Institut für Europäische Politik

#BerlinPerspectives

Analysing German European Policy

Judges trigger a Political Break-Through for the Future of the EU

How the Constitutional Court pushed Germany towards financial solidarity

by Ingolf Pernice

- *The PSPP-Judgment of the GFCC is not only violating principles of EU law but also created a serious constitutional dilemma in Germany*
- *It demonstrates that ECB programmes alone cannot be the solution to the crisis before and after COVID-19*
- *The pragmatic reply of the ECB does not exclude that the PSPP and the new PEPP will be accepted by the GFCC*
- *The Franco-German Corona Recovery Proposals are a fundamental break-through: common EU liability coupled with common control allows for financial solidarity*
- *The Recovery Fund might serve as a laboratory for an EMU reform towards democratically controlled EU economic and fiscal policies*
- *The PSPP-ruling of the GFCC contributed to a reform process that might ulimately lead to a more democratic and stable EU*

In May 2020, Germany's Federal Constitutional Court (FCC) ruled that the country's government and the parliament had violated the "right to democracy" of German citizens by failing to meet their responsibility with regard to European integration, for these institutions did not prevent the European Central Bank (ECB) to adopt the Public Sector Purchase Programme (PSPP) without an appropriate proportionality assessment. The PSPP was unveiled in 2015 and foresees the purchase of sovereign bonds, issued by euro area governments, by the respective national central banks and the ECB in order to fight deflation and thereby preserve price stability.

The FCC argued that the ECB, as well as the European Court of Justice in exercising its judicial control over the bank, had acted arbitrarily from an objective perspective and beyond their legal authority. Therefore, their decisions were void and inapplicable in Germany, unless the ECB satisfyingly demonstrated that the PSPP was proportional and therefore justified as a measure of monetary policy. Germany's executive and legislative branches of government consequently found themselves facing a constitutional dilemma: either to violate EU law in putting pressure on the ECB to act by undermining the ECB's political independence or to violate German constitutional law in continuing to apply the PSPP.

While the FCC's ruling was widely seen as a threat to the European Community of law and to democracy, it may have triggered an important move towards a stronger and more democratic EU

In this context, the initiative of Chancellor Angela Merkel and France's President Emmanuel Macron on 18 May 2020 proposing a European recovery plan was a courageous political turn – one for elected leaders to taking responsibility for the economic and political destiny of the EU instead of leaving it to the ECB to rescue the European Monetary Union as was the case for years. The plan, if adopted as proposed, could reach far beyond dealing with the impact of the coronavirus pandemic and serve as a laboratory for a new concept for developing a common economic and fiscal policy and so to bring the architecture of the EMU into the right balance and allow for better parliamentary control.
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Germany's constitutional dilemma

The Federal Constitutional Court placed Germany's government and parliament in a legally and politically impossible position. With a view to protecting and promoting the "right to democracy", which is "enshrined" in the constitutional provision for the right to vote, the Court called on them to take steps to ensure that the ECB conducts a proper proportionality assessment in relation to the PSPP. It set a time limit of three months within which the ECB Governing Council may adopt "a new decision that demonstrates in a comprehensible and substantiated manner that the monetary policy objectives pursued by the ECB are not disproportionate to the economic and fiscal policy effects resulting from the programme". Failing this, the Bundesbank would be bound to stop its participation in the PSPP and sell its portfolio acquired under the programme.

The FCC judgment was heavily criticized by legal experts not only for creating this dilemma but, more importantly, for applying the proportionality principle as a criterion for the delimitation of monetary policy, which is an exclusive EU competence, and economic policy, which remains basically a matter for the member states. This new understanding is contrary to the clear provisions of Article 5 (1) TEU and the established jurisprudence of the ECJ. The FCC applied it without another reference to the European Court of Justice, as it is compelled to do in such a case. As a result, the judgment, which disregards the decisions of the ECB and the judgment of the ECJ, which was handed down without a new reference to the ECJ and which, finally, forces the government and the Bundestag to influence the ECB, is a serious violation of EU law, susceptible to an infringement procedure under Article 258 TFEU.

Yet, the FCC judgement does not only question the PSPP programme, but implicitly threatens the new Pandemic Emergency Purchase Programme (PEPP), which was unveiled in March in response to the severe economic crisis triggered by the COVID-19 pandemic. The PEPP follows the same principle as the PSPP and seeks to keep interest rates on public debt low, and thereby act against a possible effect of the economic downturn. Yet, the ECB Governing Council appears to have taken the PSPP judgment into account, since in section 2 under "Monetary policy stance and policy considerations" of the account of its June Meeting, published June 25, it explained more exhaustively the proportionality considerations of the programs. Consequently, Germany's government and parliament, with its conclusions of 2 July 2020, stated their satisfaction with the ECB's explanations. This does not mean, however, that the FCC would accept these explanations and complainants may still find a way to trigger another ruling in the matter. It is therefore possible that the PEPP will be challenged before the FCC on similar terms as the PSPP was, which could result in the programme impossible to implement.

A new perspective: The EU coronavirus recovery plan

It was probably the ruling of the Federal Constitutional Court on the PSPP, together with the looming uncertainties regarding the PEPP, that brought about a political breakthrough in Germany: It became evident that the ECB alone cannot save the euro, stop the internal market from breaking down or continue to substitute a determined policy response to the crisis born by the spirit of solidarity. It means that the concept of autonomous economic policies of the member states, of budget financing by countries borrowing on the financial markets and of EU convergence by simple policy coordination is not sustainable.

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The door has been opened to a "new deal". Merkel and Macron have agreed to launch a temporary fund of €500 billion for EU budget expenditure as grants, in addition to the package already agreed by the European Council that involves the European Investment Bank, the European Stability Mechanism and the Support to mitigate Unemployment Risks in an Emergency (SURE) scheme. What is new, first, is that – whatever the proportion of grants and loans instead of loans might finally be – part of the money will be spent as direct grants to the affected countries and sectors. Second, the European Commission will be authorized to raise money on the financial markets. Having the recovery fund financed this way and then managed at EU level will end the hopeless debate over Eurobonds. Third, this new approach allows Germany to accept real European financial solidarity, even if limited only to the emergency situation caused by the pandemic.

If the recovery fund were to be agreed along the lines of the plan proposed by the European Commission, a common liability for repayment would be coupled with a common EU management and control of the expenditure. And if the taxes envisaged for the repayment – a carbon tax based upon the Emissions Trading Scheme, a digital tax and a tax on non-recycled plastics – are introduced as new own resources of the EU, this would be an important first step towards a more democratic and sustainable financial structure in the EU.

Given the fundamental interest of Germany, as of the "frugal four" member states, to not only strengthen the euro but also preserve the proper functioning of the internal market, adopting the European recovery plan is not charity or a gift to countries in trouble but a promising step to overcome the crisis – to the benefit of all.

Test case for a concept for a common economic and fiscal policy

Chancellor Merkel's press release of 18 May 2020 regarding the French-German Initiative for the European recovery from the coronavirus crisis refers to the Conference on the Future of Europe. There is indeed a close link between the two, and the recovery plan will give new momentum to the EU reform process. It could serve as a test case or laboratory for gaining experience with and, if successful, further developing a new model for a common EU economic and fiscal policy structure.

Although the reform of the European Monetary Union undertaken in response to the global financial crisis was audacious and effective, it is clear that such emergency measures cannot be a final solution for the imbalance of the EMU architecture. Ensuring convergence of the economic policies of member states, which is needed to support the euro, requires binding decisions and strong guidelines adopted at the EU level under the control of the European Parliament and the national parliaments.

Future experience with the European coronavirus recovery fund, its management and parliamentary control may show that alternatives to the present system are possible. The EU borrowing for specific needs to be determined by law and has to be combined with a drastically augmented budget to be fed by its own resources, including taxation decided and collected at the EU level. Replacing contributions by the member states would ultimately strengthen the solidarity and financial accountability of the EU.

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The principle of "no taxation without representation" is equally valid if reversed. People who know that it is them and not others (states) who pay for the policies to be led by their representatives in Brussels will be more mindful about EU policies and engage in European politics and elections. Thus, the EU would grow into a mature democratic system with responsibilities for the convergence of national economic and fiscal policies on the basis of European taxes to finance its policies end ensure enhanced economic and social cohesion.

The reform discussions may be informed by the proposals submitted by the Five Presidents in 2015, and a Europe-wide online ideas competition should be organized in advance of the Conference on the Future of Europe, under the patronage of the European Council, to provide political leaders with some fresh and original input for the process. Emerging stronger from the crisis was the motto of the Franco-German initiative for a European recovery plan. Those measures proposed by the two countries should be seen as a promising first step on a further-reaching path to be followed.

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