Passive and Unequal: The Karlsruhe Vision for the Eurozone

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27.05.2020 doi: 10.17176/20200528-013331-0

1. The decision of the *Bundesverfassungsgericht* (BVerfG) on the European Central Bank's PSPP program did not come as a shock. All the critical arguments of that decision can be found explicitly or implicitly in the BVerfG's referral to the Court of Justice of the EU on 18 July 2017. The CJEU replied through the preliminary ruling of 11 December 2018 (*Weiss and Others*, C-493/17).

2. The real object of the decision of the BVerfG is the economic governance of the Eurozone or rather the big bet of European solidarity and European integration, in the midst of a pandemic even. These are all of particular interest to Greece, which has acted as a lever of pressure and as a laboratory to test new institutions of economic governance and even quantitative easing.

3. The reasoning of the BVerfG tries to make itself appear as simple. The principle of proportionality (points 124-157), together with the principle of subsidiarity, is, in accordance with Article 5 TEU, the criterion for determining the competences of the Member States and the Union. Therefore, the competences of the Union, its institutions and bodies must not be exercised unless it is appropriate and necessary. When the limit of the principle of proportionality is not respected, EU competence shall be exercised in excess of power, *ultra vires*. *Ultra vires* control shall be exercised on the basis of the principle of conferred (from Member States to the EU) competences (point 158), explicitly provided for in Article 5 TEU, which introduces (according to the BVerfG logic) a presumption of competence in favour of the Member States. This control ensures – according to this logic – the equality among Member States and the respect towards their national identity which is in line with their fundamental political and constitutional structure, as provided for in Article 4 TEU.

4. Who has contributed in this case to excess of power, according to the logic of BVerfG? The BVerfG holds that this is double *ultra vires*, through actions and through omissions. The ECB is operating *ultra vires* due to its initiatives in the field of monetary policy that enter into the field of economic policy. The CJEU does because it is satisfied with a marginal judicial review of these actions in a methodologically lacking way.

5. The irony is that, in the name of equality among Member States, a blow is inflicted to the institutional equality between the Member States. The exceeding of the competence of the EU is ascertained by one of the 27 national constitutional or supreme courts, while the rest may have a completely different view. In fact, the question if we are outside the scope of the legal order of the EU can, as a question of international law, only be resolved by all the High Contracting Parties in accordance with the Vienna Convention on the law of treaties (VCLT), not unilaterally. After all, the Member State in question is not represented internationally by its national constitutional court, but by the bodies of its executive.

6. Perhaps for this reason the BVerfG interlaces *ultra vires* control with the control of respect for the national constitutional identity (points 98-105), in accordance with the provision and therefore in application of Article 4 TEU. However, in my opinion, the national constitutional identity should refer to a specific institutional feature. The distinction between the monetary policy pursued by the ECB/ESCB and the economic policy pursued by the Member States applies equally to all EU Member States and is not a specific element of the German constitutional order. Accepting

the view that there are differences in sensitivities among Member States in matters of democratic principle, popular sovereignty, parliamentary competences over state budgets would be risky and precarious for the democratic and legal foundations of the EU and for the equality of Member States. All these are common elements and not a German constitutional feature, such as e.g. the constitutional regulation of the relationship between the State and religious entities or the constitutional protection of the limitation period as an institution of substantive criminal law.

7. There is also a second issue of general theory of constitutional law and fundamental principles of EU law stemming from the judgement of the German Constitutional Court: According to the BVerfG (in particular point 142), in the common European constitutional and judicial tradition, the judicial review of acts of independent authorities in the field of monetary policy must be exercised in all its depth and breadth by the competent court which, in the frame of the EU institutional system, is the CJEU. According to the BVerfG, this is a constitutional tradition, common among Member States and therefore a fundamental principle of EU law (Article 6 (3) TEU), especially when the competent body, e.g. the ECB, is independent and lacks democratic legitimacy. If the judicial control exercised by the CJEU is marginal, i.e. exercised only in case of an obvious breach of EU law, this, according to the BVerfG, violates a general principle of EU law resulting from the common constitutional traditions of the Member States, i.e. that the national courts exercise intensive judicial control of the actions of independent bodies such as central banks.

Thus, the BVerfG turns judicial activism in complex technical monetary policy issues into a general principle of European law which it derives from common constitutional traditions. But if there is a common tradition, it is judicial self-restraint in the control of technical assessments, including monetary policy decisions, where this is still practised at national level. According to the BVerfG, when the CJEU does not apply the methodological conception of the German Constitutional Court, it does not act as an institution of the EU, so it moves *ultra vires*. That is why the CJEU decision in the *Weiss* case is denounced as incomprehensible and irrational.

8. All this, of course, begins with the fact that we have a Monetary Union without an Economic Union. This creates a perpetual friction with regard to the allocation of powers, because monetary policy – a key instrument of economic policy – is exercised by the ECB, while economic policy – without the instrument of monetary policy, but using the remaining instruments (such as fiscal policy) – is exercised by the Member States which also claim their remaining sovereignty. The monetary policy is being implemented at Union level, in spite of the great economic and budgetary disparities between the Member States of the Eurozone.

9. Which gets us to the point: Can economic policy be clearly distinguished from monetary policy? The path taken by CJEU case law between the *Pringle* and the *Weiss* Decision essentially shows that this is largely impossible. There is no monetary policy that does not have economic implications and *vice versa*. There is an obvious centre of gravity, though. On the contrary, according to the BVerfG (cf. in particular point 139), incidental economic implications of monetary policy are one thing. Having monetary policy (as is the case with the PSPP) set central economic policy objectives with implications relating to a chain of issues is another, such as interest rates, stock values, real estate values, bank deposit interest yields, the stability of commercial banks, the stability of central banks, the financing conditions of the Member States, the ability of financing non-viable enterprises at low interest rates.

In my view, the main axis of thought of the BVerfG in the decision of 05 May 2020 is the following: In 2012, in the *Pringle* case, the CJEU ruled that the field of operation was that of economic policy, in 2015 in the *Gauweiler I* case that it was that of monetary policy, and now the BVerfG is offering its own ruling concerning the field: The principle of proportionality requires the ECB to provide a precise and detailed explanation of what constitutes economic policy and what constitutes monetary policy, as well as why the burden of its acts on quantitative easing falls within

the boundaries of monetary policy and therefore it has competence over it. The ECB is obliged, according to the BVerfG, to delimitate monetary policy interventions if they impact economic policy decisively and on a wide scale. According to the BVerfG, the program of quantitative easing, at its start in 2015, may not have caused any issues, but after three, four, five years, when it has exceeded 2 trillion EUR and it is on the way to reach 2.5 trillion, it will have affected all aspects of the economy. It does not just seek to achieve an inflation rate below 2%, but close to that, in line with the ECB's basic institutional purpose. It affects the entirety of economic policy.

10. The ECB does nothing more than what all central banks of major economies that are competitive to the EU, like the US Federal Bank, do. Unfortunately, the European Union has imposed on itself irrational institutional arrangements leading to misinterpretations such as the decision of the BVerfG.

11. The BVerfG calls on the Federal Government and the Federal Parliament (cf. in particular point 232) to act politically and legally in order for the ECB/ESCB to comply with the decision. Additionally (points 234-235), the *Bundesbank* must wait three months for the additional documentation of the PSPP's proportionality on part of the ECB/ECSC, but as of now it must arrange an exit strategy from the quantitative easing program in cooperation with the ECB. All this takes place on 05 May 2020, when it is known that the "pandemic" quantitative easing program PEPP is beginning.

12. After all, who will judge whether or not the ECB/ESCB has within the transitional period of three months complied with the requirements for additional documentation and justification based on the criteria of the principle of proportionality? The Federal Government and the Federal Parliament? The *Bundesbank*? The CJEU? The BVerfG itself through a new constitutional appeal? A new constitutional appeal will probably be lodged against the Pandemic Emergency Purchase Program (PEPP).

13. What has happened is a new Deauville. On 18 October 2010, as soon as the first Greek support program was launched, President Sarkozy and Chancellor Merkel, on the sidelines of a meeting with President Yeltsin in Deauville, made the infamous statement that Eurozone countries should not borrow at the same interest rates. Each country has to borrow on the basis of its fundamental economic elements and its own risk. Germany cannot have the same interest rates and returns as Greece. And thus they destroyed the first Greek bailout program.

We may be in danger of a repeat of this situation now. What the BVerfG is essentially saying is that it does not make sense to facilitate the refinancing of Member States' debt. This is an artificial valuation of their bonds on the secondary market of QE. In fact, the same can be done for commercial companies that receive low interest rates while being "zombies". According to the BVerfG, the major risk is the banking system. In order for the QE mechanism to work, states issue bonds. The commercial banks of the Member States buy the bonds (primary market). The commercial banks of the Member States resell them to the central bank system. The central banks buy them. Thus, the BVerfG says that the central banks are now exposed to this market volume of 2.5 trillion, which is accounting money, at virtually low interest rates, even with negative returns and with an obligation to hold them until maturity.

In fact, the BVerfG expresses a strong distrust towards quantitative easing. It believes that quantitative easing gives some advantages to economically weaker and less competitive Member States. That is why the objections began with OMT (Outright Monetary Transactions), which was a program for the "bad guys". It was a program only for Greece, Ireland, Portugal, Cyprus. Also, OMT was never implemented. It's a theoretical program, it worked as a threat. The PSPP, as applied now, does not include Greece. The applicants had also challenged the act on the eligibility of the Greek bonds of 2016, but in reality they did not make the Greek bonds eligible. They become eligible now with the Pandemic Emergency Purchase Program.

14. The main financial argument of the BVerfG is that, although it is not explicitly stated, it is clear that we do not have a truly secondary market here, we have a virtual secondary market. Essentially, according to

the BVerfG, the market through PSPP is primary. Countries issue their bonds and their commercial banks buy them because they know they will in turn sell them to the Eurosystem.

15. It is rather easy to contradict and respond to the financial analyses and assumptions of the BVerfG, by referring to the internationally prevalent practices of central banks. The question is how and to whom the answer will be given so as not to disturb the institutional structure of the EU. What will come next largely depends on how the *Bundesbank* will behave within the ECB and the European System of Central Banks (point 235). In my opinion, a trap has been created: How should the ECB, the European Commission and the Council react? Will an infringement procedure be initiated against Germany? When should this be done and what effects will it have?

16. On 18 May the joint Franco-German proposal by President Macron and Chancellor Merkel was presented. It concerns a recovery plan from the economic crisis caused by the Covid-19 pandemic, worth € 500 million and financed through the issuance of bonds by the European Union itself in the context of multi-year fiscal planning. Can it be perceived as a first actual and clear answer to the decision of the BVerfG?

One reading is that this proposal is a step forward, towards the "common debt" and the issuance of Eurobonds. Political as well as legal objections are already being voiced from Member States (Austria and the Netherlands) and in Germany (by Friedrich Merz, a candidate for CDU leadership and the succession of Chancellor Angela Merkel). A relevant constitutional appeal to the BVerfG is possible.

The other reading is that with this plan, the economically and fiscally more robust Member States, which function as net contributors, avoid contributing additional funds to the EU budget. The EU borrows directly as an entity, the same way as the EIB and the ESM. There is not even the need for Member States to function as guarantors, since the existing budget of the EU itself is a guarantee. Therefore, the joint proposal seems to be a step in the right direction, towards the common debt and the Eurobond even. However, it is actually a means of avoiding additional charges and transfers from the Member States that are net contributors to the EU. Institutional symbolism, nevertheless, may be seen as being more important than economic substance. We will see relatively soon, how the German Constitutional Court, which wanted to enter the field of economic policy that belongs primarily to the democratically legitimate and responsible political leadership, responds to these new questions.

17. The final control over almost everything in the European Union lies with the Council and the European Council, because critical issues are dealt with intergovernmentally and through political negotiation. The European Council cannot therefore remain on the fence in this issue. The legal actions and the financial arguments are all well and good, but in the end the project of European integration is a historic bet which must be made and won by those who lead a Europe that is being tried and tested in every field possible.

18. The decision of the German Constitutional Court essentially promises a Union that is financially passive in the context of international economy and economically unequal within itself. This is a dangerous concept, not only economically, but also socially, since European societies are insecure, tired and demanding, above all politically, and the first objective should be to protect European liberal democracy against the threats of ideological, political and economic nationalism-populism.

On 05 May 2020, a mine has been set in the institutional and monetary foundations of the EU, and we have to see if it can be defused immediately, so that it stops lurking there, poisoning the EU's functioning and prospects.

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SUGGESTED CITATION

Venizelos, Evangelos: Passive and Unequal: The Karlsruhe Vision for the Eurozone, Verfassungsblog, 27.05.2020, doi: 10.17176/20200528-013331-0.

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Langzeitarchiviert bei IntRechtDok unter: doi.org/10.17176/20200528-013331-0.