

Newsalert

Europe first: the judgment of the German Federal Constitutional Court on the Public Sector Purchase Programme (PSPP) of the European Central Bank (ECB) and the reply of the EU Institutions



In its judgment of 5 May 2020, the Second Senate of the German Federal Constitutional Court (*Bundesverfassungsgericht*) granted several constitutional complaints directed against the Public Sector Purchase Programme (PSPP) of the European Central Bank (ECB). The Court found that the Federal Government and the German Bundestag violated the complainants' rights under Art. 38(1) first sentence in conjunction with Art. 20(1) and (2), and Art. 79(3) of the Basic Law (*Grundgesetz – GG*) **by failing to take steps challenging that the ECB**, in its decisions on the adoption and implementation of the PSPP, neither assessed nor substantiated that the measures provided for in these decisions satisfy the principle of proportionality. In the related press release the Federal Constitutional Court clarified that the decision at issue **does not concern** any financial assistance measures taken by the European Union or the ECB in the context of the **current coronavirus crisis**.

I Facts of the case

The PSPP is part of the Expanded Asset Purchase Programme (EAPP), a framework programme of the Eurosystem for the purchase of assets on financial markets. The EAPP is meant to **increase money supply** and intended to support consumption and investment spending in the euro area and ultimately contribute to **achieving an inflation target of below, but close to, 2%**. The ECB launched the PSPP with its decision of 4 March 2015, which was later amended by five subsequent decisions. Under the PSPP, the Eurosystem central banks – subject to the framework set out in detail in the ECB decisions – purchase government bonds or other marketable debt securities issued by central governments of euro area Member States, by ‘recognised agencies’ and international organisations or by multilateral development banks located in the euro area. The PSPP accounts for the largest share of the EAPP’s total volume. As of 8 November 2019, the total value of the securities purchased under the EAPP by the Eurosystem amounted to EUR 2,557,800 million, including purchases under the PSPP in the amount of EUR 2,088,100 million.

The complainants’ constitutional complaint is that the PSPP violates the prohibition of monetary financing (Art. 123 TFEU) and the principle of conferral (Art. 5(1) TEU in conjunction with Art. 119, Art. 127 et seq. TFEU). The Federal Constitutional Court referred a request for a preliminary ruling to the CJEU, under Art. 267 TFEU. In particular, the questions submitted to the CJEU concerned the prohibition of monetary financing of Member State budgets, the monetary policy mandate of the ECB, and a potential encroachment upon the Member States’ competences and sovereignty in budget matters. In the judgment delivered on 11 December 2018 (*Weiss and Others*, C-493/17), the CJEU maintained that the PSPP neither exceeded the ECB’s mandate nor violated the prohibition on monetary financing, so confirming the **validity** of Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme, as amended by Decision (EU) 2017/100. Following the CJEU ruling, the Federal Constitutional Court held an oral hearing in Karlsruhe on 30 and 31 July 2019.

II The judgment of the German Federal Constitutional Court

The German Federal Constitutional Court’s judgment included the following findings.

1) EU law interpretation and application

The Federal Constitutional Court found that, in light of Art. 119 and Art. 127 et seq. TFEU as well as Art. 17 et seq. European System of Central Banks (ESCB) Statute, the ECB Governing Council’s Decision of 4 March 2015 (EU) 2015/774 and the subsequent Decisions (EU) 2015/2101, (EU) 2015/2464, (EU) 2016/702 and (EU)

2017/100 must be qualified as *ultra vires* acts, despite the CJEU's judgment to the contrary.

While the Federal Constitutional Court must review substantiated *ultra vires* challenges regarding acts of institutions, bodies, offices and agencies of the European Union, the Treaties confer upon the CJEU the mandate to interpret and apply the Treaties and to ensure uniformity and coherence of EU law (cf. Art. 19(1) TEU, Art. 267 TFEU). According to the Federal Constitutional Court's established case-law, it is imperative that the respective judicial mandates be exercised in a coordinated manner. If any Member State could readily invoke the authority to decide, through its own courts, on the validity of EU acts, this could undermine the precedence of application accorded to EU law and **jeopardise its uniform application**. Yet if the Member States were to completely refrain from conducting any kind of *ultra vires* review, they would grant EU organs exclusive authority over the Treaties even in cases where the EU adopts a legal interpretation that would essentially amount to a treaty amendment or an expansion of its competences. Although cases where EU institutions exceed their competences are exceptionally possible, one can expect such instances to be rare due to the institutional and procedural safeguards enshrined in EU law. Nevertheless, where they do occur, the constitutional perspective might not perfectly match the perspective of EU law given that, even under the Lisbon Treaty, **the Member States remain the 'Masters of the Treaties'** and the EU has not evolved into a federal state. In principle, certain tensions are thus inherent in the design of the European Union; they must be resolved in a cooperative manner, in keeping with the spirit of European integration, and mitigated through mutual respect and understanding. This reflects the nature of the European Union, which is based on the **multi-level cooperation** of sovereign states, constitutions, administrations and courts.

The interpretation and application of EU law, including the determination of the applicable methodological standards, primarily falls to the CJEU, which in Art. 19(1) second sentence TEU is called upon to ensure that the law is observed when interpreting and applying the Treaties. The methodological standards recognised by the CJEU for the judicial development of the law are based on the **(constitutional) legal traditions common to the Member States** (cf. also Art. 6(3) TEU, Art. 340(2) TFEU), which are notably reflected in the case-law of the Member States' constitutional and apex courts and of the European Court of Human Rights. The mandate conferred on CJEU in Art. 19(1) second sentence TEU is exceeded where the traditional European methods of interpretation or, more broadly, the general legal principles that are common to the laws of Member States are manifestly disregarded. As long as the CJEU applies recognised methodological principles and the decision it renders is not arbitrary from an objective perspective, the Federal Constitutional Court must respect the decision of the CJEU even when it adopts a view against which weighty arguments could be made.

2) The principle of proportionality and the principle of conferral

In its judgment of 11 December 2018, the CJEU held that the Decision of the ECB Governing Council on the PSPP and its subsequent amendments were still within the ambit of the ECB's competences. The Federal Constitutional Court's judgment is that

this view manifestly fails to give consideration to the importance and scope of the **principle of proportionality** (Art. 5(1) second sentence and Art. 5(4) TEU) – which applies to the division of competences between the European Union and the Member States – and is untenable from a methodological perspective given that it completely disregards the actual economic policy effects of the programme.

The CJEU's approach to disregard the actual effects of the PSPP in its assessment of the programme's proportionality, and to refrain from conducting an overall assessment and appraisal in this regard, does not satisfy the requirements of a comprehensible review as to whether the ESCB and the ECB observe the limits of their monetary policy mandate. Applied in this manner, the principle of proportionality (Art. 5(1) second sentence and Art. 5(4) TEU) cannot fulfil its corrective function for the purposes of safeguarding the competences of the Member States, which renders meaningless the **principle of conferral** (Art. 5(1) first sentence and Art. 5(2) TEU).

Moreover, by completely disregarding all **economic policy effects** arising from the programme, the judgment of 11 December 2018 contradicts the methodological approach taken by the CJEU in virtually all other areas of EU law. It fails to give effect to the function of the principle of conferral as a key determinant in the division of competences, and to the methodological consequences this entails for the review as to whether that principle is observed.

Therefore, the interpretation of the principle of proportionality undertaken by the CJEU, and the determination of the ESCB's mandate based thereon, exceed the judicial mandate conferred upon the CJEU in Art. 19(1) second sentence TEU. With **self-imposed restraint**, the CJEU limits its judicial review to whether there is a "manifest" error of assessment on the part of the ECB, whether the PSPP "manifestly" goes beyond what is necessary to achieve its objective, and whether its disadvantages are "manifestly" disproportionate to the objectives pursued. This standard of review is by no means conducive to restricting the scope of the competences conferred upon the ECB, which are limited to monetary policy. Rather, it allows the ECB to gradually expand its competences on its own authority; at the very least, it largely or completely exempts such action on the part of the ECB from **judicial review**. Yet for safeguarding the **principle of democracy** and upholding the legal bases of the European Union, it is imperative that the **division of competences** be respected.

3) The Federal Constitutional Court's assessment

In light of the aforementioned considerations, the Federal Constitutional Court finds that it is not bound by the CJEU's decision but must conduct **its own review** to determine whether the Eurosystem's decisions on the adoption and implementation of the PSPP remain within the competences conferred upon it under EU primary law. As these decisions were made on the basis of insufficient proportionality considerations, they exceed the ECB's competences.

A programme for the purchase of government bonds, such as the PSPP, that has significant economic policy effects requires that the programme's **monetary policy objective** and **economic policy effects** be identified, weighed and balanced against one another. By unconditionally pursuing the PSPP's monetary policy objective – to achieve inflation rates below, but close to, 2% – while ignoring its economic policy effects, the ECB manifestly disregards the principle of proportionality.

In the decisions at issue, the ECB fails to conduct the necessary balancing of the monetary policy objective against the economic policy effects arising from the programme. Therefore, the decisions at issue violate Art. 5(1) second sentence and Art. 5(4) TEU and, in consequence, **exceed the monetary policy mandate of the ECB**. It would have been incumbent upon the ECB to weigh the considerable economic policy effects and balance them, based on proportionality considerations, against the expected positive contributions to achieving the monetary policy objective the ECB itself has set. It is not ascertainable that **any such balancing was conducted**, neither when the programme was first launched nor at any point during its implementation. Unless the ECB provides documentation demonstrating that such balancing took place, and in what form, it is not possible to carry out an effective judicial review as to **whether the ECB stayed within its mandate**.

To the extent that the CJEU concludes in its judgment of 11 December 2018 that the PSPP does not violate Art. 123(1) TFEU, the manner in which it applies the “safeguards” developed in its Gauweiler judgment raises considerable concerns because it neither subjects these “safeguards” to closer scrutiny nor does it test them against counter indications. Nevertheless, the Federal Constitutional Court accepts the CJEU’s findings as binding in this respect, given the real possibility that the ECB observed the “safeguards” set out by the CJEU, which means that, **for now, a manifest violation of Art. 123(1) TFEU is not ascertainable**.

The approach taken by the CJEU may render some of these “safeguards” largely ineffective in practice; this is true, for instance, with regard to the prohibition of prior announcements, the blackout period, the holding of bonds until maturity and the requirement to decide on an exit strategy. Nonetheless, the determination whether a programme like the PSPP manifestly circumvents the prohibition in Art. 123(1) TFEU is not contingent on a single criterion; rather, it requires an overall assessment and appraisal of the relevant circumstances. Ultimately, **a manifest circumvention of the prohibition of monetary financing is not ascertainable**.

It is not ascertainable that the PSPP violates the constitutional identity of the Basic Law in general or the overall budgetary responsibility of the German Bundestag in particular. In light of the volume of bond purchases under the PSPP, which amounts to more than two trillion euros, a risk-sharing regime between the ECB and the national central banks, at least if it were subject to (retroactive) changes, would affect the limits set by the overall budgetary responsibility of the German Bundestag, as recognised by the Federal Constitutional Court’s case-law, and be incompatible with Art. 79(3) GG. However, **the PSPP does not provide for such a risk-sharing regime** – which would also be impermissible under primary law – in relation to bonds of the Member States purchased by the national central banks.

4) The orders to German competent authorities

Based on their responsibility with regard to European integration (*Integrationsverantwortung*), **the Federal Government and the German Bundestag have a duty to take active steps against the PSPP** in its current form:

- i. in the event of a manifest and structurally significant exceeding of competences by institutions, bodies, offices and agencies of the European

Union, the German constitutional organs must, within the scope of their competences and the means at their disposal, actively **take steps seeking to ensure adherence to the European integration agenda** (*Integrationsprogramm*) and respect for its limits, work towards the rescission of acts not covered by the integration agenda and – as long as these acts continue to have effect – take suitable action to limit the German domestic impact of such acts to the greatest extent possible;

- ii. based on their responsibility with regard to European integration (*Integrationsverantwortung*), the Federal Government and the Bundestag are required to take steps seeking to ensure that the ECB conducts a **proportionality assessment**. This applies accordingly with regard to the reinvestments under the PSPP that began on 1 January 2019 and the restart of the programme as of 1 November 2019. In this respect, the Federal Government and the Bundestag also have a **duty to continue monitoring** the decisions of the Eurosystem on the purchases of government bonds under the PSPP and use the means at their disposal to ensure that the ESCB stays within its mandate;
- iii. German constitutional organs, administrative authorities and courts may participate **neither in the development nor in the implementation, execution or operationalisation** of *ultra vires* acts. Following a transitional period of **no more than three months** allowing for the necessary coordination with the Eurosystem, the Bundesbank may thus **no longer participate** in the implementation and execution of the ECB decisions at issue, unless the ECB Governing Council adopts a **new decision** that demonstrates in a comprehensible and substantiated manner that the monetary policy objectives pursued by the PSPP **are not disproportionate** to the economic and fiscal policy effects resulting from the programme. For the same reason, the Bundesbank must ensure that the **bonds** already purchased and held in its portfolio **are sold** based on a – possibly long-term – strategy coordinated with the Eurosystem.

III Institutional reactions in Europe and in Germany

The judgment of the Court is very controversial and can seriously **undermine the unity of the EU legal order**. This explains why some of the main institutions involved in the ruling of the Federal Constitutional Court have formally taken a position on this issue and namely:

- on the same day as publication of the German Federal Constitutional Court's judgment, 5 May – by means of a press release – the ECB clarified that the Institution "takes note" of that judgment regarding the PSPP and that the

Governing Council remains fully committed to doing everything necessary within its mandate to ensure that inflation rises to levels consistent with its medium-term aim and that the monetary policy action taken in pursuit of the objective of maintaining price stability is transmitted to all parts of the economy and to all jurisdictions of the euro area. The ECB also points out that the Court of Justice of the European Union ruled in December 2018 that the ECB is acting within its price stability mandate;

- still on the 5 May the **Bundesbank** President declared that in its judgement, the Federal Constitutional Court highlights important features of the PSPP which, overall, ensure a sufficient safety margin to monetary financing of governments and reaffirms to have indicated the importance of this margin in the past. Finally, he also declared that while respecting the independence of the ECB's Governing Council, he will support efforts to meet the requirement concerning the proportionality of the programme to be demonstrated by the Governing Council of the ECB within a period of three months;
- on 8 May the **Court of Justice of the European Union** issued a press release. Although pointing out that it does not usually comment on a judgment of a national court, the CJEU restates that its preliminary rulings are binding on national courts, as well as for all national institutions and bodies. In order to ensure the uniform application of EU law, the CJEU alone – which was created for that purpose by the Member States – is entitled to rule on the validity of acts adopted by EU institutions. Divergences between national courts as to the validity of such acts would indeed be liable to place in jeopardy the unity of the EU legal order and to detract from legal certainty. Like other authorities of the Member States, national courts are required to ensure that EU law takes full effect. That is the only way of ensuring the “equality of Member States in the Union they created”. The Court concludes pointing out that the Institution will refrain from communicating further on the matter;
- the President of the **Bundestag** (and former Minister of Finance of Germany) also spoke about the decision of the German Constitutional Court, saying that this ruling represents a threat to the future of the common currency. He considers it very likely that the existence of the euro will now be called into question in other EU member states, if each national constitutional court can decide for itself, concluding with an invitation to all Member States to carry out all the political manoeuvres necessary to succeed in strengthening the European Union;
- even the former President of the **European Commission** criticized the German judges for breaking with the assessment of the EU's top court declaring that for the first time in the EU's jurisprudence history, a national jurisdiction has openly attacked the European jurisdiction and adding that the decision could lead other countries to ignore the Luxembourg-based court as well. In his view, we will come to realize in the coming years what a grave mistake the decision of the German Constitutional Court was, unless it is corrected;

- last, but not least, the President of the EU Commission, Ursula von der Leyen, has taken a clear and resolute stance. In the statement released on 10 May 2020, the President highlights three points: (a) *“that the Union's monetary policy is a matter of exclusive competence”*; (b) *“that EU law has primacy over national law and that rulings of the European Court of Justice are binding on all national courts”*; (c) that *“the final word on EU law is always spoken in Luxembourg. Nowhere else”*. Significantly, the President adds a conclusive remark that sounds as a clear warning message: *“We are now analysing the ruling of the German Constitutional Court in detail. And we will look into possible next steps, which may include the option of infringement proceedings. The European Union is a community of values and of law, which must be upheld and defended at all times. This is what keeps us together. This is what we stand for”*.

IV What's next?

1) The implication of the German Federal Constitutional Court's ruling

The Federal Constitutional Court ruled that the Public Sector Purchase Programme (PSPP) does not finance States and therefore respects the Treaty prohibition against the monetisation of national public debts but gives a **three-month ultimatum to the ECB** to have an understandable and proven proof that the billions of euros spent on buying government bonds were necessary. Germany is the richest member of the Eurozone and its central bank has the most money in the ECB. It is therefore easy to imagine that this decision will have a follow-up.

The roots of the German Court's position lie in two rulings of 1993 and 2009 on the Treaty of Maastricht and the Treaty of Lisbon, respectively. The Karlsruhe Court had already dealt with the ECB's first programme (the OMT, which remained on paper) and censored the overlap of economic policy and monetary policy. In the case of the OMT, however, the initial assessment of unconstitutionality was then translated into a substantial green light for the programme, following the preliminary opinion of the CJEU and the clarifications offered by the ECB. Therefore, while the German Court could have been expected to reiterate once again the need for a rigorous assessment of compliance with the limits of the ECB's mandate, the German Court was not expected to be so aggressive and to go so far as to expressly censure the CJEU's actions by reprimanding it for its shallow control of the ECB's decisions, to the point of declaring the CJEU's judgment to be *ultra vires* and thus *'tamquam non esset'*. This is a real (unprecedented) attack against the Luxembourg Court by an apex court of one of the founding countries of the EU, which undoubtedly gives rise to a worrying *vulnus* to the principles of loyal cooperation which should govern the 'dialogue' between courts within the European Union, all the more so given that the CJEU's opinion in the case at issue was requested by the German Court and that the former has no opportunity to reply, at least within the same proceedings. Hence the caustic but firm press release of the CJEU referred to in the previous section. In addressing the German Court, the CJEU thus seeks to speak also to the courts of other countries in an attempt to prevent similar 'leaps forward'.

2) Ball passes to the ECB

According to the Federal Constitutional Court, it would be up to the ECB's Governing Council to **demonstrate** in a comprehensible and proven manner that the monetary policy objectives pursued by the programme have been **proportionate** to its powers and have not encroached on the pursuit of economic policy, which would be beyond the powers of the ECB. In doing so, the ECB will have to make an interpretative effort, although not necessarily according to the questionable (even in terms of the appropriateness of the economic analysis) parameter the Federal Constitutional Court would like to impose on it. In the light of the German ruling, should ECB fail to demonstrate those requirements, the Bundesbank will probably have to withdraw from the purchasing plan. Therefore, the ECB can (and must) carry out **monetary policy** but not **economic policy**. But who is going to decide when this boundary is overstepped? This is a major issue since the decision could also impact on the **Pandemic Emergency securities Purchasing Programme (PEPP)**: 750 billion euros from March to at least 31 December 2020 or at least for the duration of the **coronavirus crisis**. The PEPP does not foresee for the moment the reinvestment of government bonds, a **"thorny" point** for the Federal Constitutional Court (the reinvestment in fact extends beyond the end of the purchase programme the holding of government bonds in the ECB portfolio). The Federal Constitutional Court has hastened to point out that its judgment does not concern the PEPP, but who can rule out the possibility that the results to which the heated debate on the PSPP will lead will also indirectly affect the PEPP?

As explained above, the position taken by the Federal Constitutional Court is creating a serious fracture in the institutional balance between the EU and the Member States. By summoning an EU Institution to justify its conduct before a domestic judge – as important as it might be – and by threatening irreversible legal consequences in case of unsatisfactory justifications, the German Court is substantially undermining the basic tenets of the EU legal system. The EU Commission appears to be fully aware of the institutional implications stemming from the German judgement, as well as of the risk that other Member States could rely on it in order to disregard (or circumvent) EU rules and principles. Ultimately, this could lead to an unprecedented institutional confrontation within the Union. The firm position taken by President von der Leyen is a clear warning message in this respect. This is all the more important considering that on 9 May 2020 the Union celebrated the 70th anniversary of the Schuman Declaration.

For further details, please reach out to your usual Chiomenti contact.

Contacts

Gian Michele Roberti

Partner – Chiomenti
EU Law Department
T. +39.06.46622.508
gianmichele.roberti@chiomenti.net

Giulio Napolitano

Of Counsel – Chiomenti
Administrative Law Department
T. +39.06.46622.706
giulio.napolitano@chiomenti.net

Isabella Perego

Partner - Chiomenti
Eu Law Department
T.+32 (0)2 5127731
isabella.perego@chiomenti.net

Lorenzo Bimbi

Associate - Chiomenti
Administrative Law Department
T. +39.06.466.221
lorenzo.bimbi@chiomenti.net

Stefania Bariatti

Of Counsel – Chiomenti
EU Law Department
T. +39.02.72157.410 - +32.2.7759.900
stefania.bariatti@chiomenti.net
