



THE *PSPP* JUDGMENT OF THE GERMAN FEDERAL CONSTITUTIONAL COURT: THROWING SAND IN THE WHEELS OF THE EUROPEAN CENTRAL BANK

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ABSTRACT: After describing the measures adopted by the European Central Bank (ECB) to mitigate the crisis caused by the COVID-19 pandemic in the euro area, the *Insight* focusses on the repercussions of the controversial judgment adopted by the German Federal Constitutional Court (BVerfG) on 5 May 2020. It is contended that the criteria adopted by the BVerfG to assess the consistency of the Public Sector Purchase Programme with the monetary financing prohibition might lead to a future finding that the PEPP programme indeed circumvents the prohibition. While the BVerfG judgment is putting sand in the wheels of the ECB and is exposing the limits of the current legal framework, it might also prompt a leap forward in the European integration process.

KEYWORDS: COVID-19 and the EU – European Central Bank – pandemic emergency purchase programme – German Federal Constitutional Court – PSPP – monetary financing.

I. INTRODUCTION

On 12 March 2020, the day after the WHO Director-General finally defined the outbreak of COVID-19 a pandemic,¹ the European Central Bank (ECB) Governing Council adopted a comprehensive package of monetary policy measures consisting of: *a*) additional longer-term refinancing operations aimed at providing immediate liquidity support to the euro area financial system, *b*) negative interest rates for Targeted Longer-Term Refinancing Operations to stimulate bank lending to households and small and medium

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¹ See WHO Director-General's opening remarks at the media briefing on COVID-19, 11 March 2020, www.who.int.



enterprises, and c) an additional temporary €120 billion financial envelope to broaden private asset purchases.²

Quite unexpectedly though, during the press conference following the announcement of these measures, the ECB President Christine Lagarde affirmed that it was not the ECB's role to narrow the spread in sovereign debt markets: *"this is not the function or the mission of the ECB. There are other tools for that, and there are other actors to actually deal with those issues [read: the European Stability Mechanism]"*.³

The statement left everyone bewildered and comparisons were immediately made with the famous *"whatever it takes"* pronounced by the former President of the ECB Mario Draghi in 2012, at the peak of the European sovereign debt crisis.⁴

Market reaction came without delay, causing Italian sovereign bonds to suffer the biggest single day fall in almost a decade, amid widespread euro area debt market sell-offs.⁵

The fear was that the ECB would retreat from its role of buyer of sovereign bonds at a time when public debt levels were forecast to rise steadily, with spreads already widening (in particular, between Italian and German sovereign bond yields) and financial fragmentation (certainly detrimental to a currency union) spiking.

ECB official declarations to reassure the markets quickly followed, signalling how dire the situation already was and making everyone suddenly aware of the tangible threats that were looming once again over the euro area.⁶

Less than a week later, on 18 March 2020, the ECB decided to launch the new Pandemic Emergency Purchase Programme (PEPP)⁷ covering both private and public sector

² See ECB Press Release of 12 March 2020, *Monetary policy decisions*, www.ecb.europa.eu. The package of measures was welcomed by the Eurogroup on 16 March 2020, see Eurogroup, *Statement on COVID-19 economic policy response*, www.consilium.europa.eu.

³ The ECB President also affirmed "I do not have a claim to history for being whatever-it-takes number two". Press conference of Christine Lagarde, President of the ECB, of 12 March 2020, www.ecb.europa.eu. Among other reactions to Lagarde's press conference, see M. ARNOLD, T. STUBBINGTON, *Lagarde Triggers Investor Jitters as ECB Launches Virus Response*, in *Financial Times*, 13 March 2020.

⁴ The full quotation is *"Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough"* (speech of 26 July 2012 by M. DRAGHI, President of the European Central Bank, at the Global Investment Conference in London, www.ecb.europa.eu).

⁵ Source: M. ARNOLD, M. KHAN, *Five Ways the ECB Can Bolster the Eurozone's Pandemic Firepower*, in *Financial Times*, 30 April 2020.

⁶ See for instance P.R. Lane, Member of the Executive Board of the ECB: "We will not tolerate any risks to the smooth transmission of our monetary policy in all jurisdictions of the euro area. We clearly stand ready to do more and adjust all of our instruments, if needed to ensure that the elevated spreads that we see in response to the acceleration of the spreading of the coronavirus do not undermine transmission" (P.R. LANE, *The Monetary Policy Package: An Analytical Framework*, in *ECB Blog*, 13 March 2020, www.ecb.europa.eu). In addition, see the Eurogroup, *Statement on COVID-19 Economic Policy Response* of 16 March 2020, www.consilium.europa.eu.

⁷ Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17) (hereinafter "PEPP Decision").

securities. In particular, the PEPP is aimed at ensuring that euro area Member States will enjoy low funding costs during the economic disruption triggered by the pandemic.

The PEPP decision was complemented by a package of collateral easing measures.⁸ On 7 April 2020, anticipating a spate of downgrades of credit ratings (sovereign ratings included), the ECB decided to relax the eligibility requirements for marketable assets used as collateral in Eurosystem credit operations as well as for their issuers.⁹ In parallel, the Governing Council of the ECB decided to waive the minimum rating requirement for Greek government bonds.¹⁰

On 22 April 2020, the ECB adopted an additional “grandfathering” decision by which all assets and issuers¹¹ that, at 7 April 2020 met collateral eligibility requirements, will remain eligible until September 2021, even in the face of a deterioration in credit ratings, provided that they remain above a minimum credit quality threshold (i.e. Credit Quality Step 5 on the Eurosystem harmonised rating scale).¹²

A few days later, Fitch downgraded Italy’s sovereign rating from BBB to BBB- (with stable outlook), just above non-investment grade and Credit Quality Step 4.

Notably, the grandfathering decision was not extended to eligibility criteria for outright purchases under the asset purchase (APP) and PEPP programmes.¹³ However, the ECB

⁸ According to Art. 18.1 of the ESCB Statute, the ECB and euro area national central banks (NCBs) can operate in financial markets and provide credit to counterparties only against “adequate collateral”. The assumption is that central banks should only lend against high quality collateral. Collateral requirements are conceived to mitigate credit risk, ensure equal treatment of counterparties and enhance operational efficiency and transparency. Criteria to determine assets adequacy, as well as entities that may act as counterparties in credit operations, are established by two sets of provisions: the ECB General and Temporary Frameworks. The emergency collateral package consists in a set of temporary measures that, as part of the Temporary framework, complement, amend or overrule the General Framework. The Temporary Framework in fact allows the ECB to adopt derogatory measures that may become necessary under exceptional circumstances.

⁹ Decision (EU) 2020/506 of the European Central Bank of 7 April 2020 amending Guideline (EU) 2015/510 on the implementation of the Eurosystem monetary policy framework and Guideline (EU) 2016/65 on the valuation haircuts applied in the implementation of the Eurosystem monetary policy framework.

¹⁰ See ECB announces package of temporary collateral easing measures, in ECB Press Release of 7 April 2020 and Guideline (EU) 2020/515 of the ECB of 7 April 2020 amending Guideline ECB/2014/31 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2020/21).

¹¹ Other than asset-backed securities.

¹² See ECB takes steps to mitigate impact of possible rating downgrades on collateral availability, in ECB Press Release of 22 April 2020 and Guideline (EU) 2020/634 of the ECB of 7 May 2020 amending Guideline ECB/2014/31 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2020/29).

¹³ See recital no. 4, Guideline (EU) 2020/634, cit.

hinted that it was ready to go further following the example of the US Federal Reserve, which had already included “fallen angels”¹⁴ in its corporate bond purchase programme.

Therefore, after initial hesitation, the ECB showed that it was willing to act resolutely, while the Eurogroup and the European Council were struggling to progress on crucial and highly sensitive issues like the increase of EU own resources, the issuance of common European bonds, the reform of the European Stability Mechanism (ESM) and the establishment of a European Recovery Fund.¹⁵

Soon after, though, the German Federal Constitutional Court (*Bundesverfassungsgericht*, hereinafter “BVerfG”) would pour gasoline on the pandemic fire.

As we will see, the decision of the Second Senate of the BVerfG – expected for 16 March 2020 but craftily postponed to 5 May 2020¹⁶ – has thrown sand in the wheels of the ECB and might have serious repercussions on the resilience of the euro area.

After describing the main features of the PEPP, this research will focus on the impact of the BVerfG’s ruling on the ability of the ECB to act in times of crisis.

II. THE PANDEMIC EMERGENCY PURCHASE PROGRAMME (PEPP)

The Pandemic Emergency Purchase Programme (PEPP) is a non-standard monetary policy measure in line with the other non-standard measures adopted by the ECB between 2010 and 2014: the Securities Markets Programme (SMP),¹⁷ the Outright Monetary Transactions programme (OMT)¹⁸ and the package of Asset Purchase Programmes (APP).¹⁹

¹⁴ Is defined “fallen angel” a bond – corporate or sovereign – that has been downgraded from investment grade to a high yield credit rating (junk bond status). This may result from the economic slowdown caused by the pandemic.

¹⁵ See the Letter of Eurogroup President Mario Centeno to the President of the European Council following the Eurogroup of 24 March 2020, www.consilium.europa.eu.

¹⁶ German Federal Constitutional Court, judgment of the Second Senate of 5 May 2020, 2 BvR 859/15, 2 BvR 1651/15, 2 BvR 2006/15, 2 BvR 980/16 (hereinafter *PSPP* judgment).

¹⁷ The ECB’s Decision that established the SMP was adopted in May 2010, to counter the severe tension in the securities markets of certain euro area countries caused by the outburst of the Greek debt crisis and restore an appropriate monetary policy transmission (Decision of 14 May 2010 of the ECB establishing a securities markets programme (ECB/2010/5) (hereinafter *SMP* Decision)). A first group of secondary market purchases were made between 10 May 2010 – 25 March 2011 for debt securities issued by Greece, Ireland and Portugal and a second one, between 4 August 2011 – February 2012, for debt securities issued by Ireland and Portugal as well as by Italy and Spain. The SMP programme ended on 6 September 2012, when the OMT was announced.

¹⁸ The OMT programme was intended to safeguard an appropriate monetary policy transmission and the singleness of the monetary policy at a time when disturbances affected specific countries. The OMT was therefore a selective instrument, designed to target individual member States. No official ECB decision on the OMT programme was ever adopted. The technical features of the OMT are described in Technical Features of Outright Monetary Transactions, in ECB Press Release of 6 September 2012, www.ecb.europa.eu. See also: ECB Monthly Bulletin, September 2012, pp. 7-11 and ECB Monthly Bulletin, October 2012, pp. 7-9.

The APP, which is the only one currently active, includes the Public Sector Purchase Programme (PSPP) for the purchase of bonds issued by euro area member States, recognised agencies, international organisations and supranational institutions located in the eurozone.²⁰

The PEPP is a separate and additional temporary tool²¹ which blends some of the features of previous programmes.²²

The decision to introduce the PEPP was prompted not only by the concrete risk of disruption of the monetary transmission mechanism across the whole euro area but also by the downside risks to price stability caused by the COVID-19 exogenous shock.²³

Initially, the volume of the PEPP was set at €750 billion. On 4 June 2020, however, the ECB's Governing Council decided to increase it by €600 billion. The current PEPP envelope of €1350 billion is considerably large. Suffice it will be to compare it to the total value of securities purchased under the APP until April 2020 (€2.7 trillion, of which almost €2.2 trillion under the PSPP), to the 2019 EU budget (€165.8 billion) and to the first financial assistance package for Greece (€110 billion).²⁴

The PEPP financial envelope will be used to purchase all the asset categories already eligible under the APP (i.e. both private and public sector securities). In addition,

¹⁹ The Asset Purchase Programme (APP) consists of four parts: the Corporate Sector Purchase Programme (CSPP), the Public Sector Purchase Programme (PSPP), the Asset-Backed Securities Purchase Programme (ABSPP) and the Third Covered Bond Purchase Programme (CBPP3).

²⁰ Decision (EU) 2015/774 of the ECB of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10), as lastly amended by Decision (EU) 2020/188 of the ECB of 3 February 2020 on a secondary markets public sector asset purchase programme (ECB/2020/9) (hereinafter PSPP Decision). The Eurosystem conducted net purchases of public sector securities under the PSPP between 9 March 2015 and 19 December 2018. Since January 2019 principal repayments received at maturity on securities held in the PSPP portfolio are being reinvested to buy new government bonds. On 1 November 2019, the Eurosystem restarted net purchases under the PSPP (see the Decision of the ECB Governing Council adopted on 12 September 2019).

²¹ Purchases under the PEPP will terminate at the end of June 2021 or as soon as the crisis will be over. Principal payments on maturing securities purchased under the PEPP will be reinvested until at least the end of 2022.

²² For a legal analysis of the PEPP before the BVerfG ruling, see among others A. BOBIC, M. DAWSON, *COVID-19 and the European Central Bank: The Legal Foundations of EMU as the Next Victim?*, in *Verfassungsblog*, 27 March 2020, verfassungsblog.de; M. GOLDMANN, *Borrowing Time*, in *Verfassungsblog*, 27 March 2020, verfassungsblog.de; S. GRUND, *Legal, Compliant and Suitable: The ECB's Pandemic Emergency Purchase Programme (PEPP)*, in *Hertie School and Jacques Delors Centre Policy Brief*, 25 March 2020, www.delorscentre.eu; R. SMITS, *Op-Ed: The European Central Bank's Pandemic Bazooka: Mandate Fulfilment in Extraordinary Times*, in *EULawLive*, 23 March 2020, eulawlive.com; M. VAN DER SLUIS, *Analysis: Fighting the Fallout: the ECB Adopts a Purchase Programme in Response to the Coronavirus*, in *EULawLive*, 24 March 2020, eulawlive.com.

²³ Recital no. 4 of the Preamble of the PEPP Decision, *cit.*

²⁴ Data are available at www.ecb.europa.eu.

the PEPP also covers instruments issued by non-financial companies²⁵ and debt securities with a remaining maturity of at least 70 days.²⁶

The eligibility requirements for marketable debt securities under the PEPP are the same established by the PSPP Decision (as amended in 2020).²⁷ Therefore, the minimum rating requirement for issuers of debt securities is set at Credit Quality Step 3 (i.e. Fitch: BBB-, Moody's: Baa3, Standard & Poor's: BBB-).

Moreover, by referring to the PSPP Decision, the PEPP follows the same conditionality policy, in practice importing that attached to ESM financial assistance.²⁸ In fact, should an ESM programme country no longer comply with Credit Quality Step 3, its debt securities would remain nonetheless eligible, provided that a waiver is granted by the ECB Governing Council after assessing compliance of the country concerned with financial assistance conditionality.²⁹

It is worth noting that the PEPP Decision contains a special waiver for Greek debt securities.³⁰ The waiver was granted not only because Greece had regained market access but also considering the commitments undertaken by the country in the context of the enhanced surveillance framework after successfully completing the ESM programme in August 2018.

It should be underlined, though, that both the PSPP and the PEPP might be expanded to include sovereign fallen angels, either by granting *ad hoc* waivers (as already done with Greece) or by amending the eligibility criteria. Similar decisions are likely to stir controversy, not much from a monetary policy point of view but for their implica-

²⁵ In particular, the eligibility requirements for CSPP were broadened to include short-term instruments issued by non-financial corporations.

²⁶ Under the PSPP, the remaining maturity of debt securities is set at a minimum of one year.

²⁷ In particular, the PEPP Decision contains a reference to the PSPP Decision which, in turn, refers back to the General Framework and in particular to Part Four of Guideline (EU) 2015/510 of the ECB as lastly amended, cit.

²⁸ According to Art. 3, para. 2, let. d), of the PSPP Decision, "*In the event of a review of an ongoing financial assistance programme, eligibility for PSPP purchases shall be suspended and shall resume only in the event of a positive outcome of the review*". "Positive outcome of the review" means "the later of the following two decisions: the decision by the Board of Directors of the European Stability Mechanism and, in case the International Monetary Fund co-finances the financial assistance programme, the Executive Board of the International Monetary Fund to approve the next disbursement under that programme, on the understanding that both decisions are necessary for the resumption of purchases under the PSPP" (Art. 2, no. 5, of the PSPP Decision).

²⁹ See Art. 3, para. 2, let. d), of the PSPP Decision, cit. and Art. 8 of the Guideline of the European Central Bank of 9 July 2014 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral and amending Guideline ECB/2007/9. Notably, pursuant to Art. 16 of the ESM Treaty, the ESM Board of Directors (which mirrors the composition of the Eurogroup) will be called to decide on the disbursement of the different tranches of financial assistance after the European Commission monitored compliance with the programme conditionality. In practice, this provides political coverage to any ECB waiver decision.

³⁰ Art. 3 of the PEPP Decision, cit.

tions on purchase programmes as these would risk be considered tools that circumvent the monetary financing prohibition set by Art. 123 TFEU.³¹

Notably, some important safeguards that were included in the PSPP to mitigate financial risks are absent in the PEPP.

First of all, there are no purchase limits to avoid that the Eurosystem becomes a predominant creditor of certain euro area countries, as the PEPP does not have the issue and issuer limits contained in the PSPP.³²

Second, the PEPP is significantly more flexible than earlier programmes even for what concerns the allocation of purchases among euro area Member States. In fact, even though PEPP purchases of debt securities are proportionally allocated among member States on the basis of their share in the ECB's capital (the so-called "capital key"),³³ the PEPP allows "fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions".³⁴ In practice, the ECB is allowed to focus, at least temporarily, on buying government bonds issued by certain States. Admittedly though, since the Eurosystem will not target specific member States for the entire duration of the programme, the PEPP cannot be considered a selective instrument.³⁵

On the other hand, similarly to the PSPP, only 20 per cent of public sector asset purchases will be subject to risk sharing.

Even if data on PEPP purchases at country level are not published by the ECB, we can presume that the flexibility embedded in the programme not only has already been applied but that it was also extended to the PSPP.

In fact, in March, April and May 2020, Eurosystem's purchases under the PSPP deviated significantly from the capital key (in particular, purchases of Italian bonds were above the capital key and those of German bonds below the capital key).³⁶

³¹ See also Art. 21, para. 1, of the ESCB Statute.

³² The issue limit refers to the maximum share of a single PSPP-eligible security that the Eurosystem may hold. The issuer limit refers to the maximum share of an issuer's outstanding securities that the Eurosystem may buy. The Eurosystem can buy only up to 33 per cent of a country's outstanding securities (issuer limit) and up to 33 per cent of any particular bond series as identified by its ISIN number (issue limit).

³³ Pursuant to Art. 29 of the Protocol on the ESCB and of the ECB, the share of each national central bank (NCB) in the ECB's capital is calculated on the basis of the share of each member State in the total population and gross domestic product of the EU, with each factor having equal weighting. Percentage shares are recalculated every five years and whenever there is a change in the number of NCBs contributing to the ECB's capital. The most recent changes to the capital keys entered into force on 1 January 2019. For instance, among other adjustments, the contribution of the Bank of Italy to the ECB capital was reduced from 12.31 per cent to 11.8 per cent. As a result, the ECB had to readjust its holdings in the PSPP portfolio to bring them in alignment with the new capital key.

³⁴ Art. 5 of the PEPP Decision and recital no. 5 of its preamble.

³⁵ Cfr. Court of Justice, judgment of 16 June 2015, case C-62/14, *Gauweiler and Others v. ECB* [GC], paras 89-90.

³⁶ Data on PSPP monthly net purchases at country level are regularly published by the ECB and are available at www.ecb.europa.eu. The ECB will not publish information on PEPP purchases at country level.

It is here maintained that the PEPP is an appropriate tool to respond to the new economic circumstances, as demonstrated by the fact that, since the day of its announcement, spreads have fallen and a deflationary spiral has been avoided. Unfortunately, however, some of the features of the programme seem at odds with the interpretation of the monetary financing prohibition given by the BVerfG in its recent judgment.

After describing where the interpretation of Art. 123 TFEU given by the CJEU and the BVerfG differs, the possible implications will be analysed in the next section.

III. A MESSAGE FROM KARLSRUHE: IS THE PEPP ON THE VERGE OF MONETARY FINANCING?

Compliance of the SMP, the OMT and the PSPP with Arts 119, 123, 127 TFEU and Arts 17 to 24 of ESCB Protocol³⁷ has been systematically challenged before the Court of Justice of the European Union (CJEU), leading to the very first judgments on the matter.

As regards the SMP, in *Accorinti*, the General Court found that the programme fell within the ECB's monetary policy mandate, a mandate that, due to the complex and technical evaluations involved, the ECB can exercise with "broad discretion".³⁸

In *Gauweiler*³⁹ and *Weiss*,⁴⁰ the Court of Justice also found that the OMT and PSPP programmes did not contravene the principle of conferral or the prohibition of monetary financing. Notably, in both cases the referral came from the BVerfG, which had until then never submitted to the Court of Justice a request for a preliminary ruling.

It is at this point of the "dialogue" between the BVerfG and the Court of Justice that the communication was interrupted (more accurately, the BVerfG put the phone down).

On 5 May 2020, the Second Senate of the BVerfG delivered its judgment on the constitutional complaints concerning the PSPP from which the *Weiss* decision of the Court of Justice originated. The BVerfG affirmed that the judgment of the Court of Justice was rendered *ultra vires*: in its assessment of the PSPP proportionality, the Court of Justice had entirely disregarded the actual economic policy effects of the programme nor did it undertake a "comprehensible review"⁴¹ as to whether the ECB had observed the limits

³⁷ Protocol no. 4 on the Statute of the ESCB Statute, cit.

³⁸ General Court, judgment of 7 October 2015, case T-79/13, *Alessandro Accorinti and Others v. ECB*, para. 68. The case did not directly concern the validity of the programme, but the fact that the ECB's holdings of Greek sovereign bonds were excluded from the 2012 debt restructuring. During the Greek sovereign debt restructuring, the ECB was shielded from bearing any losses on the Greek bonds it had purchased through the SMP programme: in mid-February 2012, shortly before Greece launched its exchange offer, the ECB swapped the Greek bonds it had purchased for "new" bonds with identical nominal value, payment terms and maturity dates, but different serial numbers, so that they could be kept outside the remit of the Greek Bondholder Act and therefore were not involved in the application of retroactive collective action clauses.

³⁹ *Gauweiler* [GC], cit.

⁴⁰ Court of Justice, judgment of 11 December 2018, case C-493/17, *Heinrich Weiss and Others v. ECB* [GC] (hereinafter *Weiss*).

⁴¹ BVerfG, *PSPP* judgment, cit., para. 123.

of its mandate. Since *ultra vires* acts do not have binding effect and are not applicable in Germany, the BVerfG held that it was entitled to conduct its own review of the validity of the PSPP programme.

As a result of its own review, the BVerfG concluded that, by unconditionally pursuing the PSPP monetary policy objective without considering its economic policy effects, the ECB manifestly disregarded the principle of proportionality; in the PSPP decision, the ECB failed to balance the monetary policy objective with the economic policy effects stemming from the programme.⁴² Therefore, the interpretation of the proportionality principle carried out by the Court of Justice, and the resulting delimitation of the ESCB's competence, exceeded its judicial mandate.

As a consequence, the BVerfG has required the Federal Government and the *Bundesbank* to ensure that the ECB will conduct a proportionality assessment of the PSPP.⁴³ In addition, unless "the ECB Governing Council adopts a new decision that demonstrates in a comprehensible and substantiated manner"⁴⁴ the proportionality of the PSPP within 3 months from the judgment, the *Bundesbank* would no longer be allowed to take part in the implementation and execution of the PSPP.

It is not the purpose of this paper to review the above-mentioned CJEU decisions, nor to provide an in-depth analysis of the BVerfG ruling on the PSPP. The latter has been rightly received with fierce criticism by legal scholars⁴⁵ and EU institutions alike.⁴⁶

⁴² *Ibid.*, para. 119.

⁴³ *Ibid.*, paras 229-233.

⁴⁴ *Ibid.*, paras 234-235.

⁴⁵ See, among others, S. CAFARO, *Quale Quantitative Easing e quale Unione Europea dopo la Sentenza del 5 maggio?*, in *SIDIBlog*, 8 May 2020, www.sidiblog.org; G. CLAEYS, *The ECB in the COVID-19 Crisis: Whatever It Takes, Within Its Mandate*, in *The ECB's Mandate: Perspectives on General Economic Policies: Compilation of Papers, Study requested by the ECON Committee of the European Parliament for the Monetary Dialogue*, June 2020, p. 115 *et seq.*, www.europarl.europa.eu; G. DAVIES, *The German Constitutional Court Decides Price Stability May not Be Worth Its Price*, in *European Law Blog*, 21 May 2020, europeanlawblog.eu; R.M. LASTRA, K. ALEXANDER, *The ECB Mandate: Perspectives on Sustainability and Solidarity*, in *The ECB's Mandate: Perspectives on General Economic Policies*, Compilation of Papers, study requested by the ECON Committee of the European Parliament for the Monetary Dialogue, June 2020, p. 5 *et seq.*, www.europarl.europa.eu; F. MARTUCCI, *La BCE et la Cour constitutionnelle allemande: souligner les paradoxes de l'arrêt du 5 mai de la Cour constitutionnelle allemande*, in *Le club des juristes*, 11 May 2020, www.leclubdesjuristes.com; M. POIARES MADURO, *Some Preliminary Remarks on the PSPP Decision of the German Constitutional Court*, in *Verfassungsblog*, 6 May 2020, verfassungsblog.de; D. URANIA-GALETTA, *Karlsruhe über alles? Il ragionamento sul principio di proporzionalità nella pronuncia del 5 maggio 2020 del BVerfG tedesco e le sue conseguenze*, in *Federalismi*, 7 May 2020, www.federalismi.it; J. ZILLER, *The Unbearable Heaviness of the German Constitutional Judge: on the Judgment of the Second Chamber of the German Federal Constitutional Court of 5 May 2020 Concerning the European Central Bank's PSPP Programme*, in *CERIDAP*, 7 May 2020, ceridap.eu.

⁴⁶ See the unorthodox press release of the Court of Justice of the European Union following the judgment of the German Constitutional Court of 5 May 2020 (CJEU, Press Release no. 58/20 of 8 May 2020, available at curia.europa.eu) as well as the ECB Press Release of 5 May 2020, *ECB takes note of Ger-*

We certainly agree that the BVerfG's judgment is a *vulnus* to the primacy of EU law and to the independence of the ECB⁴⁷ and that it can jeopardise the unity of the EU legal system.⁴⁸ We intend though to focus on a relatively neglected aspect: the potential impact of the BVerfG ruling on the ability of the ECB to act in times of crisis.⁴⁹

Although the BVerfG explicitly affirmed that its judgment – postponed while awaiting the PEPP – only applied to the PSPP,⁵⁰ the way in which the German Court interpreted the criteria to assess the consistency of the PSPP with the monetary financing prohibition is problematic.

It is true that the BVerfG reached the conclusion that the PSPP does not circumvent Art. 123 TFEU,⁵¹ but will it maintain this stance in future cases? The BVerfG decision seems in fact – and not even in a concealed way – to invite the filing of new constitutional complaints against the PEPP.

At this stage of the analysis, a comparison between the interpretation provided by the Court of Justice and the BVerfG of Art. 123 TFEU is necessary.

From the combined reading of the *Gauweiler* and *Weiss* judgments we can infer the interpretative criteria that the Court of Justice will most probably use to assess whether the PEPP circumvents the monetary financing prohibition.

First of all, the programme must not have an *equivalent effect* to that of a direct purchase of bonds on primary markets.⁵² Secondly, the ECB has to put in place *sufficient safeguards* to ensure that the issuing country keeps pursuing a sound budgetary policy.⁵³

man Federal Constitutional Court ruling and remains fully committed to its mandate, available at www.ecb.europa.eu.

⁴⁷ Pursuant to Art. 130 TFEU, in the performance of the tasks conferred upon them by the Treaty and the ESCB Statute, the ECB and the NCBs are independent both from national instruction and from the instruction of other EU institutions.

⁴⁸ The European Commission has already announced that it is considering opening an infringement procedure against Germany (see Statement by President Von der Leyen of 10 May 2020, available at ec.europa.eu). For what concerns the eventuality of the Bundesbank not taking part in the PSPP, the ECB might resort to Art. 271, let. d), TFEU, pursuant to which the Court of Justice has jurisdiction in disputes concerning the fulfilment by national central banks of obligations under the Treaties and the Statute of the ESCB and of the ECB. In the context of this procedure, the Governing Council of the ECB will have the same powers conferred upon the Commission by Art. 258 TFEU.

⁴⁹ On the flawed legal and economic analysis of the BVerfG on the proportionality principle and on the distinction between monetary and economic policies, see K. WHELAN, *The ECB's Mandate and Legal Constraints*, in *The ECB's Mandate: Perspectives on General Economic Policies*, Compilation of Papers, study requested by the ECON Committee of the European Parliament for the Monetary Dialogue, June 2020, p. 47 *et seq.*, www.europarl.europa.eu. See also M. POIARES MADURO, *Some Preliminary Remarks*, *cit.*

⁵⁰ See the Press Release no. 32/2020 of the German Constitutional Court of 5 May 2020, *ECB Decisions on the Public Sector Purchase Programme Exceed EU Competences*, www.bundesverfassungsgericht.de.

⁵¹ See BVerfG, *PSPP* judgment, *cit.*, paras 213-217.

⁵² *Gauweiler* [GC], *cit.*, para. 97; *Weiss* [GC], *cit.*, paras 109-128.

⁵³ *Gauweiler* [GC], *cit.*, paras 100-102 and 109; *Weiss* [GC], *cit.*, paras 129-132.

According to the Court of Justice, there will be no equivalent effect in the absence of foreseeability: in other words, private operators should not have the certainty that their bonds will be repurchased by the Eurosystem on secondary markets.⁵⁴ This may be averted by adopting precautions such as black-out periods, the non-disclosure of volumes purchased from each Member State in a given month and the setting of purchase limits.⁵⁵

As for the built-in safeguards conceived to avoid the loss of impetus in pursuing a sound budgetary policy, the Court of Justice focusses on the following aspects: the temporariness and volume of a programme;⁵⁶ the possibility of selling bonds at any time;⁵⁷ the application of the capital key;⁵⁸ purchase limits per issue and per issuer;⁵⁹ the adoption of strict eligibility criteria based on a credit quality assessment with exceptions solely for States that have entered a financial assistance programme.⁶⁰ In the presence of these safeguards, a Member State abandoning a sound budgetary policy will not be able to rely on the financing possibilities of a purchase programme without risking that its sovereign bonds become ineligible or are sold by the Eurosystem.

It has to be emphasised though that, according to the Court of Justice, these safeguards do not amount to necessary requirements and that they can either be relaxed or recombined. In fact, their weight in the Court's assessment can change depending "both on the particular features of the programme under consideration and on the economic context in which that programme is adopted and implemented".⁶¹

The BVerfG met with "considerable concerns" the conclusions reached by the Court of Justice in the *Weiss* decision on the PSPP consistency with the monetary financing prohibition, as these did "not satisfy the requirements relating to effective judicial review".⁶² The German Court conceded that the PSPP does not violate Art. 123 TFEU, but only when the safeguards – autonomously interpreted by the same BVerfG – are strictly observed.⁶³

In fact, the BVerfG provided its own interpretation to (the "proper application of"⁶⁴) the criteria that it deemed crucial for the validity of the programme: the existence of a margin of uncertainty over the fact that newly issued government bonds would in any case be purchased by the Eurosystem; the adoption of purchase limits; a rigorous distribution of purchases according to the ECB's capital key; the observance of a blackout period; the application of stringent eligibility requirements limiting purchases to bonds

⁵⁴ *Gauweiler* [GC], cit., para. 104; *Weiss* [GC], cit., para. 110.

⁵⁵ *Gauweiler* [GC], cit., paras 106-107; *Weiss* [GC], cit., paras 113-128.

⁵⁶ *Gauweiler* [GC], cit., para. 112; *Weiss* [GC], cit., paras 133-134.

⁵⁷ *Weiss* [GC], cit., para. 135.

⁵⁸ *Ibid.*, para. 140.

⁵⁹ *Ibid.*, para. 141.

⁶⁰ *Gauweiler* [GC], cit., paras 119-120; *Weiss* [GC], cit., para. 142.

⁶¹ *Weiss* [GC], cit., para. 108.

⁶² BVerfG, *PSPP* judgment, cit., paras 180 and 184.

⁶³ *Ibid.*, para. 180.

⁶⁴ *Ibid.*, para. 197.

issued by States satisfying a minimum credit rating; the holding until maturity only as an exception; and the existence of an exit strategy.⁶⁵

The first effect of the BVerfG ruling is certainly a stiffening of the interpretative criteria adopted by the Court of Justice, which would reduce the ECB's ability to achieve its primary objective of price stability and adopt crisis prevention measures.

The second consequence concerns the future application of the BVerfG criteria to the PEPP, the most problematic of which are: *a)* purchase limits,⁶⁶ *b)* the allocation of purchases on the basis of the capital key⁶⁷ and *c)* the eligibility requirements.⁶⁸

a) There are no purchase limits in the PEPP,⁶⁹ whereas the BVerfG affirmed that "only on this condition can it be assumed that the market is not dominated by the Eurosystem, which is imperative for preventing Member States and market operators from being largely certain that newly issued government bonds will be purchased by the ESCB".⁷⁰

b) According to the BVerfG, reference to the capital key "constitutes an objective criterion that is independent of the economic and budgetary situation of the respective member State of the euro area".⁷¹ Therefore, for the BVerfG any departure from this criterion will be an unequivocal signal that bond purchases are intended to meet the specific financing needs of countries in distress.

On the contrary, the PEPP expressly provides for a flexible – albeit temporary – application of the capital key.⁷² For the ECB, this flexible approach – which by the way has already been applied and extended to the PSPP – is "essential to prevent current dislocation in the aggregate euro area sovereign yield curve from being translated into further distortions in the euro area risk-free yield curve".⁷³

⁶⁵ *Ibid.*, paras 198-217.

⁶⁶ *Ibid.*, paras 201-202.

⁶⁷ *Ibid.*, paras 203-204.

⁶⁸ *Ibid.*, paras 207-208.

⁶⁹ See recital no. 6 of the PEPP Decision, according to which "The Governing Council also decided that to the extent some self-imposed limits might hamper action that the Eurosystem is required to take in order to fulfil its mandate, the Governing Council will consider revising them to the extent necessary to make its action proportionate to the risks faced". On the contrary, Art. 5 of the PSPP Decision establishes issue purchase limits as well as issuer purchase limits.

⁷⁰ BVerfG, *PSPP* judgment, cit., para. 202.

⁷¹ *Ibid.*, para. 203.

⁷² On the capital key "self-imposed limit", the President of the European Central Bank, Christine Lagarde, recently affirmed: "The capital keys provide a general guide to our purchases under PEPP, but it does not have to be applied at each and every point in time, so there can be deviation at any point in time [...] in order to reach the goals that we assign to the tool we are using." (from: European Parliament, Committee on Economic and Monetary Affairs, Monetary Dialogue with Christine Lagarde, President of the European Central Bank (pursuant to Art. 284, para. 3, TFEU), 8 June 2020, p. 10, transcript available at www.ecb.europa.eu).

⁷³ Recital no. 5 of the PEPP Decision, cit.

c) For what concerns the eligibility requirements, their future relaxation either by granting additional *ad hoc* waivers like in the case of Greece or by their amendment will drive the PEPP on the verge of monetary financing. In fact, the BVerfG warned that “Any further lowering of the criteria below a rating complying with at least Credit Quality Step 3 would – as was confirmed in the oral hearing – no longer meet the aforementioned standards in terms of credit quality assessment”.⁷⁴

The message to the ECB from Karlsruhe could not be clearer: *achtung*, you are testing the limits of our patience!

This blunt message is even more worrisome considering that the Court of Justice had already found the PSPP programme to be consistent with EU law in its *Weiss* decision, a decision that is the only one by which the ECB has to abide and that is binding on all national courts.

If a new constitutional complaint on the PEPP is brought before the BVerfG – something that is very likely in the near future – the clash between the two courts will be further exacerbated.

While the restrictions placed by the Court of Justice on the design of asset purchase programmes are flexible enough not to curtail the ECB’s room for manoeuvre, the BVerfG’s strict interpretation of the monetary policy mandate and of the monetary financing prohibition would hamper the ECB’s ability to do “whatever it takes” in the event of a crisis.

The resulting legal uncertainty and erosion of the ECB’s credibility will have lasting and negative repercussions on the euro area.

To preserve the integrity of the EU’s legal order, tensions between the two courts have to be solved. Many have already advocated for an infringement procedure against Germany.⁷⁵

On the main point of contention, however, Art. 125, para. 2, of the TFEU may provide a solution: on a proposal from the European Commission and after consulting the European Parliament, the Council can in fact specify definitions for the application of Arts 123 to 125 TFEU.⁷⁶

Maybe the time is ripe – even from a political point of view – for revising the 1993 Regulation that provides various definitions and exemptions from the monetary financ-

⁷⁴ BVerfG, *PSPP* judgment, cit., para. 208.

⁷⁵ See, among others, D. SARMIENTO, J.H.H. WEILER, *After Weiss: Proposing A New Mixed Chamber of the Court of Justice*, in *Verfassungsblog*, 2 June 2020, verfassungsblog.de. The Authors also propose the creation of a new appeal jurisdiction within the Court of Justice having a mixed composition (six judges of the Court of Justice and six judges from three Constitutional or Highest Courts of Member States) which would only rule on the distribution of competences between the EU and its Member States.

⁷⁶ Art. 125, para. 2, TFEU empowers the Council to adopt definitions for the application of the monetary financing prohibition (Art. 123 TFEU), of the prohibition of privileged access to financial institutions (Art. 124 TFEU) and of the so-called “no bail-out clause” (Art. 125 TFEU).

ing prohibition.⁷⁷ This instrument may be used to clarify the purpose of Art. 123 TFEU and to allow for more flexibility in exceptional circumstances, provided that the minimum requirements identified by the Court of Justice are met.

IV. CONCLUSIONS

As pointed out by Mario Draghi, the current crisis is caused by an unprecedented economic shock that does not originate from reckless behaviour. It requires exceptional measures and an expansionary fiscal policy which will inevitably lead to a significant increase of public debt.⁷⁸

In this context, and in the absence of a common fiscal policy, the ECB is called to play a subsidiary role, with its purchase programmes becoming critical to keep debt servicing costs under control.

The BVerfG judgment, however, is putting sand in the wheels of the ECB and is exposing the limits of the current legal framework, with the ECB called to justify its activities under its narrow price stability mandate and to demonstrate that the effects of its interventions on the general economy are merely “secondary”.⁷⁹

Most probably, the BVerfG will interpret the PEPP as a measure that diverts certain countries from pursuing a sound fiscal policy, in breach of Art. 123 TFEU.

The key question – on which the BVerfG and the Court of Justice may provide opposite answers – will be: what does “sound fiscal policy” mean in times of recession, when government spending is desperately needed to boost aggregate demand and even the EU Stability and Growth Pact has been relaxed activating the general escape clause?⁸⁰

The context is quickly changing and to conclude on a more positive note it is worth underlining that, despite the BVerfG’s controversial ruling, the German government is

⁷⁷ See Council Regulation (EC) 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Arts 104 and 104b(1) of the Treaty on European Union [1992] (now Arts. 123 and 125 TFEU). See also Council Regulation (EC) 3604/93 of 13 December 1993 specifying definitions for the application of the prohibition of privileged access referred to in Article 104a of the Treaty on European Union [1992] (now Art. 124 TFEU).

⁷⁸ M. DRAGHI, *We Face a War Against Coronavirus and Must Mobilise Accordingly*, in *Financial Times*, 25 March 2020.

⁷⁹ See also P. DE SENA, S. D’ACUNTO, *La Corte di Karlsruhe, il mito della ‘neutralità’ della politica monetaria e i nodi del processo di integrazione europea*, in *SIDIBlog*, 14 May 2020, www.sidiblog.org.

⁸⁰ On 23 March 2020, on the basis of a European Commission’s proposal, the European Council endorsed the activation of the so-called “general escape clause” of the Stability and Growth Pact (as set out by Arts 5, para. 1, 6, para. 3, 9, para. 1, and 10, para. 3, Regulation (EC) 1466/97, and Arts 3, para. 5, and 5, para. 2, Regulation (EC) 1467/97), which allows temporary deviations from the medium-term budgetary objective and the appropriate adjustment path towards it in a situation of severe economic downturn of the euro area or of the EU as a whole. See, in particular, Communication COM (2020) 123 final of 23 March 2020 from the European Commission on the activation of the general escape clause of the Stability and Growth Pact.

changing its political stance on burden sharing and common European bonds, thus contributing to a leap forward in the European integration process.

On 18 May 2020, the German Chancellor Angela Merkel and the French President Emmanuel Macron presented their joint EU Recovery Initiative.⁸¹

Soon afterwards, the European Commission put forward a comprehensive set of proposals for a major recovery plan based on two pillars: on the one side, the 2021-2027 Multiannual Financial Framework and the Own Resources Decision and, on the other side, the Next Generation EU recovery plan, which consists of several facilities among which, most importantly, the Recovery and Resilience Facility.⁸² Overall, to support economic recovery from the COVID-19 crisis, the EU will mobilise €750 billion, of which €500 in grants and the rest in loans.

Together with the €1350 billion bazooka the ECB is deploying through the PEPP, the EU recovery plan will hopefully be enough to avoid a painful and protracted recession, but it will have to be accompanied by deep reforms in the direction of further integration and solidarity.

⁸¹ See the initiative *France et Allemagne unies pour une relance européenne*, 18 May 2020, available at www.elysee.fr.

⁸² The package of proposals set forth by the European Commission is available at ec.europa.eu and at ec.europa.eu. For a first comment, see F. COSTAMAGNA, M. GOLDMANN, *Constitutional Innovation, Democratic Stagnation? The EU Recovery Plan*, in *Verfassungsblog*, 30 May 2020, verfassungsblog.de.