The Breakdown of the Rule of Law in the Euro-Crisis: Implications for the Reform of the EU Court of Justice

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A) Introduction

- „‘We can only achieve a political union if we have a crisis‘ Mr. Schäuble said“ (New York Times, 18.11.11).
- In responding to the European sovereign debt crisis, the EU member states have considerably expanded the power of the EU institutions.
- There has been only a single amendment of the treaties (the addition of a section to Art. 136 TFEU, permitting the ESM).
- The Euro-area governments have either circumvented the European Treaties by concluding separate treaties among themselves (like the ESM Treaty and the envisaged treaty on the Single Resolution Fund) or stretched the provisions of the European Treaties beyond recognition.

B) The breakdown of the rule of law at the EU level

Examples:

1. The bailout

- Art. 125 Sect. 1 TFEU: „A member state shall not be liable for or assume the commitments of central governments … of another Member State …“
- The initial EU loans to Greece and the establishment of the European Financial Stability Facility (EFSF) by the eurozone were flagrant breaches of the no-bailout rule (as admitted e.g. by Lagarde, Lellouche, Wauquiez, de Gucht and Simitis).
- The Court of Justice of the European Union (CJEU), in its preliminary reference of 26 November 2012 (Thomas Pringle v Government of Ireland), has upheld EFSF and ESM on the grounds that

  „the granting of financial assistance to an ESM member in the form of a credit line … or in the form of loans … in no way implies that the ESM will assume the debts of the recipient Member State.“
- Credits used to retire outstanding government bonds and purchases of outstanding government bonds are strictly equivalent forms of assuming the debt of another government *(Breach No. 1)*

- The Council used the simplified amendment procedure of Art. 48 Sect. 6 TEU to add a section to Art. 136 TFEU as a legal basis for the ESM.
- However, the simplified procedure is only permitted if the amendment does „not increase the competences conferred on the Union in the Treaties“.
- The permission to establish a stability mechanism does increase the competencies of the monetary union, and the monetary union is part of the European Union and enshrined in the European treaties. Moreover, the Commission is a member of the ESM „Troika“. *(Breach No. 2)*
- The Commission based the EU loans to Greece on Art. 122 Sect. 2 TFEU:

  „Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural desasters or exceptional occurrences beyond its control, the Council, on a proposal of the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned“.
- Not beyond their control *(Breach No. 3)*

- In March 2013, the governments of the euro-area bailed out Cyprus. This was not permitted by the new Section 6 of Art. 136 TFEU:

  „The member states whose currency is the euro may establish a stability mechanism to be activated if indispenable to safeguard the stability of the euro area as a whole“.

- The Cypriot banks were too small to be systemically relevant for the financial stability of the euro area as a whole. *(Breach No. 4)*

2. Conditionality

- The bailout conditions negotiated by the Troika and approved by the Council concern, for example, budgetary appropriations for solidarity allowances, the indexation of pensions, pay rates for overtime work, the reform of health care for Greece, social protection expenditure, public service pensions, the minimum wage for Ireland and public sector wages and employment, pensions, education and health spending in Portugal.

- The European Union is not entitled to impose or negotiate any of these policy measures. If this were accepted as legal, the EU could bring about any national policy it wants simply by offering money in exchange. *(Breach No. 5)*

3. Macroeconomic Policy Coordination

- The „Sixpack“ adopted in December 2011 empowers the EU to impose far-reaching sanctions on the individual member states in case of excessive budget deficits or macroeconomic imbalances.
- The Sixpack has been based on Art. 136 TFEU in combination with Art. 121 TFEU.
- However, Art. 121 TFEU permits only recommendations, not sanctions. *(Breach No. 6)*

4. The purchase of government bonds by the European Central Bank

- Since May 2010, the ECB has bought Greek, Irish, Portuguese, Italian and Spanish government bonds in the secondary market.
- According to Art. 123 TFEU, any „credit facility with the European Central Bank … in favour of … central governments … of member states shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments“.
- The prohibition of direct purchases of government bonds implies that monetary deficit financing is prohibited and that purchases of government bonds in the secondary market are only permitted if they are necessary to attain other ends, notably price stability.

- If they had been necessary for monetary policy purposes, the ECB would have bought a more or less representative portfolio of government bonds or possibly corporate bonds.
- Since the ECB has exclusively bought bonds issued by over-indebted governments, it engaged in monetary deficit financing which is illegal. The German Federal Constitutional Court and 150 German professors of eocnomics share this view. *(Breach No. 7)*
- In September 2012, the ECB announced that it was ready to buy unlimited amounts of bonds issued by over-indebted governments (so-called OMT programme).
- It added that „a necessary condition for OMTs is strict and effective conditionality attached to an appropriate EFSF or ESM programme“.
- This is inconsistent with Art. 130 TFEU:

  „When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body“.
- If, for example the Governing Council of the ESM decides that some country is not eligible for ESM credits, this would exclude the country from the OMTs of the ECB.
- In this way, the ECB would „seek and take instructions“ from the finance ministers constituting the Governing Council of the ESM. *(Breach No. 8)*

5. The supervision of euro area banks by the ECB

- In June 2013, the European Council decided that the ECB alone will supervise the largest banks of the euro area member states.

- The Council decision has been based on Art. 127 Sect. 6 TFEU:

  „The Council … may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings".

- This clause is not an adequate legal base because it does not refer to the supervision of a specific group of banks but to specific aspects of supervising all banks. *(Breach No. 9)*

- According to the German Minister of Finance, the ultimate supervisory decisions shall rest with an intermediation committee whose members shall be selected by the governments of the member states from the ECB Governing Council and/or from the Supervisory Board comprising one supervisor from each member state plus six others.

- Thus, the intermediation committee may not contain a single member – let alone a majority of representatives – from the ECB.

- This would be illegal. *(Breach No. 10)*

- The European Banking Authority (EBA), which supervises all EU banks, may also give direct orders to banks and may override the supervisory decisions of the ECB. This is incompatible with the independence of the ECB, i.e., Art. 130 TFEU. *(Breach No. 11)*
- The EBA Regulation and the envisaged regulation for the Single Resolution Mechanism cannot be based on Art. 114 TFEU because international differences in the regulation and resolution of banks are perfectly consistent with the free movement of capital (*Breach No. 12*).

6. Explaining the breakdown of the rule of law

- The difficulties of ratifying the abortive Constitutional Treaty and the Reform Treaty of Lisbon have taught the EU political class to avoid ordinary treaty amendments.
- Amendments would have required the assent of the British Conservatives and – according to the ordinary amendment procedure – the assent of Irish voters in a referendum.
- All political actors assume that the Court of Justice of the European Union would back the Commission in disputes over the interpretation of the treaties (as it has done over the no-bailout rule).
- In matters of objective union legislation, only the EU institutions and the member states may take legal action – not individual citizens.
- Up to now, the German Federal Constitutional Court has always, in the last resort, shied away from outlawing EU policies.
- Thus, the key to restoring the rule of law is reforming the CJEU.

C) Reforming the Court of Justice of the European Union

1. The status quo

- The CJEU is often called a „motor of integration“ – both market integration and political integration, i.e., centralization.
- A court should not propagate a political program. It ought to be an impartial interpreter of the law.
- The court has been criticized for its centralist bias e.g. by H. Schermers (1974), E. Stein (1981), C. Philip (1983), H. Rasmussen (1986), A. Bzdera (1992), A.-M. Burley, W. Mattli (1993)., G. Garrett (1993), P. Neill (1995), J. Bednar, J. Ferejohn, G. Garrett (1996), G. Garrett, D. Kelemen, H. Schulz (1998), J.-Y. Pitarakis, G. Tridimas (2003), S. Voigt (2003), J.-M. Josselin, A. Marciano (2007), M. Höreth (2008).

Quantitative evidence

- The Court significantly favours the Commission at the expense of the Council (Jupille 2004).
- The probability of a ruling in favour of the plaintiff is significantly higher when the Commission is the plaintiff or submits an observation favouring the plaintiff, and significantly lower when the Commission is the defendant or submits an observation favouring the defendant (Carruba, Gabel, Hankla 2008).
- Regardless of the net position in the Council, the Commission‘s observations significantly affect the Court‘s decision. By contrast, if the Commission does not file an observation, the balance of the Council does not have a significant effect (Sweet, Brunell 2010).
- The Court sides with the Commission rather than the Council in 69 per cent of the cases (Sweet, Brunell 2010).

- Constitutional courts predominantly tend to expand the power of central institutions in the economic sector”. (Alexander von Brünneck 1988)
- „The few existing comparative studies of federal high courts indicate that all such courts do not hinder the accrual of power to the political centre through legislative actions of the central government, and sometimes these high courts actively encourage such centralist tendencies“. (André Bzdera 1992)
- „Central judicial institutions almost invariably have centralising rather than particularist tendencies“. (Damian Chalmers 2004)
- „Federal polities sustained through effective judicial review tend to evolve in ways that centralize power“. (A.S. Sweet 2004)

2. Explanations

- Hypotheses:
  Constitutional courts centralise because

  i. the judges depend on the central government („dependency hypothesis“),
  ii. the judges – even though they are independent – share the centralist preferences of the members of the central government who have appointed them (“shared preference hypothesis”),
  iii. lawyers who cherish centralisation are more likely to specialise in constitutional and European law (“self-selection hypothesis”),
  iv. the judges increase their power and prestige by enlarging the domain of the central government (“vested interest hypothesis”).

- The fact that the Court systematically favours the Commission against the governments of the member states, is inconsistent with Hypotheses i. and ii.
- Thus, the Court’s centralist bias is due to self-selection and/or vested interest.

3. Reforming the Court

- Proposals (in the literature):
  i. Facilitate legislative override by the Council (Posner and Yoo 2005).
  ii. Require a qualified majority of the judges for overturning EU legislation (Weiler 1999).
  iii. Publish the voting record and dissenting opinions to reinforce the re-appointment constraint.
  iv. Require judicial experience to limit self-selection.
  v. The EU judges ought to be delegated from the highest courts of the member states (European Constitutional Group 1993).
  vi. Establish a second court ("Subsidiarity Court") which decides all cases affecting the distribution of powers between the EU and its member states (European Constitutional Group 1993).
- What is the economic approach to reform?
- Do not weaken the Court (i-iii).
- Correct the biased incentives of the judges (v, vi) and reduce self-selection (iv, v).