COVID-19 and the European Central Bank: The Legal Foundations of EMU as the Next Victim?

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The spread of Covid-19 has done little less than brought the Eurozone economy to its knees. The Eurozone is projected to be in a deep recession by the end of 2020 with some of its most vulnerable economies being the worst affected by the virus outbreak. Such a crisis demands that economic institutions utilize their full weaponry. In response to the crisis, the Council agreed to the suspension of the zone's normal debt and deficit limits, anticipating a far more active fiscal stance from European governments. As in the last Eurozone crisis, the ECB has also played a major role. After a week of hesitancy over how to intervene, the ECB announced on the 18th of March an ambitious further roll-out of its asset purchase programme (the 'Pandemic Emergency Purchase Programme' or PEPP), promising to invest up to 750 billion euro in Eurozone asset and debt instruments. The initial impact of the proposed measures was promising. While the outbreak of Covid-19 in Europe had prompted increasing divergences between bond yields in affected European states (reminiscent of the 2011 Euro crisis), the announcement seemed to reverse this trend, effectively lowering interest rates on Italian v German debt within hours.

Below, we will attempt both to highlight the (in)consistencies between the new PEPP programme and existing EU law, and to point to some alternative ways forward given the legal impasse over the powers of the ECB in responding to the COVID-19 crisis. As we will argue, the PEPP programme signals both the increasing redundancy of the legal framework governing EMU and an opportunity to develop a new one in its place.

ECB restricted by the legal framework in times of crisis

The legal difficulty behind the PEPP programme is that its ability to bolster more vulnerable economies questions its very legality under EU law, at least as far as the legality of the ECB's quantitative easing (QE) programmes has been understood by Europe's highest Courts in recent years. This relates to a larger paradox of the law governing EMU: the institution within EMU with the greatest capacity to support the Eurozone economy in times of crisis, the ECB, is repeatedly restricted in its ability to do so by the applicable legal framework.

The ECB's ability to legally defend QE programmes depends both on their necessity in light of the bank's price stability mandate and observable limits regarding their effects on broader economic policy. Earlier ECB programmes, such as the Outright Monetary Transactions (OMT) and Asset Purchase Programme (APP) schemes, were judged by the CJEU to be Treaty consistent only on the basis of a number of pre-conditions. In *Gauweiler*, the CJEU set out the necessary safeguards against the circumvention of Article 123(1) TFEU (the prohibition on monetary financing) when the ECB is purchasing bonds: (1) a lack of certainty must exist concerning whether, when, which, and for how long the purchases will be made; (2) the buying programme must not disincentivize Member States from following a sound budgetary policy; (3) holding purchased bonds until maturity is allowed only as long as the market operators cannot be certain that this option will be used; and (4) the risk to which the ECB is exposed must be mitigated by the condition of compliance with the European Stability Mechanism financing, attached to potential purchases.

These safeguards have been of particular importance to the German Constitutional Court.

The current COVID-19 programme poses challenges regarding each of these criteria. In terms of the first, PEPP signals a drastic increase in the volume of ECB purchases: according to one recent analysis almost 68% of new Italian debt is likely to be purchased under the programme. While governments and investors, therefore lack complete certainty that particular bonds will be purchased, they are hardly in the dark either. In terms of the other criteria, PEPP leaves out any reference to conditionality, explicitly waiving previous requirements for the purchase of Greek debt under QE. It also loosens the requirements for eligibility of purchases (while maintaining the rough allocation of purchases according to the 'capital key' of national central banks).

More important may be the long-term signaling implicit in this announcement: the PEPP press release ends by announcing that the ECB 'is fully prepared to increase the size of its asset purchase programmes and adjust their composition, by as much as necessary and for as long as needed'. The Bank therefore retains the possibility of reviewing the size of its purchase programmes, their scope and length. This includes a promise to revisit 'some self-imposed limits' which might hamper action necessary for the ECB to fulfil its mandate. This approach is clearly at odds with the relevant case law. As much as the case law diverges on particular points, it converges on one point: limits on the ECB's activities in the economic domain are not 'self-imposed' but follow from the Treaty itself and the principle of conferral (or of enumerated competences) it represents. The press-release's wording thus casts legitimate doubt over whether the ECB takes into account possible legal requirements and/or barriers in its decision-making.

Karlsruhe's three choices

Procedurally, the CJEU is presently not in a position to review the new PEPP programme as it has not yet been legally challenged. However, the second Senate of the German Constitutional Court fortuitously decided on March 16th to delay by 2 months its response to the CJEU's most recent *Weiss judgment* on QE, thus leaving open the possibility to glance over the characteristics and features of the PEPP programme. Karlsruhe had already indicated in its jurisprudence an increasing skepticism that ECB activity on QE was consistent with the principle of conferral and hence with the democratic rights of the *Bundestag* in the field of budgetary policy. This skepticism raised the possibility that future QE programmes could be deemed *Ultra Vires* by the German Court. What had been – with the ECB winding down its previous APP programme – largely hypothetical, could now become a ruling of existential importance for the Eurozone's future.

A showdown between the demands of the Eurozone economy in times of crisis and the current legal framework governing EMU thus seems likely. The German Court will have before it three choices when ultimately issuing its *Weiss* decision (the following is subject to the constitutional role of the German Court and its limits). First, it can disregard the PEPP programme entirely and not take it into account at all on procedural grounds. In this context, it will merely address the CJEU's reply concerning *Weiss* and will make some general conclusions on what is a tolerable use of the ECB's mandate under the Treaties. The second option for the German Court is to address it cursorily in the context of the pandemic, thereby putting forward some opinion concerning the current context and whether it at all influences the scope of ECB action. The first two options share the latent acceptance of the severity of the present situation, as well as agreeing with the CJEU's reply from *Weiss*.

The final option for the German Court is to openly assess both the Public Sector Purchase Programme and the PEPP according to the established criteria in the case law (most recently with *Weiss*). If that does indeed take place, it is difficult to see how the PEPP, as announced, may meet the criteria from *Gauweiler*, and comply with the prohibition of monetary financing and the maintenance of a sound budgetary policy by the EU's Member States. It may well be that the German Court adds conditions to German participation in such programmes, or transfers the responsibility to determine German participation to the

Bundestag. This would initiate a period of uncertainty as to Germany's involvement in the PEPP, and other QE programmes of the ECB. In any event, we can observe an increasing disconnect between what the ECB is doing, and what the courts have been interpreting it can do within the confines of its mandate. This means that the back and forth between the ECB, the CJEU and the German Court may have reached the limits of its usefulness. This suggests a need to explore possible alternatives.

How to reconcile PEPP with existing EU law

The 'fit' between the criteria above and the features of the PEPP (at least as far as we can understand them from the few details we now have) suggest severe difficulties with reconciling PEPP with existing EU law. This does not mean, however, that the PEPP is likely to be judicially struck down. One possibility is that – given the gravity of Europe's public health crisis – no judicial challenge is raised. Another is that PEPP will comfortably survive judicial review. The CJEU is notoriously generous when reviewing the proportionality of measures adopted by the EU institutions – it has tended to give the ECB a particularly large margin of discretion. If part of the job of the EU Courts is to 'limit' in some way the EU's executive institutions, the CJEU has tended in its monetary policy case law to accept limits on ECB activity of *any kind*, however remote and hypothetical, as demonstrating the necessity of ECB programmes (or has simply not engaged in the 'necessity' element of the proportionality test). In so far as PEPP contains limitations on its overall size and could be terminated by the Bank at a time of its choosing, it is also limited in a formal sense. In short, the CJEU found creative ways to find OMT and APP legal, developing relatively open and expansive tests. There is thus plenty of room to judicially endorse the PEPP too.

Even if the CJEU were to endorse the PEPP, however, a crucial question remains: How did it all come to this? Why are some of Europe's highest Courts now in a position where they have to make this choice, i.e. to either act as apologist for increasing transgressions of the spirit of EMU rules, or to enforce the rules plainly but in doing so prompt potential economic catastrophe? The logical solution is to recognize that the rules governing EMU need reform (or at least need to be interpreted differently). Three possible routes present themselves.

The first is to re-visit the current definition of the ECB's Treaty mandate. As is well known the Bank carries a primary mandate focused on price stability and a secondary mandate to support the Union's general economic policies. The narrowness of the Bank's mandate is meant to focus its tasks: in reality, it forces the ECB to obfuscate its activities by demanding that all major programmes are justified first and foremost under a price stability lens. What this distinction fails to understand – as repeatedly pointed out by the EU Courts – is the close inter-dependency of monetary and broader economic policy. Achieving price stability depends on broader economic conditions just as larger fiscal stability is highly affected by monetary decisions. A mandate more reflective of the realities of the ECB's role in the wider structure of EMU would be one important step in avoiding the legal quagmire. At the very least, the endless need for the ECB to link every economic intervention back to the monetary transmission mechanism (insisting that effects on the general economy are merely 'secondary') should be ended at the quickest opportunity.

If this route of Treaty change is too far-fetched, a second route is to use the more traditional legal toolbox and to simply re-interpret the way the rules governing EMU are understood. While the PEPP's abandonment of conditionality may be legally problematic, it is only so because of the strict reading given to Treaty provisions seemingly designed to avoid fiscal irresponsibility and moral hazard on the part of the Member States (particularly Art. 123(1) and 125 TFEU). As pointed out by others, the CJEU has here been the architect of some of its own difficulties, essentially elevating austerity conditionality to the level of a constitutional requirement. Rather than pretend that broad interventions such as the PEPP do not alter the Treaty mandated incentive to ensure sound budgetary policy, the EU Courts might consider whether Art. 123(1) and 125 should be read in light of other Treaty

provisions. The principle of solidarity and to promote social justice and cohesion is also a Treaty objective; one that could be used to balance and re-formulate what 'sound' budgetary policy means in times of economic emergency. In short, the PEPP (if brought before the EU Courts, or indeed before Karlsruhe) could present an opportunity to re-consider how the Chapter of the Treaty on economic policy is interpreted.

A final route would be to leave the existing substantive rules surrounding EMU in place but allow greater political accountability and control of ECB activity. One of the more unnerving aspects of PEPP (at least for lawyers) is the form in which it was established. Like some of its predecessors, PEPP is essentially a programme of 750 billion euro (some 5 times the EU's annual budget and significantly greater than the Greek bail-outs) instigated by a press release (not to mention by an intentionally electorally unaccountable institution). While there are good reasons to respect the ECB's operational independence, one may question whether its increasing forays into more general economic policy require greater political control. One possibility, for example, would be for certain decisions (of a particular dimension or in relation to the secondary mandate) to require a larger decision-making threshold within the Bank's governing council. Another would be to heed the concern of national constitutional Courts that national Parliaments are increasingly undermined by the Union's executive institutions by building a yellow-card procedure for ECB programmes akin to that applicable to the Commission under the subsidiarity protocol. These measures would again require Treaty change but would have the effect of providing greater legitimacy to the acts of an institution whose increasing power has not gone hand in hand with greater legal and political control.

Re-thinking the legal and political accountability structure of the Eurozone

Most readers would agree, as we do, that action by the ECB to face this crisis is urgent and necessary. Surely then it tells us something that the applicable legal framework is not a facilitator of the activity needed to bolster EMU but instead a burden. COVID-19 may yet provide the much-needed impulse to re-think the legal and political accountability structure of the Eurozone. To do so, however, the conflicts between PEPP and the existing legal structure need to be both recognized *and* remedied.

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