MICHAL PETR*

Is the Economic and Monetary Union Headed to Becoming a Fiscal Federation?

ABSTRACT: *Since the financial and Eurozone crises, the rules on the functioning of the Economic and Monetary Union (EMU) have changed fundamentally. In this article, I argue that these changes are moving the balance from national to supranational institutions and lead the EMU in a direction frequently referred to as 'fiscal federation'. At the same time, I contend that these changes are not fully in line with European Union's primary law, as it stands today. Without contradicting the necessity and effectiveness of these measures on economic terms, I put forward that, to accommodate this substantially modified architecture of the EMU, it would be beneficial to change the primary law in order to clarify the EMU rules. This argument will be made upon an example of three specific policy changes: creation of the European Stability Mechanism, enabling the EU to bail-out states in financial difficulties, introduction of the European Semester, granting the EU the capacity to extensively coordinate the budgetary policies of the Member States, and establishment of the EU Recovery Instrument, empowering the EU to take on itself debt and to redistribute the money across the Member States. For each of these instruments, their legal basis will be thoroughly discussed. I will underline the fact that they were established outside of the regular legal architecture, outlined in the Treaty on the Functioning of the European Union, and suggest specific ways in which the primary law could be modified in order to accommodate these instruments. In conclusion, their combined effect on the operation of the EMU will be analysed and assessed.*

KEYWORDS: Eurozone, European Semester, European Stability Mechanism, fiscal federation, Next Generation EU

* Associate Professor, Head of the Department of International and European Law, Palacky University of Olomouc, Faculty of Law, michal.petr@upol.cz, ORCID ID: 0000-0001-6495-4530.

https://doi.org/10.47078/2024.2.211-228

1. Introduction

The legal and institutional architecture of the European Union (EU) is not yet settled, and as reflected in many EU policies, the forces of supranationalism struggle with intergovernmentalism.[1] The Economic and Monetary Union (EMU) stands as an example. Originally, the monetary policy was dedicated exclusively to EU institutions, while national fiscal and economic policy remained in principle the competence of the Member States.

Following the global financial crises of 2007–2009 and the subsequent economic difficulties of several members in the Euro area, the architecture of the EMU has been significantly modified and changes are still ongoing. In this article, I concentrate on three of them: the creation of the European Stability Mechanism, the introduction of the European Semester, and new ways of financing the Member States through the EU Recovery Instrument. As these instruments have been repeatedly discussed in detail in the literature, I only concentrate on their implications for the balance between supranationalism and intergovernmentalism. I propose that, cumulatively, they can significantly increase EU's powers over national fiscal and economic policy. Yet as consequential as these changes are, they are based on a questionable legal basis and are arguably not fully aligned with the current EU law.

Generally, I also argue that the newly acquired powers of the EU in fiscal measures start to resemble those of a federation,[2] in that it extensively coordinates the budgetary policies of the Member States (the European Semester), it may, in principle, bail-out Member States in financial difficulties (the European Stability Mechanism), and it executes an extensive redistribution of wealth, eclipsing the cohesion policy as we know it (the EU Recovery Instrument).

The next section describes the architecture of EMU, as it was originally conceived. Section 3 analyses the impact of the three fundamental changes on EMU's architecture, which enables me to reflect on EMU's trajectory and on the compatibility of these measures with the existing Treaties. Finally, Section 4 draws conclusions to this paper.

1 Whereas supranationalism may be characterised as a design feature whereby international organisations grow governmental structures by possessing full jurisdiction over a policy domain (Sweet and Sandholtz, 1997, p. 304), intergovernmentalism is characterised as a design whereby international organisations maintain governmental structures in which decisions are taken by member states whose autonomy is not pre-empted (Tsebelis and Garrett, 2001, p. 386).

2 Hinajeros, 2013.

2. Basic characteristics of the Economic and Monetary Union

The overall design of the EMU was laid down already by the Treaty of Maastricht. Its rules differentiate between competencies regarding monetary policies and economic policies. While the former are of the exclusive competences of the EU,[3] the latter remain predominantly the domain of the Member States, as EU institutions should only assume a coordinating role.[4] The Treaty on the Functioning of the European Union (TFEU) thus foresees a '*single monetary policy*'[5] and '*close coordination of Member States' economic policies*'.[6]

However, the extent of this 'close coordination' is still disputed. The discussions leading to the adoption of relevant rules on EMU have already been extensively discussed in the literature.[7] As such, in this article, it suffices to say that the different proponents of the Euro had different ideas about the functioning of the EMU. Most prominent among them were the visions of France and Germany, the former arguing for some form of common economic governance under EMU and the latter stressing the need of price stability and sound public finances. As a result, the architecture of the EMU is based on two pillars, a 'German' one and a 'French' one.[8]

The first pillar was constructed around a concept of 'stability union' (the stability pillar). Under this understanding, the principal goal of EMU is to ensure fair and stable conditions for efficient free-market competition by maintaining a currency that is solid both internally (i.e. low inflation), and externally (i.e. stable exchange rates). In this context, an interventionist fiscal policy (financial stimuli) needs to be avoided, because it ultimately leads to inflation and devaluation.[9] Government deficits are, thus, the only area in which the co-ordination among members of a monetary union is needed, because excessive deficits may lead to a debt crisis and ultimately to a bailout demand.[10] That would be totally unacceptable, as there needs to be a clear liability for fiscal decisions.[11] Therefore, the EMU should be centred on two principles: an independent central bank and the fiscal discipline of its member states.[12] These principles are strongly enshrined in the

3 Art. 3 (1) (a) TFEU.
4 Art. 5 (1) TFEU states: 'The Member States shall coordinate their economic policies within the Union. To this end, the Council shall adopt measures, in particular broad guidelines for these policies'.
5 Art. 119 (2) TFEU.
6 Art. 119 (1) TFEU.
7 Dyson and Featherstone, 1999.
8 Pisani-Ferry, 2006, p. 827.
9 Hacker and Koch, 2017, p. 11.
10 Dullien and Guérot, 2012, p. 3.
11 Feld et al., 2016, p. 48.
12 Wyplosz, 2017, p. 149.

Treaties. In particular, Article 126 (1) TFEU states unambiguously that Member States shall avoid excessive government deficits. At the same time, according to Article 125, the EU and the Member States shall not be liable for or assume the commitments of other Member States (the 'no-bailout clause').

The second pillar connects with the concept of 'fiscal union' (the governance pillar). Under this understanding, the EMU cannot work properly without being supported by some form of an economic union.[13] The demand side of the economy needs to be stimulated by public authorities (and public finances) to prevent cyclical crises and contain regional asymmetric shocks. Extensive spending capacity on the EU side is thus necessary for the EMU to function,[14] as well as the close coordination of economic policies of Member States. Therefore, the proponents of this approach call for introduction of specific stabilisation funds[15] and a significantly increased fiscal capacity at the EU level.[16]

Whereas TFEU's provisions on the stability union are relatively specific and clear, those on fiscal union are either general or contradictory. As such, Article 121 TFEU merely proclaims that Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council. Expansive fiscal stimuli seem to be prevented by the 'no-bailout' clause[17] and by the requirement of a balanced EU budget.[18] Indeed, while the stability pillar includes a specified objective, numerical targets and a detailed excessive deficit procedure,[19] the governance pillar 'is a general-purpose provision with no corresponding policy rule or teeth'.[20]

In 1997, even before the provisions on the Euro entered fully into force, both pillars were strengthened. Concerning the stability pillar, the Stability and Growth Pact (SGP) was adopted to reinforce the procedures concerning budgetary discipline.[21] On side of the governance pillar, the creation of the Eurogroup, an informal meeting of the ministers of finance of Euro-countries, was endorsed by the European Council in Luxembourg.[22]

As argued in the literature,[23] these additions only strengthened the emphasise on budgetary discipline:

13 Pisani-Ferry, 2006, p. 841.
14 De Grauwe, 2006, p. 727.
15 De Grauwe and Ji, 2016, p. 144.
16 Pisani-Ferry, Vihriala, and Wolff, 2013, p. 3.
17 Art. 125 TFEU.
18 Art. 310 (1) TFEU.
19 Art. 126 TFEU and protocol No. 12 on the excessive deficit procedure.
20 Pisani-Ferry, 2006, p. 827.
21 Amtenbrink, de Haan, and Sleijpen, 1997.
22 Luxembourg European Council 12 and 13 December 1997. Presidency Conclusions.
23 Pisani-Ferry, 2006, p. 828.

> Those additions [...] reinforced the already existing imbalance between the two pillars: with the adoption of the Pact, some more bricks and mortar were added to the first, strong one; [...] and through the creation of that new institution, the Eurogroup, another seemingly plaster decoration was added to the second, weak one.

Interestingly, although the rules on the stability pillar appeared significantly stronger, they nonetheless failed in practice.[24] The country that stood behind its adoption – Germany – was the one to first break the rules, alongside France. Because of the development of their public finances, excessive deficit procedures were initiated against Germany in 2002 and against France in 2003. At the end of 2003, the Commission recommended the Council to adopt a decision on the basis of the Article 126 (8) and (9) TFEU, declaring that the measures adopted so far by both France and Germany were inappropriate; it also issued a formal notice to these two Member States, obliging them to adopt specific measures within a specific timeframe. However, these decisions were not adopted, as the Council failed to establish the required majority. Instead, the Council adopted conclusions, noting that it decided not to act upon the Commission's recommendations and that it agrees 'to hold the Excessive Deficit Procedure in abeyance for the time being'.[25] The Council then sent recommendations to both the countries. These recommendations significantly differed from those proposed by the Commission.[26]

The Commission challenged the Council's proceedings before the Court of Justice of the European Union (CJEU). Unsurprisingly, the CJEU concluded that an action for annulment is inadmissible insofar as it seeks annulment of the Council's failure to adopt the formal instruments contained in the Commission's recommendations.[27] Conversely, the action against the Council's conclusions was admissible.[28] On the merits, the CJEU declared that the Council's decision to hold the excessive deficit procedure in abeyance was illegal.[29] Similarly, it held that it was not possible for the Council to adopt recommendations different from those put forward by the Commission.[30] In any event, the fact that the Council had not followed the Commission's recommendations sparked a debate concerning the effectiveness of the SGP,[31] as well as the equality of the Member States bound by its rules. Were "big" countries in a more favourable position?

Even before the economic crises, many scholars argued that EMU's architecture is not fit for its purpose and that further steps towards fiscal union would

24 De Haan, Berger, and Jansen, 2004.
25 CJEU, C-27/04, 13 July 2004, para 20.
26 Ibid., para 19.
27 Ibid., para 36.
28 Ibid., para 51.
29 Ibid., para 89.
30 Ibid., para 96.
31 Bekker, 2020, p. 71.

be needed.[32] Some outlined the reforms to be adopted, including far-reaching amendments of the TFEU.[33] The next decade proved them right, although the reforms (still not living up to all the proposed changes) were adopted without a change of primary law.

3. Crucial modifications to the EMU's architecture

In this section, the three arguably most consequential modifications of the EMU's architecture will be discussed. Specifically, the ability of the EU to bail-out Member States in financial difficulties (the European Stability Mechanism), the capacity of the EU to extensively coordinate the budgetary policies of the Member States (the European Semester) and the EU's redistributive powers (the EU Recovery Instrument).

■ *3.1. European Stability Mechanism*

As discussed in the previous section, the budgetary discipline of the Euro Area Member States constitutes a fundamental principle of the functioning of EMU. In this regard, the Member States need to be aware that they are solely responsible for their obligations.[34] Indeed, the economic governance of the EMU is built on two principles: budgetary self-restraint and market discipline of the Member States.[35] This is why the TFEU explicitly prohibits any type of credit facility with the European Central Bank or national central banks in favour of the Member States.[36] Any privileged access not based on prudential consideration to financial institutions is also prohibited.[37] Most prominently,, the TFEU proclaims in its 'no-bailout clause' that the EU shall not be liable for or assume the commitments of the Member States and that a Member State shall not be liable for or assume the commitments of other Member States.[38] EU financial assistance may be granted only to Member States in difficulties, caused by natural disasters or exceptional occurrences beyond their control.[39]

32 See, for example, De Grauwe, 2013, p. 29: '[I]n the long run the monetary union will have to be embedded in a significant fiscal union. […] Without significant steps towards a fiscal union there is no future for the euro'.

33 See, for example, De Grauwe, 2013; Münchau, 2013.

34 Van Malleghem, 2013, p. 161 stated:
'Through the "no bailout" clause the Member States were thought to have irrevocably committed themselves to not helping other members of the monetary union, thereby reinforcing the fiscal discipline of all of its members. That prohibition was at the core of the design of the monetary constitution implemented in the Maastricht Treaty'.

35 Borger, 2013, p. 118.

36 Art. 123 (1) TFEU.

37 Art. 124 TFEU.

38 Art. 125 TFEU.

39 Art. 122 (2) TFEU.

Yet, when several Member States were severely hit by the financial crises, financial assistance was provided to them. Initially, the European Financial Stability Mechanism, which issued EUR 60 billion of its own bonds, guaranteed by the EU Member States, was established in 2010 on the basis of Article 122 (2) TFEU.[40] However, these funds were insufficient. Therefore, later that year, the European Financial Stability Facility was established, bundling EUR 440 billion worth of securities of the Euro area Member States.[41] This 'facility' was created as a public limited company governed by the laws of Luxembourg,[42] outside of the architecture of EU law.

Finally, as a permanent rescue facility, the European Stability Mechanism (ESM) was established in 2012. The legal basis for its creation is Article 136 (3) TFEU, which was newly added to the TFEU by a decision of the European Council in March 2011.[43] This amendment entered into force only in May 2013, after being ratified by the last Member State – the Czech Republic.[44] The ESM itself was not established by any measure of EU law, but by an international treaty, the Treaty Establishing the European Stability Mechanism (TESM), originally concluded in July 2011 (and later amended to its final version in February 2012) and in force since September 2012[45] (i.e. almost a year before the TFEU had been amended). This gave rise to serious speculations concerning the legality of the ESM itself.

The questions surrounding the establishment of the ESM may be divided into three broad categories: (I) the compatibility of such a rescue mechanism with the EU law, (II) the establishment of the ESM itself 'outside' EU law, and (III) the fact that it was established months before the amendment of the TFEU, which was meant to enable its creation, entered into force. The TESM was challenged in several jurisdictions.[46] In addition, an Irish court addressed the CJEU with a request for preliminary ruling concerning these questions. CJEU's answer in the

40 Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism.

41 Ruffert, 2011, p. 1779.

42 Tomkin, 2013, p. 171.

43 European Council Decision 2011/199/EU. The CJEU concluded in C-370/12, 27 November 2012, para 65, that Article 122 (2) TFEU would not constitute an appropriate legal basis, as the ESM '*is to be permanent and (…) its objectives are to safeguard the financial stability of the euro area as a whole*', whereas Article 122 (2) TFEU is aimed at provision of specific *ad hoc* financial assistance to specific Member States.

44 European Council Decision 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.

45 Treaty establishing the European Stability Mechanism. Factsheet.

46 Next to Ireland, whose Supreme Court addressed the CJEU with a request for preliminary reference, the TESM was also reviewed by the courts in Estonia and in particular Germany (Tomkin (2013), p. 172).

Pringle case[47] will be discussed below briefly, as the judgment has been thoroughly analysed elsewhere.[48]

As underlined above, EU law is very much biased against bailouts and any form of financial assistance to Member States running excessive deficits. Therefore, the main question for the CJEU was, to what extent is the ESM in essence a bailout fund,[49] established by the Member States to rescue other Member States in financial trouble, and to what extent would that be compatible with EU law. In answering, the CJEU first concluded that the principle objective of ESM, which is to grant financial assistance to Member States, does not fall within monetary policy,[50] which belongs to exclusive competences of the EU. Instead, it complements the new regulatory framework for strengthened economic governance of the EU, which establishes a closer coordination and surveillance of the economic and budgetary policies conducted by the Member States and is intended to consolidate macroeconomic stability and the sustainability of public finances.[51] It is not the purpose of the ESM to maintain price stability, but rather to meet the financing requirements of ESM Members, namely the Member States whose currency is the Euro, who are experiencing or are threatened by severe financing problems, if it is indispensable to safeguard the financial stability of the euro area as a whole and of its Member States.[52] The establishment of the ESM thus falls within economic policy,[53] principally reserved for Member States. However, the ESM is not an instrument of economic coordination, but merely a financing mechanism.[54] The CJEU thus concluded that 'the Member States remain free to establish a stability mechanism such as the ESM, provided however that, in its operation, that mechanism complies with European Union law'.[55]

Concerning the specific provision of the Treaties on the functioning of EMU, the CJEU declared, unsurprisingly, that Article 123 TFEU is addressed specifically to the European Central Bank and the central banks of the Member States, whereas the grant of financial assistance by one Member State or by a group of Member States to another Member State is not covered by that prohibition.[56]

The most consequential was the interpretation of the 'no-bailout clause'.[57] The CJEU recalled that the aim of that provision was to prompt the Member

47 CJEU, C-370/12, 27 November 2012.
48 Adam and Mena Parras, 2011; Borger, 2013; Tomkin, 2013.
49 Tomkin, 2013, p. 173.
50 CJEU C-370/12, 27 November 2012, para 57.
51 Ibid., para 58.
52 Ibid., para 96.
53 Ibid., para 60.
54 Ibid., para 110.
55 Ibid., para 121.
56 Ibid., para 125.
57 Art. 125 TFEU.

States to maintain budgetary discipline,[58] not to prohibit 'any financial assistance whatever to a Member State'.[59] Under this interpretation, Article 125 TFEU only prohibits the EU 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'.[60] According to the CJEU, Article 125 TFEU specifically prohibits only situations when the EU or a Member State might become liable for the commitments of another Member State or assume such commitments;[61] the court concluded that this does not happen with the ESM.[62]

Based on these considerations, it was easy for the CJEU to deal with the remaining questions. As the creation of a financial stability mechanism did not belong to the exclusive competence of the EU, the Member States were free to base their cooperation on an international treaty. At the same time, there were entitled to entrust existing EU institutions with specific tasks on the basis of it.[63] Finally, as the Member States already enjoyed the power to create a rescue facility before the TFEU was amended, it was immaterial that the TESM was concluded before te new Article 136 (3) TFEU entered into force.[64]

CJEU's reasoning concerning the 'no bail-out' clause was both welcomed as '*particularly well-articulated*'[65] and criticised for containing contradictions and performing 'conceptual gymnastics'.[66] While the CJEU is the supreme guarantor of legality within the EU and its conclusions cannot be legally challenged, they may nonetheless give rise to doubts as to how persuasive they are. This is a concerning issue.

First, the ESM, an institution created outside the EU law architecture, is doing exactly what the central banks are expressly prohibited from doing, that is, providing loans to Member States and purchasing their debt instruments. It may well be argued that this 'constitutes a circumvention of the spirit of the prohibition contained in Article 123 TFEU'.[67] Similarly, despite the 'no bailout' clause, to bail out Member States in financial difficulty is exactly the aim of the ESM.[68]

This is not to challenge the necessity of the ESM from a macroeconomic viewpoint. Indeed, if the funds were not provided to the Member States in need, the entire Eurozone would have been destabilised and possibly the single currency

58 Ibid., para 135.
59 Ibid., para 132.
60 Ibid., para 136.
61 Ibid., para 130.
62 Ibid., paras 138–141.
63 Ibid., para 158.
64 Ibid., para 184.
65 Adam and Mena Parras, 2011, p. 862.
66 Tomkin, 2013.
67 Tomkin, 2013, p. 181.
68 Ibid.

itself threatened.[69] What I question are the legal means employed to achieve this goal. If there had been agreement among the Member States on the need to establish a rescue fund and if there had been an unanimity needed to amend the TFEU, it would have been possible to create the ESM within the EU law, not outside of it, and to define its relationship with the 'no bailout' clause. It would have had the same effect, but its legality would not have been questioned.

In any event, the establishment of the ESM constituted a paradigm shift in EU's economic constitution.[70] Together with the instruments discussed below, this was arguably the first step to transform the EMU from a stability union to a fiscal union, as discussed in Section 2.

■ *3.2. The European Semester*

The Eurozone crisis showed clearly the inadequacies of the fiscal and economic governance, based on the SGP. A series of far-reaching modifications was thus adopted, in particular the so-called 'Six-Pack' in 2011 and 'Two-Pack' with the 'Fiscal Compact' in 2013.[71] One of the regulations contained in the 'Six-Pack' introduced the European Semester,[72] which, in essence, is 'nothing more than a period of about nine months in which all EU socio-economic coordination activities occur'.[73] At the same time, it is a major step in the development of the architecture of EU governance.[74] It incorporates into a single procedure the employment and social policy coordination, including the European Employment Strategy and the Social Open method of Coordination, with the fiscal and economic procedures of coordination, in particular the Broad Economic Policy Guidelines, SGP, and the Macroeconomic Imbalance Procedure, also newly introduced by the 'Six-Pack'.[75]

The processes of the European Semester are relatively clear and there is no need to discuss them in detail here.[76] What is important for this study is where the European Semester shifts the balance between supranationalism and

69 Adam and Mena Parras, 2011, p. 863.
70 Van Malleghem, 2013.
71 In this article, these measures will not be discussed in detail. For a complete analysis, see, for example, Hinajeros, 2013.
72 Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, Section 1-A. These provisions on the European Semester were redrafted in 2024 by Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97.
73 Bekker, 2020, p. 67.
74 Verdun and Zeitlin, 2018, p. 137.
75 Ibid., p. 138.
76 For a detailed discussion, see, for example, Bekker, 2020; Verdun and Zeitlin, 2018.

intergovernmentalism. There is no simple answer, as the boundaries between these two approaches have become blurred and, some argue, even irrelevant.[77]

Two points need to be highlighted. First, it is true that all significant measures foreseen within the European Semester are still adopted by the Council. However, the Council acts on the recommendation of the Commission and decides by qualified majority; the Member States concerned do not get to vote at all in the most serious cases.[78] Even more consequentially, the voting procedure has been transformed to reverse qualified majority voting in such cases, which shifted the institutional balance in favour of the Commission as, under this procedure, the Commission's proposal is deemed to be adopted unless a qualified majority votes against it.[79]

Second, the major economic reforms and budgetary decisions of the Member States are to be executed under the auspices of the Commission. The national medium-term fiscal-structural plans are proposed by the Member States, but finally adopted by the Council on the Commission's recommendation.[80] Implementation of the plan is monitored by the Commission.[81] This significantly limits the manoeuvre space for Member States' economic policies because the national budgets need to be *ex ante* reviewed by the EU institutions.[82] Ultimately, the role of national parliaments over budgetary affairs is marginalised.[83]

At the same time, it cannot be said that the role of Member States has diminished in all practical terms. The cases of Spain and Portugal, where the Council decided not to impose any sanction in 2016, despite the fact that it found that they did not adopt any effective measures within the Excessive Deficit Procedure, stand as examples. This strongly reminds us of the situation before the reforms even started, the case of France and Germany, and questions the efficiency of the new system.[84]

The experience so far seems to suggest that despite the reform, the bargaining power of individual Member States is crucial.[85] Some authors even warn of the

77 Verdun and Zeitlin, 2018, p. 145.

78 That is the case when the economic policies of a Member State are not consistent with the Broad Economic Policy Guidelines or risk jeopardising the proper functioning of the EMU (Art. 1421 (4) TFEU) or in case of the excessive deficit procedure (Art. 126 (13) TFEU).

79 Van Aken and Artige, 2013.

80 Regulation (EU) 2024/1263, Chapter IV.

81 Regulation (EU) 2024/1263, Chapter V.

82 Papadopoulos and Piattoni, 2019, p. 70.

83 Ibid,, p. 63. As argued by Crum, 2018, p. 269: '*Although the eventual right to adopt the budget is preserved at the national level, governments' economic decisions are increasingly constrained and parliaments thus find themselves at the losing side of a reinforced two-level game*.

84 Begg, 2017, p. 12.

85 As argued by Papadopoulos and Piattoni, 2019, p. 65: '*rather than being an exercise at economic policy coordination through mutual learning, the [European Semester] results in complex intergovernmental bargains and in several rounds of negotiations between individual member governments and the Commission*'.

'new intergovernmentalism', characterised by 'asymmetric negotiations'.[86] Arguably, as a result, the rules on fiscal coordination are not necessarily clearer, but have '*led to further institutional complexity and the absence of clarity in the allocation of responsibilities*'.[87]

From a purely legalistic viewpoint, the actual functioning of the European Semester is questionable. This needs to be seen in a wider context. I have argued above that the creation of ESM outside of the EU law architecture was questionable as well. So are other measures, employed for fiscal coordination. The Treaty on Stability, Coordination and Governance (TSCG),[88] known also as 'Fiscal Compact' according to its chapter devoted to budgetary rules, stands out in this regard. These rules were originally prepared as a 'standard' part of EU law, but because of the United Kingdom's opposition, they were ultimately adopted in the form of an international treaty.[89] The TSCG was meant to be subsequently incorporated in EU law,[90] but nothing has happened in this regard until now. As argued by professor Craig:

> Whatever one believes about its desirability or not, this new treaty does raise an issue of principle, which you can call a rule-of-law issue of principle, that is concerned with whether we should bear with equanimity the idea of those decision making rules being circumvented by a treaty outside the fabric of the Lisbon Treaty in circumstances where the rules as to how change should be undertaken within the Lisbon Treaty are not capable of being met.[91]

Professor Craig is not the only one to criticise the form of TSCG.[92] The procedures of the European Semester are scattered across a number of instruments of secondary and international law. It is difficult to get a complex picture of how it actually works. Its impact on the institutional balance within the EU and on the forces of supranationalism and intergovernmentalism are unclear. Again, a clear endorsement of these procedures in the TFEU would have removed the questions about their legality.

86 As argued by Papadopoulos and Piattoni, 2019, p. 69: '*Although the Commission launched proposals and initiatives, they were only successful if in line with German preferences*'.

87 Papadopoulos and Piattoni, 2019, p. 69.

88 The full text of the TSCG is available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A42012A0302%2801%29 (Accessed: 1 July 2024).

89 Craig, 2012, p. 233.

90 TSCG, Art. 16.

91 Oral evidence by Professor Paul Craig, taken before the European Scrutiny Committee of the House of Commons on 7 February 2012.

92 For instance, Týč and Sehnálek argue in general in favour of using international treaties for the purposes of further EU integration, they nonetheless describe the TSCG as a part of '*unwelcomed trend*' (Týč and Sehnálek, 2017, p. 206).

■ *3.3. The EU Recovery Instrument*

The last tectonic shift in the EMU's architecture is arguably connected to the EU Recovery Instrument (EURI),[93] a fund of EUR 750 billion situated outside of the Multiannual Financial Framework, which for the first time created an EU-wide fiscal stabilisation instrument.[94] The disbursement of money at the national level is subject to *ex ante* approval by the Council and monitored by the Commission, under a procedure integrated to the European Semester.[95]

EURI was set up on the basis of the existing primary law, even though until 2020, there was a consensus among EU institutions that any deeper fiscal integration, in particular involving issuance of EU debt, would require an amendment of the Treaties.[96] The EURI was established on the basis of Article 122 TFEU as a debt-financed EU fund, designed to help Member States in unexpected difficulties. The distribution of the money thus accumulated can be realised through different instruments. The most significant one is the Recovery and Resilience Facility (RRF),[97] based on Article 175 (3) TFEU (i.e. as a part of the cohesion policy).

These two legal bases are difficult to reconcile.[98] The transfer of funds through RRF to Member States is no longer designed as a crisis-management mechanism. It is instead a redistribution of money from Member States with high GDP and low unemployment to those with low GDP and high unemployment.[99] Crucially, it abandons the condition of the strict conditionality of aid to Member States, required by the CJEU, as discussed in connection with the *Pringle* case above.

Several comments need to be made in this regard. First, it is doubtful to what extent Article 122 TFEU provides a legal basis for financing that is not related to an emergency, but to criteria of cohesion, based on Article 175 TFEU.[100]

Second, the funding model is based on empowering the EU to incur debt to cover its expenditures. Simultaneously, Article 310 (1) TFEU clearly requires the revenue and expenditure shown in the budget to be in balance. This provision has been consistently interpreted as prohibiting the EU from issuing public debt for the purposes of filling the gap between revenue and expenditure.[101]

Both these doubts are in line with the observations I made in the two previous sections. I do not question the economic benefit of the EURI, but I have reservations concerning its compatibility with EU law, as it stands today.

93 Council Regulation (EU) 2020/2094 of 14 December 2020 establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis.
94 Porras-Gómez, 2023, p. 6. For a detailed analysis of EURI, see, for example, De Witte (2021).
95 Vanhercke and Verdun, 2022.
96 Leino-Sandberg and Ruffert, 2022, p. 434.
97 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility.
98 Porras-Gómez, 2023, p. 14.
99 Regulation 2021/241, Art. 11.
100 Leino-Sandberg and Ruffert, 2022, p. 444.
101 Ibid., p. 451.

Third, EURI was set up as a one-off program,[102] yet it is broadly understood – including by key stakeholders – as the beginning of a more permanent solution.[103] Characteristically, EURI is part of a project named ‘NextGenerationEU’,[104] which suggests that, in the ‘next generation’, the EU might return to such measures.

Finally, by creating the EURI outside of the EU budget, it circumvents the European Parliament, which has a crucial role to play in budgetary discussions. Significant budgetary powers are thus transferred from the legislature to the executive, in particular at the EU level but presumably also at the national one,[105] as the funds are ultimately distributed by national governments. This amounts to unprecedented, far-reaching institutional reforms, which have the potential to transform the founding structures and template of European integration,[106] without being foreseen by the primary law.

4. Conclusions

Over the past 10 years, the functioning of the EMU has significantly changed. The Eurozone has now practically unlimited funds to help its members in financial difficulty. The EU is empowered to create vast debt-financed funds and use them for redistributive purposes. And fiscal and economic policies of Member States, including national budgets, are to a large extent controlled by EU institutions.

It was not my intention to discuss the merits of these changes. It may well be that, from an economic viewpoint, they are beneficial or even necessary for the effective functioning of the EMU. My concern is that they are not in line with the Treaties. Financial aid is being provided to states in difficulties, despite the clear message of the no-bailout clause. The EU is incurring debt on an unprecedented scale, despite the requirement of its budget to be balanced.[107] Further, the Member States are no longer free to decide their economic policies.

The EMU is arguably moving on course toward a fiscal federation, but the rules in the Lisbon Treaty do not support it. This has broader consequences. In the

102 Regulation 2020/2094, Art. 3.

103 Leino-Sandberg and Ruffert, 2022, p. 437.

104 See the project’s web page, available at: https://next-generation-eu.europa.eu/index_en (Accessed: 1 July 2024).

105 Ibid., p. 455.

106 Dermina, 2020, p. 647.

107 Admittedly, the EU budget is still very small compared to those of ‘real’ federations. While EU’s budget remained at 1% of the EU GDP since the end of the 1980s (Buti, 2023), the federal US budget represented approximately 20% of US GDP over that period of time. See: https://www.presidency.ucsb.edu/statistics/data/federal-budget-receipts-and-outlays. However, although still relatively small, the NextGenerationEU funds almost double EU’s budget (Multiannual Financial Framework) for the 2021–2026 period and overall amount to almost 5% of EU’s GDP (Codogno and van den Noord (2021).

Lisbon Treaty, the Member States agreed to certain model of the EU, but they are getting something else in practice. This has a direct impact on their sovereignty.

At the same time, the balance between intergovernmental and supranational forces and the institutional balance is shifting. Legislature aims to play a significantly smaller role than the executive and so are the Member States being weakened to the benefit of the EU institutions.

I am by no means arguing against the changes to the EMU themselves. I simply put forward that the Treaties need to be changed to accommodate them and the Member States thus given a chance to express clearly their consensus. Admittedly, this would be very difficult under the current political conditions. However, at the same, a deep reform of EU's architecture is needed for EU to remain effective. The EMU should be part of such a reform.

Bibliography

- Adam, S., and Mena Parras, F. J. (2011) 'The European Stability Mechanism through the legal meanderings of the Union's constitutionalism: Comment on Pringle', *European Law Review,* 38(6), pp. 848–865.
- Amtenbrink, F., de Haan, J., Sleijpen, O. (1997) 'Stability and Growth Pact: Placebo or Panacea?', *European Business Law Review,* 8(10), pp. 233–238; https://doi.org/10.54648/EULR1997050.
- Van Aken, W., Artige. L. (2013) *A Comparative Analysis of Reverse Majority Voting: The WTO's Dispute Settlement Mechanism, the EU Anti-Dumping Policy and the Reinforced SGP and Fiscal Compact*. SSRN [Online]. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2202787 (Accessed: 1 July 2024), https://doi.org/10.2139/ssrn.2202787.
- Begg, I. (2017) 'Fiscal and Other Rules in EU Economic Governance: Helpful, Largely Irrelevant or Unenforceable?' *National Institute Economic Review,* 2017/239; pp. R3–R13; [Online]. Available at: https://doi.org/10.1177/002795011723900110 (Accessed: 1 July 2024).
- Bekker, S. (2020) 'The European Semester: understanding an innovative governance model' in Cardwell, P. J. and Granger, M. (eds) *Research Handbook on the Politics of EU Law*, Cheltenham: Edward Elgar Publishing, pp. 67 – 81; https://doi.org/10.4337/9781788971287.00013.
- Borger, V. (2013) 'The ESM and the European Court's Predicament in *Pringle*', *German Law Journal*, 14 (1), pp. 113–139; https://doi.org/10.1017/S2071832200001735.
- Buti, M. (2023) 'When will the European Union finally get the budget it needs?', *Bruegel,* 07 December 2023 [Online]. Available at: https://www.bruegel.org/analysis/when-will-european-union-finally-get-budget-it-needs (Accessed: 1 July 2024).
- Codogno, L., van den Noord, P. (2021) 'Assessing Next Generation EU', *LEQS Paper No. 166/2020* [Online]. Available at: https://www.lse.ac.uk/european-institute/Assets/Documents/LEQS-Discussion-Papers/LEQSPaper166.pdf (Accessed: 1 July 2024).
- Craig, P. (2012) 'The Stability, Coordination and Governance Treaty: Principle, Politics and Pragmatism', *European Law Review,* 37(3), pp. 231–248.
- Crum, B. (2018) 'Parliamentary Accountability in Multilevel Governance: What Role for Parliaments in Post-crisis EU Economic Governance?', *Journal of European Public Policy,* 25(2), pp. 268–286; https://doi.org/10.1080/13501763.2017.1363270.
- Dermine, P. (2020) 'The EU's response to the COVID-19 crisis and the trajectory of fiscal integration in Europe: Between continuity and rupture', *Legal issues of economic integration,* 47(4), pp. 337–358; https://doi.org/10.54648/LEIE2020020.
- Dullien, S., Guérot, U. (2012) *The Long Shadow of Ordoliberalism: Germany's Approach to the Euro Crisis*. European Council of Foreign Relations, 22 February 2012 [Online]. Available at: https://ecfr.eu/publication/the_long_shadow_of_ordoliberalism_germanys_approach_to_the_euro_crisis/ (Accessed: 1 July 2024).
- Dyson, K., Featherstone, K. (1999) *The Road to Maastricht*. Oxford: Oxford University Press, https://doi.org/10.1093/019829638X.001.0001.

- Feld, L., Schmidt, C., Schnabel, I, Wieland, V. (2016) 'Maastricht 2.0: Safeguarding the Future of Euro' in Baldwin, R., Giavazzi, F. (eds) *How to Fix Europe's Monetary Union. Views of Leading Economists*. Centre for Economic and Policy Research. [Online]. Available at: https://cepr.org/voxeu/columns/how-fix-eurozone-views-leading-economists (Accessed: 1 July 2024).
- De Grauwe, P. (2006) 'What Have we Learnt about Monetary Integration since the Maastricht Treaty?', *Journal of Common Market Studies*, 44(4), pp. 711–730; https://doi.org/10.1111/j.1468-5965.2006.00659.x.
- De Grauwe, P. (2013) 'Design Failures in the Eurozone – can they be fixed?', *European Commission* [Online]. Available at: https://ec.europa.eu/economy_finance/publications/economic_paper/2013/ecp491_en.htm (Accessed: 1 July 2024).
- De Grauwe, P., Ji, Y. (2016) 'How to Reboot the Eurozone and Ensure its Long-Term Survival' in Baldwin, R., Giavazzi, F. (eds) *How to Fix Erope's Monetary Union. Views of Leading Economists*. Centre for Economic and Policy Research. [Online]. Available at: https://cepr.org/voxeu/columns/how-fix-eurozone-views-leading-economists (Accessed: 1 July 2024), https://doi.org/10.2139/ssrn.2215762.
- De Haan, J., Berger, H., Jansen, D. (2004) 'Why has the Stability and Growth Pact Failed?', *International Finance*, 7(2), pp. 235–260; https://doi.org/10.1111/j.1367-0271.2004.00137.x.
- Hacker, B., Koch, C. (2017) 'The Divided Eurozone. Mapping Conflicting Interests on the Reform of the Monetary Union', *Friedrich-Ebert-Stiftung*. [Online]. Available at: https://brussels.fes.de/e/the-divided-eurozone (Accessed: 1 July 2024).
- Hinajeros, A. (2013) 'Fiscal Federalism in the European Union: Evolution and Future Choices for EMU', *Common Market Law Review*, 50(6), pp. 1621–1642; https://doi.org/10.54648/COLA2013161.
- Leino-Sandberg, P., Ruffert, M. (2022) 'Next Generation EU and its Constitutional Ramifications: A Critical Assessment', *Common Market Law Review*, 59(2), pp. 433–472; https://doi.org/10.54648/COLA2022031.
- Van Malleghem, P.-A. (2013) 'Pringle: A Paradigm Shift in the European Union's Monetary Constitution', *German Law Journal*, 14(1), pp. 141–168; https://doi.org/10.1017/S2071832200001747.
- Münchau, W. (2013) 'The Euro at Crossroads', *Cato Journal*, 33(3), pp. 535–540.
- Papadopoulos, Y., Piattoni, S. (2019) 'The European Semester: Democratic Weaknesses as Limits to Learning', *European Policy Analysis*, 5(1), pp. 58–79; https://doi.org/10.1002/epa2.1060.
- Pisani-Ferry, J. (2006) 'Only One Bed for Two Dreams: A Critical Retrospective on the Debate over the Economic Governance of the Euro Area', *Journal of Common Market Studies*, 44(4), pp. 823–844; https://doi.org/10.1111/j.1468-5965.2006.00664.x.
- Pisani-Ferry, J., Vihriala, E., Wolff, G. (2013) 'Options for a Euro-Area Fiscal Capacity', *Bruegel Policy Contribution*. [Online]. Available at: https://www.bruegel.org/policy-brief/options-euro-area-fiscal-capacity (Accessed: 1 July 2024).
- Porras-Gómez, A.-M. (2023) 'The EU Recovery Instrument and the Constitutional Implications of its Expenditure', *European Constitutional Law Review*, 19(1), pp. 1–24; https://doi.org/10.1017/S1574019622000323.

- De la Porte, C., Heins, E. (2017) 'The Aftermath of the Eurozone Crisis: Towards Fiscal Federalism?' in Dinan, D., Paterson, W., Nugent, N. (eds.) *The EU Public Policies and the Crises,* Palgrave Macmillan.
- Ruffert, M. (2011) 'European Debt Crisis and European Union Law', *Common Market Law Review,* 48(6), pp. 1777–1805; https://doi.org/10.54648/COLA2011070.
- Sweet, A. S., Sandholtz, W. (1997) 'European Integration and Supranational Governance', *Journal of European Public Policy,* 4(3), pp. 297–313; https://doi.org/10.1080/13501769780000011.
- Týč, V., Sehnálek, D. (2017) 'Mezinárodní smlouva jako další možný perspektivní nástroj evropské integrace', *Právník,* 156(3), pp. 192–212.
- Tomkin, J. (2013) 'Contradiction, Circumvention and Conceptual Gymnastics: The Impact of the Adoption of the ESM Treaty on the State of European Democracy', *German Law Journal,* 14(1), pp. 169–189; https://doi.org/10.1017/S2071832200001759.
- Tsebelis, G., Garrett, G. (2001) 'The Institutional Foundations of Intergovernmentalism and Supranationalism in the European Union', *International Organization,* 55(2), pp. 357–390; https://doi.org/10.1162/00208180151140603.
- Vanhercke, B., Verdun, A. (2022) 'The European Semester as Goldilocks: Macroeconomic Policy Coordination and the Recovery and Resilience Facility', *Journal of Common Market Studies,* 60(1), pp. 204–223; https://doi.org/10.1111/jcms.13267.
- Verdun, A., Zeitlin, J. (2018) 'Introduction: the European Semester as a new architecture of EU socioeconomic governance in theory and practice', *Journal of European Public Policy,* 25(2), pp. 137–147; https://doi.org/10.1080/13501763.2017.1363807.
- De Witte, B. (2021) 'The European Union's COVID-19 Recovery Plan: The Legal Engineering of an Economic Policy Shift', *Common Market Law Review,* 58(3), pp. 635–682; https://doi.org/10.54648/COLA2021046.
- Wyplosz, C. (2017) 'The Euro and Ordoliberalism' in Beck, T., Kotz, H. (eds.) *Ordoliberalism: A German Oddity,* Centre for Economic Policy Research. [Online]. Available at: https://cepr.org/publications/books-and-reports/ordoliberalism-german-oddity (Accessed: 1 July 2024).