed: the prohibition of monetary financing (section 4), the independence of the Eurosystem (section 5), and the provision that “the” official foreign reserves are held and managed by the Eurosystem (section 6). Section 7 then elaborates the requirement of joint decision-making at EU level on pledging gold. Suggestions for appropriate Treaty language which would permit beyond doubt use of gold in bond issuance are given in section 8. Section 9 contains summary conclusions. This memorandum begins with a one-page executive summary.

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overview, see: <http://www.ecb.int/mopo/implement/omo/html/index.en.html> (accessed 31 October 2012). On 6 September 2012, the ECB announced Outright Monetary Transactions (‘OMT’); see the press release at [http://www.ecb.int/press/pr/date/2012/html/pr120906\\_1.en.html](http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html) (accessed 31 October 2012). During the crisis, the ECB has repeatedly widened the eligibility criteria for collateral. See: <http://www.ecb.int/ecb/legal/date/2012/html/index.en.html> and <http://www.ecb.int/paym/coll/html/index.en.html> (accessed 31 October 2012).

### **Executive summary**

Gold held by the National Central Banks ('NCBs') forms part of the official foreign reserves of the Member States. These reserves are held and managed by the Eurosystem, i.e. the European Central Bank ('ECB') and the NCBs of the Member States that have the euro as their currency. "The" official foreign reserves of the Member States have been entrusted to the Eurosystem; the Treaty does not envisage holding of gold or other official foreign reserves by others than the central banking system, with the exception of "foreign exchange working balances" allowed to national governments. The Eurosystem is entrusted with two objectives: to maintain price stability and, subject to this primary objective, to support the economic policies in the EU. The Eurosystem is to perform its functions in full independence. One of its functions is to contribute to the stability of the financial system. The Eurosystem is not permitted to grant direct credit to governments (prohibition of monetary financing). Any use of gold in the context of the issue of bonds by State governments needs to take into account the following quadruple legal restrictions:

- 1) gold is independently held by the Eurosystem in the context of its objectives and functions;
- 2) "the" official foreign reserves of the Member States have been entrusted to the Eurosystem, with only "foreign exchange working balances" remaining with governments;
- 3) the Eurosystem decides autonomously upon the use of its official foreign reserves;
- 4) any such use should not contravene the prohibition of monetary financing.

Should the Governing Council of the ECB, the primary decision-making body within the Eurosystem, consider it necessary or conducive to the performance of its tasks to enable the use of gold for the purpose of collateralising bonds issued by Member States, such a decision would, in my view, constitute a reasonable weighing of options in the present circumstances of the euro area debt crisis. An interpretation of the Treaty which allows reserves to be used for their public functions is to be preferred in line with the general thrust of the case law of the ECJ which seeks to give as much useful effect to provisions as possible within their wording, context and purpose ('*effet utile*'). Pledging gold on the balance sheet of the NCB, or the ECB, would run the risk of being seen as monetary financing, the prohibition of which is one of the cornerstones of the legal set-up of EMU. Thus, the use of gold as collateral would imply the transfer of gold to a national debt agency. (Future use of gold in the context of a European debt agency to be entrusted with the issuance of Eurobonds may similarly be considered valid under EU law.) It would be preferable to amend the TFEU specifically permitting the use of gold as collateral. Even without such a Treaty amendment, the use of gold as collateral can legally be envisaged under EU law, provided decisions to that end are taken independently by the Eurosystem (in conjunction with decisions by the governments and the EU institutions) and the prohibition of monetary financing is upheld (i.e., gold is taken from the balance sheet of the Eurosystem in advance of any pledge). A challenge before the ECJ is unlikely to be successful as the ECJ generally upholds the discretion of the Union institutions when taking decisions in complex economic questions and may be expected to do so, here, as well, especially in the current euro area debt crisis.

2. *The law on official foreign reserves in the euro area*

a) *Official foreign reserves held and managed by Eurosystem*

The official foreign reserves of the participating Member States are held and managed by their NCBs as part of the Eurosystem, the monetary authority of the eurozone. The NCBs of all EU Member States are part of the European System of Central Banks ('ESCB') but only the ECB and the NCBs of participating Member States act as the monetary authority of the eurozone; these entities together are referred to as the 'Eurosystem'<sup>10</sup>. In the context of EMU, NCBs have transferred part of their official foreign reserves, including a part of their gold holdings, to the ECB in return for a claim on the ECB.

The Treaty on the Functioning of the European Union ('TFEU') and the attached Statute of the ESCB and of the ECB ('Statute')<sup>11</sup> entrust the Eurosystem with the objective of maintaining price stability and, as a secondary objective, to support the general economic policies in the EU. They also entrust the Eurosystem with the tasks of, inter alia, defining and implementing monetary policy, conducting foreign exchange operations and holding and managing the official foreign reserves of the Member States. These are three of the four "basic tasks" of the Eurosystem<sup>12</sup>. The Treaty makes clear that official foreign reserves are to be held and managed by central banks as it entrusts the Eurosystem with holding and managing "the official reserves" (emphasis added, RS)<sup>13</sup> and specifically allows Governments to hold and manage "working balances" in foreign exchange<sup>14</sup>. The implication is that these balances are limited to specific, immediate needs to finance operations and even then, they are subject to the ECB's approval when they exceed certain limits, as will be explained further below. The

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<sup>10</sup> The term "Eurosystem" appears in the TFEU only once, in Article 282. Its first paragraph reads as follows: "The European Central Bank, together with the national central banks, shall constitute the European System of Central Banks (ESCB). The European Central Bank, together with the national central banks of the Member States whose currency is the euro, which constitute the Eurosystem, shall conduct the monetary policy of the Union."

<sup>11</sup> The ESCB Statute has provisions repeating those of the TFEU and provisions containing additional rights and obligations. In this memorandum, references are to the TFEU mostly when the Statute's provisions repeat Treaty texts.

<sup>12</sup> In all provisions referring to the NCBs, one has to bear in mind that their rights and obligations may vary according to their status as an NCB of a participating Member State (and, hence, subject to all obligations and enjoying all rights relating to the Eurosystem) or as an NCB of a Member State with a derogation or an opt-out (in which case their rights and obligations may differ from those of the participating NCBs). This memorandum focuses on the NCBs which participate in the Eurosystem and does not address the position of the NCBs of other Member States. I note in passing that the requirement of independence, which is related to the holding and managing of official foreign reserves, including gold, relates to the NCBs of all Member States except the United Kingdom (see Paragraphs 4 and 7 of Protocol No. 15 on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland, attached to the TFEU ('UK Opt-out Protocol in respect of EMU')).

<sup>13</sup> Article 127 (2) TFEU reads as follows:

"2. The basic tasks to be carried out through the ESCB shall be:  
— to define and implement the monetary policy of the Union,  
— to conduct foreign-exchange operations consistent with the provisions of Article 219,  
— to hold and manage the official foreign reserves of the Member States,  
— to promote the smooth operation of payment systems."

<sup>14</sup> Article 127 (3) TFEU reads as follows:

"The third indent of paragraph 2 shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances."

Eurosystem is entrusted with further tasks of which, in this context, an indirect contribution to the stability of the financial system is the most relevant<sup>15</sup>. This function has added in significance during the crisis with the granting of lender-of-last-resort assistance to distressed banks and with the conferral of tasks upon the ECB, first in the context of the establishment of the European Systemic Risk Board ('ESRB'), the body entrusted with macro-prudential oversight with a view to maintain the stability of the financial system and, then, with the proposed conferral of specific micro-prudential tasks<sup>16</sup>.

*b) Official foreign reserves transferred to ECB*

The assignment to the Eurosystem of the task of holding and managing the official foreign reserves of the Member States has been further elaborated in the Statute, Article 30 of which<sup>17</sup> requires a transfer of such assets from the NCBs of the participating Member States to the ECB.

*c) NCB operations in remaining official foreign reserves subject to ECB approval*

Article 31 of the Statute provides that operations by NCBs<sup>18</sup> in foreign reserve assets remaining with them, if beyond a threshold established by the Governing Council of the ECB, shall be subject to approval by the ECB. This should ensure "consistency with the exchange rate and monetary policies of the Union".

*d) Gold forms part of the official foreign reserves*

That gold forms part of such foreign reserve assets is clear from the wording of the Statute and its implementation in the initial Guideline for the transfer of reserves to the ECB<sup>19</sup>. This ECB legal act specifies the euro equivalent amounts of gold to be transferred; throughout, the relevant Guideline makes clear that the reserve assets to be transferred include gold. See, e.g., Article 1, saying: "foreign-reserve assets' shall mean securities, gold or cash", and defining 'gold' as follows: "gold' shall mean fine troy ounces of gold in the form of London Good Delivery Bars, as specified by the

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<sup>15</sup> Article 127 (5) TFEU reads as follows:

"The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system".

Article 127 (6) TFEU reads as follows:

"The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings." On the activation of the latter provision, see footnote 3 above.

<sup>16</sup> See the legislative acts and proposals referred to in footnote 3 above.

<sup>17</sup> Read in conjunction with Article 42.4 of the Statute which specifies that 'national central banks' are to be read as 'central banks whose currency is the euro' in, amongst other provisions, Article 30. See, providing for a similar exception for the Bank of England, Paragraph 7 of the UK Opt-out Protocol in respect of EMU.

<sup>18</sup> The same restrictions applies as in respect of Article 30: Article 42.4 of the Statute makes clear only NCBs of participating Member States are meant. See, again, Paragraph 7 of the UK Opt-out Protocol in respect of EMU.

<sup>19</sup> See the Annex to Guideline of 3 November 1998 as amended by the Guideline of 16 November 2000 on the composition, valuation and modalities for the initial transfer of foreign-reserve assets, and the denomination and remuneration of equivalent claims (ECB/2000/15), OJ L 283/81, 30.12.2000. See: <http://www.ecb.int/ecb/legal/107663/1011/html/index.en.html> (accessed on 31 October 2012).

London Bullion Market Association”. The inclusion of gold among the foreign reserve assets of the Member States to be transferred to the ECB is confirmed in subsequent legal acts concerning this transfer, the latest of which concerns the accession of Estonia.<sup>20</sup>

Whilst the ECB legal act refers to the gold (to be) transferred to the ECB, all gold held by the Eurosystem, i.e. by either the ECB or the NCBs of the participating Member States, forms part of the official foreign reserves of the Member States, held and managed by the Eurosystem in implementation of its third “basic task”<sup>21</sup>. The consolidated statement of the Eurosystem as at 28 October 2012 makes this clear, as well: it lists among assets gold and gold receivables of almost € 49 billion<sup>22</sup>.

*e) Rights in respect of official foreign reserves, including gold*

In respect of the official foreign reserves transferred, the ECB enjoys an undisputed right of use and disposal. Article 30.1 of the Statute states: “The ECB shall have the full right to hold and manage the foreign reserves that are transferred to it and to use them for the purposes set out in this Statute”. Since the Eurosystem consists of an integrated whole, the same must by implication hold for the NCBs in respect of official foreign reserves remaining with them.

*f) Such rights including full ownership rights?*

The precise legal status of the foreign reserves assets of the Eurosystem is disputed. The terms used by the Treaty and the Statute (“to hold and manage”) suggest the most complete rights in respect of them. Whether these rights extend to ‘naked ownership’ is unclear. In my thesis on the ECB<sup>23</sup>, I found that central bank ownership of official foreign reserves would continue in respect of those central banks which were legal owner, whereas central banks that had less than full legal title to these reserves could be maintained in this position. Although the precise legal relationship between the central banks and the official foreign reserves seems not to have been determined at law, most central banks may be assumed to have ownership rights. The Bank of England is exceptional. The Annual Report of 1992 of the Committee of Governors of the Central Banks of the European Economic Community<sup>24</sup>, indicates it as acting as agent of the UK Government in its role of managing the official reserves<sup>25</sup>.

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<sup>20</sup> See Articles 1 and 3 of Decision ECB/2010/34 on the paying-up of capital, transfer of foreign reserve assets and contributions by *Eesti Pank* to the European Central Bank’s reserves and provisions, OJ. L 11/58, 15.1.2011. See: <http://www.ecb.int/ecb/legal/107663/1011/html/index.en.html> (accessed on 31 October 2012).

<sup>21</sup> Article 127 (2), third indent, TFEU; Article 3.1, third indent, Statute.

<sup>22</sup> See: <http://www.ecb.int/press/pr/wfs/2012/html/fs121030.en.html> (accessed on 31 October 2012).

<sup>23</sup> René Smits, *The European Central Bank – Institutional Aspects*, 1997 (2000 reprint), pp. 199-200.

<sup>24</sup> The EEC was established in 1958 by the Treaty establishing the European Economic Community (EEC). This Treaty was subsequently amended on numerous occasions, notably by the Maastricht Treaty on European Union which renamed the EEC: European Community (EC), and by the Lisbon Reform Treaty which renamed the 1957 Treaty: Treaty on the Functioning of the European Union (TFEU), with the European Union replacing and succeeding the European Community (Article 1 Treaty on European Union in its post-Lisbon version). The

In a judicial decision concerning the interpretation of the terms “to hold and manage the official foreign reserves of [a Member State]”, a national court has refrained from determining the precise legal relationship. It found that these terms merely confirmed the status of such reserves as having a public interest function<sup>26</sup>. This decision was taken in 2003 in a case that originated from a claim by shareholders of the National Bank of Belgium who argued that Belgian legislation containing aforementioned terms was unconstitutional as it would amount to a transfer to the Belgian State of assets hitherto held by the Belgian NCB, thereby favouring one shareholder (the State) above others (themselves). In its defence before the Belgian Constitutional Court, the Belgian State had taken the position that the attacked wording did not alter the legal ownership in respect of the reserves (“*La disposition attaquée n’emporte en effet aucune modification du régime de la propriété des réserves officielles de change de l’Etat belge.*”) The Belgian Constitutional Court held that official reserves “have always been destined for the implementation of the public interest”. The Belgian Constitutional Court, deciding on the lawfulness of the new legislative provisions governing the *Banque Nationale de Belgique* (BNB or NBB, the Belgian central bank) said: “*Les réserves gérées par la B.N.B. ont donc toujours fait l’objet d’une affectation à des missions d’intérêt public.*” / “*De reserves beheerd door de N.B.B. zijn dus altijd bestemd geweest voor taken van algemeen belang.*” / “*Die von der BNB verwalteten Rücklagen seien also immer für das Gemeinwohl bestimmt gewesen.*”

In the context of this case, it has thus been held that official foreign reserves have always been subject to the implementation of official functions and their precise status is not affected by the insertion into Belgian domestic law of the words “to hold and manage the official foreign reserves”. The Belgian Constitutional Court found that inserting the same wording as contained in Article 105 (2) of the Treaty establishing the European Community (nowadays: Article 127 (2) TFEU) did not at all alter the ownership rights in respect of these reserves and only regulated their status in the context of the European System [of Central Banks] (“*ne modifie en rien le droit de propriété desdites réserves et règle uniquement le statut de celles-ci dans le système européen*”). The Belgian Constitutional Court saw in the wording a confirmation of the destination that these reserves have always had, namely to be used for the public interest. Thus, when the legal ownership of official foreign reserves held by an NCB became the issue of focus in a judicial dispute, the exact legal nature of such ownership was not determined.

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Committee of Governors was a body established by the EEC Treaty whose functions were later taken over by the European Monetary Institute (EMI), the predecessor (1994-1998) of the ECB.

<sup>25</sup> Table 7: Institutional features of Community central banks, in: Committee of Governors of the Central Banks of the Member States of the European Economic Community, Annual Report 1992, April 1993, at: <http://www.ecb.int/pub/pubbydate/1993/html/index.en.html> (accessed on 31 October 2012).

<sup>26</sup> Belgian Constitutional Court (previously called: Court of Arbitration), Decision 160/2003 of 10 December 2003 in Case No. 2577, French text of the decision. See: <http://www.const-court.be/> (accessed on 31 October 2012).

*g) Irrespective of ownership rights: full management and control by Eurosystem*

Even when the precise legal nature of the ownership rights has not been established, it is clear that the NCBs, and the ECB for the gold and other official foreign reserves transferred to it, enjoy full rights of management and control in respect of the gold and other reserve assets held by them. Thus, any decision in respect of maintaining gold on their books, or transferring it, is an exclusive right of the relevant NCBs and the ECB, to be exercised jointly in the context of the joint task of holding and managing official foreign reserves. This implies that decisions are to be taken by the Governing Council of the ECB as primary carrier of the responsibility “to ensure the performance of the tasks entrusted to the ESCB”<sup>27</sup>. This extends to any decisions on the use of gold as collateral.

*h) Independence of Eurosystem requires Governments to keep hands off gold*

All official foreign reserves held and managed by NCBs are part of the Eurosystem reserves, so even in so far as they have not been transferred to the ECB, gold and other foreign reserve assets are part of the foreign exchange reserves of the Eurosystem. This is borne out by the provision on the ECB’s approval for operations in foreign reserves assets above a certain limit<sup>28</sup>. Even Member States’ transactions with their foreign exchange working balances, above a certain threshold, are subject to such approval from the ECB<sup>29</sup>. The independence of the Eurosystem implies that these reserves are available solely for the execution of the tasks of the EU’s monetary authority. Thus, they cannot be used by the Government of any Member State or otherwise be ‘touched’ by them.

In its assessment of the independence of NCBs and the legal convergence of Member States, the ECB attaches great value to the independence in respect of reserves. The system of the Treaty and the Statute being thus, that foreign reserves are in the hands of the independent central banks and Governments only maintain “working balances”, operations in which are even subject to ECB approval beyond a certain threshold, the ECB insists that NCBs, rather than Governments, should hold and manage the official foreign reserves<sup>30</sup>.

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<sup>27</sup> See Article 12.1 of the Statute, the first subparagraph of which reads as follows: “The Governing Council shall adopt the guidelines and take the decisions necessary to ensure the performance of the tasks entrusted to the ESCB under these Treaties and this Statute. The Governing Council shall formulate the monetary policy of the Union including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the ESCB, and shall establish the necessary guidelines for their implementation.”

<sup>28</sup> Article 31.2 of the Statute, which reads as follows: “All other operations in foreign reserve assets remaining with the national central banks after the transfers referred to in Article 30, and Member States’ transactions with their foreign exchange working balances shall, above a certain limit to be established within the framework of Article 31.3, be subject to approval by the ECB in order to ensure consistency with the exchange rate and monetary policies of the Union.” See section 2 c) of this memorandum.

<sup>29</sup> See Article 31.2 of the Statute and Guideline ECB/2003/12 of 23 October 2003 for participating Member States’ transactions with their foreign exchange working balances pursuant to Article 31.3 of the Statute of the European System of Central Banks and of the European Central Bank, OJ. L 283/81, 31.10.2003.

<sup>30</sup> See, for instance, the ECB Opinion on a draft Italian plan to tax the unrealised profits on gold held by the *Banca d’Italia* (its actual value exceeding the original book value). The ECB considered this did not comply with the principle of central bank independence (currently, Article 130 TFEU) nor with the prohibition on monetary financing (currently Article 123 (1) TFEU). See ECB Opinion CON/2009/59 on the taxation of the

The ECB's predecessor, the European Monetary Institute (EMI), in its 1998 Convergence Report<sup>31</sup>, specifically held as follows in respect of the legal convergence of national law with EC (now: EU) law, one of the requirements for the adoption of the single currency<sup>32</sup>:

#### **4.3 Foreign reserve management**

One of the main tasks of the ESCB is to hold and manage the official foreign reserves of the Member States (Article 105 (2) of the Treaty). **Member States which do not transfer their official foreign reserves to their NCB do not comply with this requirement of the Treaty** (with the exception of foreign exchange working balances, which the governments of the Member States may keep under Article 105 (3) of the Treaty). In addition, **a right of a third party, for example government or parliament, to influence decisions of an NCB with regard to the management of the official foreign reserves would (under Article 105 (2) of the Treaty) not be in conformity with the Treaty**. Furthermore, NCBs will have to provide the ECB with foreign reserve assets in proportion to their shares in the subscribed capital of the ECB. This means that there must be no statutory obstacles to NCBs transferring foreign reserve assets to the ECB.

For a recent example in respect of the requirement that foreign reserves management be free from government influence, see the ECB's 2010 Convergence Report which contains the following language in respect of the legislation in respect of the Latvian central bank<sup>33</sup>:

#### **Official foreign reserve management**

Article 5 of the Law, which provides for Latvijas Banka's powers relating to foreign reserve management, does not recognise the ECB's powers in this field. In addition, Article 5(2) of the Law, which provides that the Government maintains foreign currency gold reserves with Latvijas Banka, is not in line with Article 31.2 of the Statute in accordance with which the Government is to maintain only foreign exchange working balances.

Since independence of the Eurosystem extends beyond financial independence, and includes functional independence (the ability to function autonomously and perform its tasks without interference from governments, whether at EU or at State level), the Eurosystem may independently decide on the proper course of action to achieve its objectives. This implies that, should the Governing Council of the ECB decide that the use of reserves is necessary or conducive to the performance of a Eurosystem function, it can autonomously decide to use such reserves. In this context, it is relevant that the Eurosystem is to contribute to the stability of the financial system.

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Banca d'Italia's gold reserves of 14 July 2009. See: [http://www.ecb.int/ecb/legal/pdf/en\\_con\\_2009\\_59\\_it\\_taxation\\_of\\_banca\\_ditalias\\_gold.pdf](http://www.ecb.int/ecb/legal/pdf/en_con_2009_59_it_taxation_of_banca_ditalias_gold.pdf) (accessed 31 October 2011).

<sup>31</sup> EMI Convergence Report, 1998, see: <http://www.ecb.europa.eu/pub/convergence/html/index.en.html> (accessed on 31 October 2012); emphasis added.

<sup>32</sup> See Article 140 in conjunction with Articles 130 and 131 TFEU (previously, Article 121 in conjunction with Articles 108 and 109 EC Treaty).

<sup>33</sup> ECB Convergence Report, May 2010, p. 246. See: <http://www.ecb.europa.eu/pub/convergence/html/index.en.html> (accessed on 31 October 2012).

3. *EU law issues relevant for the use of ‘gold bonds’ by Member States*

The previous section makes clear that the independent fulfilment by the Eurosystem of its Treaty-given tasks requires that Governments keep their hands off the gold held by NCBs and off the gold transferred to the ECB. It also makes clear that, if the Eurosystem considers a certain use of the official foreign reserves entrusted to it – including gold – necessary or conducive for the performance of its tasks, it can lawfully employ such reserves to that end. However, the prohibition of monetary financing implies that NCBs, or the ECB, may not use their assets to directly finance governments. Nevertheless, should the Eurosystem consider it necessary in the circumstances of the current crisis, or otherwise conducive to the performance of its tasks, and not contrary to the achievement of its objectives, it could independently decide to use gold (or other assets) as collateral in operations engaged in by Member States. Three problems of a legal nature arise were such a decision to be taken:

1. the prohibition of monetary financing;
2. the independence of the Eurosystem from governments; and
3. the provision that “the official foreign reserves (my emphasis, RS)” of the Member States are held and managed by the Eurosystem.

4. *The prohibition of monetary financing*

The prohibition of monetary financing is a cornerstone of EMU. It became effective on 1 January 1994 with the transition to Stage 2 of EMU. It applies to all NCBs with the sole exception of the Bank of England<sup>34</sup>. The prohibition<sup>35</sup> entails that central banks may not directly finance governments at any level (EU, State or lower level of government). Central banks should scrupulously avoid direct financing governments, or becoming liable for their obligations.

The prohibition of monetary financing implies that any use of reserves as collateral may not result in the Eurosystem, or one of its constituent parts, directly financing governments of the Member States (or the European Union). This prohibition may require that gold is used as collateral by first severing it from NCB’s balance sheets so that, should a Member State government find itself unable to repay its public debts for which the gold has been pledged, the transfer of such gold for the benefit of that State’s creditors would not amount to the NCB paying this public debt. Prior transfer of gold to a debt issuing agency of a Member State, which would then pledge gold in the context of bond-issuing,

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<sup>34</sup> See Paragraph 10 of the UK Opt-out Protocol in respect of EMU.

<sup>35</sup> Laid down in Article 123 TFEU, paragraph 1 of which reads as follows (see, also, Article 21.1 Statute): “Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as ‘national central banks’) in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.”

would be a method to prevent the direct financing of public debt by NCBs<sup>36</sup>. In its Opinions, the ECB has been adamant that Member States do not transgress the prohibition of monetary financing<sup>37</sup>.

5. *The independence of the Eurosystem from governments*

a) *Deciding on the use of gold: an issue for the ECB's Governing Council*

A decision on the use of gold as collateral, or on the transfer of gold to a debt issuing agency for that purpose, would have to be undertaken independently by the ECB's Governing Council.

b) *Wide discretion for Governing Council to decide on operations*

It is for the Governing Council to decide whether the Eurosystem's operations are in conformity with its over-riding price stability mandate and with its other objective and tasks. The Commission, the Council, the European Parliament and the Member States may request the European Court of Justice ('ECJ') to review the legality of acts adopted by the ECB producing legal effects vis-à-vis third parties (Article 263 TFEU). As long as such a judicial challenge is not made, the ECB is autonomous in its decision whether its operations conform with its mandate. And, supposing there is a judicial challenge, the ECJ may be expected to respect the independence of the ECB as it generally upholds the discretion of the Commission and the Council when taking decisions in complex economic questions. I consider it likely that the ECJ will do the same in respect of decisions of the ECB.

c) *Judicial challenges of ECB operations*

The extraordinary measures of the ECB, notably the widening of the eligibility criteria for collateral and the Securities Market Programme ('SMP')<sup>38</sup>, have already led to a direct challenge before the General Court by an individual. *Herr Städter*, a German national, raised the invalidity of the contested measures as contrary to Articles 123-125 TFEU, which contain three basic prohibitions of EMU law: on monetary financing, on privileged access of public authorities to financial institutions, and the 'no bail-out' clause. He did so five days after the period to challenge a legal act had lapsed for the latest of the several measures he attacked. The Court rejected his complaint on this procedural ground without

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<sup>36</sup> One may argue that, by thus reducing their gold holdings to assist Member States in issuing bonds and, ultimately, repaying their debt, the NCBs do indirectly finance governments. I do not consider such an operation to be contrary to Article 123 TFEU, or to Article 21.1 ESCB Statute which copies this Treaty provision. A reduction of assets in the context of a facilitation of government borrowing does not constitute a prohibited overdraft, credit facility or direct purchase of government bonds. Bringing gold outside the ambit of the central banks in order for it to be used as collateral does not go against the spirit of this provision, either.

<sup>37</sup> See, e.g., the ECB's Opinions on the reform of the Dutch deposit guarantee scheme (CON/2011/60 and CON/2011/76), and its Opinions on the rules on the distribution of *Lietuvos bankas'* profit (CON/2011/91 and CON/2011/99). In the latter, the ECB stated that "any transfer of national central bank (NCB) resources to a Member State, either in the form of a profit distribution scheme or any equivalent form, needs to comply with the limitations imposed in this respect by the Treaty, in particular with the principle of central bank independence pursuant to Article 130 of the Treaty, and with the prohibition on monetary financing laid down in Article 123(1)". These and further strictly worded ECB Opinions are to be found at: <http://www.ecb.europa.eu/ecb/legal/opinions/html/index.en.html> (accessed 31 October 2012).

<sup>38</sup> See footnote 9 above.

going into the question of standing<sup>39</sup>. The Court was not moved by the plea that these decisions were still being applied. Since the complainant had not indicated the specific execution measures that he had wanted to be declared invalid, the Court considered the time-bar for claims concerning the invalidity of legal acts of a public order nature in order to safeguard the clarity and security of legal situations (“*d’assurer la clarté et la sécurité des situations juridiques*”). The case is on appeal before the ECJ (Case C-102/12 P).

Other judicial challenges come via an indirect route: that of proceedings for a preliminary ruling. Natural and legal persons may seek to address the legality of acts adopted by way of crisis management through national judicial channels and, through the preliminary ruling procedure, arrive at the ECJ. Under references for a preliminary ruling, the ECJ can interpret EU law and rule on the validity of acts of EU “institutions, bodies, offices or agencies” (Article 267 TFEU). Assuming a legal venue for interested parties at national level through which they can access a national court with a challenge of measures taken in connection with the crisis, the national court *may* (in the case of the highest court that is competent to adjudicate on this matter in a Member State: *should*) refer the issue of validity or interpretation to the ECJ. Thus, parties may be able to circumvent the limited direct access to the ECJ. Two such indirect challenges have appeared thus far. One of these concerns a German eurosceptic think tank (Europolis)<sup>40</sup> that is reported to have requested the German Constitutional Court to refer the legality under EU law of the European Stability Mechanism (‘ESM’)<sup>41</sup> to the ECJ<sup>42</sup>. The other case originates with the Irish Supreme Court<sup>43</sup>. It directly addresses the compatibility of the ESM with the ‘no bail-out clause’ and also encompasses wider questions. Among these is the legal validity of adopting crisis measures in the form of intergovernmental acts in an area of exclusive competence of the EU (monetary union is an exclusive EU competence for the Member States that have adopted the euro). The Irish Supreme Court also asks where the TFEU assigns particular functions to the EU institutions which are alleged by the claimant to be varied, or enlarged, through the ESM Treaty. In Luxembourg<sup>44</sup>, the reference has been entered as Case C-370/12.

*d) Wide discretion of Union institutions in complex economic decision-making*

In any case before the ECJ, this court may be expected to respect the discretionary powers of the relevant actors at the EU level and not to substitute its assessment for theirs in complex economic decisions. Notably in cases concerning the enforcement of EU competition law, which often lead to judicial challenges of decisions of the Commission, the European judicature imposes self-restraint.

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<sup>39</sup> Judgment of 16 December 2011 in Case T 532/11. Only the German and French versions of this decision are available at the ECJ’s website; see: [www.curia.eu](http://www.curia.eu).

<sup>40</sup> See: <http://www.europolis-online.org/>.

<sup>41</sup> See footnote 7 above.

<sup>42</sup> “Fresh challenge to bailout fund”, *Financial Times*, 14 August 2012, page 6.

<sup>43</sup> *Thomas Pringle v The Government of Ireland, Ireland and the Attorney General*, [2012] IESC 47.

<sup>44</sup> By Order of the President of the Court of 4 October 2012, the ECJ granted the Irish Supreme Court’s request for an accelerated procedure.

This has been a continuous feature of ECJ case law<sup>45</sup>. Referring to a 1985 precedent<sup>46</sup>, the ECJ held in 2009 as follows<sup>47</sup>:

Examination by the Community judicature of the complex economic assessments made by the Commission must necessarily be confined to

- verifying whether the rules on procedure and on the statement of reasons have been complied with,
- whether the facts have been accurately stated

and

- whether there has been any manifest error of appraisal or misuse of powers (underlining added, RS).

As recently as this year, the General Court held as follows in a competition case<sup>48</sup>:

“the Court dealing with an application for annulment of a decision applying Article 81(3) EC [now: Article 101 (3) TFEU, RS] carries out, in so far as it is faced with complex economic assessments, a review confined, as regards the merits, to verifying whether the facts have been accurately stated, whether there has been any manifest error of appraisal and whether the legal consequences deduced from those facts were accurate.”

“It is nevertheless for the Court to establish not only whether the evidence relied on is factually accurate, reliable and consistent, but also whether it contains all the information which must be taken into account for the purpose of assessing a complex situation and whether it is capable of substantiating the conclusions drawn from it. On the other hand, it is not for the Court to substitute its own economic assessment for that of the institution which adopted the decision the legality of which it is requested to review”

(underlining added and references to case law deleted, RS)

Whilst scrutinising the legality of decisions from various angles, both procedural and substantive, the courts will refrain from substituting the Commission’s assessment with their own assessment of complex economic situations. This deference to the executive’s role in taking decisions in complex economic situations extends beyond competition law<sup>49</sup> and can be seen in other areas<sup>50</sup>, as well.

<sup>45</sup> ECJ judgment of 13 July 1966 in Joined Cases 56 and 58/64 (*Consten/Grundig*), [1966] European Court Reports (‘ECR’) 566:

“Furthermore, the exercise of the Commission’s powers necessarily implies complex evaluations on economic matters. A judicial review of these evaluations must take account of their nature by confining itself to an examination of the relevance of the facts and of the legal consequences which the Commission deduces therefrom. This review must in the first place be carried out in respect of the reasons given for the decisions which must set out the facts and considerations on which the said evaluations are based.” ([1966] ECR page 347; underlining added, RS).

<sup>46</sup> Case 42/84 *Remia and Others v Commission*, [1985] ECR 2545, paragraph 34

<sup>47</sup> Judgment of 7 January 2004 in Case C-204/00 P (*Aalborg Portland*), [2004] ECR, I-00123.

<sup>48</sup> Judgment of the General Court of 24 May 2012 in Case T-111/08 (*MasterCard*), not yet reported (‘nyr’). This decision is under appeal before the ECJ as Case C-382/12 P.

<sup>49</sup> Where a seminal judgment concerning concentration review held as follows (ECJ’s judgment of 15 February 2005 in Case C-13/03 P (*Tetra Laval*), [2005] ECR I-01113):

“Whilst the Court recognises that the Commission has a margin of discretion with regard to economic matters, that does not mean that the Community Courts must refrain from reviewing the Commission’s interpretation of information of an economic nature. Not only must the Community Courts, *inter alia*, establish whether the evidence relied on is factually accurate, reliable and consistent but also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it. Such a review is all the more necessary in the case of a prospective analysis required when examining a planned merger with conglomerate effect.”

(paragraph 39; underlining added, RS)

<sup>50</sup> See, e.g., the ECJ’s judgment of 18 March 1974 in Case 78/74 (*Deuka*), [1974] ECR 422, or its judgment of 14 February 1990 in Case C-350/88 (*Société française des Biscuits Delacre*), [1990] ECR I-395, both decisions concerning agricultural policy. And, in yet another area, paragraphs 61 and 62, and the case law referred to therein, of the judgment of the Court of First Instance [now: General Court] of 13 July 2006 in Case T-413/03 (*Shandong Reipu Biochemicals*), [2006] ECR II-02243 concerning trade law.

*e) Additional financial-stability mandate supportive of operations in current crisis*

The ECB's mandate extends to the stability of the financial system<sup>51</sup>. This means that the ECB and NCBs can also act in the interest of financial stability. If such action requires use of gold or other reserves, they are free to take decisions in respect of gold.

*f) Wide discretionary powers of Governing Council should remain within EMU limits*

In my view, the Governing Council has considerable discretion in its decision-making on how to achieve the Union interests it is called to serve. This discretion is especially wide in the context of the current crisis. The law accepts that extraordinary circumstances may warrant measures that would not have been undertaken in a more normal situation. However, even then, the basic parameters of the constitution of EMU may not be breached. This means that any measures or operations should arguably be in the interest of the pursuit of the objectives with a reasonable balancing of multiple objectives. Disagreement among reasonable actors, as has ostensibly been the case with respect to the question whether the ECB can establish an SMP or engage in Outright Monetary Transactions ('OMT')<sup>52</sup>, does not invalidate the ECB's course of action. Even with high-profile dissent amongst its ranks, I would consider the outcome of the Governing Council's deliberations on the required action in the current crisis beyond the risk of annulment by the ECJ as the Union's highest court will most likely accept the discretion of economic policy-making actors.

*g) Wide discretionary powers of Governing Council extend to level of gold holdings*

As the primary carrier of the responsibility "to ensure the performance of the tasks entrusted to the ESCB", the Governing Council has wide discretion in deciding whether the gold holdings of the Eurosystem are sufficient to be reduced in the context of debt servicing by one or more euro area Member States and on the methods of achieving this outcome.

*h) Equal treatment, and monetary income (and profit) distribution issues likely to play a role*

Considerations of equal treatment and coherence of the Eurosystem may very well come into play when the use of gold is envisaged for some Member States only. Any consequences on the distribution of monetary income of the Eurosystem, and/or on the distribution of profits, would also weigh heavily.

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<sup>51</sup> Article 127 (5) TFEU, cited in footnote 15 of this memorandum. See, also, Article 3.3 ESCB Statute. The ECB's financial stability mandate has of late been reinforced by the use of Article 127 (6) TFEU with the adoption of Regulation No. 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the ESRB: see footnote 3 above. The preamble of this regulation states: "As it is the task of the ESRB to cover all aspects and areas of financial stability, the ECB should involve national central banks and supervisors to provide their specific expertise. The option to confer specific tasks concerning policies relating to prudential supervision upon the ECB provided for by the Treaty on the Functioning of the European Union should therefore be exercised, by conferring on the ECB the task of ensuring the Secretariat to the ESRB." See, also, Regulation (EU) No 1092/2010 mentioned in footnote 3 above.

<sup>52</sup> See footnote 9 above.

As indicated in the introductory section, these issues have not been studied and do not form part of this memorandum. Let me confine myself to stating that it would seem likely that using gold as collateral for the joint issuance of Eurobonds may prove less difficult than permitting one or several NCBs to reduce gold holdings for individual State debt issuance.

6. The provision that “the official foreign reserves” of the Member States are held and managed by the Eurosystem

a) *Basic presumption: all public holding of gold within the Eurosystem*

The Treaty clearly assumes that all official foreign reserves are held and managed by the NCBs of the participating Member States or by the ECB, with the sole exception of foreign-exchange working balances by Member State governments. The presumption is that gold held by the central banks forms part of the official foreign reserves of the ESCB.

b) *This presumption would undermine purposes of official foreign reserves, notably gold*

However, this reading of the Treaty as implicitly prohibiting gold holdings by Member States does not do justice to the purposes of official foreign reserves. These constitute claims on the outside world which should be available for international transactions and in times of emergency. Gold has a public interest function<sup>53</sup>. An interpretation according to which the Treaty would ban any use of gold, under the appropriate safeguards against monetary financing and fully respecting central bank independence, for legitimate Member State purposes (or for lawful Union purposes, for that matter) would undermine the role of official foreign reserves and be self-defeating. In effect, the Treaty would then recognise the role of official foreign reserves but deny their usefulness in times of need. My preferred, teleological interpretation would allow gold, or other reserves, to be used for the purposes for which they are generally considered to be held.

c) *Treaty does not predetermine level of foreign official reserves (including level of gold)*

Moreover, by assuming all official foreign reserves to be held by the central banks (with the exception of foreign-exchange working balances that remain with governments), the Treaty does not

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<sup>53</sup> Reference is made to the decision of the Belgian Constitutional Court, mentioned in section 2 f) of this memorandum that official reserves are subject to the implementation of official functions. Further reference is made to the answer of the Dutch Minister of Finance to a parliamentary question, as gold fulfilling a function as ultimate reserve and anchor of confidence in times of crisis. In October 2011, the Dutch Minister of Finance answered in reply to questions on the function of gold that (unofficial translation): “DNB (*De Nederlandsche Bank*, the Netherlands Central Bank, RS)’s physical stock of gold fulfils a function as ultimate reserve and anchor of confidence in times of crisis. A further consideration for keeping gold is diversification of reserves.” The original Dutch text of the answer is as follows:

*De fysieke goudvoorraad van DNB vervult in tijden van financiële crisis een functie als ultieme reserve en vertrouwensanker. Verder wordt goud aangehouden uit diversificatieoverwegingen.*

See the questions of Socialist Party MP Mr. Ewout Irrgang of 19 September 2011 and the answers given by Minister of Finance Jan-Kees de Jager on 6 October 2011, available at: <http://www.rijksoverheid.nl/documenten-en-publicaties/kamerstukken/2011/10/06/beantwoording-kamervragen-goudvoorraad-dnb.html> (accessed on 31 October 2012).

predetermine the exact level of such reserves. The Treaty certainly permits the Eurosystem, as holding and managing of the foreign official reserves, to decide on the appropriate level of such reserves. Since the Treaty assumes these reserves to be “of” the Member States, such decisions should be taken in conjunction with the Member States, acting through the Council, or the Eurogroup. Thus, a decision may be made to transfer gold, or other assets, if the Eurosystem, acting in full independence, considers this conducive to the performance of its functions.

*d) A fortiori: if transfer is permitted, so is a pledge*

Deducing from this finding, one comes – a fortiori – to the following conclusion: if gold can be transferred – in appropriate circumstances and under adequate safeguards for the independent decisions of the Eurosystem in the context of the performance of its tasks – thus reducing the level of official foreign reserves, using it as collateral would also be permitted.

*e) This reasoning finds support in predominant interpretation approach of ECJ*

Furthermore, the ECJ favours an interpretation of EU law which gives useful effect to provisions (‘*effet utile*’ case law). Interpreting EMU law in a way that would prevent official foreign reserves, including gold, from being used effectively would defeat rather than serve the purposes of the Treaty authors.

*f) Urgency of current crisis argues in favour of this outcome, as well*

Moreover, I consider the urgency and necessity of the present-day situation a valid argument to tilt the interpretation of the Treaty which, admittedly, presumes gold to be held by central banks independently and not held by governments for debt issuance, to favour such use under the circumstances. Compliance with the prohibition of monetary financing (which I assume to require that gold be taken from NCB balance sheets first) and with the independence of the central banks (which requires that decisions on the use of gold are taken independently by the Governing Council of the ECB) is a prerequisite.

*g) Additional argument: pledging gold would not be not inflationary*

My preferred interpretation would be underpinned by the knowledge that gold will not be used for inflationary purposes, since all State governments are under strict scrutiny of the Excessive Deficit Procedure (‘EDP’) and the Stability and Growth Pact (‘SGP’) whose effectiveness have been enhanced by the strengthened economic governance measures adopted (the so-called ‘six-pack’<sup>54</sup> and the so-called Fiscal Compact Treaty<sup>55</sup>). This safeguard permits an interpretation of the Treaty provisions which might otherwise be considered by some to go against the intentions of its authors.

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<sup>54</sup> See footnote 4 above.

<sup>55</sup> TSCG; see footnote 8 above.

7. Common, no national decision-making on pledging gold – EU law takes precedence

a) *ECB should decide on use of gold as pledge in State borrowing*

The above sketch of the legal situation makes clear that it is not up to the Governments of the individual Member States, whether acting alone or together, to decide on the use of gold as collateral. Any such decision is to be taken by the Governing Council of the ECB, even when gold held at an individual NCB is concerned<sup>56</sup>. The ECB may decide that the performance of its tasks requires, in the current circumstances, that gold be used, ultimately, as collateral by the governments of one or more Member States. As said, this may require transferring such gold, and possibly gold holdings linked to several other Member States<sup>57</sup>, thus diminishing the gold holdings of the Eurosystem in order to prevent central banks while pledging gold themselves directly financing governments that fail to repay debt.

Any pledge of gold by a Member State does not rest with its Government<sup>58</sup>, or its central bank, but would have to result from decision-making at the EU level, notably within the Governing Council of the ECB. As said, I consider the Governing Council to have ample discretion. The Governing Council has a wide discretion to act in the interest of its mandate, and may independently decide which operations and measures serve its price stability and financial stability objectives. I consider the risk of an adverse ECJ decision annulling a decision which can reasonably be said to serve these objectives, and the secondary objective of supporting the Member States' economic policies, to be very low.

b) *Unilateral decisions on gold would meet Commission and ECB powers under TFEU*

No Member State can decide autonomously on using 'its' gold as collateral for the issue of public debt. Should national governments do so unilaterally, they would be confronted with the Commission and/or the ECB acting to preserve the application of EU law.

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<sup>56</sup> Please note, that I use the word "at" instead of "by": even though formal legal title to gold may be held by the individual NCBs, their membership of the ESCB implies that 'their' gold forms part of the official foreign reserves of the Member States that are collectively, and independently, held and managed by the Eurosystem in the interest of the performance of its functions.

<sup>57</sup> This additional remark relates to the unequal distribution of gold holdings among Member States and the influence of any gold sales on the monetary income of the ESCB, and its distribution. These issues have not been studied in the context of this memorandum.

<sup>58</sup> The ECB is adamant that third parties do not have any discretion in respect of the reserves entrusted to the Eurosystem. See, e.g., what it remarks in its 2012 Convergence Report: ““(…) any right of a third party – for example, the government or parliament – to influence an NCB’s decisions with regard to the management of the official foreign reserves would be inconsistent with the third indent of Article 127(2) of the Treaty [the provision entrusting the Eurosystem with the task to hold and manage the official foreign reserves of the Member States].” (emphasis added, RS). See: <http://www.ecb.europa.eu/pub/convergence/html/index.en.html> (accessed 31 October 2012).

*c) Commission as guardian of Union law*

The Commission could act against a Government pursuant to its task as guardian of the Treaty, requesting the ECJ to issue an injunction against such a measure (Article 279 TFEU). Ultimately, a finding by the ECJ that a Member State would have breached its obligations under the Treaty (pursuant to a procedure set out in Articles 258 and 260 TFEU) may lead to this Member State being imposed a lump sum or a penalty payment by the ECJ upon a request by the Commission.

*d) ECB as guardian of NCB's observance of EMU law and ECB's advisory function*

The ECB is in a similar position vis-à-vis the NCBs of Member States to uphold their obligations under the TFEU or the Statute: it may request the ECJ to find that an NCB has failed its obligations under Treaty or Statute (Article 271 (d) TFEU) should it have acted unilaterally in respect of its gold. Any government exploring unilateral action in respect of gold would be confronted from the outset with the incompatibility of its proposed measure with EU law. Article 127 (4) TFEU and implementing legislation<sup>59</sup> require it to consult the ECB beforehand on draft legislation within the ECB's field of competence<sup>60</sup>. Holding and managing official foreign reserves (including gold) are one of the "basic" tasks of the ECB. Thus, the ECB would have to be consulted on draft national legislation concerning the use of gold as collateral. This consultation should allow the ECB sufficient time to adopt an Opinion that can still be taken into account by the national legislator<sup>61</sup>. The ECB's

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<sup>59</sup> Council Decision 98/415/EC of 29 June 1998 on the consultation of the ECB by national authorities regarding draft legislative provisions, Official Journal of the EC L 189/42, 3 July 1998. This legal act requires that any draft legislation in respect of the NCBs be submitted for advice to Frankfurt. Wider still, any draft within the field of competence of the ECB is to be submitted to it in advance.

<sup>60</sup> The ECB is adamant that it be consulted well in advance. In a recent Opinion, it stated: "(...), even in cases of extreme urgency national authorities are not relieved from their duty to consult the ECB and to allow sufficient time to take the ECB's views into account as laid down in Articles 127(4) and 282(5) of the Treaty". In this case, the ECB was consulted after a Decree-Law had been adopted by the Government but before Parliament was to decide on its conversion into law. Since Italian Decree-Laws are valid legal acts after adoption by the Government, the ECB harshly concludes as follows: "Consulting the ECB after the submission of the Decree-Law to Parliament for its conversion into law is not sufficient to comply with the abovementioned obligation; rather, this is tantamount to a non-consultation of the ECB." In a footnote, the ECB refers to the legal consequences of non-consultation which may include "proceedings before the relevant courts, where the validity of a legal act on which the ECB should have been, but was not, consulted may be challenged". See the Opinion of the European Central Bank of 16 March 2012 on Italy's participation in International Monetary Fund programmes in response to the financial crisis (CON/2012/20), at: <http://www.ecb.eu/ecb/legal/opinions/html/index.en.html> (accessed on 31 October 2012).

<sup>61</sup> As the ECB remarked in another recent Opinion, "The second sentence of Article 4 of Decision 98/415/EC provides that the ECB must be consulted 'at an appropriate stage' in the legislative process. This implies that the consultation should take place at a point in the legislative process that affords the ECB sufficient time to examine the draft legislative provisions and to adopt its opinion in all required language versions, and also enables the relevant national authorities to take the ECB's opinion into account before the provisions are adopted. Article 3(4) of Decision 98/415/EC obliges Member States to suspend the process of adoption of draft legislative provisions pending receipt of the ECB's opinion." In this particular instance, the ECB concluded that the Italian Ministry of Economic Affairs and Finance "failed to comply with the consultation obligation". See the Opinion of the European Central Bank of 13 February 2012 on the management of liquidity in the Treasury accounts at the *Banca d'Italia* and the selection of counterparties for related operations (CON/2012/9), at: <http://www.ecb.eu/ecb/legal/opinions/html/index.en.html> (accessed on 31 October 2012).

views on the encumbrance of financial independence of NCBs are known from previous occasions<sup>62</sup>. It can be counted on to strongly disagree with unilateral measures that would affect the gold held and managed by NCBs.

*e) Precedence of Union law*

Since EU law gives clear authority to the Eurosystem to decide on the use of official foreign reserves – including gold – of the Member States that have adopted the euro, any national measure that deviates from this or that undermines the effectiveness of the independent holding and management of these reserves would be overridden by Union law. This follows from the precedence of Union law over State law<sup>63</sup>. Furthermore, national bodies and courts would be bound to uphold Union law and not to apply any contrary national law.

8. Treaty change

A long-term avenue open to advocates of the use of gold as collateral would be Treaty change. Since amendments to the Treaty are being called for in the context of stronger economic governance, even though some of the required changes are brought about through other venues than Treaty change<sup>64</sup>, Treaty change is ‘in the air’. Convincing governments<sup>65</sup> to adopt an amendment which would specifically allow pledging of gold may be difficult but feasible, leading to a Treaty provision that gold pledges are permissible with ECB consent. Since the use of gold held by the Eurosystem as collateral without violating the prohibition of monetary financing seems an intractable issue, a specific exemption from this prohibition for the limited purposes of use of gold as collateral would be needed. Barring such an outcome, the transfer of gold in advance of its pledge to creditors seems the only viable option, as said. Such a transfer would bring gold outside the Eurosystem and, thus, beyond the restriction on independent holding and management by the ECB and the NCBs. It should result from

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<sup>62</sup> Reference is made to the ECB’s 2010 Convergence Report which contains a passage on the gold holdings by the Latvian government, rather than the central bank (see text accompanying footnote 33 in this memorandum) and to Opinion of the European Central Bank of 14 July 2009 on the taxation of the *Banca d’Italia’s* gold reserves (CON/2009/59). In this Opinion, the ECB held, rightly in my view, that taxing the unrealised profits on gold (its actual value exceeding the original book value) did not comply with the principle of central bank independence (currently, Article 130 TFEU) nor with the prohibition on monetary financing (currently Article 123 (1) TFEU).; see:

[http://www.ecb.europa.eu/ecb/legal/pdf/en\\_con\\_2009\\_59\\_it\\_taxation\\_of\\_banca\\_ditalias\\_gold.pdf](http://www.ecb.europa.eu/ecb/legal/pdf/en_con_2009_59_it_taxation_of_banca_ditalias_gold.pdf). (accessed 31 October 2012)

<sup>63</sup> *Costa vs. Enel* (Case 6/64), judgment of the ECJ of 15 July 1964, [1964] ECR 585. See, also, the ECJ’s Opinion 1/91 (*EEA Agreement*), 14 December 1991, [1991] ECR I-6079.

<sup>64</sup> I refer to the establishment of temporary (European Financial Stability Facility, EFSF) and permanent (European Stability Mechanism, ESM) frameworks for the granting of financial assistance through means other than the adoption of provisions on the basis of the Treaty, or by Treaty change (international agreements, private-law mechanisms) and the adoption of the inter-governmental ‘Fiscal Compact’ Treaty (officially: TSCG); see footnotes 6, 7 and 8 above.

<sup>65</sup> It is the governments of the 27 Member States that are “*Herren der Verträge*” (“masters of the treaties”) but the process of adopting major amendments involves the Commission and the European parliament, as well as the ECB (Article 48 Treaty on European Union, or ‘TEU’). So, the convincing should extend beyond national capitals to Brussels, Strasbourg and Frankfurt. Resulting Treaty changes have to be ratified by all 27 Member States, in several among these by referendum.

an independent finding that gold holdings can be reduced, based on a finding that gold may be held outside the Eurosystem as part of the assets of Member States or their debt agencies. This course of action, that I consider open to the Eurosystem and the euro area Member States in the current crisis, would ideally be underpinned by amended Treaty language permitting this explicitly.

By way of example, Article 127 (3) TFEU, and the concomitant provision in the ESCB Statute (Article 3.2)<sup>66</sup>, may be amended as follows:

“The third indent of paragraph 2 [*and*: of Article 3.1 ESCB Statute] shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances, or to the holding and management of gold by the governments of Member States, or their individual or joint debt agencies, for use as collateral in the context of the issuance of debt instruments.”<sup>67</sup>

One may consider linking this exception to a reinforcement of fiscal discipline by adding language that such collateral may only be given for debt issuance which is in accordance with the applicable fiscal prudence provisions. Thus, a Member State could only use gold as collateral for as long as it stays within the bounds of the deficit and debt caps contained in the EDP, the SGP and the TSCG (“Fiscal Compact” Treaty). One could envisage the Commission and the ECB having to agree beforehand on this requirement being met. Advancing gold as collateral while at the same time reinforcing budgetary discipline will make the proposition more attractive to reluctant players. The same holds for schemes to issue Eurobonds<sup>68</sup>.

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<sup>66</sup> The third indent of paragraph 2 [of Article 3.1 ESCB Statute] reads as follows:

“[T]he basic tasks to be carried out through the ESCB shall be: (...)

— to hold and manage the official foreign reserves of the Member States, (...).”

<sup>67</sup> The proposed text permits joint issue of Eurobonds by the reference to “their joint debt agencies”. If a debt agency were to be established as an EU body rather than the ESM, different wording would have to be chosen.

<sup>68</sup> See the recent proposal for the issuance of Euro Bills by an expert group in which I participated: *The ELEC “Euro T-Bill Fund”*, at: <http://renesmits.eu/publications/> or <http://www.grahambishop.com>.

9. *Summary conclusions*

Individual Member States are not free to use gold as collateral. ‘Their’ gold is held and managed by their NCBs, or has been transferred by the latter to the ECB, in the context of their membership of the Eurosystem. The Eurosystem holds and manages gold independently in the interest of the achievement of its objectives: first and foremost price stability and, as a secondary objective, the support of the economic policies in the Union. The Eurosystem further has a contribution to make to the stability of the financial system. The recent establishment of the European Systemic Risk Board (‘ESRB’)<sup>69</sup> strengthened the Eurosystem’s responsibility for systemic (financial) stability. In my opinion, an interpretation of EU law that gold, and other reserve assets, have a public function to be used, certainly in the current crisis, is to be preferred. Should the Eurosystem’s holdings of gold exceed its long-term needs, this finding may result in a decision to reduce these holdings, the gold transferred to Member State governments to be used as collateral for their debt issuance. Even this option would require a wide reading of the Treaty as permitting public gold to be held and managed outside the central banking system as the Treaty only envisages *foreign exchange* working balances to be held by governments, not *gold*. The prohibition of direct government financing by central banks would be the most likely obstacle – use of gold as collateral may require it to be transferred in advance to national debt issuance agencies<sup>70</sup>. My preferred interpretation of the Treaty does not read this assumption as an absolute bar against the use of gold as collateral by individual governments or jointly in case of the issue of Eurobonds. This is consistent with the ECJ’s ‘*effet utile*’ interpretation of Community (Union) law. Treaty change is the best venue to secure legal certainty in respect of the use of gold as collateral.

Hoofddorp, The Netherlands, European Union, 31 October 2012

Professor René Smits

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<sup>69</sup> See footnotes 50, 16 and 3 above.

<sup>70</sup> Or to a euro area debt issuing agency in case of envisaged joint issuance of Eurobonds.