Chapter 8
The EU Economic Governance Framework and the Issue of Debt

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Abstract The Maastricht Treaty introduced the Economic and Monetary Union (EMU) based on a supranational pillar covering the monetary policy and on an intergovernmental pillar covering the coordination of entirely national economic and fiscal policies. This construction relies on the assumption that the disappearance of monetary policy measures to remedy excessive government deficits would discipline Member States' spending policies. In addition, the European level should only guarantee that Member States do not enter into excessive deficits and debts. The recent economic crisis unveiled the weaknesses of the Maastricht EMU construction and its underlying assumptions. Some Member States piled up debt in such an excessive manner that they were not able anymore to refinance themselves on the private markets. Reforms of the EMU's economic governance framework made in the aftermath of the peak of the crisis tightened the margin of public spending without addressing the issue of reducing excessive debt within the tightened limits of the reformed framework. In this context, the idea of establishing a European Redemption Fund (ERF) was put forward, into which all government debts amounting to above 60% of Gross Domestic Product (GDP) would be transferred, and where participating Member States would be obliged to redeem the transferred debt over a fixed period of time. This idea can be realised within the existing Treaty boundaries and would not violate the so-called "no bail-out" clause. It would put overindebted Member States in a position to comply effectively with the reformed economic governance framework.

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8.1 Introduction

Europe is in a state of permanent crisis. Since the outbreak of the economic and financial crisis in 2008, the European Union operates in "crisis modus.' The tools for managing the economic crisis can be found in Title VIII of the Treaty on the Functioning of the European Union (TFEU) on "Economic and Monetary Policy." Essentially, the crisis revolves around the declining refinancing of Member States' expenditure.[1] By that, government debt, as well as its origins and its management in the future, forms the core of the challenges for the European Union. The origins of the excessive debt in some Member States are linked to the existing economic governance framework as it was apparently not able to prevent it. Based on this consideration, the question arises whether this framework is able to manage debt in the future, and which reforms are necessary for enhancing its effectiveness. This chapter will analyse the role of debt in the existing economic governance framework in Sect. 8.2. Section 8.3 will explore ways to manage government debt in the future within the Treaty boundaries.

[1] For a comprehensive understanding of the economic and financial crisis, one has, of course, also to look at the reasons for increasing expenditure of Member States such as the reasons for the reputed necessity to save ailing credit institutions.

8.2 The Role of Debt in the Existing Economic Governance Framework

8.2.1 The Asymmetric Economic and Monetary Union in the Maastricht Treaty

The Maastricht Treaty established “an economic and monetary union”[2] in which “Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council.”[3] It installed “a European System of Central Banks”[4] whose “primary objective […] shall be to maintain price stability”[5] (and which shall “define and implement the monetary policy of the Community.”[6] This basic construction of EMU remained untouched during the subsequent Treaty reforms and can hence be found in this state in the Lisbon Treaty.

The basic construction of EMU is characterised by its asymmetry. Whilst the Monetary Union is a supranational union, the Economic Union remains for the most part an intergovernmental construct. This asymmetry follows from the kind of competences the European Union (EU) has for implementing policies in the respective union and from the kind of mechanisms the Union can use in order to achieve compliance. A supranational union is defined by the existence of exclusive or shared Union competences.[7] Adopting legally binding acts on these competences takes precedence over conflicting national law and includes the obligation for the Member States to implement Union law into national law. An intergovernmental “union” is characterised by the existence of mere coordination competences.[8] In fields covered by these competences, national law remains unaffected by Union action. Monetary policy is, according to Article 3(1)(c) TFEU, an exclusive Union competence, where Member States are not allowed to act unilaterally anymore. Economic policies can, according to Article 5(1) TFEU, only be coordinated so that Member States remain, in principle, legally free to pursue own economic and fiscal policies.

In order to achieve compliance of Member States with Union action, one can distinguish five means to ensure compliance: *First*, there can be private enforcement. Private action builds up pressure on the non-compliant Member State, and

[2] Treaty establishing the European Community, OJ 1992 C 224, entered into force on 1 November 1993 [hereinafter “EC Treaty”], Article 2.

[3] *Ibid.*, Article 103(1).

[4] *Ibid.*, Article 4a.

[5] *Ibid.*, Article 105(1).

[6] *Ibid.*, Article 105(2).

[7] Consolidated version of the Treaty on the Functioning of the European Union, OJ 2016 C 202/47, entered into force on 1 December 2009 [hereinafter “TFEU”], Articles 3 and 4.

[8] *Ibid.*, Articles 5 and 6.

pushes the latter to modify its economic and fiscal policy decisions. *Second*, there can be public enforcement. Within public enforcement, one may distinguish several degrees of intensity. The least intense means of enforcement is "naming and shaming." A publication of non-compliance creates public pressure on the non-compliant Member State to align its economic and fiscal policies with the commonly set policy goals. There can be, *third*, sanctions for non-compliance, and, *fourth*, incentives for compliance. *Fifth*—and this is the most intense means to ensure compliance—European policy decisions substitute national economic and fiscal policy decisions. Non-compliance is then "sanctioned" by substitution. The latter compliance mechanism is characteristic of a supranational union, whilst an intergovernmental "union" can be identified by the absence of such a mechanism. Within the Monetary Union, national central banks and the European Central Bank (ECB) form the "European System of Central Banks" (ESCB).[9] According to Article 14 of the Statute of the ESCB and of the ECB,[10] national central banks are legally bound by the decisions taken by the Governing Council of the ECB within its mandate. By that, ECB Governing Council decisions replace national central bank decisions.

When it comes to the Economic Union, Article 121(1) TFEU only requires that "Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council." Guidelines adopted by the Council may therefore only set policy goals and benchmarks for national economic and fiscal policies, but cannot replace national decisions that are inconsistent with the Union guidelines. National policies have to be aligned with those policy goals without any legally binding enforcement mechanism. They should be disciplined by the markets based on the assumption that, as long as the position of a Member State on the financial markets is the same as of any other private institution, markets will indicate—in the form of decreasing or increasing interest rates on government bonds—whether a national economic and fiscal policy is sustainable and convincing. Therefore, the Treaties provide for the so-called "no bail-out" clause,[11] according to which neither the Union nor the Member States shall be liable for or assume the commitments of other Member States. The provisions also bar central banks from purchasing government bonds on primary markets,[12] and prevent any kind of privileged access by central governments to financial institutions.[13]

Based on these considerations, one can classify the current choice of the Treaties to achieve compliance within the Economic Union, as a combination of private enforcement and "naming and shaming." As already mentioned, higher interest rates on government bonds should make Member States modify their national policy choices. This "private enforcement" can be reinforced or

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[9] *Ibid.*, Article 282(1).

[10] Protocol (No. 4) on the Statute of the European System of Central Banks and of the European Central Bank, 2016 C 202/230.

[11] TFEU, above n 7, Article 125.

[12] *Ibid.*, Article 123.

[13] *Ibid.*, Article 124.

even triggered by the Council under the multilateral surveillance procedure in Article 121(4) TFEU. Where non-compliance of a Member State's national policies with the Union economic policy guidelines is established, and where the Member State concerned persistently refuses to remedy the state of non-compliance, the Council can make this situation and its recommendations public. Further means to achieve compliance are, however, not foreseen under the Treaties.

8.2.2 The Role of Debt

Yet, the EMU legal framework draws one red line for Member States' freedom to conduct their economic and fiscal policies by setting certain budgetary goals that should not be exceeded. This red line is based on the assumption that national economic and fiscal policies of one Member State can only harm other Member States if the budgetary consequences of these economic and fiscal policies lead to a default risk of the Member State in question, which could entail the necessity for a bailout by the other Member States.[14] Therefore the debt situation of the Member States should remain underneath a certain threshold that guarantees that a Member State can refinance its expenditure, which surpasses the revenue generated from own resources such as taxes, on the financial markets at low interest rates. Article 126(1) TFEU implements this assumption by requiring that "Member States shall avoid excessive deficits." An excessive deficit is thereby assumed if either the ratio of the planned or actual government deficit to GDP exceeds 3% or the ratio of government debt to GDP exceeds 60%.[15] The choice of both reference values is considered "arbitrary"[16] and was only reflecting the budgetary situations of the Member States at the time of the negotiations of the Maastricht Treaty. This can be demonstrated by looking closer at the explanation for the introduction of the reference value of 3% of GDP for the tolerated deficit: If, on the basis of a given debt of 60% of GDP, one assumes that nominal GDP increases annually by 5%, a deficit of 3% would not result into any increase of government debt.[17] The fact that since the entry into force of the Maastricht Treaty in 1992, the Member States that form today's Euro area had, on average, only five times a nominal growth of more than 5% of GDP,[18] already shows these reference values could not be suitable to prevent excessive deficits.

[14] De Grauwe 2016, p. 148.

[15] Cf. Article 126(2) TFEU in conjunction with Article 1 of Protocol (No. 12) on the Excessive Deficit Procedure.

[16] De Grauwe 2016, p. 148.

[17] This is based on the following simple calculation: deficit d = annual growth g × government debt D: 5% × 60% = 3%, cf. De Grauwe 2016, p. 148.

[18] This was in 1992, 1994, 2000, 2006 and 2007, cf. OECD 2016.

The arbitrariness of the chosen reference values led soon to the adoption of the so-called Stability and Growth Pact (SGP),[19] which consisted of two Council regulations that aim at preventing a government deficit to become excessive[20] and at correcting an excessive government deficit.[21] The former implements its purpose by "lowering" the tolerated annual government deficit to "close to balance or in surplus." This "lowered deficit" was called "medium-term objective" (MTO) and Member States, whose budgets were not in line with this objective, had to present an "adjustment path" towards this objective in so-called "stability programmes" or, for non-Euro Area Member States, in "convergence programmes." Those programmes were monitored by the Commission and the Council under the multilateral surveillance procedure. When reforming the SGP in 2005,[22] the legislator specified the MTO so that it had to be "within a defined range between −1% of GDP and balance or surplus, in cyclically adjusted terms, net of one-off and temporary measures".[23] From an economic perspective, lowering the tolerated annual government deficit from 3 to 1% in the form of the MTO was only consequent given the lower nominal growth in the EU.

Yet both the limit for government deficit and the limit for government debt are already under the budgetary surveillance procedure under Article 126 TFEU, and are not as strict as they appear to be at first sight. A transgression of the reference values is only considered an excessive government deficit if a Member State cannot rely on certain "mitigating" factors. A transgression of the 3-per-cent-criterion with regard to the annual deficit is exempted if either "the ratio has declined substantially and continuously" in the past or the excess was "only exceptional and temporary and the ratio remains close to the reference value." The excess is considered to be exceptional if it results "from an unusual event outside the control of the Member State concerned and which has a major impact on the financial position of the general government, or when resulting from a severe economic downturn".[24] A government debt of more than 60% of GDP is negligible if "the ratio is

[19] European Council (1997) Resolution on the Stability and Growth Pact, 17 June 1997, OJ 1997 C 236/1.

[20] Council Regulation (EC) (1997) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ 1997 L 209/1 amended by Council Regulation (EC) (2005) No. 1055/2005, OJ 2005 L 174/1 and by Regulation (EU) (2011) No. 1175/2011, OJ 2011 L 306/12.

[21] Council Regulation (EC) (1997) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, OJ 1997 L 209/6 amended by Council Regulation (EC) (2011) No. 1056/2005, OJ 2005 L 174/5 and by Council Regulation (EU) No. 1177/2011, OJ 2011 L 306/33.

[22] Council Regulation (EC) (2005) No. 1055/2005 amending Regulation (EC) (1997) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ 2005 L 174/1.

[23] Regulation (EC) No. 1055/2005, above n 20, Article 1(1) introducing Regulation (EC) No. 1466/97, Article 2a.

[24] Regulation (EC) No. 1467/97, above n 21 Article 2(1).

sufficiently diminishing and approaching the reference value at a satisfactory pace." It is worth mentioning that until the adoption of the reformed SGP with the so-called "six-pack" legislation[25] in 2011 the Commission and the Council did not initiate one excessive deficit procedure because of a transgression of the debt criterion.[26]

Beyond these mitigating factors, in case one or both reference values is exceeded, the Commission has, when preparing its report on the existence of an excessive deficit, to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State."[27] If despite all mitigating factors the Commission considers the presence of an excessive deficit, the Council has still formally to establish its existence by a decision. Before adopting this decision, the Council has to consider, "any observations which the Member State concerned may wish to make."[28] In doing so, the Council is not bound by the considerations of the Commission and may, in particular on the basis of a different assessment of the relevant economic data, come to a different conclusion, and reject to establish the existence of an excessive deficit. The Council has, hence, a broad political discretion.[29] The same applies, in case the Council establishes the existence of an excessive deficit, to subsequent Council recommendations outlining policy measures to remedy the situation. Since, finally, Article 126(10) TFEU excludes the infringement procedure at the ECJ, the Commission is also not allowed to prosecute Member States with judicial means.

In sum, a system of economic and fiscal policy coordination, which ensures compliance mainly by inducing self-determined states to modify their policy choices through the increase or decrease of the costs of refinancing these choices on private markets, must focus on the control of Member States' debt, in particular with regard to states that are unified in a monetary union. If markets for whatever reason do not trigger necessary policy choices of states and their debt level increases continuously, the risk of state bankruptcy and, by that, of assisting

[25] The "Six Pack" consists of five regulations and one directive: Regulation (EU) No. 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, OJ 2011 L 306/1; Regulation (EU) No. 1174/2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, OJ 2011 L 306/8; Regulation (EU) No. 1175/2011 amending Council Regulation (EU) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ 2011 L 306/12; Regulation (EU) No. 1176/2011 on the prevention and correction of macroeconomic imbalances, OJ 2011 L 306/25; Council Regulation (EU) No. 1177/2011 amending Regulation (EC) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, OJ 2011 L 306/33; Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, OJ 2011 L 306/41.

[26] Ohler 2010, p. 340.

[27] TFEU, above n 7, Article 126(3).

[28] *Ibid*. Article 126(6).

[29] ECJ, *Commission v Council, Judgement, 2004,* Case C-27/04, ECR I-6649, para 80.

failing states financially by the higher level or other states increases simultaneously. The usual last resort in such a situation to devaluate the own currency in order to reduce government debt denominated in own currency is excluded for states that are part of a monetary union. Based on these considerations, it becomes clear that debt and the control of debt is crucial in an asymmetric Economic and Monetary Union. Against this background, one may cast serious doubts whether a surveillance procedure such as the one introduced by the Maastricht Treaty and specified by the SGP is suited to meet the challenge of an effective debt control. These doubts refer to the very foundations of the debt control assuming that no debt issues would raise as long as the annual government deficit remains below 3% of GDP and the government debt remains below 60% of GDP, foundations which induce pro-cyclical spending. The doubts refer, furthermore, to the decision-making procedure, which puts the Member States in the Council in the driver's seat of the debt control procedure although it is them that accumulate the debt. The financial and economic crisis that broke out in 2008 revealed ultimately the shortcomings of both the asymmetric EMU and the erroneous debt control.

8.2.3 The Reformed Economic Governance Framework After the Economic Crisis

The debt control in place did not achieve its goal to keep government debt underneath the 60% threshold. Before the outbreak of the crisis, in 2006 and in 2007, the consolidated government debt of only 18 out of 27 EU Member States or only 9 out of 17 Euro area Member States met the debt criterion.[30] After the outbreak of the crisis government debt rocketed upwards so that several Member States were not even able to refinance their expenditure on the financial markets anymore.

In order to address and to overcome shortcomings in the debt control, the Union legislator and the Member States introduced several modifications. The debt level is now already important for the prevention of an excessive deficit. Member States faced with a debt level exceeding 60% of GDP or with pronounced risks of overall debt sustainability have to provide in their stability or convergence programmes for an annual improvement of the cyclically adjusted budget balance, net of one-off and other temporary measures of more than 0.5% of GDP.[31] Furthermore, the reformed corrective arm of the SGP clarified that an excessive deficit procedure may also be initiated if only the debt criterion is not met.[32] When

[30] Eurostat (2016), Government consolidated gross debt 1999–2015.

[31] Regulation (EC) No. 1466/97, above n 20, Article 5(1)(2) as amended by Regulation (EU) No. 1175/2011.

[32] Regulation (EC) No. 1467/97, above n 21, Article 1(1) and Article 2(4)(1) as amended by Regulation (EU) No. 1177/2011.

assessing whether an excessive government deficit because of the transgression of the debt criterion exists, the ratio of the government debt exceeding 60% of GDP is now only considered as "sufficiently diminishing" under Article 126(2) TFEU if "the differential with respect to the reference value has decreased over the previous three years at an average rate of one twentieth per year as a benchmark."[33] In addition to these modifications to the SGP, 25 Member States concluded the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG).[34] This international Treaty supplements the existing primary and secondary EU law without modifying it.[35] It requires from the Contracting Parties to introduce a debt brake rule into their national law "of binding force and permanent character, preferably constitutional."[36] Under this rule, an automatic correction mechanism shall be triggered in the event of a significant observed deviation from the MTO or the adjustment path towards it, whereby the MTO is defined with a lower limit of 0.5% of GDP.[37] Only where the ratio of the government debt is "significantly below 60%," the country-specific MTO can be of at most 1% of GDP.

The role of the Commission was strengthened in the face of the Council by introducing the reversed qualified majority voting.[38] Briefly, this voting procedure foresees that a Commission recommendation is deemed to be adopted by the Council unless the latter decides by a qualified majority to reject the recommendation within 10 days of the Commission's adoption thereof or otherwise to adopt an amended decision. According to Article 7 TSCG "the Contracting Parties whose currency is the euro commit to support the proposals or recommendations submitted by the Commission where it considers that a Member State […] is in breach of the deficit criterion in the framework of an excessive deficit procedure," unless "it is established among the Contracting Parties […] that a qualified majority of them […] is opposed to the decision proposed or recommended." Surprisingly, the reverse qualified majority voting only applies to Council decisions or recommendations relating to the deficit criterion and not to the debt criterion.

In sum, the reformed economic governance framework adopted after the outbreak of the economic crisis in 2008 defined the criteria for the existence of an excessive deficit in a more precise and strict manner and enhanced the importance

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[33] *Ibid*., Article 2(1a).

[34] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union [hereinafter "TSCG"], opened for signature (2012), entered into force on 1 January 2013 http://www.consilium.europa.eu/european-council/pdf/Treaty-on-Stability-Coordination-and-Governance-TSCG, accessed on May 23, 2016.

[35] See for more details Repasi 2013, p. 45.

[36] TSCG, above n 34, Article 3(2).

[37] *Ibid*., Article 3(1)(b) and (e).

[38] Critical on the legality of the introduction of the reversed qualified majority voting: Ruffert 2011, p. 1800 et seq. with further references.

of the debt criterion. The reforms try to overcome the shortcomings of the market-induced enforcement mechanism under the existing framework by placing the emphasis on legal enforcement based on national law and initiated by national institutions. The predominant role of the Council is supposed to be reduced by the introduction of the necessity to organise a qualified majority against Commission proposals and recommendations instead of organising a blocking minority in order to reject these proposals and recommendations.

Stepping back from the details of the reformed economic governance framework, one has to come to conclusion that these reforms of the asymmetric EMU were rather of cosmetic than of substantive nature. The reforms did not mitigate the risk of a sovereign default of those Member States whose budgets got into troubled waters in the aftermath of the economic and financial crisis. The requirement to reduce the annual government deficit is, in practice, impossible to meet for a state whose economy is in a state of heavy recession or even depression. Public spending in times of decreasing private consumption and investments is needed in order to keep the national economy running and to maintain the working capacity of state institutions without the state being able to reduce government debt. In times, in which five Member States have a government debt of more than 100% of GDP[39] and further 7 Member States have a government debt of more than 80% of GDP[40] and in which between 2009 and 2014 only 4 out of 28 EU Member States managed to reduce their government debt for more than only one year,[41] it appears detached from reality to believe that the annual government deficit could be in balance and even in surplus and is used in order to reduce government debt. At the same time, refinancing government debt, provided that the Member State concerned has still access to private financial markets, entails for Member States with a high ratio of government debt to GDP additional expenses, which have to be covered by the annual government deficit.

All things considered, beyond the reforms already made, one has to face the challenge of how to reduce the existing high levels of government debt of the Member States and of how to avoid that Member States pile up government debt in an excessive manner again in the future.

[39] Data for the year 2015: Belgium (106.0%), Greece (176.9%), Italy (132.7%), Cyprus (108.9%) and Portugal (129.0%), cf. Eurostat (2016), Government consolidated gross debt 1999–2015.

[40] Data for the year 2015: Ireland (93.8%), Spain (99.2%), France (95.8%), Croatia (86.7%), Austria (86.2%), Slovenia (83.2%) and the United Kingdom (89.2%), cf. Eurostat (2016), Government consolidated gross debt 1999–2015.

[41] Denmark, Germany, Ireland and Hungary, cf. Eurostat (2016), Government consolidated gross debt 1999–2015.

8.3 Managing Government Debt Within the Treaty Boundaries[42]

As a preliminary remark, it is worth mentioning that the basic asymmetric construction of the EMU cannot be changed outside a formal Treaty change procedure. This sets the limits for secondary law such as the "Six Pack" or the "Two Pack"[43] legislation as well as for international treaties concluded by a subset of Member States such as the TSCG and the Treaty establishing the European Stability Mechanism (ESM-Treaty). The ECJ confirmed this view in its "Pringle" decision on the compatibility of the ESM-Treaty with EU law when it concluded that the ESM-Treaty could enter into force even before the formal introduction of the third paragraph of Article 136 into the TFEU, which stated that the Euro area Member States might establish a stability mechanism.[44] Independently of this "Treaty change," the ESM-Treaty had to comply with the EU Treaties in order to be lawful.

In the following, it will first be discussed how to solve, within the Treaty boundaries, the issue of the existing government debt that is, in parts, too high to ever steer a Member State's budget into calmer waters, in which the current economic governance framework can be applied effectively (Sect. 3.1). In this context, in particular the idea of a European Redemption Fund will be addressed. After having discussed the issue of existing government debt, the management of future debt of Member States will be addressed (Sect. 3.2). Here the prospect of success of automatic correction mechanisms and of the debt brake, as foreseen by the TSCG, will be considered before turning to a short assessment of the possibility to issue common debt at EU level in form of "Eurobonds."

[42] This section partly reproduces Repasi (2016). This study was commissioned, overseen and published by the European Parliament's Policy Department for Citizens' Rights and Constitutional Affairs in the framework of a project IP/C/AFCO/IC/2015-080 at the request of the Parliament's Committee on Constitutional Affairs. It is available at EP website www.europal.europa/studies free of charge.

[43] The "Two Pack" consists of two regulations: Regulation (EU) No. 472/2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, OJ 2013, L 140/1, and Regulation (EU) No. 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficits of the Member States in the euro area, OJ 2013, L 140/11.

[44] ECJ, *Thomas Pringle v Government of Ireland, Ireland and The Attorney General* Judgment 2012, Case C-370/12 [Hereinafter "*Pringle*"] ECLI:EU:C:2012:756, para 185.

8.3.1 *The Fate of the Existing Government Debt: The European Redemption Fund*

In 2012, the German Council of Economic Experts ("Sachverständigenrat") proposed in its annual report a solution on how to deal with the excessive past government debt of the Member States. It recommended the establishment of a European Redemption Fund (ERF) following the sample of the German "Redemption Fund for Inherited Liabilities" ("Erblastentilgungsfonds"), which was created in 1995 in order to pay off debts incurred by the former German Democratic Republic.[45] The ERF proposal consists of several elements:[46] Government debt, which amounts above the reference value of 60% of GDP, would be transferred to a common redemption fund subject to joint and several liability. During a "roll in" phase of around five years the transferral of government debt is made by a purchase of bonds with a maturity of more than two years of participating Member States on the primary market.[47] The debts remain exclusively with the participating countries. A consolidation path has to be laid down for each Member State in a legally binding way, which would require from the Member State to redeem autonomously the transferred debt over a period of 20 to 25 years.

After the "roll in" phase, a Member State's outstanding debt level would comprise (1) debts for which it is individually liable amounting to 60% of GDP, and (2) debts that, at the time of the transfer, exceed the reference value of 60% of GDP, which are transferred to the ERF. The transferring Member States bear the primary liability and the ERF a secondary liability. The joint liability during the repayment phase means that bonds would be issued by the ERF with a high rating in order to stabilise the European financial system until the national bond markets regain sufficient functionality. Participation is subject to strict conditionality. If a Member State does not meet its political reform commitments, which are supposed to lead to consolidation and growth, the "roll in" would be discontinued and the Member State in question would be fully exposed once again to the financial markets. Finally, in order to cover the eventuality that an individual participating Member State is called on to pay up under its joint and several liability, its risk would have to be limited by agreeing a burden-sharing scheme amongst the participating Member States.

In September 2013, the European Commission established an expert group chaired by the former member of the ECB Executive Board Gertrude Tumpel-Gugerell whose mission was to analyse possible merits, risks, requirements and obstacles of partial substitution of national issuance of debt through joint issuance in the form of a redemption fund and eurobills (hereinafter: "Expert Group"). The

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[45] See Gesetz über die Errichtung eines Erblastentilgungsfonds (1993), Bundesgesetzblatt 1993, vol I, pp. 944, 984.

[46] German Council of Economic Experts 2011, p. 107.

[47] Schorkopf 2012, p. 9.

report of the Expert Group dealt with legal issues relating to the establishment of an ERF and came to the conclusion that it could not to be introduced under the existing Treaties.[48] This conclusion was based on two arguments. First, the ERF would violate Article 125 TFEU, even read in the light of the ECJ's decision in the "Pringle" case.[49] Second, Article 352(1) TFEU would not suffice as a legal base within the existing Treaties. A Treaty change is required.[50] Both arguments will be critically assessed in the following.

8.3.1.1 Violation of Article 125 TFEU

According to Article 125(1) TFEU, neither the Union nor a Member State is "liable for […] the commitments" of another Member State or "assume[s] [those] commitments." The wording of Article 125(1) TFEU suggests that any legal construction which leads to an automatic payment of the full amount of financial commitments of one Member State by the other Member States or the Union, such as a guarantee structure based on joint and several liability, violates per se Article 125(1) TFEU.

Yet, in its *Pringle* judgement, the ECJ specified the content of this provision. According to the Court, Article 125 TFEU is not intended to prohibit either the Union or the Member States from granting *any* form of financial assistance whatsoever to another Member State. The Court relies on the purpose of Article 125 TFEU, which is to ensure that Member States remain subject to the logic of the market when they enter into debt. Markets 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 Court therefore concludes that "Article 125 TFEU […] prohibits the Union and the Member States from granting financial assistance as a result of which the incentive of the recipient Member State to conduct a sound budgetary policy is diminished. However, Article 125 TFEU does not prohibit the granting of financial assistance by one or more Member States to a Member State, which remains responsible for its commitments to its creditors provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy."[51] This leads to the assumption that financial assistance, which meets the two following criteria, does not violate Article 125(1) TFEU. Financial assistance must be indispensable for the safeguarding of the financial stability of the euro area as a whole and must be subject to strict conditions.

When applying these two conditions to the establishment of a redemption fund, one comes to the conclusion that it would not violate Article 125(1) TFEU.

[48] Expert Group 2014, pp. 57–66.

[49] *Ibid.*, p. 58 et seq.

[50] *Ibid.*, p. 64 at para 250.

[51] *Pringle*, above n 44, para 136 et seq.

The financial and economic crisis revealed that overindebted government budgets lead to significant crises of the financial stability within the monetary union. Reducing debt to the level that can be tolerated under the Maastricht criteria is therefore indispensable for the safeguarding of the financial stability of the euro area. Furthermore, participation in the redemption fund is, as shown above, subject to strict conditionality.

This strict application of the two conditions ignores, however, the purpose of Article 125(1) TFEU. If one reduces the legality test of financial assistance programmes under Article 125(1) TFEU to the fulfilment of these two criteria, any financial assistance programme could pass it. The purpose of Article 125(1) TFEU, which is that Member States remain subject to the logic of the market that coordinates their economic, fiscal and budgetary policies, would be completely ignored.[52] Therefore, the ECJ also required in the *Pringle* judgement that the Member State, which receives financial assistance, "will remain responsible to its creditors for its financial commitments".[53] It appears now that the legality test for a redemption fund fails to meet this understanding of the purpose of Article 125(1) TFEU. Government debt of more than 60% of the GDP of the participating Member State is taken over by the ERF. The ERF is backed by a joint and several guarantee of the participating Member States. Member States will rather be pulled out of the market than remain subject to market logic. This was the main argument, on which the Expert Group based its assumption that Article 125(1) TFEU would be violated by the establishment of an ERF.

Against this understanding, one may now refer to the concrete assessment of the ECJ in the *Pringle* case of the several instruments of the ESM. Under Articles 17 and 18 of the ESM-Treaty, the ESM may purchase bonds issued by an ESM Member State on the primary market. The ECJ compared such purchases to the granting of a loan under Articles 15 and 16 of the ESM-Treaty.[54] According to the ECJ, granting a loan does not imply "that the ESM will assume the debts of the recipient Member State. On the contrary, such assistance amounts to the creation of a new debt, owed to the ESM by that recipient Member State, which remains responsible for its commitments to its creditors in respect of its existing debts."[55] The Court emphasised that "any financial assistance granted on the basis of Articles 14 to 16 thereof must be repaid to the ESM by the recipient Member State."[56] In light of these considerations, the purchase of government bonds covering the government debt above 60% of GDP by the ERF would not violate Article 125(1) TFEU. The Member State in question remains responsible for its commitments. These commitments are now not anymore vis-à-vis a private financial market operator but vis-à-vis the ERF.

[52] Expert Group 2014, p. 60.

[53] *Pringle*, above n 44, para 138.

[54] *Ibid.*, para 140.

[55] *Ibid.*, para 139.

[56] *Ibid.*, para 139.

This leads to the final question whether the joint and several liability of the participating Member States for the ERF is to be considered a violation of Article 125(1) TFEU. The wording of Article 125(1) TFEU refers to "the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State" when defining which commitments are covered by it. The wording does not refer to commitments of the EU or other international entities. Commitments of a European redemption fund therefore seem not to be covered by Article 125(1) TFEU and, thus, a joint and several liability of Member States participating in the ERF is not violating Article 125(1) TFEU.[57] Yet, one may argue, as the Expert Group did, that such an understanding of Article 125(1) TFEU would undermine its effectiveness as Member States could escape their obligations under this article by simply establishing an international fund.[58] Even if Article 125(1) TFEU could be applied to commitments of the ERF, a joint and several liability would not conflict with it.

In the *Pringle* case, the ECJ examined the legality of Article 25(2) ESM-Treaty, which dealt with a situation in which an ESM member fails to meet the required payment under a capital call under the ESM-Treaty. In such a situation, under Article 25(2) ESM-Treaty, "a revised increased capital call shall be made to all ESM Members with a view to ensuring that the ESM receives the total amount of paid-in capital needed." This situation can be understood as some sort of joint and several liability of the other ESM members in case of the inability to pay by one of the ESM members. The ECJ upheld this provision by referring to the fact that "under that same provision, the defaulting ESM Member State remains bound to pay its part of the capital. Accordingly, the other ESM Members do not act as guarantors of the debt of the defaulting ESM Member."[59] This means that as long as every Member State participating in the ERF remains bound to its consolidation path—even in the event of a default—a temporary additional financial assistance of the other participating Member States to the ERF would be in line with Article 125(1) TFEU. This shows that, according to the ECJ, a legally binding internal burden sharing between the participating Member States is sufficient in order to consider a liability of participating Member States, which goes beyond its predefined share, to be a financial commitment, which is not in violation of Article 125(1) TFEU.

8.3.1.2 Legal Basis

The second line of arguments against a legally possible establishment of an ERF under the existing Treaties relates to the legal basis.[60] A possible legal basis is

[57] Nettesheim 2013, p. 607.

[58] Expert Group 2014, p. 59.

[59] *Pringle*, above n 44, para 145.

[60] Expert Group 2014, p. 63.

Article 352(1) TFEU. According to this article, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, may adopt measures if Union action should prove necessary to attain one of the objectives set out in the Treaties provided that there are no specific competences in the Treaties. The objective can be found in Article 3(4) TEU, referring to the establishment of an economic and monetary union whose currency is the euro, which includes the safeguarding of the financial stability of the euro area as a necessary condition for the functioning of the EMU. This objective is met with regard to the ERF since it guarantees a reduction of government debt down to the Maastricht criterion of 60% of GDP and stabilises, by this means, Member States' national budgets. Based on these arguments, the ESM could have been established on the basis of Article 352(1) TFEU, which was not excluded by the ECJ in the *Pringle* case.[61]

Yet, a legal act based on Article 352(1) TFEU may not modify Primary law. Otherwise, it would undermine the Treaty change procedure foreseen by Article 48 TEU. Based on these observations, one may argue against the use of Article 352(1) TFEU for the establishment of an ERF. The use of this provision would undermine Member States' budgetary sovereignty, as protected by Article 311 TFEU.[62] One may, indeed, establish a principle, according to which Union legal acts may not request any payments from Member States' budgets outside their contributions to the Union budget. Whilst this is not completely true, since Article 311(2) allows for "other revenue" including payments from Member States' budgets without being an own resource, payments to the ERF could be established at least as a new "own resource" of the Union, in accordance with Article 311(3) TFEU. It is therefore true to argue that a legal act based on Article 352(1) TFEU may not circumvent Article 311(3) TFEU and its reference to an approval of the introduction of a new category of own resources by the Member States in accordance with their respective constitutional requirements.[63] However, this argument is not against the establishment of an ERF within the existing Treaties, but in favour of it.

8.3.1.3 Conclusion

The ERF, as proposed by the German Council of Economic Experts, could legally be established within the existing Treaties on the basis of Article 352(1) TFEU,

[61] *Pringle* above n 44, para 67. It should be noted that the ECJ examined the legality of the ESM before the entry into force of Decision 2011/199, which introduced Article 136(3) in the TFEU. Since this did not harm the legality of the ESM (para 185), neither an international Treaty such as the ESM-Treaty nor a Union act based on Article 352(1) TFEU would have been in violation of the Treaties. The reasoning of the ECJ with regard to the ESM-Treaty would have to be applied in the same manner to a Union legal act.

[62] Expert Group 2014, p. 63.

[63] *Ibid.*

supplemented by a new category of own resources covering the payments of the participating Member States to the ERF on the basis of Article 311(3) TFEU. A redemption fund is not violating Article 125(1) TFEU if the Member States remain responsible for their commitments to their creditors. The ERF would purchase during the "roll in" phase bonds issued by the participating Member States. This purchase is similar to the purchase of bonds under Article 17 of the ESM-Treaty. The purchase creates a new debt, owed to the redemption fund by the recipient Member State. Participation in the ERF is subject to strict conditionality whose purpose is to prompt the implementation of a sound budgetary policy of participating Member States. Finally, there has to be a legally binding burden sharing between the participating Member States, which is not conditional upon the ability of the Member States to pay.

8.3.2 Future Refinancing of Eurozone Member States

After having discussed the issue of existing government debt, the question arises how to control the level of future debt issued by the Member States. An effective reduction of past debt is rendered widely meaningless if Member States can afterwards pile up again new debts, which lays the ground for future debt crises. In the reformed economic governance framework, the TSCG requires that issuing excessive new debt is to be controlled by automatic correction mechanisms and a debt brake in national law.

An interim evaluation of this instrument does, however, not turn out positively. Although all Contracting Parties of the TSCG that were obliged to implement both the balanced budget rule and automatic correction mechanisms[64] had included these rules into their national law, only three of the Contracting Parties are forecast to meet the criterion of a lower limit of the structural deficit of 0.5% of GDP in 2015.[65] The comparison of the forecast structural balance two years after the entry into force of the TSCG with the state of its implementation demonstrates that the mere adoption of national rules does not result into the desired outcome to reduce the government deficit. The German Council of Economic Experts already observed in its annual report 2012/2013 that in the past (prior to the TSCG) "the introduction of such fiscal rules was accompanied by a political willingness to consolidate government budgets, whereas their introduction by way of the Fiscal

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[64] TSCG, above n 34, Article 14(5); according to Article 14(5), these obligations only enter into force for Contracting Parties that are not part of the Euro area "as from the day when the decision abrogating that derogation or exemption takes effect, unless the Contracting Party concerned declares its intention to be bound at an earlier date by all or part of the provisions in Titles III and IV of this Treaty." Such declaration was made by Denmark and Romania. On the implementation, see Burret and Schnellenbach 2013; Bova et al. 2015.

[65] These are Germany, Greece and Luxemburg, cf. Commission, European Economic Forecast, Autumn 2014.

Compact was largely driven by political pressure, since the euro-area states cannot apply for ESM support unless they ratify the Fiscal Compact. It remains to be seen whether the introduction of national fiscal rules under such circumstances will have a similarly positive impact on budget consolidation."[66] In short, the lack of political willingness to consolidate public spending cannot be replaced by simply adopting a national debt brake rule. Furthermore, if, for economic reasons, a Member State is not capable of complying with EU rules, this incapacity will not be overcome by merely implementing the TSCG rules into national law. Therefore, one has to conclude that neither the automatic correction mechanism nor the debt brake rule in the TSCG provides for sufficient legal certainty to prevent another piling up of debt of Member States in the future.

This leads to the discussion whether the common issuance of debt by the EU or at least by the Euro Area Member States could be an effective instrument to control the future level of government debt.[67] Consequence of a common issuance of debt would namely be that participating Member States would not be entitled anymore to issue debt themselves.[68] Debt issuance is, however, only an instrument to refinance public expenditure. It does not define expenditure. Member States are, under the current asymmetric legal framework, still free in pursuing a certain economic policy, which entails certain expenditure. If national expenditure goes beyond what commonly issued debt is willing or able to refinance, the Union will face similar challenges regarding the control of a non-compliant Member State as under the existing reformed economic governance framework. This last thought reveals the 'moral hazard' issue inherent to the common issuance of debt. This 'moral hazard' does not only challenge the political persuasiveness of an introduction of 'Eurobonds' but also points at the main legal impediment for their introduction. As mentioned above, the so-called 'no bail-out' clause in Article 125(1) TFEU requires that the conditions attached to any financial assistance from the Union or the Member States have to be such as to prompt the recipient Member State to implement a sound budgetary policy. In other words, common issuance of debt requires the neutralisation of the 'moral hazard' attached to it. Since this 'moral hazard' derives from Member States' autonomy to define their economic and fiscal policies within a largely still intergovernmental Economic Union, it can only be overcome by 'symmetrising' EMU. The latter as well as the alternative deletion of the 'no bail-out' clause in Article 125(1) TFEU require a Treaty change. By that, very briefly,[69] fully fledged 'Eurobonds' can only be introduced after such a Treaty change.

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[66] German Council of Economic Experts 2012, para 180.

[67] De Haan et al. 2012, p. 323.

[68] For the sake of completeness, it has to be noted that not all the models proposed under the name of "Eurobonds" provide for a total replacement of national government bonds, cf. Claessens et al. 2012.

[69] In detail on legal options for introducing Eurobonds: Mayer and Heidfeld 2012, p. 422.

8.4 Conclusion

An effective debt control is crucial for an asymmetric Economic and Monetary Union, where Member States are free in conducting their economic and fiscal policies, but bound to the monetary policy decisions taken at European level. Market-induced enforcement of European economic policy coordination failed. Since symmetrising EMU cannot be achieved without Treaty change, existing government debt should be transferred into a redemption fund in order to put Member States into a budgetary situation, in which the reformed economic governance framework could have a chance to work effectively. This can be realised without Treaty change. A sustainable solution aims, however, not at controlling debt, but at controlling the national expenditure in a democratically legitimate manner.

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