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Policy Brief

An early Christmas Gift from Karlsruhe?

The Bundesverfassungsgericht's NextGenerationEU Ruling

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#NextGenerationEU
#Bundesverfassungsgericht
#Pandemic

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The 6 December ruling of the German Constitutional Court on the constitutional complaints against the EU's recovery instrument NextGenerationEU seemed to come as an early Christmas gift from Karlsruhe. This time, the German court avoided the head-on collision with the EU. At the same time, the ruling raises crucial questions about the future of EU fiscal integration. While it is not as constraining as some might have feared, it does not give *card blanche* for a more permanent EU fiscal capacity. In this policy brief, Thu Nguyen and Martijn van den Brink analyse the judgment and its possible implications going forward.

Introduction[1]

The 6 December Karlsruhe ruling on the constitutional complaints against the 'Act Ratifying the EU Own Resources Decision' (ORD) will be received by many as a Saint Nicholas present. This time, the Federal Constitutional Court (FCC) avoided the head-on collision with the EU it caused with its *PSPP* judgment two and a half years ago. Instead, it opted for a seemingly constructive assessment of the EU's pandemic recovery instrument with a majority of 6:1. In particular, it found that the ORD did not manifestly exceed the competences conferred on the EU – i.e., it was not *ultra vires* – and did not affect the constitutional identity of the Basic Law (*Grundgesetz*).

Parts of the judgment were to be expected. In its preliminary injunction of 15 April 2021, it had already found that the ORD does not appear to violate the budgetary powers of the Bundestag and, hence, the identity of the German constitution. In yesterday's ruling, the FCC offered additional arguments to reach the same conclusion. Other parts, however, raise not only eyebrows but also crucial questions about the future of EU fiscal integration. While the ruling is not as constraining as some might have feared, it does not give *card blanche* for a more permanent EU fiscal capacity.

[1] This text was published in parallel on Verfassungsblog as: An early Christmas Gift from Karlsruhe?: The Bundesverfassungsgericht's NextGenerationEU Ruling, VerfBlog, 2022/12/09.

The legal construction of NGEU

To understand the reasoning of the Court, it is necessary to explain the legal construction of the NextGenerationEU (NGEU). In essence, the recovery instrument is established through three different legal components: First, the Regulation establishing the European Union Recovery Instrument (EURI), based on article 122 TFEU. Second, the EU Own Resources Decision (ORD), based on article 311 TFEU. And third, various legal acts establishing the spending programmes, with the Recovery and Resilience Facility (RRF) as the centrepiece of the instrument. The ORD and the EURI regulation relate to one another in that article 4 of the ORD expressly states that the 750 billion Euros raised on the markets for NGEU are solely for the purpose of addressing the consequences of the COVID-19 crisis through the EURI regulation. Whether the ORD is compatible with the Treaties hence also depends on whether the boundaries of article 122 TFEU, which is the legal basis of the EURI regulation, are complied with.

Ultra vires in argument but not in outcome?

Since the part of the decision assessing the ORD against the constitutional identity of the German Basic Law is relatively unexciting, we will mostly focus on the FCC's reasoning regarding the question of whether the ORD is *ultra vires*.

Briefly, however, with respect to its constitutional identity reasoning: the FCC rejected the claim that the ORD would seriously infringe on the budgetary responsibilities of the Bundestag. As the instrument is limited in time, volume, and purpose, the Court does not believe that it poses substantial risks to the national budget and the Bundestag's responsibilities. The FCC does, however, emphasize that the Bundestag is under a duty to monitor the use of NGEU funds and the risks arising from the programme and to take action to protect the budget where necessary.

Things get more contentious when it comes to the question of whether the ORD constitutes an *ultra vires* act. The complainants put forward three grounds in support of their claim: that the ORD violates the non-bailout clause (art. 125 TFEU), that it violates the rules on the EU's own resources (art. 311 TFEU), and that it is based on an inappropriate legal basis (art. 122 TFEU).

On article 125 TFEU, the Court reluctantly accepts the compatibility of NGEU with the no bail-out clause. It does not entirely rule out the possibility that the ORD circumvents article 125 TFEU, pointing to the risk that member states might have to provisionally make money available if other states cannot meet their share of the debt repayment. However, since the defaulting member states remain under an obligation to ultimately pay their share, the FCC concludes that financing by other member states would only be temporary, not permanent.

On article 311 TFEU, the Court accepts that borrowing can be authorised as 'other revenue' under article 311(2) TFEU under four conditions: (1) the authorization to borrow must have been given in the ORD; (2) the funds are exclusively used for tasks for which the EU has competence; (3) the borrowing is limited in duration and volume; and (4) the amount of borrowed funds ('other revenues') does not exceed the total amount of own resources. The Court considers that the first, third and fourth conditions have been met, albeit with some hesitation. It is with respect to the second condition, that the borrowed funds must be strictly limited to specific purposes in the exercise of EU competences, where it is most critical. In particular, it doubts whether the funds borrowed under the ORD are used for tasks that can be justified under article 122 TFEU. Here, the FCC seems to conflate the

question of whether the EU has a right to borrow with the question of whether the ORD is justified as a crisis measure under article 122 TFEU, but it ultimately finds that the EU is authorised to borrow.

On article 122 TFEU, while the FCC has its doubts about whether this provision offers an adequate legal basis for the use of the borrowed funds, ultimately it does not rule out that the EU has *not* manifestly exceeded its competences. More specifically, the FCC critically examines five points: (1) whether article 122 TFEU allows for groups of member states to be supported; (2) whether there is a sufficient link between the pandemic and the measures financed through NGEU; (3) that the funds are to be spent between 2021-2026, possibly too long a period to alleviate the consequences of the pandemic; (4) that about 10% of the funds are used for operational EU programmes with no connection to the pandemic; and (5) that the funds are distributed between member states on the basis of past data.

Of these points, the second was the most contentious. It concerns the existence of a link between the emergency for which assistance is required, and the assistance measures themselves. On the one hand, article 122 TFEU does not explicitly require such a link. On the other hand, the Court argues that, without such a link, the article would cease to be exceptional in nature and become a general clause. In the case of NGEU this means that there must be a link between the pandemic and the measures financed by the borrowed funds. The Court clearly does not see this link for most of the funds, in particular not those that are to be spent on NGEU's climate goals, which amount to 37 percent of the RRF. Given these doubts, it is surprising that the Court majority did not refer the question to Luxembourg for a clarification. Instead, the FCC concluded that it cannot rule out that the ORD remains within the competences of article 122 TFEU and rejected the claims brought by the applicants.

What does this decision mean going forward?

The judgment seems to send conflicting messages. On the one hand, it expresses severe doubts about the legality of the ORD. At the same time, the FCC did not declare the programme *ultra vires* or refer a preliminary question to Luxembourg. We see two possible ways to read this.

The first reading is that this is a judgment that should be welcomed by the EU. The FCC does not impose any surprising or restrictive conditions on the creation of fiscal instruments such as NGEU, other than that the *Bundestag*'s budgetary responsibilities must be respected. More importantly, the judgment appears to signal a retreat from its more confrontational stance in *PSPP*. It seems that the FCC tried to avoid having to shoot down the pandemic recovery instrument, seeking to behave more constructively than in some of its past cases. In particular, the FCC appears to have set the bar for *ultra vires* review lower. In *PSPP*, it ruled that the CJEU acted *ultra vires* in its Weiss judgment because the CJEU's proportionality assessment and distinction between monetary and economic policy was manifestly untenable. Although the language used in the *NGEU* judgment is similar, the FCC this time seems to say effectively: 'all is okay because there is a small chance the ORD is not illegal' under EU law. One may wonder whether it would have reached a different conclusion in *PSPP* had it applied a similarly lenient standard.

The second reading is less optimistic. The tone of the decision is not always as conciliatory as the outcome suggests, and it remains unclear whether the FCC will be equally lenient in its findings the next time an instrument such as NGEU ends up before it. In particular, the judgment raises some questions with regard to other planned instruments, such as REPowerEU. The Court clearly states that there is no manifest violation of article 122 TFEU, as long as the EURI regulation remains strictly limited to the consequences of the

pandemic. It is questionable whether REPowerEU, which is the 300 billion Euros plan of the Commission to become independent from Russian energy exports and which relies heavily on NGEU funds, would fulfil this criterion. While 225 billion Euros out of the 300 billion Euros are supposed to come out of the NGEU funds, it is not yet clear whether the purpose of REPowerEU can be sufficiently linked to the pandemic. Moreover, while the fact that the FCC did not refer a preliminary question to the CJEU could be interpreted positively, it could also be interpreted as a retreat from the FCC's willingness to engage in a constructive dialogue with Luxembourg, as Judge Müller puts it in his dissent. Especially the fact that Karlsruhe does not seem to believe that Luxembourg would interpret article 122 TFEU more narrowly than it does itself, and that a referral would therefore make no difference to the outcome of the case, could be read as a sign of distrust toward the CJEU.

A gift, but not a heartfelt one

All in all, the FCC's ruling may be a gift, but it does not feel like a heartfelt gift, considering the deeply sceptical tone it is emitting at times. Given this scepticism, the judgment begs the question as to why the FCC did not refer preliminary questions to the CJEU, requesting an interpretation of the relevant EU law. Such a referral appears to would have been coherent given the many doubts the majority expressed regarding the compatibility of the ORD with the Treaties, if not given the outcome of the case. Did Karlsruhe not want to put the CJEU in an uncomfortable position, or did it not want to find itself in an uncomfortable position a few years down the line, having to either concede to a CJEU ruling with which it disagrees, or bark at a *fait accompli* – since most NGEU money will have been spent by then anyway? Or maybe the reason is simply that the judgment was a compromise between the more conservative and the more liberal judges in Karlsruhe, which would also explain why it is at times difficult to make sense of the reasoning.

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