

Legal and Institutional Design of EMU

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Session 3: Legal aspects of risk-sharing mechanisms

The key Treaty provision for discussions relating to risk-sharing is the no bail-out clause included in Article 125(1) TFEU:

The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.

The Court interpreted this clause in *Pringle* as follows:

the aim of Article 125 TFEU is to ensure that the Member States follow a sound budgetary policy. The prohibition laid down in Article 125 TFEU ensures that the Member States remain subject to the logic of the market when they enter into debt, since that ought to prompt them to maintain budgetary discipline. Compliance with such discipline contributes at Union level to the attainment of a higher objective, namely maintaining the financial stability of the monetary union.

The no bail-out clause is linked to the prohibition of monetary financing contained in Article 123(1) TFEU.

During the crisis, various different solutions have been used, ranging from bilateral loans, the establishment of the European Financial Stabilisation Mechanism and the European Financial Stability Facility to the establishment of the European Stability Mechanism and funding from the IMF and ECB. Notwithstanding Article 125 TFEU, many of these mechanisms have relied on varying degrees of risk-sharing among the Member States. The EFSM was adopted as an economic policy measure. Under this mechanism, all Member States formally share the risk through the EU budget, which is used as collateral. In the EFSF the risk is shared by the euro states. The key measure is however the ESM, which is the permanent stability mechanism, established outside the formal Treaty framework with reference to the revised Article 136 TFEU.

There is a great deal of literature on the mechanisms of financial assistance adopted during the crisis. For example the following offers a good overview of the measures that have been adopted during the crisis:

De Gregorio Merino, 'Legal developments in the Economic and Monetary Union during the debt crisis: The mechanisms of financial assistance' (2012) *Common Market Law Review*, 1613-1645

Read Case C-370/12, *Thomas Pringle v. Government of Ireland, Ireland, The Attorney General*, Judgment of the Court of Justice (Full Court) of 27 November 2012, paras 123-147 concerning the interpretation of Article 123 and 135 TFEU. What is their relevance for a discussion on risk-sharing mechanisms other than the ESM?

A further means of risk-sharing during the crisis has also been through the operations of the ECB: when the ECB balance includes bonds of a euro state, the risks related to those bonds are in practice carried jointly by the whole euro area, and ultimately divided among them. ECB actions are, however, not a "mechanism" as such. Still, they are of a high relevance for any discussion on the legal limits of risk-sharing, for example as concerns the compatibility of its SMP and OMT programs with the no bail-out clause mentioned above.

The plans for developing the EMU include further mechanisms of risk-sharing, including the creation of a fiscal capacity that could be used for the absorption of macroeconomic shocks, and the earlier proposals relating to the issuing of common debt in some form. While this discussion is closely linked to the question of constitutional limits and budgetary sovereignty (Session 1), especially in recent debates the linkage to the themes discussed during Session 2 is apparent. With more centralised steering of Member States' policies comes further sharing of risks. President Juncker noted this linkage recently in his State of the Union speech in September 2015:

"Some say we need a government of the euro. Others say we need more discipline and respect of the rules. I agree with both: we need collective responsibility, a greater sense of the common good and respect and implementation of what is collectively agreed."

During Session 3, we will focus on the legal and institutional aspects relating to risk-sharing mechanisms at EU level. In addition to the European Stability Mechanism, we will discuss the June 2015 Five Presidents' Report on Completing Europe's Economic and Monetary Union and the plans it presents for further risk-sharing among the Member States. In addition, we will discuss some of the earlier proposals that have been discussed in this context, even if they have not been included in the Five Presidents' Report.

The readings listed below are not by any means exhaustive of the topics, but include some suggestions for where to begin. Reading a selection from across the various themes will suffice for the purposes of the workshop.

1) European Stability Mechanism

The most fundamental legal question concerning the European Stability Mechanism is its compatibility with the EU Treaties is *Pringle*.

Case C-370/12, *Thomas Pringle v. Government of Ireland, Ireland, The Attorney General*, Judgment of the Court of Justice (Full Court) of 27 November 2012.

Lenaerts, (2014). EMU and the European Union's Constitutional Framework. (2014) *European Law Review* 753-769.

Adam & Mena Parras, 'The European Stability Mechanism through the legal meanderings of the Union's constitutionalism: comment on Pringle' (2013) *European Law Review*, 848

De Witte & Beukers, 'Case C-370/12, Thomas Pringle v. Government of Ireland, Ireland, The Attorney General, Judgment of the Court of Justice (Full Court) of 27 November 2012' (2013) *Common Market Law Review*, 805-848

The case law establishes that the decision to build the ESM outside the EU Treaties is a legally possible and solid solution, which has so far persisted all legal challenges. However, even if the ESM Treaty itself does not provide for a formal review clause (unlike the Fiscal Compact and the SRF Agreement), the question constantly raised in debates concerning the future design of the EMU is the incorporation of the Mechanism into the legal framework of the EU Treaties. The Five Presidents report proposes its inclusion into the EU Treaties as a medium-term objective (after 2017).

Many commentators also suggest that the ESM should be developed towards a true "euro area IMF", even if it is seldom specified what this would entail in practice, and how its tasks would be affected. The Five Presidents' Report is silent on the need to develop the tasks of the ESM, even if the ESM relevant in the context of creating a permanent back-stop for the banking union (both the single resolution mechanism and the possible future deposit guarantee scheme), something that would require an amendment of the ESM Treaty.

- ***In light of Pringle, and the Lenaerts' paper listed above, what would the inclusion of the ESM require from a legal point-of-view?***
 - ***The inclusion of the ESM into the EU legal framework is usually tied to a discussion of the "normalization" of the EMU solutions, and making them a part of the mainstream institutional setting. What kind of institutional consequences would the inclusion have? What are the options? Think about institutional roles, governance bodies and possible implications for ESM funding.***

Under the new Article 136(3) TFEU,

The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.

This paragraph has been recently discussed for at least two reasons. First, in the context of the Greek solution found last summer, the question was raised whether the ESM funding granted actually fulfilled the criteria relating to the indispensability of funding in order to "safeguard the stability of the euro area as a whole". Second, questions have been raised concerning the role of conditionality in the wider crisis management framework.

- ***What is the relationship between conditionality and the EU economic policy competence? Why is conditionality presumed necessary?***

The experiences from the crisis have stressed the need to separate liquidity problems from solvency problems. The ESM Treaty establishes that from the beginning of 2013, new sovereign bonds in the euro area must include standard collective clauses (CACs) to simplify sovereign debt restructuring. Various proposals aimed at operationalizing sovereign debt restructuring have been made both at the euro area level and based on international law.

Bianco, 'The Bitter End of Sovereign Debt Restructurings: The Abaclat v. Argentina Arbitration and the Eurozone Crisis' (2013) *Legal Issues of Economic Integration*, 315

Pottakis, 'In Search of a Modern Deus ex Machina: Towards an Orderly Bankruptcy of European Legal Orders' (2011) *European Public Law*, 181

- ***What is the legal function of CACs and what would sovereign debt restructuring require from a legal and institutional point of view?***

2) Prospects for Euro-bonds

In recent years a number of proposals relating to greater risk-sharing have been made, building on joint and several debt, a debt redemption fund, and Eurobonds. Apart from their economic function, the discussion has also related to their compatibility with the current Treaties, and led to the appointment of an Expert Group on Debt Redemption Fund and Eurobills.

Final Report of the Expert Group on Debt Redemption Fund and Eurobills Chaired by Gertrude Tumpel-Gugerell, 31 March 2014.

Allemand, 'La faisabilité juridique des projets d'euro-obligations' (2012) *Revue trimestrielle de droit européen*, 553-594

- ***Study the findings of the Expert Group in particular relating to legal and institutional questions and compare them with the Five Presidents' Report.***

3) Fiscal stabilisation mechanisms

Hinarejos, 'Fiscal Federalism in the European Union: Evolution and future choices for EMU' (2014) *Common Market Law Review*, 1621-1642

Pisani-Ferry, Vihriälä, and Wolff, "Options for a Euro-area fiscal capacity", Bruegel Policy Contribution, No 2013/01 (2013).

European Parliament, Legal options for an additional EMU fiscal capacity (2013)

The plans towards the development of a fiscal union include proposals relating to the establishment of fiscal stabilisation mechanisms. However, very few proposals have been made concerning how the resources would be collected, and what they would be used for.

Concerning the unemployment benefit scheme, see e.g.

Andor, "Social dimension of the Economic and Monetary Union: what lessons to draw from the European elections?", Lecture at Hertie School of Governance, Berlin, 13 June 2014.

Andor, "Basic European unemployment insurance: Countering divergences within the Economic and Monetary Union", Speech at Vienna University of Economics and Business, Vienna, 29 September 2014.

Beblavý, Gros and Maselli, "Reinsurance of National Unemployment Benefit Schemes" (2015) available at <<http://www.ceps.eu/system/files/wd401.pdf>> (last visited 27 June 2015);

Dolls, Fuest, Neumann and Peichl, "An Unemployment Insurance Scheme for the Euro Area", ZEW Discussion Paper No 14-095 (2014);

Would such a scheme be compatible with the EU Treaties? What legal basis could it be based on?

The Five Presidents' Report proposes the introduction of a stability scheme for the euro area's public economy. The report states that in its early stages the stability scheme could be based on e.g. the European Fund for Strategic Investments. The scheme must not lead to the permanent redistribution of income between euro area countries, nor should it be a method to balance income between countries. The stability scheme must not impair incentives to practice policies that aim at a healthy public economy or inhibit intervention in structural deficiencies. The scheme should not become a crisis management tool, i.e. its purpose is not to replace the ESM. It should be open and transparent with regard to all EU Member States. Compliance with the euro convergence criteria would be the prerequisite for participation in the stability scheme. The report emphasises that the stability scheme must be implemented within the framework of the EU, so that it is compatible with the EU's public economy framework and coordination procedures.

- ***The mechanism will be further developed by a specific expert group. What are the relevant legal considerations they should focus on?***