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# **MECHANISMS OF FINANCIAL STABILISATION**

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## ABSTRACT

One of the measures that the Eurozone Member States took in their attempt to combat the financial and debt crisis was to give financial assistance to the crises-ridden states. The purpose of such assistance was to safeguard the financial stability of the euro area as a whole. Thus, these mechanisms can be referred to as financial stabilisation mechanisms. The purpose of this paper is to provide an overview of the different mechanism of financial stabilisation and their constitutional significance. Due to the fact that there are actually several mechanisms, the discussion will focus mainly on the European Stability Mechanism (ESM), the permanent mechanism. Out of the various constitutional questions that such mechanisms give rise to, this paper will emphasise those issues that relate to the asymmetrical structure of the Economic and Monetary Union (EMU). The choice to focus on issues that relate to the asymmetry of the EMU stems from the fact that these questions are politically most contentious, which also meant that addressing them proved legally difficult.

**Keywords:** European Stability Mechanism, European Monetary Fund, financial stability, C-370/12 Pringle.

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**1. Introduction • 2. The need for financial stabilisation • 2.1 Maastricht and asymmetry • 2.2 An economic narrative to the crisis • 3. Adoption of financial stabilisation mechanisms • 4. The European stability mechanism as an institution • 5. The ECJ approves financial stabilization: Pringle • 6. Constitutional assessment • 6.1 Moral hazard concerns • 6.2 Financial stability as an overriding policy concern • 6.3 Fundamental rights concerns • 7. Future prospects**

## **1. Introduction**

One of the measures that the euro area Member States took in their attempt to combat the Eurozone financial and debt crisis was to give financial assistance to the crises-ridden states. The purpose of such assistance was to safeguard the financial stability of the euro area as a whole. Thus, these mechanisms can be referred to as financial stabilisation mechanisms.

The purpose of this paper is to provide an overview of the different mechanisms of financial stabilisation and their constitutional significance. Due to the fact that there are actually several mechanisms, the discussion will focus mainly on the European Stability Mechanism (ESM), which replaced the earlier temporary mechanisms – namely the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF). Out of the various constitutional questions that such mechanisms give rise to, this paper will emphasise those issues that relate to the asymmetrical structure of the Economic and Monetary Union (EMU). The choice to focus on issues that relate to the asymmetry of the EMU stems from the fact that these questions are politically most contentious, which also meant that addressing them proved legally difficult.

This paper will be structured as follows. Section 2 will explain the economic and political background for why financial stabilisation mechanisms were deemed necessary. Such contextualisation is important to understand why the mechanisms were adopted. Section 3 will provide a chronological reconstruction of the main political and legal events that affected the process of adopting the mechanisms. The purpose of explaining how the mechanisms were adopted is to stress the interplay between economics, politics and law. Then, section 4 explains the role and functioning of the ESM. After this, section 5 will discuss the Court of Justice's (CJEU) landmark ruling in the case *Pringle*,<sup>1</sup> in which the CJEU blessed the creation of the ESM. This is followed in section 6 by an assessment of the constitutional significance of the ESM. Finally, the last section gazes shortly at the possible future of financial stabilisation within the EMU in light of recent proposal for the development of the EMU.

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<sup>1</sup> Case C-370/12 *Thomas Pringle v Government of Ireland, Ireland and The Attorney General* ECLI:EU:C:2012:756.

## 2. The need for financial stabilisation

### 2.1 Maastricht and asymmetry

The key issue with the establishment of the EMU in Maastricht was that the EU's competences regarding economic policy were limited to coordination (Articles 121–126 TFEU), while monetary policy was supranationalized into the exclusive domain of the European Central Bank (ECB) (Article 127 TFEU). In strict legal terms, the EU's competences in monetary policy are legally binding, whereas those relating to economic policy are non-binding. The apparent disparity between these two policies is commonly referred to as the asymmetry of the EMU.<sup>2</sup> Thus, the term 'economic union' is a bit of a misnomer as there is an open contrast between the single monetary policy and the multiple national fiscal policies.<sup>3</sup> Due to the strong link between economic and monetary policies in general, such asymmetry has led to the conclusion that the euro is a currency without a state.<sup>4</sup>

To handle the asymmetry of EMU, the Treaty of Maastricht introduced a number of fiscal rules, notably the Stability and Growth Pact (SGP). Furthermore, national central banks and the ECB were prohibited from providing monetary financing to the Eurozone Member States (Article 123 TFEU), while the EU and the Member States were prohibited from assuming the liabilities of other Member States through the 'no bail-out' clause (Article 125 TFEU). Together, these rules were intended to counter the negative consequences that a common currency without a common economic policy might bring about, as the rules were thought to subject the Eurozone Member States to the logic of the markets; that they would conduct prudent fiscal policy in the hopes of thus getting cheap financing for their government debt from the markets. Without the no bail-out clause the SGP would be meaningless, since independently conducted economic policies would not be independent if they would in the end be backed up by mutual liability, that is, a bail-out by the other Member States.

It is by now common knowledge that the framework did not work as designed. The political nature of the SGP had become apparent already before the Eurozone crisis, when it was not enforced against Germany and France even though they had breached the deficit and debt criteria.<sup>5</sup> During the economic boom prior to the crisis, spreads in the interest rates of different Eurozone Member States did not reflect their governments' financial situations.<sup>6</sup> The logic of the market was not functioning.

Herein lies the background to the Eurozone crisis: a common monetary policy that creates mutual interdependence, but no common economic (fiscal) policy that would stabilize this

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<sup>2</sup> On this asymmetry, see Ian Harden, 'The Fiscal Constitution of the EMU' in Paul Beaumont and Neil Walker (eds), *Legal Framework of the Single European Currency* (Oxford: Hart Publishing 1999) 71–74. On the constitutional paradoxes, when compared to the USA, that the asymmetry resulted in following the Eurozone crisis, see Federico Fabbrini, *Economic Governance in Europe: Comparative Paradoxes and Constitutional Challenges* (Oxford: Oxford University Press 2016).

<sup>3</sup> Rosa Maria Lastra and Jean-Victor Louis, 'European Economic and Monetary Union: History, Trends, and Prospects' (2013) 32 *Yearbook of European Law* 57, 90–91.

<sup>4</sup> See Tommaso Padoa-Schioppa, *The Euro and Its Central Bank: Getting United After the Union* (Cambridge, Massachusetts: MIT Press 2004) 35–36.

<sup>5</sup> See Case C-27/04 *Commission v Council* ECLI:EU:C:2004:436.

<sup>6</sup> See Salvador Barrios *et al*, 'Determinants of intra-euro area government bond spreads during the financial crisis' (2009) European Commission, DG Economic and Social Affairs.

interdependence. Thus, the asymmetry of EMU, as established in Maastricht, ‘has come back to haunt Europe in the context of the European financial and euro area debt crisis’.<sup>7</sup>

## 2.2 An economic narrative to the crisis

Soon after the onset of the global financial crisis that begun from the 2007 USA subprime mortgage crisis the economic situation of certain Eurozone Member States started to deteriorate. International rating agencies lowered the ratings for their government bonds as well as those of several important national banks. This started to threaten the stability of the banking system in the Eurozone since due to the common currency and mutual borrowing the still better of countries and banks were also affected. If in the USA the fall of Lehman Brothers in 2008 was the decisive moment, in Europe it was the announcement by the Greek Prime Minister George Papandreou in October 2009 that the debt and deficit levels previously reported by Greece had been tremendously wrong. After this announcement, ‘the euro decisively ceased being boring’.<sup>8</sup>

While all of this affected various parts of the Eurozone differently, some common denominators can be found. Ireland and Spain were hit by the initial global financial crisis. When consumption plummeted, especially the construction sector faced problems. Greece, Portugal and Italy were hit by a fiscal crisis caused by their own government spending. The northern European creditor countries were hit by a balance of payments crisis, as suddenly capital started to flow out from them. National governments failed to react to these problems since cheap debt was available due to the euro. Monetary stability did not mean financial stability and due to its strict monetary policy mandate, the ECB had no way of tackling this. The link between governments and banks meant that it was difficult for sovereigns to react to the crisis.

After the initiation of the financial crisis in Europe it soon became obvious that the most indebted and economically weak Eurozone Member States might actually face bankruptcy. This, so it was perceived, could consequently threaten the existence of the whole Eurozone. Due to a home bias in the holdings of sovereign debt by banks, sovereign default in the Eurozone results also in the private banks of that country running into trouble as they are no longer able to receive liquidity from the ECB because the sovereign debt they hold is worthless and thus not suitable as collateral. The only option left would be to exit the Eurozone. Furthermore, default by one Eurozone Member State would have given the markets a signal that investments in other crisis states are not safe either, resulting in their debt refinancing costs soaring and therefore bringing also them closer to default. Such contagion was seen to threaten the existence of the euro. Whether or not this would have resulted in the breakup of the euro, we will never know, but the economic consequences of this would have been catastrophic no doubt. In this situation giving financial assistance to both states and banks seemed like the best and only option as the link between the two had not yet been severed.<sup>9</sup>

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<sup>7</sup> Fabian Amtenbrink, ‘The Metamorphosis of European Economic and Monetary Union’ in Anthony Arnall and Damian Chalmers (eds), *The Oxford Handbook of European Union Law* (Oxford: Oxford University Press 2015) 722.

<sup>8</sup> Jean Pisani-Ferry, *The Euro Crisis and Its Aftermath* (Oxford: Oxford University Press 2014) 8.

<sup>9</sup> The European Banking union is meant to sever the link between sovereigns and banks.

However, it were the political consequences that were most feared. This sentiment is depicted well in the words of German Chancellor Angel Merkel: ‘If the euro fails, Europe fails’.<sup>10</sup> This attitude – of being ready and willing to do ‘whatever it takes’ to preserve the euro<sup>11</sup> – is important for understanding the political events that resulted in the uptake of the various mechanisms of financial stabilisation and their subsequent constitutionalisation by the CJEU in *Pringle*.

### 3. Adoption of financial stabilization mechanisms

During the spring of 2009 the global financial markets showed some sign of recovery following two years of turmoil. But things started to develop for the worse after France, Greece, Ireland and Spain were deemed to have excessive deficit levels.<sup>12</sup> The real kick-off for the sovereign debt crisis in Europe was delivered on 21 October 2009, when the newly elected Greek Government revealed actual deficit levels that were considerably higher than what had been reported by the previous Government: 12,5 per cent of GDP instead of 3,7 per cent of GDP.<sup>13</sup> This announcement triggered a series of events that eventually led to the establishment of the ESM, an amendment to the Treaty on the Functioning of the European Union (TFEU), and the constitutionalisation of bail-outs by the CJEU in *Pringle*.

During the spring of 2010 several meetings by the Eurozone Heads of State or Government were held, in which the will to and the form how to resolve the crisis was carved out. On 11 February 2010, Eurozone Member States declared at an informal meeting that they ‘will take determined and coordinated action, if needed, to *safeguard financial stability in the euro area as a whole*’.<sup>14</sup> The form of assistance that was going to be given to Greece was decided in the meeting of the Heads of State or Government of the Eurozone on 25 March 2010.<sup>15</sup>

Prior to this, there had been proposals from Germany to amend the Treaties and to establish a European alternative to the International Monetary Fund (IMF). German Chancellor Merkel had endorsed such ideas, but since amending the EU Treaties would have required the consent of all Member States, and it could also have been deemed *ultra vires* by the German Federal Constitutional Court,<sup>16</sup> these German aspirations had to be abandoned.<sup>17</sup> Thus, the rescue package to support Greece took the form of coordinated bilateral loans between the Member States, on the one hand, and the Greek government, on the other. This is usually referred to as the Greek Loan Facility (GLF). Then, on 11 April 2010, the Eurozone Member States issued a joint statement in

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<sup>10</sup> “‘If the Euro Fails, Europe Fails’: Merkel Says EU Must Be Bound Closer Together”: *Spiegel Online* (7 September 2011) <<http://www.spiegel.de/international/germany/if-the-euro-fails-europe-fails-merkel-says-eu-must-be-bound-closer-together-a-784953.html>>.

<sup>11</sup> ‘Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.’ Speech by Mario Draghi, President of the European Central Bank at the Global Investment Conference. London, 26 July 2012.

<sup>12</sup> ECOFIN Council 226, 228, 230 and 232. Brussels, 23 April 2009.

<sup>13</sup> COM(2010) 1 final, Report on Greek Government Deficit and Debt Statistics. Brussels, 8 January 2010.

<sup>14</sup> Statement by the Heads of State or government of the European Union. Brussels, 11 February 2010. Emphasis added.

<sup>15</sup> Statement by the heads of state and government of the euro area. Brussels, 25 March 2010.

<sup>16</sup> It had only recently, in June 2009, pronounced on the Treaty of Lisbon and especially the economic competences of the EU. See BVerfG, Judgment of the Second Senate of 30 June 2009 - 2 BvE 2/08 - paras. (1-421), ECLI:DE:BVerfG:2009:es20090630.2bve000208.

<sup>17</sup> Ledina Gocaj and Sophie Meunier, ‘Time Will Tell: The EFSF, the ESM, and the Euro Crisis’ (2013) 35 *Journal of European Integration* 239, 242.

which they specified some of the conditions for this bilateral assistance, for example, the interest rates and the maturity of these loans.<sup>18</sup> The formal agreement on granting assistance was reached on 2 May 2010.<sup>19</sup>

However, this was not the end of the crisis – far from it. There was the fear of contagion from Greece to the considerably bigger economies of Spain and Italy, and the possibility that the now agreed measures would not be enough for Greece.<sup>20</sup> For these reasons, other additional measures were seen as necessary. On 7 May 2010 the Eurozone Heads of State or Government issued a statement in which they spelled out some of their aspirations on how to solve the current crisis and prevent future crises.<sup>21</sup> One of these measures included ‘a European stabilization mechanism to preserve financial stability in Europe’. This was basically the announcement of both the European Financial Stability Mechanism (EFSM) and the European Financial Stability Facility (EFSF). Following this, the Council meeting on 9–10 May 2010 decided on the EFSM Regulation,<sup>22</sup> after which the Eurozone Heads of State or Government agreed on the EFSF as a special purpose vehicle outside the EU’s legal framework.<sup>23</sup>

The EFSM was established with a Regulation, the legal basis of which was Article 122(2) TFEU. Similarly to the EFSF, the EFSM finances its actions by issuing debt instruments on the markets. However, as the EFSM is part of EU law, the collateral for these loans is provided in the form of the EU’s own budget. This means that the capacity of the EFSM is very limited: about € 60 billion in 2010. Through the EU’s budget, the Member States are indirectly liable for the EFSM. Support through the EFSM has been given to Ireland (€ 22.5 billion), Portugal (€ 24.3 billion) and Greece (€ 7.1 billion as a short-term bridge loan)<sup>24</sup>. Being a part of EU law, the Commission has a central role in the operation of the EFSM. The beneficiary Member State and the Commission conclude a Memorandum of Understanding (MoU) in which the conditions for financial assistance are prescribed (Article 3(5) EFSM Regulation). The decision to grant financial assistance is made by the Council, acting by a qualified majority (Article 3(2) EFSM Regulation). Although the ESM is in operation now, the EFSM remains in place for specific tasks such as providing bridge loans.<sup>25</sup>

The EFSF was established as a limited liability company (*Société Anonyme*) under Luxembourg law. The EFSF shareholders are the Eurozone Member States, with the exception of Latvia and Lithuania. They participated into the support mechanisms only later, when the ESM was already in place. The EFSF provided financial assistance to Ireland (€ 17.7 billion), Portugal (€ 26 billion) and Greece (€ 141.8 billion). These operations were financed through bonds and other debt instruments issued on the financial markets. Each EFSF Member guaranteed a part of these instruments, which means that they are not liable for the totality of the debts of the EFSF. These guarantee commitments were divided between the EFSF Members according to the capital

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<sup>18</sup> Statement on the support to Greece by Euro area Members States. Brussels, 11 April 2010.

<sup>19</sup> Statement by President Van Rompuy following the Eurogroup agreement on Greece. Brussels, 2 May 2010.

<sup>20</sup> ‘Central banks are losing credibility’: *Financial Times* (12 May 2010).

<sup>21</sup> Statement by the heads of state and government of the euro area. Brussels, 7 May 2010.

<sup>22</sup> Council Regulation (EU) No 407/2010 establishing a European financial stabilisation mechanism [2010] OJ L118/1.

<sup>23</sup> ECOFIN Council 265, Annex. Brussels, 10 May 2010.

<sup>24</sup> Council Implementing Decision (EU) 2015/1181 of 17 July 2015 on granting short-term Union financial assistance to Greece. OJ L 192, 18.7.2015, p. 15–18.

<sup>25</sup> Information on the EFSM is available on the Commission’s website: <[https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance/loan-programmes/european-financial-stabilisation-mechanism-efsm\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance/loan-programmes/european-financial-stabilisation-mechanism-efsm_en)>.

subscription key of the ECB.<sup>26</sup> The main decision-making body of the EFSF is the General Meeting of Shareholders, in which the finance ministers of the 17 participating Eurozone Member States meet. As the EFSF is no longer used for new assistance operations, its most important decisions concern, for example, the appropriation and distribution of net profits. Administrative decisions are carried out by the Board of Directors, in which each EFSF Member has a representative. The Chief Executive Officer of the EFSF is the same person as the Managing Director of the ESM. Although the EFSF is no longer used in new financial assistance operations, it is still functioning and active on the bond markets as it needs to roll over existing debt.<sup>27</sup>

The reasons for adopting two separate bail-out mechanisms were rather simple. First, it was thought that because the EFSM was an EU law instrument, and because the EU has only a limited budget, the EFSM would not be enough to deal with the crisis. Therefore, a substantially larger fund was seen to be needed. Second, a mechanism based on secondary EU law and thus applicable to all Member States requires those outside the Eurozone to participate to the financing of a crisis that was inherently seen as one of only the Eurozone. Therefore, something in addition to the EU law based EFSM was seen as necessary.<sup>28</sup> The answer came in the form of the EFSF, which was modelled on the GLF.<sup>29</sup>

Immediately after this, the *Euro rescue package* case was submitted before the German Federal Constitutional Court by a group of German scholars who argued, inter alia, that Article 122 TFEU was not an adequate legal basis for the EFSM Regulation, and that both the EFSM and the special purpose vehicle EFSF violated the no bail-out clause of Article 125 TFEU.<sup>30</sup> This had the effect that, in fear of the German court accepting such claims, German Chancellor Merkel had to come up with a more reliable way of dealing with the crisis. Thus, the idea for a Treaty amendment and the ESM was born.<sup>31</sup> Following this, on 18 October 2010, France and Germany issued a joint declaration that the EU Treaties should be amended to facilitate the solving of the Eurozone crisis in a more efficient manner.<sup>32</sup>

Such an amendment had also been on the agenda of the European Council President Herman van Rompuy,<sup>33</sup> but it had become clear during the year that British Prime Minister David Cameron opposed such plans in an attempt to secure opt-outs to the EU's ever tightening regulatory framework for the banking sector of the City of London.<sup>34</sup> In the European Council meeting of 28–29 October 2010 a compromise was reached on the establishment of a permanent aid

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<sup>26</sup> Alberto de Gregorio Merino, 'Legal Developments in the Economic and Monetary Union During the Debt Crisis: the Mechanisms of Financial Assistance' (2012) 49 *Common Market Law Review* 1613, 1619.

<sup>27</sup> Information on the EFSF is available on the ESM's website: <<https://www.esm.europa.eu/efsf-overview>>.

<sup>28</sup> Bruno de Witte and Thomas Beukers, 'The Court of Justice Approves the Creation of the European Stability Mechanism outside the EU Legal Order: Pringle' (2013) 50 *Common Market Law Review* 805, 808–809.

<sup>29</sup> Amy Verdun, 'A Historical Institutional Explanation of the EU's Responses to the Euro Area Financial Crisis' (2015) 22 *Journal of European Public Policy* 219, 225.

<sup>30</sup> See BVerfG, Judgment of the Second Senate of 07 September 2011 - 2 BvR 987/10 - paras. (1-142), ECLI:DE:BVerfG:2011:rs20110907.2bvr098710.

<sup>31</sup> Gavin Barrett, 'First Amendment? The Treaty Change to Facilitate the European Stability Mechanism' (2011) *The Institute of International and European Affairs* 1, 15.

<sup>32</sup> Piotr Kaczyński and Peadar ó Broin, 'From Lisbon to Deauville: Practicalities of the Lisbon Treaty Revision(s)' (2010) 216 *CEPS Policy Brief* 1.

<sup>33</sup> Strengthening economic governance in the EU. Report from the task force to the European Council. Brussels, 21 October 2010.

<sup>34</sup> 'Don't expect Britain to back a new EU treaty, Cameron tells Merkel': *Independent* (22 May 2010).

mechanism.<sup>35</sup> It was agreed that this mechanism would be based on a limited change of the EU Treaties, thus leaving the no bail-out clause of Article 125 TFEU intact, and that it would be the Member States themselves and not the EU that would establish this mechanism. The permanent mechanism was to replace the EFSM and the EFSF in 2013. This approach had the effect that, first, the mechanism would be based on international law and not EU law, and second, that the simplified revision procedure of Article 48(6) TEU could be used to facilitate the necessary Treaty amendment.<sup>36</sup> The European Council took the final decision on amending Article 136 TFEU in its meeting on 25 March 2011.<sup>37</sup>

The need for a permanent mechanism became evident during January 2011, when, despite the EFSF bond auction for Ireland going through well, there was much speculation of Portugal, Spain and Italy also needing support from the EFSF and its capacity not being enough to bail-out all three in addition to Greece.<sup>38</sup> The underlying reason limiting the EFSF's capacity was Germany's determination to retain the AAA rating of bonds issued by the EFSF, which limited its actual capacity from what it was originally supposed to be. This left the Member States underprepared to deal with possible future crises. These negative market reactions also forced the Member States to establish a permanent mechanism faster than Germany would have wanted to.<sup>39</sup>

#### **4. The European stability mechanism as an institution**

The Eurozone Member States established the ESM by an international law based treaty.<sup>40</sup> In the ESM Treaty, the Eurozone Member States are called ESM Members. Due to its legal nature, the ESM thus functions outside the scope of EU law and what is more, despite the close connection it has with the EU's economic governance regime, it is not an official institution of the EU. It is a permanent international organization headquartered in Luxembourg. As indicated in the preamble of the Treaty, the ESM intendeds to safeguard the financial stability of the euro area (Preamble 6 ESM Treaty). To do this, it offers loans and direct financial assistance to ESM Members and banks (Articles 13–18). It finances its actions by issuing debt instruments on the public markets. In order to do this, the ESM Members have given it its own capital and have committed to pay in more capital if need be.

The capital structure of the ESM consists of paid-in capital and callable capital. As of 2018, the total authorised capital stock is 704,8 billion euros, of which 80,5 billion euros is paid-in capital and 624,3 billion euros callable capital (Article 8 ESM). Contributions by the Members are apportioned proportionally according to their contributions to the ECB's capital, pursuant to Article 29 of the ESCB Statute (Article 11 ESM). For example, Germany's share of the ESM's capital

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<sup>35</sup> European Council conclusions, EUCO 25/1/10. Brussels, 30 November 2010.

<sup>36</sup> de Witte and Beukers (n 28) 811.

<sup>37</sup> 2011/199/EU: European Council Decision of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro.

<sup>38</sup> 'Rush for eurozone bail-out bond': *Financial Times* (26 January 2011).

<sup>39</sup> Gocaj and Meunier (n 17) 247–248.

<sup>40</sup> Treaty Establishing the European Stability Mechanism. 2 February 2012. Available at: <<https://www.esm.europa.eu/legal-documents/esm-treaty>>.

is 26,9 per cent, which equates to 190 billion euros, of which Germany has contributed 21 billion euros as paid-in capital to the ESM.<sup>41</sup>

The ESM may call in more authorised unpaid capital in three circumstances. The Board of Governors, deciding by mutual agreement, may make a capital call at any time (Article 9(1) ESM). Such capital calls could become relevant, for example, in the case of another financial crisis, when the credibility of the ESM to safeguard the financial stability of the euro area would need to be reinforced. The Board of Directors may call in authorised unpaid capital by simple majority decision to restore the level of paid-in capital if the amount of the latter has reduced by the absorption of losses below that of 80,5 billion euros (Article 9(2) ESM). The Managing Director shall call authorised unpaid capital in a timely manner if needed to avoid the ESM being in default of any scheduled or other payment obligation due to ESM creditors (Article 9(3) ESM). This procedure exists essentially for the purpose of rolling over old debt.

The liability of each ESM Member is limited to its portion of the authorised capital stock and the Members are not liable for obligations of the ESM (Article 8(5) ESM). This is where the ESM differs from its predecessor the EFSF, since the EFSF was guaranteed by its Members' commitments.

The ESM has a three-layer governance structure. At the top sits the Board of Governors, comprising of national finance ministers (Article 5 ESM). The Board of Governors is essentially a political organ since it comprises of national ministers. This is so because it decides on issues that require political legitimacy: the use of the ESM's resources, which in essence constitutes a bail-out, and can ultimately lead to the use of tax-payer's money. Second, there is the Board of Directors, to which each ESM Member appoints one director. These are experts in economic and financial matters. They are to carry out specific tasks that the Governors delegate to them or that are assigned to them in the ESM Treaty itself (Article 6 ESM). Third, there is the Managing Director, appointed by the Governors, who is responsible for the day-to-day management of the ESM (Article 7 ESM).

The Board of Governors take its decisions according to four different procedures: mutual agreement (unanimity), a qualified majority of either 85 or 80 per cent of the votes cast, or a simple majority. Mutual agreement is required for issues such as providing stability support from the ESM, the choice of instrument used for support, calling in authorised unpaid capital (with the above mentioned exception), changing the authorised capital stock and adapting the maximum lending volume (Article 5(6) ESM). The emergency voting procedure, which requires a qualified majority of 85 per cent of the votes cast, can be used to grant financial assistance when the Commission and the ECB both conclude that 'the economic and financial sustainability of the euro area' is threatened if action by the ESM is not taken. This procedure covers both the decision to give assistance and the conditions of assistance (Article 4(4) and Article 5(6) (f)–(g) ESM). The main decision-making procedure of the ESM, the 'normal' qualified majority procedure, requiring a majority of 80 per cent of the votes cast, applies to several key issues relating to the functioning of the ESM: setting out by-laws of the ESM, appointing its Managing Director, approving its

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<sup>41</sup> France's capital share is 20,2 per cent with 142 billion euros of capital, of which 16 billion euros is paid-in capital, whereas Italy's capital share is 17,79 per cent with 125 billion euros of capital, of which 14 billion euros is paid-in capital.

annual accounts, waiving the immunity of the various officials of the ESM, and resolving disputes on the interpretation of the ESM Treaty (Article 5(7) ESM).

Germany (29,96 per cent) and France (20,23) are the only Members to hold a veto in both situations utilising a qualified majority, whereas Italy (17,79) only has a veto in decisions requiring the higher threshold. Conversely, both thresholds can be reached if the five biggest contributors (Germany, France, Italy, Spain (11,82) and the Netherlands (5,68)) vote in favour of a proposition. For this reason, both thresholds have been criticized. First, as the aim of the ESM is to safeguard the financial stability of the euro area (Preamble 6 ESM), the scope of the emergency voting procedure concerns ‘the statutory aim of the ESM’. Meaning, that the most relevant decisions to be taken by the ESM are subject to the emergency voting procedure. Second, the fact that many relevant decisions are subject to the 80 per cent threshold results in Germany and France being the ‘hegemonic parties’ in the management of the ESM.<sup>42</sup>

The above described system of decision-making means, that although the ESM can be used against the will of individual Members, the total amount of commitments given by a Member cannot be increased without their consent. The level of authorised capital stock can be changed by the Board of Governors, by mutual agreement, and this requires national ratification (Article 10 ESM).

The ESM can activate a host of different assistance instruments. These include direct loans (either precautionary or actual loans, Articles 14 and 16 ESM), loans for the recapitalisation of banks (Article 15 ESM), and primary or secondary market support by acquiring the ESM Member’s bonds (Articles 17 and 18 ESM). It is important to note that the ESM is thus allowed to purchase government bonds directly from the primary markets – something, which the ECB is explicitly prohibited from doing under Article 123 TFEU. As of June 2018, the ESM has so far given loans within a macroeconomic adjustment programme (Cyprus, Greece, Ireland and Portugal) and loans for indirect bank recapitalisation (Spain).<sup>43</sup>

The possible activation of the financial assistance instruments begins by a request for assistance by an ESM Member. The request shall indicate which assistance instrument should be used. The Commission and the ECB are then asked to assess the overall situation from the perspective of the requesting Member as well as the whole euro area. Based on this assessment, the Board of Governors may decide to grant financial assistance, after which it shall entrust the Commission to negotiate a MoU with the requesting Member. The decision to grant assistance is made by mutual agreement by the Governors (or under the emergency voting procedure). The technicalities of the financial assistance facility are drawn up by the Managing Director and accepted by the Board of Directors (Article 13 ESM).

An essential element in granting assistance is whether the situation adheres to the four principles spelled out in Article 12 ESM:

If [i)] indispensable to safeguard the financial stability of the euro area as a whole and of its Member States, the ESM may provide stability support to an ESM Member [ii)] subject to strict conditionality, [iii)] appropriate to the financial assistance instrument chosen. Such

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<sup>42</sup> Fabbrini (n 2) 132.

<sup>43</sup> See <<https://www.esm.europa.eu/assistance/lending-toolkit>>.

[iv]) conditionality may range from a macro-economic adjustment programme to continuous respect of pre-established eligibility conditions.

The Council of the European Union is also involved through the Two-Pack legislation. An ESM Member requesting financial assistance has to prepare a macroeconomic adjustment programme in agreement with the Commission. This programme has to be fully consistent with the MoU that has been agreed by the Commission and the requesting Member. The Council, acting by a qualified majority on a proposal from the Commission, shall approve the macroeconomic adjustment programme prepared by the Member requesting financial assistance. Furthermore, the Commission and the ECB shall then monitor the implementation of the programme after financial assistance is granted.<sup>44</sup>

Although the ESM is in some sense a bail-out mechanism, it tries to priorities bail-in. This is reflected in the fact that ESM loans enjoy preferred creditor status, junior only to loans by the IMF (Preamble 13 ESM).<sup>45</sup> When it comes to the recapitalisation of banks, the Bank Recovery and Resolution Directive requires a contribution to loss absorption and recapitalisation equal to an amount not less than 8 per cent of total liabilities including own funds of the institution under resolution before government financial stabilisation tools (i.e. bail-in through the ESM) can be used.<sup>46</sup>

## 5. The ECJ approves financial stabilization: Pringle

The ESM ended up for review before the CJEU through a preliminary reference from Ireland, where a Member of Parliament, Thomas Pringle, challenged both the ESM and the amendment of Article 136 TFEU before local courts.<sup>47</sup> The referring court presented the CJEU with three questions. Their meaning can be condensed into a structural and a substantive argument. First, that the European Council decision on amending Article 136 TFEU is contrary to Article 48(6) TEU on the simplified revision procedure, since the amendment broadens the EU's competence, which would require the use of the ordinary revision procedure of Article 48 (2)–(5) TEU. Second, that the ESM violates the no bail-out clause of Article 125 TFEU.<sup>48</sup> These two issues are of course linked, since the answer to the first hinges on the delineation between economic and monetary policy, whereas the answer to the second is about defining the content of economic and monetary policy. Thus, the case revolved around the asymmetry of the EMU.<sup>49</sup> The CJEU, sitting

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<sup>44</sup> Regulation (EU) No 472/2013 of the European Parliament and of the Council 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 [2013] OJ L40/1, Article 7.

<sup>45</sup> See Statement by the Eurogroup. Brussels, 28 November 2010.

<sup>46</sup> Directive 2014/49/EU of the European Parliament and of the Council on deposit guarantee schemes [2014] OJ L137/149, Articles 37(10)(a) and 56.

<sup>47</sup> *Pringle v Government of Ireland and others* [2012] IEHC 296 and *Pringle v The Government of Ireland*, [2012] IESC 47.

<sup>48</sup> *Pringle* (n 1), para 28.

<sup>49</sup> The case addressed, inter alia, also important institutional questions but they are not relevant for this analysis. *Pringle* (n1), para 148–182. See Stanislas Adam and Francisco Javier Mena Parras, 'The European Stability Mechanism through the Legal Meanderings of the Union's Constitutionalism: Comment on Pringle' (2013) 38 *European Law Review* 848; Paul Craig, 'Pringle and Use of EU Institutions outside the EU Legal Framework: Foundations, Procedure and Substance' (2013) 9 *European Constitutional Law Review* 263; Steve Peers, 'Towards a New Form of EU Law?: The Use of EU Institutions outside the EU Legal Framework' (2013) 9 *European Constitutional Law Review* 37.

as a full court, rejected the references holding in its judgment of 27 November 2012 that the ESM was compatible with the EU Treaties.

Answering the first question required an assessment of whether the ESM is a monetary or an economic policy measure, and whether it broadens the scope of the EU's competences. According to Article 3(1)(c) TFEU the EU has exclusive competence over monetary policy, whereas regarding economic policy, under Articles 2(3) and 5(1) TFEU, the EU has only coordinating competences. These articles on the EU's competences are found in Part One of the TFEU, but the amended Article 136 TFEU is located in Part Three of the TFEU. If the ESM constitutes an economic policy measure, then it does not violate the conferral of competences since the EU only has a coordinating competence within this policy area, which does not preclude actions by the Member States. However, if the ESM constitutes a monetary policy measure, then it does violate the exclusive competence of the EU, and thus the amendment of Article 136 TFEU is contrary to the rules on the simplified revision procedure in Article 48(6) TEU since the competences of the EU are regulated in Part One of the TFEU.

The CJEU ruled, that the ESM is an economic policy measure on the following grounds. As is evidenced by Articles 127(1) and 282(2) TFEU, what counts as a monetary policy measure is to be defined according to the objectives of a measure, not the instruments used to attain those objectives.<sup>50</sup> As the objective of the EU's monetary policy is to maintain price stability, the ESM is not a monetary policy measure since its objective is to safeguard the financial stability of the euro area as a whole. The fact that price stability and financial stability as a whole are somewhat interlinked does not change this conclusion.<sup>51</sup> Furthermore, this conclusion is supported by the link that the ESM has with the EU's new economic governance regime, the Six-Pack.<sup>52</sup> The economic policy nature of the ESM is made even clearer, when contrasted with Articles 123 and 125 TFEU: these Articles aim at preventing financial crises whereas the ESM aims at resolving financial crises.<sup>53</sup>

The CJEU then considered whether the ESM affects the EU's competences, as stipulated in Articles 2(3) and 5(1) TFEU, with regard to the coordination of the Member States' economic policies. Since within the domain of economic policy the EU's competences are restricted to the adoption of coordinating measures, the EU as such does not have a competence to establish a mechanism like the ESM.<sup>54</sup> Article 122(2) TFEU on EU financial assistance to a Member State only concerns *ad hoc* assistance and thus is not a suitable legal basis for a permanent mechanism like the ESM, which therefore means that the ESM does not affect the EU's competences in this regard as the EU has no competence for such a mechanism.<sup>55</sup> These points lead to the conclusion that the EU Treaties do not preclude the Member States from concluding the ESM Treaty, however they are required to comply with EU law whilst doing so.<sup>56</sup>

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<sup>50</sup> *Pringle* (n 1), para 53–55.

<sup>51</sup> *Pringle* (n 1), para 56.

<sup>52</sup> *Pringle* (n 1), para 58.

<sup>53</sup> *Pringle* (n 1), para 59.

<sup>54</sup> *Pringle* (n 1), para 64.

<sup>55</sup> *Pringle* (n 1), para 65.

<sup>56</sup> *Pringle* (n 1), para 68–69.

According to the CJEU, the amendment of Article 136 TFEU did not increase the competences conferred to the EU. As Council Decision 2011/199 on amending Article 136 TFEU only states that the Eurozone Member States ‘may establish a stability mechanism’ such as the ESM, the amendment does not increase the EU’s competences, and since assistance through such a mechanism ‘will be made subject to strict conditionality’, the actions to be taken pursuant to the amendment comply substantively with EU law.<sup>57</sup> The amendment does not create a new legal basis for the EU, which means that the EU could have pursued such actions already before the amendment.<sup>58</sup>

Answering the second questions required an assessment of the joint meaning of Articles 119, 120, 121, 123, 125, 126 and 127 TFEU. When it comes to the exclusive monetary policy competence of the EU as defined in Articles 3(1)(c) and 127 TFEU, the CJEU found, that as the purpose of the ESM is to provide stability support to its Members (Article 3 ESM), any effects that ESM financial assistance operations might have on price stability or inflation are only indirect consequences.<sup>59</sup>

As for the EU’s coordinating competences within economic policy, as defined in Articles 119, 120, 121 and 126 TFEU, the CJEU found no interference with them by the ESM. First, the ESM concerns financial assistance, not the coordination of economic policies. Second, the strict conditionality requirement set for financial assistance from the ESM is there to guarantee that the no-bailout clause of Article 125 TFEU is not violated, not for the purpose of coordinating Member States’ economic policies. Third, as the conditions imposed on aid receiving ESM Members are to comply with the recommendations that the Council can issue under Article 127 TFEU (Article 13 ESM), ESM operations and their conditionality requirement does not affect the EU’s competences.<sup>60</sup>

With regards to the ESM’s effects on the EU’s competences on giving financial assistance to Member States, as defined in Article 122 TFEU, the CJEU continued with a similar logic. Due to their different purposes, there is no overlap between the competence established by Article 122(1) TFEU (‘the area of energy’) and the actions of the ESM (‘severe financing problems’).<sup>61</sup> Neither is there any overlap between the competence established by Article 122(2) TFEU and the ESM, as the said Article concerns aid given by the EU, whereas the ESM is a measure constituted by the Member States.<sup>62</sup>

When assessing whether the ESM circumvents the prohibition on central bank financing, the CJEU stated first, that Article 123 TFEU only concerns assistance given directly by the ECB or national central banks, and therefore not the ESM. Second, the fact that Member States are acting via the ESM does not change this conclusion since the Member States are not derogating from the prohibition laid down in Article 123 TFEU as that article is not addressed to them.<sup>63</sup> What is more, the fact that ESM operations are financed through the capital structure of the ESM also needs to be taken into consideration.<sup>64</sup>

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<sup>57</sup> *Pringle* (n 1), para 72.

<sup>58</sup> *Pringle* (n 1), para 73.

<sup>59</sup> *Pringle* (n 1), para 93–97.

<sup>60</sup> *Pringle* (n 1), para 110–113.

<sup>61</sup> *Pringle* (n 1), para 115–116.

<sup>62</sup> *Pringle* (n 1), para 117–120.

<sup>63</sup> *Pringle* (n 1), para 125–126.

<sup>64</sup> *Pringle* (n 1), para 96.

The most difficult question the CJEU faced was whether the ESM breaches the no bail-out clause of Article 125 TFEU. The CJEU employed two types of arguments to find the ESM compatible with Article 125 TFEU. On a literal reading, Article 125 TFEU does not prohibit the EU or the Member States from giving financial assistance to a Member State. This interpretation is backed up by the fact that Article 122(2) TFEU on *ad hoc* financial assistance does not state that it is an exception to the no bail-out clause. The same conclusion is backed up by the fact that the wording of Article 123 TFEU ('shall be prohibited') is stricter than that of Article 125 TFEU ('shall not be liable').<sup>65</sup>

After having thus defined that there is a limited space within which Article 125 TFEU allows for financial assistance, the CJEU then turned to teleological reasoning to define the contours of this space. Article 125 TFEU prohibits financial assistance that would be unconditional, as the objective of the Article, according to the preparatory work of the Treaty of Maastricht, is to ensure that the Member States follow a sound budgetary policy by subjecting them to the logic of the market when they enter into debt. This prompts Member States to maintain budgetary discipline, which is conducive to safeguarding the financial stability of the euro area as a whole. The way the ESM functions means that the aid receiving Member States will remain responsible to their creditors for their financial commitments. As financial stability support is provided only in exceptional circumstances, if indispensable to safeguard the financial stability of the euro area as a whole, subject to strict conditions, and in a manner that the recipient Member State complies with measures adopted by the EU in particular in the area of the coordination of Member States' economic policies, the ESM is in compliance with the objective of Article 125 TFEU. Lastly, in case of a default by an ESM Member, although according to Article 25(2) ESM the other Members are to make up for this through a revised increased capital call, the defaulting Member remains responsible for its debt to the ESM.<sup>66</sup>

## 6. Constitutional assessment

### 6.1 Moral hazard concerns

The most controversial aspect of the ESM and the CJEU's ruling in *Pringle* is the issue of moral hazard that the financial stability mechanisms as such and the teleological interpretation of Article 125 TFEU give rise to. Moral hazard within the EMU occurs, when states or their creditors assume that the indebted states will not ultimately be held responsible for their debts, but that the others will bail them out. States will have an incentive to become overly indebted and banks will see the possibility of credit losses as low and therefore continue to supply cheap funding for these states. Due to the asymmetrical structure of the EMU the other states cannot prevent this from happening as each state is in charge of their own economic policy, but the negative consequences of this will ultimately affect all states due to the common currency.

The purpose of the no bail-out clause of Article 125 TFEU was to prevent this. In conjunction with the SGP, it was supposed to guide the Eurozone Member States towards a path of sound public finances and budgetary discipline. But as financial stability support has now been

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<sup>65</sup> *Pringle* (n 1), para 130–132.

<sup>66</sup> *Pringle* (n 1), para 135–145.

constitutionalised, how can such moral hazard concerns be alleviated nevertheless? The answer lies in the ‘strict conditionality’ (Articles 3 and 12 ESM) of stability support. As explained by the CJEU, 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’. Financial assistance is acceptable as long as the receiving Member State ‘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’.<sup>67</sup> In other words, the aid receiving Member State has to agree to a new economic policy that is based on budgetary discipline and aims at the sustainability of public finances in the future.

However, the strict conditionality of stability support does not solve all aspects of the moral hazard problem. The current system just leads to a different, long term and more profound moral hazard concern. According to the CJEU’s reasoning in *Pringle*, the first-order objective of the no bail-out clause is to ward or moral hazard, but in some instances this is overridden by the second-order objective of financial stability, the protection of which justifies bail-outs. But as Tuori and Tuori have explained, although an individual bail-out might seem to serve the higher-order objective of safeguarding the financial stability of the euro area as a whole in the short term, in the long term it ends up creating moral hazard as states and their creditors can assume that bail-outs will be available also in the future; and what is more, this eventually also leads to sacrificing the higher-order objective of financial stability. This is because under the logic devised by the CJEU in *Pringle*, moral hazard is only taken into consideration with regard to the individual aid receiving Member State, but not the whole Eurozone.<sup>68</sup>

The rationale of the CJEU’s interpretation of the no bail-out clause seems to rely on the following logic: A reading of Article 125 TFEU that would allow no exceptions would transform it from a precautionary and moral hazard avoidance rule into an obstacle to combating a real crisis, which the Eurozone faced back then.<sup>69</sup> This is the logic behind elevating ‘financial stability of the euro area as a whole’ to the position of an overriding policy concern. However, adopting such a new meta-level objective has its own problems.

## 6.2 Financial stability as an overriding policy concern

The purpose of Articles 122 and 125 TFEU is to induce market discipline on the Member States, whereas the purpose of Articles 121 and 126 TFEU (the SGP) is to induce self-restraint. Both of these aim at the Member States complying with the principle of sound public finances.<sup>70</sup> The need for the no bail-out clause stems from the finding that monetary policy cannot solely be in charge

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<sup>67</sup> *Pringle* (n 1), para 136–137.

<sup>68</sup> Kaarlo Tuori and Klaus Tuori, *The Eurozone Crisis: A Constitutional Analysis* (Cambridge: Cambridge University Press 2014) 127–133.

<sup>69</sup> See Phoebus Athanassiou, ‘Of past measures and future plans for Europe’s exit from the sovereign debt crisis: what is legally possible (and what is not)’ (2011) 36 *European Law Review* 558, 564–565.

<sup>70</sup> See Vestert Borger, ‘The ESM and the European Court’s Predicament in *Pringle*’ (2013) 14 *German Law Journal* 113, 118–119.

of anti-inflation measures, and because reliance on the markets in controlling the spending of states was thought to be insufficient by itself.<sup>71</sup>

Pace *Pringle*, the principle of price stability as the overriding objective of economic policies, including the monetary policy of the ECB, has been replaced by the ‘financial stability of the euro area as a whole’. The monetary policy objective of price stability has become a second-order objective, the purpose of which is to serve the first-order objective of financial stability. This way *Pringle* confirmed the legality of the objective that the Eurozone Member States had assumed in their informal meeting in February 2010.<sup>72</sup>

Yet, to what exactly does the ‘financial stability of the euro area as a whole’ refer to? According to Article 127 TFEU price stability is the primary objective of the ECB’s monetary policy, whereas stability in the SGP refers to sound public finances and how they help in pursuing price stability.<sup>73</sup> Neither of these two are the same as the ‘financial stability of the euro area as a whole’. As no one seems to know what the concept actually means, it is problematic to give it a pinnacle position as the objective of the EMU.<sup>74</sup> Is Article 127(5) TFEU, according to which the ESCB shall contribute to the ‘stability of the financial system’ a clear enough norm to warrant such a change in the order of policy objectives? Perhaps no, since the crisis mostly concerned the stability of national financial systems, which are composed of private banks.<sup>75</sup>

The end result of this paradigm shift is, that now the EMU contains not only prevention (SGP), but also solution of sovereign insolvency crises (bail-out). Yet, this does not mean that the principle of states fiscal responsibility, as enshrined in the no bail-out clause, has been discarded. Rather, that the scope of the no bail-out prohibition has been narrowed down; that ‘[i]t is only valid for good times but no longer for bad times’.<sup>76</sup>

### 6.3 Fundamental rights concerns

The fact that support through the ESM is premised upon ‘strict conditionality’ (Article 12 ESM) means, that it relativizes budgetary sovereignty of the crisis states, both regarding the substance and overall volume of the budget. This is so because the MoU’s that the recipient states have to sign go into detail on which type of policy choices they have to make, and also since they dictate the overall size of the budget.<sup>77</sup> Because of their nature, these measures not only impinge upon the recipient states’ sovereignty in the fiscal sphere, but also in the more general economic policy

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<sup>71</sup> See René Smits, *The European Central Bank: Institutional Aspects* (The Hague: Kluwer Law International 1997) 74–75.

<sup>72</sup> ‘Euro area Member states will take determined and coordinated action, if needed, to safeguard financial stability in the euro area as a whole.’ Statement by the Heads of State or government of the European Union. Brussels, 11 February 2010.

<sup>73</sup> See Resolution of the European Council on the Stability and Growth Pact, O. J. 1997, C 236/1, Preamble I: “– – The European Council underlines the importance of safeguarding sound government finances as a means to strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. It is also necessary to ensure that national budgetary policies support stability oriented monetary policies. – –”

<sup>74</sup> See Tuori and Tuori (n 68) 120–136.

<sup>75</sup> Tuori and Tuori (n68) 183–184.

<sup>76</sup> Tuori and Tuori (n 68) 187.

<sup>77</sup> For an example of how prescriptive the MoU’s are, see Memorandum of Understanding between the European Commission acting on behalf of the European Stability Mechanism and the Hellenic Republic and the Bank of Greece. Brussels, 19 August 2015.

sphere. By explicitly referring to strict conditionality as a condition for the ESM not breaching Article 125 TFEU, *Pringle* constitutionalised this development too.<sup>78</sup>

What makes this especially concerning is the fact that the practical effects of such strict conditionality have resulted in serious fundamental rights concerns in the aid receiving states.<sup>79</sup> At first, attempts at challenging measures stemming from the MoU's mainly failed.<sup>80</sup> This was due to the CJEU's statement in *Pringle* that the Member States are not implementing EU law in the meaning of Article 51(1) EU Charter when they establish the ESM because they are acting outside the scope of the EU's competences.<sup>81</sup> Later, in *Ledra Advertising*, the CJEU opened the doors for individuals to claim damages from the EU on the basis of non-contractual liability under Article 340(2) TFEU as a result of austerity measures (forced bail-in of banks), although in this case such liability was not found to exist after the CJEU conducted a proportionality analysis.<sup>82</sup> Subsequently, the CJEU ruled in *Florescu* that (at least certain) MoU's are subject to review by the CJEU under Article 267 TFEU, and that the EU Charter also applies to the national measures that are used to implement a MoU.<sup>83</sup> These are welcome rulings as there are good arguments for why the EU Charter should apply both to the EU institutions and the Member States when they are implementing such austerity measures.<sup>84</sup> It will be interesting to see whether these two cases prompt future cases on the already agreed and implemented MoU's, and how will they effect possible future MoU's.

## 7. Future prospects

Although the ESM was meant as the EU's permanent stabilisation fund, proposals for its development have been abundant.<sup>85</sup> Therefore, it was not surprising that the Commission issued a proposal on 6 December 2017 for an EU Regulation transforming the ESM into a European Monetary Fund (EMF).<sup>86</sup>

The most important aspect of the proposal is to bring the ESM within the EU's legal framework by converting it into the EMF, the position of which would correspond to that of an EU agency. Due to the *Meroni* doctrine,<sup>87</sup> decisions of the Board of Governors and the Board of Directors would be

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<sup>78</sup> Tuori and Tuori (n 68) 188–189.

<sup>79</sup> See Lisa Ginsborg, 'The Impact of the Economic Crisis on Human Rights in Europe and the Accountability of International Institutions' (2017) 1 Global Campus Human Rights Journal 97.

<sup>80</sup> See Alicia Hinarejos, *The Euro Area Crisis in Constitutional Perspective* (Oxford: Oxford University Press 2015) 131–136. See Case T-541/10 *ADEDY and Others v. Council* ECLI:EU:T:2012:626; Case T-215/11 *ADEDY and Others v. Council* ECLI:EU:T:2012:626; Case C-128/12 *Sindicato dos Banca'rios do Norte and Others* ECLI:EU:C:2013:149; Case C-264/12 *Sindicato Nacional dos Profissionais de Seguros e Afins* ECLI:EU:C:2014:2036.

<sup>81</sup> *Pringle* (n 1), para 180.

<sup>82</sup> Joined Cases C-8/15 P to C-10/15 P *Ledra Advertising Ltd and Others v European Commission and European Central Bank (ECB)* ECLI:EU:C:2016:701.

<sup>83</sup> Case C-258/14 *Eugenia Florescu and Others v Casa Județeană de Pensii Sibiu and Others* ECLI:EU:C:2017:448.

<sup>84</sup> See Anastasia Poulou, 'Financial assistance conditionality and human rights protection: What is the role of the EU Charter of Fundamental Rights?' (2017) 54 Common Market Law Review 991.

<sup>85</sup> See Daniel Gros, 'An evolutionary path towards a European Monetary Fund' (2017) European Parliament, DG for Internal Policies, Economic Governance Support Unit.

<sup>86</sup> COM(2017) 827 on the establishment of the European Monetary Fund. The proposal contains the Regulation establishing the EMF and as a separate annex the statute of the EMF. The legal basis of the proposed Regulation is Article 352 TFEU.

<sup>87</sup> Case C-9/56 *Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community* ECLI:EU:C:1958:7.

transmitted to the Council for approval (Article 3(1) EMF Regulation). The Council would decide by qualified majority as per Article 238(3) TFEU (Article 3(4) EMF Regulation). The requirements for a qualified majority in the Council in this instance and those for qualified majority in the Board of Governors and Board of Directors of the EMF under Article 4 EMF Statute differ from each other, which might cause confusion or lead to unexpected outcomes. The scope of the different decision-making procedures utilised by the Board of Governors would remain essentially the same. The emergency voting procedure would be renamed as ‘a decision by reinforced qualified majority’ (EMF Statute Article 4(4)).

The proposal also contains the possibility for the EMF to give a credit line or guarantees to the Single Resolution Fund (SRF) with the intent of thus strengthening the fiscal backstop function and furthering the finalization of the Banking Union (Article 22 EMF Statute). The Board of Governors would decide on the use of credit lines by unanimity (Article 5(6)(f) EMF Statute). This is to be welcomed as the effectiveness of the current backstop function is questionable, mainly due to the strict conditionality rules of direct bank recapitalisation and the limited scope of the fund.<sup>88</sup>

While according to Article 3 ESM Treaty stability support is possible ‘if indispensable to safeguard the financial stability of the euro area as a whole and of its Member States’, under Article 3(2)(a) EMF Statute support would be possible ‘if indispensable to safeguard the financial stability of the euro area as a whole or of its Members’. Whether this is just a linguistic change or if it is meant to broaden the possibilities for activating financial assistance is unclear.

What would be the benefit of bringing the ESM within the EU’s legal framework? First, that the EU Charter would then apply to its actions, although these concerns have already been somewhat alleviated by the case-law discussed in section 6.3. Second, as long as the ESM operates outside EU law, it is not adequately within the scope of the principle of transparency, which makes controlling it by the European Parliament, national parliaments and the civil society difficult.<sup>89</sup> Third, it would make it possible for the Commission to challenge the decisions of the ESM before the CJEU through Article 263, as they would be formally approved by the Council.

The legal basis of the proposed Regulation is Article 352 TFEU. Under the Commission’s analysis, the CJEU confirmed the legality of using Article 352 TFEU as a legal basis for such a mechanism in *Pringle*. Several commentators agree with this viewpoint.<sup>90</sup> It should be noted, however, that Article 352 TFEU cannot be used to widen the EU’s competences.<sup>91</sup> If the measures that the EMF conduct are deemed to fall under economic policy – which could be confirmed by the CJEU’s own finding of the ESM being an economic policy measure in *Pringle*, but also owing to the clearly economic nature of the MoU’s that are a prerequisite for assistance from the ESM/EMF – then it could be argued that it broadens the EU’s competences within the field of economic policy. This question is of importance, again, due to the asymmetrical structure of the EMU: since the EU has

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<sup>88</sup> See Dirk Schoenmaker, ‘A fiscal backstop to the banking system’ in Matthias Haentjens and Bob Wessels, *Research Handbook on Crisis Management in the Banking Sector* (Cheltenham: Edward Elgar Publishing 2015).

<sup>89</sup> Tuori and Tuori (n 68) 218.

<sup>90</sup> See de Witte and Beukers (n 28), 834; René Repasi, ‘Implementation of the Lisbon Treaty – Improving Functioning of the EU: Economic and Monetary Policy’ (2016) European Parliament, DG for internal policies, 33.

<sup>91</sup> See Opinion 2/94 Accession by the Community to the European Convention for the Protection of Human Rights and Fundamental Freedoms ECLI:EU:C:1996:140, para 30.

no explicit economic policy competences, it would be wrong to introduce such by recourse to Article 352 TFEU.

If the EMF Regulation will be adopted with Article 352 TFEU as its legal basis, and were the CJEU asked to rule on its legality, it would most likely find the Regulation to be valid. This view is based on both the fact that the predecessors of Article 352 TFEU have been central to the broadening of the EU's competences for already a long time now,<sup>92</sup> and the fact that the CJEU's stance towards the EU's crisis response measures has been permissive so far.<sup>93</sup> Nevertheless, as the utilisation of Article 352 TFEU requires unanimity in the Council, it is far from obvious that the proposed Regulation will ever be adopted.

Yet again taking the driver's seat in developing the EMU, Germany and France issued a joint declaration after the meeting of President Emmanuel Macron and Chancellor Angel Merkel held in Meseberg on 19 June 2018. According to them, the ESM should be developed with view to improving its fiscal backstop function, the effectiveness of its precautionary instruments, and its role in assessing and monitoring future programs. Furthermore, they endorsed incorporating the ESM into EU law.<sup>94</sup> The following Euro Summit, held on 29 June 2018, agreed that the ESM's fiscal backstop function should be strengthened as part of completing the Banking Union. Decisions on going forward with the Commission's proposal on the EMF were postponed to a Euro Summit in December 2018.<sup>95</sup>

On 20 August 2018, Greece successfully concluded its third and final economic adjustment programme. European leaders were joyful of this and saw it as an end to an era.<sup>96</sup> However, only two months prior to this, the repayment of some of the loans given to Greece had been postponed.<sup>97</sup> Whether haircuts to these loans constitute a bail-out and are contrary to Article 125 TFEU is debatable.<sup>98</sup> It remains to be seen whether the loans will eventually be repaid in full or not.

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<sup>92</sup> See Joseph Weiler, 'The Transformation of Europe' (1991) 100 *Yale Law Journal* 2403, 2442–2447.

<sup>93</sup> E.g. *Pringle* (n 1) and Case C-62/14 *Peter Gauweiler and Others v Deutscher Bundestag* ECLI:EU:C:2015:400.

<sup>94</sup> See Meseberg Declaration of 19 June 2018: Renewing Europe's promises of security and prosperity, <<https://www.bundesregierung.de/Content/EN/Pressemitteilungen/BPA/2018/2018-06-19-meseberg-declaration.html>>.

<sup>95</sup> Statement of the Euro Summit, 29 June 2018, Brussels.

<sup>96</sup> 'EU celebrates Greek exit from third bailout programme': *Financial Times* (21 August 2018).

<sup>97</sup> See Eurogroup statement on Greece of 22 June 2018.

<sup>98</sup> See Christian Hofmann, 'Greek Debt Relief' (2017) 37 *Oxford Journal of Legal Studies* 1; but compare to 'How to Solve the Greek Debt Problem' (2018) Peterson Institute for International Economics, Policy Brief 18-10, 9, where it is argued that, in light of the conditionality requirement set by the CJEU in *Pringle*, 'debt relief could be consistent with Article 125 so long as the country delivers more fiscal adjustment with it than without it'.

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