UNIVERSIDADE CATÓLICA PORTUGUESA

TOWARDS EUROPEAN BUDGETARY UNION:

PROBLEMS AND CHALLENGES SINCE THE 2007/2008 FINANCIAL CRISIS IN COMPARATIVE INSTITUTIONAL PERSPECTIVE

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[…] as far as the sovereignty of the states cannot be reconciled to the happiness of the people, the voice of every good citizen must be, let the former be sacrificed to the latter. How far the sacrifice is necessary, has been shown. How far the unsacrificed residue will be endangered, is the question before us.

James Madison

Federalist Paper 45

The structure of the United States of Europe, if well and truly built, will be such as to make the material strength of a single state less important. Small nations will count as much as large ones and gain their honour by their contribution to the common cause.

Winston Churchill

Zurich, 19 September 1946

TABLE OF CONTENTS

Acknowledgements

Abbreviations

Table of contents

Part I. Introduction

1. Bifurcation of the European Union
2. Verticality of the relationship between the European Union and Member States
   2.1. Problems related to the European Union budget
   2.2. Problems related to institutional imbalance
   2.3. Problems related to democratic participation
   2.4. Problems related to moral hazard
3. Methodology
4. Objective and research question
5. Structure

Part II. Competences and institutional framework of the European Union before the financial crisis

1. Competences of the European Union and of Member States
   2.1. Definition of competence
   2.2. Limiting the scope of EU law: principle of conferral and flexibility clause
   2.3. Retained competences of Member States
   2.4. Exercise of EU competences: principles of subsidiarity and proportionality
   2.5. Distribution of competences
      2.5.1. Exclusive competence
      2.5.2. Shared competences
      2.5.3. Complementary and coordination competences
2. Bifurcation of the European Union
   2.1. Supranational monetary policy
      2.1.1. Principle of hierarchical subordination of the NCBs to the ECB

2.1.2. Principle of decentralised implementation
2.1.3. Principle of consistent standard
2.2. Coordination of economic policies of Member States
2.3. Effects of centralised monetary policy and decentralised economic policy
3. Evolution of the European Union budget
5.1. Initial period (1958-1970)
5.2. Interim period (1970-1988)
5.3. Present period (1989-onwards)

Part III. Developments since the 2007/2008 financial crisis and their consequences from a comparative institutional perspective

Chapter 1. European Union political institutions

1. Changing nature of executive action
1.1. Supranational action by the European Central Bank
1.1.1. Impact of the financial crisis in monetary policy
1.1.2. Compatibility with the principle of prohibition of monetary financing
1.1.3. Compatibility with the principle of central bank independence
1.2. Intergovernmentalism
1.2.1. European Council
1.2.2. European Commission
1.3. Paradox of executive legitimacy
2. Changing nature of legislative action
2.1. Supranational role of the European Parliament
2.2. Intergovernmentalism
2.2.1. Council of the European Union
2.2.2. National parliaments
2.3. Importance of parliaments for EU legitimacy and accountability
3. Adequacy of the European Union budget
3.1. Reliance on Member States for revenue
3.2. Expenditure focused on Member States
3.2.1. General considerations

3.2.2. Next Generation EU

4. Problem of participation
   4.1. Power of the many in European Union monetary policy
   4.2. Power of the few in intergovernmentalism
      4.2.1. In economic policy
      4.2.2. In the budget of the European Union
         4.2.2.1. Public awareness
         4.2.2.2. Expectations of Member States and European citizens

Chapter 2. Fiscal discipline and market incentives

5. Fiscal discipline in multi-level governance systems
   5.1. Different paths to fiscal discipline
   5.2. Reasons for fiscal centralisation
   5.3. Reasons for fiscal decentralisation
6. Fiscal discipline and surveillance in the aftermath of the financial crisis in the European Union
   6.1. Conditional financial assistance
   6.2. Budgetary and macroeconomic surveillance
      6.2.1. Treaty on Stability, Coordination and Governance
      6.2.2. Euro Plus Pact
      6.2.3. EU legislation: six-pack and two-pack
      6.2.4. Reform of the Stability and Growth Pact
      6.2.5. Differentiated integration
   6.3. Compatibility of fiscal discipline with the principle of no-bailout
7. Comparative examples
   7.1. Federalism with sub-national sovereignty: United States
      7.1.1. Revolutionary war
      7.1.2. Funding of major public projects
      7.1.3. US civil war
      7.1.4. New Deal: the rise of countercyclical policy at State level
      7.1.5. Different public finance limitations
      7.1.6. Perils on the effectiveness of public finance restrictions: judicial deference and constitutional exceptions
   7.2. Federalism without sub-national sovereignty: Germany

7.2.1. German constitutional renegotiation and problems of fiscal semi-sovereignty
7.2.2. Constitutionally-mandated financial support: the cases of Saarland and Bremen
7.3. Dependence of small and large States: brief note on Brazil
7.4. Critical assessment

Chapter 3. Judicial syndication and its limits

8. Judicial control in the European Union
8.1. General remarks
8.2. Scrutiny of financial assistance
8.2.1. ESM as economic policy
8.2.2. Interplay with Union and Member States economic policy competences
8.2.3. Preserving incentives for fiscal rectitude
8.3. Scrutiny of monetary policy
8.3.1. Limits of monetary policy competence
8.3.1.1. Gauweiler
8.3.1.2. Weiss
8.3.2. Monetary financing of Member States
8.3.2.1. Gauweiler
8.3.2.2. Weiss
8.3.3. Proportionality
8.3.3.1. Gauweiler
8.3.3.2. Weiss
8.4. *Bundesverfassungsgericht* decision pursuant to Weiss
8.5. Bifurcation of judicial control in economic and monetary union
9. Judicial control in Member States
9.1. Demand of rights
9.2. Supply of rights
10. Deference in the United States: a brief comparative overview
11. Judicial process to address issues of economic and monetary policies?
11.1. Courts and democracy
11.2. Suitability of the adjudicative process
11.3. Problem of alternatives, costs and resources

11.4. Judicial bias in European economic and monetary union?

Interim conclusions

Part IV. Democracy, autonomy and accountability: towards European Budgetary Union

Chapter 1. Democracy in the budget of the European Union

1. Addressing minoritarian bias in EU economic and budgetary policies
   1.1. Changing the voting threshold?
   1.2. Taxation of EU citizens
      1.2.1. Competence for EU taxation
      1.2.2. Should the EU exercise taxation powers more broadly?
      1.2.3. A budget funded by taxes based on policies?
      1.2.4. Linking funding to citizens to promote participation
   1.3. EU expenditure
      1.3.1. Linking expenditure to citizens to preserve the federal union of States
      1.3.2. A generality principle for EU expenditure?

2. Member States legislators as key for a two-force approach

Chapter 2. Autonomy and accountability of Member States

3. Bankruptcy framework for Member States
   3.1. Importance of sovereign debt restructuring
   3.2. Challenges
      3.2.1. Holdout problem
         3.2.1.1. Contractual-based State restructuring: collective actions clauses
         3.2.1.2. Procedure-based State restructuring
      3.2.2. Sovereignty problems
         3.2.2.1. Restriction of Member State autonomy in economic policy-making

3.2.2.2. Restriction of Member State autonomy in filing the procedure
3.2.2.3. Sovereign specificities
3.2.3. Legal problems
3.2.3.1. Moral hazard concerns of the debtor
3.2.3.2. Sufficiency and suitability of collective action clauses
3.2.3.3. Lack of independence in overseeing the process
3.2.3.4. Compatibility with the European Union Treaties
3.2.4. Financial problems
3.2.4.1. Market access and reputation
3.2.4.2. Bond market disruption and contagion
3.3. Bankruptcy procedure as bolstering Member States' democratic processes, autonomy and accountability

Part IV conclusions

Part V. Conclusive reflections

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ABBREVIATIONS

AG – Advocate-General

BBR – Balanced Budget Rule

BoJ – Bank of Japan

BVerfG – Bundesverfassungsgericht

CAC - Collective Action Clause

CAP – Common Agricultural Policy

CJEU or Court – Court of Justice of the European Union

Council – Council of the European Union

COS – Greek Council of State

CSR – Country-specific recommendation~

DIP - Debtor-in-possession

EC – European Community

ECB – European Central Bank

ECSC – European Coal and Steel Community

EDP – Excessive Deficit Procedure

EEC – European Economic Community

EFSF – European Financial Stability Facility

EIP – Excessive Imbalance Procedure

EMU – Economic and Monetary Union

EMS – European Monetary System

EP – European Parliament

ESCB – European System of Central Banks

ESCB and ECB Statute - Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank

ESM – European Stability Mechanism

ESMA – European Securities and Markets Authority

EU – European Union

Euratom – European Atomic Energy Community

EURI – European Union Recovery Instrument

FED – United States Federal Reserve System

GDP – Gross Domestic Product

GNI – Gross National Income

GNP – Gross National Product

IMF – International Monetary Fund

MEP – Member of European Parliament

MFF - Multiannual Financial Framework

MoU – Memorandum of Understanding

NCB – National Central Banks

NGEU – Next Generation EU

OMT – Outright Monetary Transactions

ORD – Own Resources Decision

PEPP – Pandemic Emergency Purchase Programme

PSPP – Public Sector Purchase Programme

RRF – Recovery and Resilience Facility

SGP – Stability and Growth Pact

SMP – Securities Market Programme

SSM – Single Supervisory Mechanism

SRB – Single Resolution Board

SRF – Single Resolution Fund

SRM – Single Resolution Mechanism

SURE – Support to mitigate Unemployment Risks in an Emergency

TEL – Tax and Expenditure Limits

TEU – Treaty on European Union

TFEU – Treaty on the Functioning of the European Union

TPI - Transmission Protection Instrument

TSCG – Treaty on Stability, Coordination and Governance

UK – United Kingdom

UN – United Nations

US – United States of America

VAT – Value-Added Tax

PART I

INTRODUCTION

1. Bifurcation of the European Union

The Maastricht Treaty created a single currency governed by a monetary policy common to all Member States, the conduction of which was entrusted to the ECB. Monetary, economic and fiscal policies are usually connected and work at the same level of governance in order to better achieve social objectives. However, in the EU, economic and fiscal policies remained a competence of each Member State. Significantly, by only supranationalising monetary policy, Member States became misaligned. Conversely, misalignment was created at the EU level. As a result, the Treaty of Maastricht marked the beginning of a bifurcation in the EU.

Such misalignment may negatively impact the economic performance of each Member State and its budgetary stability, as well as have an effect of contagion on others. Conscious of this, the Treaty framers established provisions intended to promote budgetary soundness. The first was an obligation to maintain national budgets in balance or at a surplus in the medium term. The second was a prohibition to surpass a public deficit of 3% of GDP. These two rules essentially define the SGP. Finally, the third was a prohibition of monetary financing of Member States by the ECB. These three rules were the backbone of a framework that intended to make markets responsible for assessing Member States economic performance and fiscal position, as well as making States responsive to market incentives.

The SGP quickly proved to be ineffective. Not only did it lack the capacity to discipline non-compliance but, most importantly, it focused on individual Member States rather than common issues. Therefore, the ratio of the SGP is to avoid implementation of divergent and harmful national fiscal policies, not to manage macroeconomic issues.

On the other hand, the Maastricht Treaty framework restricted national stabilisation policies because the legal framework constrained its budgetary capacity. Moreover, when such stabilisation efforts are pursued, the risk of externalities (the probability of positive effects being experienced by a country that did not make such effort) exists, thus reducing their national effectiveness.

In this context, the 2007/2008 financial crisis was a pivotal moment. How could countries without monetary policy competences handle such challenging economic conditions? In the absence of the power to issue currency to fund budgetary needs in situations of absolute necessity, or to erode the value of currency in order to correct balance of payment imbalances and to reduce the public debt burden with support of inflation, States are in a substantially weaker position.

Moreover, States came to the rescue of financial institutions, which made their public debt levels increase substantially, prompting investors to adjust the risk premium on bonds, reflecting doubts on certain States' repayment capacity. It was clear that the Maastricht perspective of discipline-induced market pressure had not succeeded.

The bailouts of a few Member States that followed prompted a significant intervention by EU institutions, particularly the ECB, by purchasing the public debt of the Member States. The same conduct was adopted to counter the economic and financial effects caused by the COVID-19 pandemic. Prior to the crisis, the ECB dealt with a situation of financial stability and confidence in the euro currency and the financial crisis had a major impact in EU Member States and tested the established legal architecture.

Moreover, national autonomy in economic and fiscal matters was severely restricted. Indeed, if a Member State has excessive public debt and deficit, as established by article 126 (2) TFEU, a shift of competence is triggered, enabling the Union to adopt significant measures on national economic policy. This signals a dilution of Member State power in this regard, which is a paradox given that economic and fiscal policies are an area to which Member States originally attributed much importance and were keen to maintain in the national sphere.

Hence, the financial crisis initiated a dynamic that has made Member States economic policy autonomy dependent on the fulfilment of certain criteria. From an institutional perspective, the intergovernmental method prevails, with the European Council and the Council gathering most competences in this regard, while the European Commission gained prominence as an enforcer. However, it is increasingly difficult to maintain that economic governance is based on mere coordination as a shift took place from soft law towards a binding framework based on supranational surveillance and control. The underlying assumption is that, in the absence of a common economic policy supported by a more robust EU budget within an increasingly integrated EU, especially

within the euro area, interdependence between Member States means their interests are better maintained through an enhanced, surveillance-based economic policy coordination.

By significantly shaping the way in which Member States take their decisions, the Union affects its relationship with its citizens, albeit in an indirect and subtle way. Top-down economic governance and fiscal rules have a bearing on democracy, such as increasing the lack of consequentiality of direct elections in Member States, reducing the role of national and EU legislative institutions or emphasising the indirect democratic legitimacy of some EU institutions.

2. Verticality of the relationship between the European Union and Member States

For the purpose of this thesis, therefore, it is considered that there is a relationship of dependence between the Union and Member States: I designate this verticality. Interestingly, this dependence works both ways. On the one hand, the Union is dependent on its Member States for political legitimacy and to provide financial means, both for the EU budget and financial assistance. On the other hand, Member States are dependent on the Union, for instance, regarding rules on economic governance and fiscal indicators, as well as the ECB's monetary policy.

There are many issues related to verticality, for instance, regarding the EU budget, institutional imbalance, democratic participation and moral hazard.

2.1. Problems related to the European Union budget

The bifurcation of the Union and the redistribution of competences regarding EU monetary and economic policies represented a development in its relationship with its Member States. However, over the decades, the EU budget remained essentially static, with limited effectiveness, at roughly 1% of GNI. Even considering that the principle of subsidiarity would allow public expenditure to largely remain at the national level, the Union's budget should rise, for instance, to 2-2,5% of GNI, to permit the exercise of a stabilisation function and growth policy.[1]

[1] Commission of the European Communities, 'Report of the Study Group on the Role of Public Finance in European Integration. Volume I. General Report' (1977)

There is a strong contrast between this situation and that of mature federations, such as the US or Germany, where several of the main functions, ie of social nature, are attached to the federal government and there is a substantial degree of direct connection with citizens of the respective States or regions. Accordingly, these federations are characterised by the predominance of federal taxes over state taxes and relatively large federal public spending, ranging from 36% to 49% of GDP,[2] respectively.

This budgetary inertia can only be properly understood if considered in connection with Member States' intention to keep economic and fiscal policies at the national level. This choice is reflected in the nature of the EU budget's funding and expenditure. The former is dependent on Member States, given that most of its revenue comes from national contributions. Regarding expenditure, despite changes in recent years towards increasing EU-added value, the most prominent segments (two-thirds of the total) continue to be the common agricultural policy and cohesion policy, which are eminently redistributive and focus on Member States rather than the EU as a whole.

The symmetry between the nature of revenue and expenditure is an important feature. As EU budgetary history shows, the source of income and source of authority/legitimacy are two essential components that need to be jointly considered. When both are aligned, as they were between 1958-1970 and as they are currently, budgetary stability emerges and endures. However, the consequence for matching source of income and authority in Member States is that a consensus is difficult to reach regarding the increase in the overall budget as well as the type of policies that it finances.

Therefore, the EU budget does not take EU-added value investment into significant account. And, even if it did, the impact would not be substantial enough to make an impact on stabilisation impact, due to its meagre size. This is, indeed, a worrying aspect, not only because the ECB is legally prohibited from acting as a lender of last resort to Member States, but also due to the restrictions in place regarding national economic policies since the enactment of the Maastricht Treaty, which hinders the national toolkit to tackle crises.

<http://aei.pitt.edu/36433/1/Report.study.group.A13.pdf> accessed 9 February 2023, 14. An unchanged EU budget mirrors the relative lack of scholarly analysis of it, as pointed out by Kilpatrick. Therefore, the author argues that it is time to focus on this important instrument. See Claire Kilpatrick, 'Explaining and remedying the near absence of the budget in EU law scholarship' (2024) 61 Common Market Law Review 623.

[2] Figures for 2022. See International Monetary Fund, 'Government Expenditure, Percent of GDP' <https://www.imf.org/external/datamapper/exp@FPP/USA/FRA/JPN/GBR/SWE/ESP/ITA/ZAF/IND> accessed 17 March 2024.

2.2. Problems related to institutional imbalance

Institutional imbalance is understood as an institution's over or under intervention in complex, challenging situations, either in supranational or national spheres, compared to what they would have done under regular circumstances. Surely, crisis situations demand different approaches by competent institutions. However, Treaties, legal principles and legal frameworks exist to grant powers to institutions and, importantly, to establish boundaries to their width of intervention, especially in difficult situations, in which complexity rises.

This thesis will highlight the over-intervention of political institutions of executive (ECB and the European Council) and legislative nature (national parliaments). I will also address the under-intervention of the EP and the CJEU. Following this, I will highlight some of the main features. The financial crisis sparked the phenomenon of the unbounding of institutions of an executive nature in the EU, both in terms of an immediate financial capacity (ECB) and what was perceived by the necessary democratic legitimacy to make decisions concerning financial and fiscal affairs (European Council).

Regarding the ECB, its intervention is as notable as it is worrisome. It is notable because it was the only institution with the necessary capacity and governance mechanisms to provide an effect of stabilisation in the EU economy. Indeed, the various asset purchase programmes led to a balance sheet of almost €9 trillion in 2021, more than quadrupling since 2008 (most of it was lent to euro area credit institutions related to monetary policy operations and purchasing the bonds of eurozone Member States from the secondary market).

It is worrisome on multiple counts, notably regarding the compatibility with the principles of prohibition of monetary financing and independence of the ECB. Moreover, and crucially, the magnitude and nature of the intervention exposed the institutional vulnerability of the E(M)U, by revealing that Member States were significantly dependent on the central bank. Given the lack of institutional alternatives at the EU level, monetary policy actions were a result of political and social necessity, rather than technical appropriateness. Significantly, the financial and COVID-19 crises occurred suddenly and, in the absence of similarly robust measures, required immediate responses, such as the provision of short-term liquidity.

Hence, the ECB has risen to be one of the most prominent executive institutions. However, the problem with making institutional choices in the context of a lack of alternatives is that there is a higher probability of making a poorer decision. Importantly, the effects of these less-than-optimal choices will only be visible when reality becomes complex and intricate. Therefore, while averting imminent financial collapse may provide some justification for central bank intervention, it also attests to the fact that other institutional alternatives need exploring.

Concerning the European Council, the view I employ in this thesis is that the bifurcation created space for what is known as *new* intergovernmentalism. Since 1992, the European Council has come to the forefront of the EU institutional landscape, assuming a coordinating role in economic governance, among other sensitive areas. However, crisis management shifted the role of the European Council from coordination to economic governance entailing discretionary executive decisions.

Finally, national parliaments have risen in the context of intergovernmentalism, which has furthered since the financial crisis. It is usually considered that more involvement from national parliaments in EU affairs, whatever the form, is important for a variety of reasons, namely, democratic legitimacy and accountability. One of the most prominent reasons for this is that national governments are sustained by parliamentary majorities and are held accountable for national parliaments.

However, national parliaments face the same shortcomings previously identified regarding the executive branch. Indeed, although the European Council can benefit from the fact that its members are individually accountable for their own national legislatures, the idea of legitimation via nationally-elected governments is far from a guarantee that the EU will be more responsive politically. As each government only holds national legitimacy, every collective decision taken in the European Council would be characterised by incomplete legitimacy. Moreover, each government and parliament focuses on the interests of its own country. As a result, the sum of all national parliaments' interventions does not equate to discussions and a decision-making process within the EP. In fact, fragmentation results in the entrenchment of national political boundaries and neither favours nor resembles a process that delivers a (more) unitary voice – one which internalises the EU citizens' diversity of perspectives and needs. Accordingly, they will be less able or willing to take into account the interests of the Union as a whole.

Conversely, there was under-intervention by the EP and the Court. In the post-Maastricht period, the EP increased its legislative competences and accountability capacity in general terms, since it was the institution that had the most to gain from successive Treaty reforms. In fact, the areas in which it is excluded are declining continuously. However, the competences of the EP are not on par with those of the Council. Co-decision has been extended but only, essentially, regarding areas that had already been transferred to the EU. Crucially, it has been broadly sidelined on economic governance, fiscal rules and financial assistance institutions. For instance, from a legal perspective, the intergovernmental solutions adopted to tackle the financial crisis did not promote parliamentary involvement, such as the ESM and TSCG. Moreover, the involvement of the EP in the discussion and adoption of the EU budget and the ORD is not substantive enough.

Regarding the CJEU, it is useful to compare the case law on the free movement of goods and monetary union case law. In the former, the Court employed a stricter standard of judicial review, assessing and striking down a significant number of measures. Importantly, it did so by adopting an effects-based approach, thus enlarging the scope of measures under its purview. In contrast, the Court detracted from an analysis on the economic effects of monetary policy and chose to apply a formalistic review of ECB competences to define monetary policy. It also stated objectives of the unconventional measures underlying this policy.

2.3. Problems related to democratic participation

Problems related to democratic participation derive from the adoption of a participation-centred approach. Such an approach provides interesting insights, because it 'identifies the actions of the mass of participants as the factor that in general best accounts for the variation in how institutions function'.[3] Such actions have to be assessed in reference to the benefits and costs of such participation across the relevant population, which defines each participant's incentives to exercise their voice. Participation incentives (or stakes) are important because they define the kind of bias that is most likely to occur during the political process. According to the two-force model, there are two

[3] Neil Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics and Public Policy* (The University of Chicago Press 1997) 7.

types of bias: minoritarian and majoritarian. Both biases represent a skewed distribution of interests.

Minoritarian bias highlights the inordinate power of the few at the expense of the many. The risks of minoritarian bias are particularly high when either the benefits or costs of a particular legislation are concentrated upon one group of individuals or countries and its reverse costs or benefits are concentrated upon a large majority. Therefore, the group with high(er) incentive to participate (because of concentration of costs or benefits) will be, unsurprisingly, better organised and informed. On the contrary, low(er) stakes result in low(er) incentive to participate, for instance because the loss to bear by each impacted person or group might be so negligible that they could possibly be completely unaware. Even if aware, they may stand still, either expecting to free ride on somebody else's actions, or because the costs of participating will outweigh the potential benefits.

Majoritarian bias is an opposite response to the same skewed distribution of impacts which characterise minoritarian bias. This means that it is an inordinate power of the many at the expense of the few. The risks of majoritarian bias come from the nature of the democratic process in which the majority wins, regardless of any cost/benefit analysis of a decision regarding the minority or the majority.

I will assess the institutional behaviour of EU political (executive) institutions as well as judicial institutions. The market process will not be assessed because, as I will explain throughout the thesis, the assumption is that this avenue for achieving social goals was not adequately considered. My assessment of institutional architecture is important in weighing the democratic problems (connected to become two identified biases) with the legitimacy that input intergovernmentalism intends to bring about.

2.4. Problems related to moral hazard

One important question loomed while establishing the EMU: whether and how Member States, with diverse economic structures, would adjust, endure and thrive under a common currency. To achieve a positive outcome, the Maastricht consensus was based on the principle of market pressure. In essence, it conveys the idea that Member States without monetary policy autonomy should rely solely on fiscal policy for public debt management.

Crucially, members of a monetary union issue government debt in a currency they do not control and, consequently, cannot always guarantee repayment to bondholders. On the contrary, countries not participating in a monetary union can provide a higher degree of trust because they have their own central bank. This contrast creates a situation in which a liquidity crisis could occur within a monetary union and, because such a crisis leads to significant increases in the interest rate on public debt, it may result in a default. Given this framework, countries should be provided with an incentive to maintain their debt at manageable levels, otherwise markets would signal this by raising the interest rates on bonds.

Hence, market pressure was translated into a no-bailout clause and the adoption of several public finance instruments, such as the SGP and the EDP. Observance of these instruments was entrusted to the Commission and sanctions would be ultimately decided by the Council.

Nevertheless, the intensity of macroeconomic instability and asset overvaluation in years of economic prosperity, as well as excessive austerity in years of economic recession, has brought about scepticism regarding the market's role. While there is support for the understanding that market failure is a major cause of instability in European economic integration, the view purported here is that, on the contrary, it is a symptom of flawed institutional choices. At the outset, the existence of a procedure to require Member States to perform fiscal adjustments in the event of the excessive debts or deficits, in fact, casts doubt on the credibility of the no-bailout clause, as excessive debt accumulation is only a problem if there is a reason to expect that ensuing difficulties will need to be resolved through a bailout.

Moreover, when the SGP was not enforced after its initial breach, neither by Member States nor the Court, it signalled to both the market and individual Member States that fiscal discipline was not as highly valued a feature as previously assumed. Implicitly, a perception of bailout began to develop.

The development of this understanding of the market process led to institutional failure, resulting in a failure of institutional choice. Indeed, the evolution of the economic governance framework towards a surveillance paradigm has imposed extensively detailed constraints, evolving into a dysfunctional process. In short, it reinforces the supranational political process as the prominent process regarding delivering fiscal and financial stability, indicating a certain level of co-responsibility.

Finally, there are comparative examples showing that balanced budget rules (such as those in the US) and supranational fiscal rules on constituent units (such as those in Germany) have limited effectiveness in delivering adequate results on financial stability. In fact, the most important lesson from these two examples is that credibility of no-bailout rule is of the utmost importance in order to ensure sub-national compliance.

3. Methodology

My understanding is that economic law and governance cannot be fully grasped purely from a legal perspective. This is a necessary, yet insufficient approach, as legal principles and rules, if improperly measured and defined, may be of limited normative power. Hence, this thesis aims to be interdisciplinary: while being a law thesis, it resorts to other social sciences, namely economics and political science, in order to provide more width and depth. Economics is useful in order to understand resource allocation efficiency and the incentives provided by legal prescriptions. Finally, political science needs to be summoned given the eminent institutional dimension of this thesis as well as the interplay between political power, legal normatives and the economic and fiscal developments in the EU.

Therefore, this research will not only be based on readings of scientific books and articles or in the deductive exercise of analysis of legal frameworks, but also on the gathering and analysis of statistical data. Moreover, this thesis will resort to inductive reasoning in order to propose a relationship between the Union and its Member States that departs from the observed shortcomings in their past and current institutional behaviour.

Importantly, this thesis will employ comparative institutional analysis in order to assess institutional capacity of different processes to deliver outcomes in a changing and developing environment, namely the political process, the market process and the judicial process. Why should one look at different institutional avenues? Is it not clear that, if there is a problem of executive predominance in the EU, the CJEU should be more active as a result? Differently, if there is an issue of fiscal profligacy in some Member States, should the political process act in order to make economic governance and fiscal rules more stringent and bolster its enforcement? Or, if the problem of the EU is one of inefficiency in the allocation of resources, should we not request Member States to

increase their contributions to the supranational budget in order to establish an absorption mechanism dealing with asymmetric shocks?

However, an overlooked assumption is that any given law or public policy result comes from a particular social goal. And, when a particular law or public policy stems primarily from goal choice, it is implicitly assumed that there is an institution best placed to carry it out. The missing link to all these questions is institutional choice and comparative institutional analysis. Connecting goal choice and institutional choice is, therefore, essential. First, because the latter is linked to institutional performance which, in turn, needs a certain goal(s) to be assessed. Second, because goals can be pursued by different policies. By choosing institutions, we link goals to results. However, one needs to avoid the search for perfect, flawless solutions, as institutional choices are rarely straightforward. In other words, it will most likely be an exercise of choice among imperfect alternatives, especially in a world of (increasing) numbers and complexity. As institutions move together in a scenario of evolving intricacy, they become progressively more strained and less able to deliver the outcomes expected of them. On the other hand, as stakes increase, more people tend to exercise their voice, making it harder to achieve consensus. The strengths and weaknesses of a certain institution or process vis-a-vis another varies with the particular set of circumstances.[4]

Within this analytical framework, the participation-centred approach offers interesting insights, because it 'identifies the actions of the mass of participants as the factor that in general best accounts for the variation in how institutions function'.[5] Such actions have to be assessed by reference to the benefits and costs of such participation across the relevant population, which will define the incentives each participant has to exercise its voice, act or not act. Participation incentives (or stakes) are crucial, because they define the kind of bias that most likely will occur in the political process. According to the two-force model, there are two types of bias: minoritarian and majoritarian.[6] What they have in common, is that both biases represent skewed distribution of interests.

[4] ibid. 5.
[5] ibid. 7.
[6] Miguel Maduro depicts a more complex picture in this regard. The author considers that in the EU there are two types of majoritarian or minoritarian biases. The first is related to State power, which is typical of intergovernmental relations. On the one hand, majoritarian bias corresponds to larger States enjoying more power than smaller States. On the other hand, minoritarian bias expresses a skewed distribution of power favouring smaller States. The author argues that this power relationship holds a vertical nature, given that it concerns relations between Member States and the Union's political process. The second is related to numbers, typically more connected to supranationalism. In this case, majoritarian or minoritarian biases

The comparative institutional analysis conducted in this thesis will, therefore, identify the distribution of interests currently in place in EU and international law institutions that are relevant in the realm of European economic governance and financial assistance. The skewed distribution of intergovernmental institutions unbalances the system and forces other (majoritarian) institutions to become biased.

I will employ a comparative perspective throughout the thesis, notably with the US. A number of factors led me to choose the US as a prime comparator. At the outset, it is a system characterised by separation of powers designed to keep the relationship between the federal level and the States in balance as well as between the States themselves, which resembles the constitutional situation in the EU. From a sociological, as well as an economic and fiscal standpoint, the US underwent many of the same challenges that the EU has faced and is currently facing, for instance, regarding the predominance of the States over the confederal and federal governments or how to strike a balance between federal and State relationship on economic, fiscal and monetary issues. The US is similar to the EU in terms of the asymmetry of States' size, population, economic development, social and political diversity. As Einstein famously stated, if you want to know the future, look at the past. Therefore, by looking at the evolution of the US, particularly in the late eighteenth century until the early twentieth century, we might well be getting a glimpse at certain features of the EU's future. Likewise, I will look at Germany regarding the fiscal relations between the federal layer and the States, as it is an example of a vertical relation, with a similar ratio as the EU's.

This methodology will be the basis for the proposals of this thesis. The proposed changes are not an attempt at perfection. Indeed, good alternatives and choices will only be possible when the facts and overall context are simple and frictionless and where different kinds of disputes may be easily settled, ie non-judicial agreements, a quick court decisions or straight-forward laws. Given that a frictionless world does not exist, these solutions would probably be impossible. Crucially, however, fluctuation of complexity is a horizontal phenomenon, meaning that all institutional processes are impacted. Accordingly, I am aware that the alternatives I propose may generate friction between EU

correspond to the inordinate power of the majority of States, regardless of their size, or the presence of supra-national interest groups capturing the legislative process. The author argues that this power relationship holds a horizontal nature, given that it derives from pressures that spread throughout Member States. See Miguel Poiares Maduro, *We The Court: The European Court of Justice and The European Economic Constitution* (Hart Publishing 1998) 117.

institutions, citizens and Member States. However, I argue that they foster more participation from different actors, hence being more democratic, transparent and inclusive than they are at present.

4. Objective and research question

The objective of this thesis is to argue for the need of an EU budgetary union and to propose a way towards it. To this end, I will argue for the creation of a different relationship between the EU and its Member States, promoting mutual democratic legitimacy as well as economic and fiscal autonomy of the supranational sphere and its constituent parts. Such a relationship would not only be more respectful of Member States' sovereign prerogatives but also more suitable to provide the Union with tools capable of fostering democratic legitimacy and mutual autonomy. By focusing on monetary and economic governance, fiscal rules and institutional setting with this objective, democratic legitimacy in the Union and Member States should significantly improve.

Conceptually, the path proposed in this thesis can be summarised as follows: verticality and horizontality. These will be the main axes I will work from throughout in order to explain how the Union has developed since the Maastricht Treaty and how it should be shaped going forward. Verticality essentially aims to convey the idea of a relationship of dependence between the Union and Member States. Horizontality, on the contrary, aims to convey the idea of independence of the Union and of Member States from each other, politically and, to a large degree, from an economic and fiscal standpoint. Firstly, it is necessary to foster the participation of EU citizens regarding the supranational executive function in order to provide a more coherent and unitary voice than that which is currently conveyed by the European Council. Importantly, an ability to choose must be accompanied with a duty to pay. In other words, EU citizens should be given a direct, transparent and visible means to individually contribute to the EU budget. Secondly, economic and fiscal choices must be consequential at the Member State level, both at the level of implementation and ultimate outcomes. Unlike the vertical approach, in which the political process prevails, horizontality demands increased participation from the market process, as it requires a more dispersed and transparent body of actors.

The research question of this study is implied in this excurse, and it may be concisely formulated as follows: how should the legal and institutional framework of the European Union develop in order to create a budgetary union?

5. Structure

This thesis is structured in three main parts. Part II looks at the competences and institutional framework of the European Union before the financial crisis. The approach I take here is mainly descriptive. At the outset, I focus on the competences of the EU and Member States, namely the evolution of the Court's case law and the problem of competence creep. Indeed, the broadening of Union's powers by judicial fiat in the early stages of EU integration is, arguably, a factor that explains the growing trend for intergovernmentalism and the ensuing choice for the federalisation of monetary policy and the coordination of Member States' economic policies, which I describe as the bifurcation of the Union. The three periods of evolution of the EU budget are also described.

Part III will present and analyse the developments that have occurred since the 2007/2008 financial crisis, as well as its consequences from a comparative institutional perspective. As the first existential threat to the EU as a federation of States, the financial crisis is understood to be a pivotal moment that spurred a number of developments that were thought to be unthinkable in its absence.

Therefore, this part will explore the legal and institutional developments that occurred in a number of interrelated policies, namely, economic, monetary and budgetary, as well as its interactions with the judicial branch, particularly the CJEU, but also some national judiciaries. In particular, this part will provide a comparison between the political, market and judicial processes of the EU. The importance of this approach is that it allows one to take a holistic view of EU integration. Rather than focusing on only one process, this methodology enables our understanding that all of the processes have strengths and weaknesses, hence providing a better-informed framework to choose the way forward.

Part IV builds on the shortcomings of all institutional processes in the EU and aims to make a substantive contribution for a broad reform in economic, fiscal and budgetary policies and the institutional landscape. It acknowledges that the judiciary should not be

the driver of changes for the future. Instead, it focuses on the need to enhance the democratic credentials of the EU budget, as well as to foster and preserve the autonomy and accountability of Member States through the market process.

Conclusions are drawn at the ends of Part III and Part IV. At the end of the thesis, conclusive reflections are presented.

PART II

COMPETENCES AND INSTITUTIONAL FRAMEWORK OF THE EUROPEAN UNION BEFORE THE FINANCIAL CRISIS

1. Competences of the European Union and of Member States

1.1. Definition of competence

The subject of European Union competence deals with the matter of distribution of powers between the Union and its Member States. It covers the issues of delimitation of areas of intervention conferred to the Union, ie its jurisdiction and nature, and the principles underpinning the choices made, ie pre-emption and the principles of subsidiarity and proportionality.

The problem of competence – or, perhaps more accurately, division of power, public functions or public activity[7] – is inextricable from the making of federations, which is the same as to question how to devise a viable duality of powers in a single territory. While comparing the French and American Republics, Hannah Arendt argues that virtues need limitations and that an excess of reason is undesirable. Therefore, Arendt considers that the US founders' main problem was establishing a Union out of thirteen sovereign republics in which it would be possible to balance the monarchy in foreign affairs and republicanism in domestic policy. To this end, the main task should be to establish a system of powers in such a way that neither the power of the Union nor of the States would decrease or destroy one another.[8] In the same vein, Carl Friedrich stated the following on what a federal order is:

> a union of group selves united by one or more common objectives, a community of communities which retain their distinctive group being. It unites without destroying the selves as uniting and is meant to strengthen them in their group and communal relations.[9]

[7] Olivier Beaud, 'The Allocation of Competences in a Federation - A General Introduction' in Loïc Azoulai (ed), *The Question of Competence in the European Union* (Oxford University Press 2014) 20.
[8] Hannah Arendt, *On Revolution* (Penguin Books 1973) 152.
[9] Carl Friedrich, *Trends of Federalism in Theory and Practice* (Pall Mall Press 1968) 183.

The reasoning and perspective adopted when performing the allocation of competence is as important as the distribution itself. Indeed, one needs to understand the logic of the input to better grasp the output. In this context, Olivier Beaud performs an interesting exercise on competence allocation within a federation, distinguishing between a State-centred and non-State-centred conception.[10] The former corresponds to the traditional understanding, according to which an allocation of competences resembles the concept of federalism and is centred on the State. Crucially, the main idea is the fact of the federal State's superiority over its component units, not because of the nature, extent or volume of allocated supranational competences, but because of the existence of a Constitution as a legal basis.[11]

This can alternatively be viewed from the perspective that it is not state-centred, which detaches the notions of competence and State. One of the issues with the state-centred approach is that it does not capture the whole range of federations, such as emerging ones, especially those which are developed from the bottom-up (integrative federalism) as opposed to from top-down (disintegrative or devolutionary federalism).[12] These are essential components to explain the way in which governmental competences are defined and structured.[13]

In the case of integrative federalism, the State's existence and powers are not a result of a supranational Constitution. Rather, the federal Constitution is, in itself, dependent and based on the powers already held by States.[14] That is why, for instance, article 2 of the 1781 US Articles of Confederation states that 'Each state retains its sovereignty, freedom, and independence, and every power, jurisdiction, and right, which

[10] Beaud (n 7) 23.
[11] For instance, article 3 of the Swiss Constitution states that the cantons 'shall exercise all rights that are not vested in the confederacy' and that the Constitution performs this allocation. This notion contradicts the delegation doctrine, notably present in the 10th Amendment of the US Constitution which states that 'The powers not delegated to the US by the Constitution, nor prohibited by it to the States, are reserved respectively to the States, or to the people'. ibid. 24-25.
[12] Koen Lenaerts, 'Constitutionalism and the Many Faces of Federalism' (1990) 38 The American Journal of Comparative Law 205, 206, argues that integrative federalism refers to a constitutional order that aims to achieve unity in diversity among previously independent or confederal-related component entities. This objective is pursued under respect of the powers of the component entities, at least to the extent that the use by the latter of these powers does not revert into divisiveness. Conversely, devolutionary federalism refers to a constitutional order that redistributes the powers of a previously unitary State among its component entities, which obtain an autonomous status within their fields of responsibility. The main concern is to organise diversity in unity. The system will only be in balance when the shift from a single sovereign towards a multi-sovereign structure is no longer resented as a merely centrifugal movement threatening national cohesion.
[13] Nicholas Aroney, 'Formation, Representation and Amendment in Federal Constitutions' (2006) 54 The American Journal of Comparative Law 277, 281.
[14] ibid. 291.

is not by this Confederation expressly delegated', a conception that is reiterated at the Philadelphia Constitutional Convention and enshrined in the 10th Amendment and the 1832 revision of the Swiss Federal Pact.[15] The same holds true regarding the EU, in which the supranational layer has the powers stemming from the Treaties, while Member States hold residual powers – a legal principle enshrined in Article 3 of the ECSC Treaty and article 4 of the EEC Treaty, currently in articles 4 (1) and 5 (2) TUE.[16]

What does it mean to be competent? Or what is the definition of competence?

It is usual to use the concept to refer to State responsibilities, as if establishing a direct connection between competence and sovereignty[17] (ie the right to issue currency or right to establish law and order). However, these rights are not competences of the State because they are equivalent to sovereignty features but because they are an expression of State power. In this sense, power is an attribute of the State, as opposed to competence.[18] Beerman argues that this is the reason that the nature of power allocation in federalism is related to subject matter and not functional. To focus on the former, we must ask different questions. Rather than asking, 'Who executes? Who adjudicates? Who taxes? Who spends?'[19] one must phrase the question in a more nuanced way:

> [W]ho gets to address what substantive issues? What general principles, if any, determine this allocation? What presumptions, if any, about the allocation may be at play? Are powers at a given level enumerated only? Do any particular rules of construction govern the exercise of power allocations? Are powers exclusively allocated to one level and one level only, or are they shared? If powers are shared, what if any principles of sharing—for example, subsidiarity—govern the sharing? Under what circumstances does the

[15] Beaud (n 7) 31.
[16] Lenaerts, 'Constitutionalism and the Many Faces of Federalism' (n 12) 213; João Nuno Calvão da Silva, *Agências de Regulação Da União Europeia* (Gestlegal 2017) 635; Fausto de Quadros, 'Anotação Ao Artigo 4.º Do TUE' in Manuel Lopes Porto and Gonçalo Anastácio (eds), *Tratado de Lisboa anotado e comentado* (Almedina 2012) 34.
[17] Daniel Elazar, 'The United States and the European Union: Models for Their Epochs' in Kalypso Nicolaidis and Robert Howse (eds), *Federal Vision: Legitimacy and Levels of Governance in the United States and the European Union* (Oxford University Press 2001) 31.
[18] Beaud (n 7) 34. Indeed, the word 'competence' is never used in federal Constitutions (ie Australia, Canada, Switzerland, United States).
[19] George Bermann, 'The Role of Law in the Functioning of Federal Systems' in Kalypso Nicolaidis and Robert Howse (eds), *The Federal Vision: Legitimacy and Levels of Governance in the United States and the European Union* (Oxford University Press 2001) 191.

> exercise of authority on a given subject at one level pre-empt the prior or subsequent exercise of power at another?[20]

Accordingly, Beaud argues for a distinction between competence and power, in a way equalling the former to the concept of jurisdiction. Crucially, by understanding competence in this sense (and not in the sense of power) it is possible to interpret it in a way that is not linked to the idea of sovereignty (which would be equivalent to power). Therefore, 'there must (…) be a clear line between the concept of a state's power, its rights, and duties, and the competence or jurisdiction that limits the exercise of this power, determines the sphere in which it is exercised and sets boundaries'.[21] In a word: competence is a tool to establish the scope of application of power and not power in and of itself.

1.2. Limiting the scope of EU law: principle of conferral and flexibility clause

The principle of conferral was enshrined in EU primary law in 1992, pursuant to the Maastricht Treaty, in conjunction with the principle of subsidiarity. Currently, it is enshrined in article 5 (2) TFEU, according to which:

> Under the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States.

Building on the positivation of the principle of conferral in primary law, the Treaty of Lisbon was referred to as 'obsessed' with it.[22] Importantly, it marked a new philosophy in European integration, intended to introduce limits to the seemingly continuous expansion of EU competences, given the 'Union's cumbersome, consensus-driven

[20] ibid. 192.
[21] Beaud (n 7) 36; See also Geoffrey Sawer, *Modern Federalism* (London: Watts 1969).
[22] Lucia Serena Rossi, 'Does the Lisbon Treaty Provide a Clearer Separation of Competences between EU and Member States?' in Andrea Biondi, Piet Eeckhout and Stefanie Ripley (eds), *EU Law After Lisbon* (Oxford University Press 2012) 85.

decision-making system', which 'cannot reliably satisfy the demands placed on the legislature'.[23] As a result of the increased prerogatives of national parliaments, ie regarding the control of the principles of subsidiarity and proportionality and the reduction of Union competences by way of the legislative and ordinary revision procedures,[24] the tendency is in favour of increased (democratic) control on the part of Member States.[25] Perhaps this was due to a feeling that the evolution and growth of Union competences could completely absorb national areas of competences,[26] which should be seen in the context of harmonisation prohibitions agreed by Member States since the Treaty of Maastricht. In fact, Member States were 'at least as much concerned with setting down boundaries, establishing what the EU cannot do, as with creating scope for future EU initiates'.[27] Initially, the drafters of the Treaty did not feel the need to state the obvious, as article 7 (1) EEC Treaty only states that 'each institution shall act within the limits of the powers conferred upon it by this Treaty'. But, over time, it became necessary to make the principle of conferral more explicit, in a tentative way, to narrow the scope for interpretation.

Indeed, the possibility of national powers absorption had been admitted in literature,[28] although not uncontestedly.[29] The principle of limited Union competence was conveyed in the early case law of the Court. In *Algera,* the Court expressly stated that '[t]he Treaty rests on a derogation of sovereignty consented by the Member States to supranational jurisdiction for an object strictly determined. The legal principle at the basis of the Treaty is a principle of limited competences. The Community is a legal person of public law and to this effect it has the necessary legal capacity to exercise its functions but only those'.[30] Crucially, given that the Union does not possess general legal

[23] Armin von Bogdandy and Jürgen Bast, 'The Federal Order of Competences' in Armin von Bogdandy and Jürgen Bast (eds), *Principles of European Constitutional Law* (2nd edn, Hart Publishing 2009) 275, 290.
[24] Bruno De Witte, 'Treaty Revision Procedures after Lisbon' in Andrea Biondi, Piet Eeckhout and Stefanie Ripley (eds), *EU Law After Lisbon* (Oxford University Press 2012) 107.
[25] Bogdandy and Bast (n 23) 275.
[26] Loïc Azoulai, 'Introduction: The Question of Competence' in Loïc Azoulai (ed), *The Question of Competence in the European Union* (Oxford University Press 2014) 6.
[27] Sacha Garben, 'Confronting the Competence Conundrum: Democratising the European Union through an Expansion of Its Legislative Powers' (2015) 35 Oxford Journal of Legal Studies 55, 59.
[28] Although in a different context, admitting the unlimited potential of the Union legislative action, see Lenaerts, 'Constitutionalism and the Many Faces of Federalism' (n 12).
[29] Contesting this approach see Robert Schütze, 'EU Competences: Existence and Exercise' in Anthony Arnull and Damian Chalmers (eds), *The Oxford Handbook of European Law* (Oxford University Press 2015) 75; Silva (n 16) 635; Quadros (n 16) 34.
[30] Joined Cases 7/56, 3-7/57, *Algera v Common Assembly* [1957] ECR 39.

competence, its legal capacity must be ascribed to the attributions conferred by the Treaties. Therefore, in order to act, EU institutions must always find a Treaty-based legal provision.[31]

However, in the absence of express Treaty empowering provisions, Union authority was established implicitly by deduction from existent express power-conferring norms (a theory known as implied powers doctrine).[32] This theory was developed by the Court regarding the conclusion of international agreements. In fact, the *ERTA* judgement[33] established that the power to negotiate the European Agreement on the work of crews of vehicles engaged in international road transport was exclusively attributed to the Community. Three interrelated arguments were made. The first argument was that the Community was capacitated to conclude agreements with third countries because it was entitled to legal personality. The second argument revolved around the idea of commonality of Community action (within the framework of a common policy) in order to better fulfil Treaty objectives. The last argument regarded the need to preserve the scope of supranational rules. Indeed, the Court stated that, although no primary law provisions were in place to confer authority on the Community to conclude international agreements, power was inferred from the existence of secondary legislation since 'Regulation No 543/69 of the Council on the harmonisation of certain social legislation relating to road transport (…) necessarily vested in the Community the power to enter into any agreements with third countries relating to the subject-matter governed by that Regulation'.[34]

The Court thus performs a competence-inference exercise from specific secondary law, in practice, absorbing[35] national powers by recognizing exclusive Community competence. In other words, in order to establish the Community's power to act, it would be necessary to ascertain whether there was already a Treaty rule in place in a particular

[31] Silva (n 16) 636. It corresponds to the international law approach as described by Schütze, 'EU Competences: Existence and Exercise' (n 29) 77.
[32] See Maria Luísa Duarte, *A Teoria Dos Poderes Implícitos e a Delimitação de Competências Entre a União Europeia e Os Estados Membros* (Lex 1997); Koen Lenaerts, *Le Juge et La Constitution Aux États-Unis d'Amérique et Dans l'ordre Juridique Européen* (Bruylant 1988); Anna Bredimas, *Methods of Interpretation and Community Law* (North-Holland Publishing Co 1978).
[33] Case 22/70, Commission of the European Communities v Council of the European Communities [1971] ECR 263.
[34] ibid. para 28.
[35] On the transformation of Union institutions, see Joseph Weiler, 'The Transformation of Europe' (1991) 100 The Yale Law Journal 2403.

area or areas corresponding to the objectives of the Treaties.[36] This was, however, an outlier case, to an extent, given that the Court has since accepted the rule of shared exercise of powers, instead of exclusivity.[37]

In any event, the Union embraced the constitutional method of teleological interpretation, which allows the holder of a competence to interpret its own competences with discretion.[38] The result of the application of this legal hermeneutic method is particularly visible regarding the two most general competences: articles 114 and 352 TFEU.[39] The former empowers the Union to harmonise national laws in order to create the internal market, whereby the Council and the EP, after consulting the Economic and Social Committee, may adopt measures to approximate laws, regulations or administrative action in Member States, which have, as their object, the establishment and function of the internal market. If these legislative, regulatory or administrative acts directly affect the internal market, article 115 TFEU entrusts the Council to issue directives for their approximation, leaving the EP and Economic and Social Committee with a consultative role.

Article 352 TFEU, on the other hand, empowers the Union in two ways: when the attributed powers are insufficient to achieve the objectives set out by the Treaties, and within a policy area where no powers have been attributed. Some caveats exist, however. On procedure, the Council needs to take a decision by unanimous vote on a proposal from the European Commission, after gaining the consent of the EP, regardless of the legislative procedure (article 352 (1) TFEU). On control, the European Commission is called to draw national parliament's attention to measures adopted under this legal basis in order to exercise a subsidiarity check (article 352 (2) TFEU). On substance, Member States are inhibited to adopt measures that entail harmonisation of laws and regulations

[36] Azoulai, 'Introduction: The Question of Competence' (n 26) 5. See also Court of Justice of the European Union, Opinion 1/03 of the Court [2006] ECR I-1150.
[37] Marise Cremona, 'EU External Relations: Unity and Conferral of Powers', *The Question of Competence in the European Union* (Oxford University Press 2014) 65, 74.
[38] Schütze, 'EU Competences: Existence and Exercise' (n 29) 77. See also Sacha Garben and Inge Govaere, 'The Division of Competences between the EU and the Member States: Reflections on the Past, the Present and the Future' in Sacha Garben and Inge Govaere (eds), *The Division of Competences between the EU and the Member States* (Hart Publishing 2017) 3, 7.
[39] For a broad interpretation of article 114 see Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (6th edn, Oxford University Press 2019). On whether article 352 should be considered as conferring Kompetenz-Kompetenz to the Union see Schütze, 'EU Competences: Existence and Exercise' (n 29) 79, and Joseph Weiler and Ulrich Haltern, 'The Autonomy of the Community Legal Order - Through the Looking Glass' (1996) 37 Harvard International Law Journal 411.

in areas excluded by the Treaties (article 352 (3) TFEU), ie economic cooperation, as well as common foreign and security policy (article 352 (4) TFEU).

These provisions have been criticised by many. Some authors argue that they may have been inappropriately used by the EU to allow for a competence expansion at the expense of Member States.[40] In fact, the approach taken by the Court on article 114 TFEU turns it into a general legislative competence, which may involve an 'effective transfer of regulatory initiative to the Union legislature in a manner which can ultimately not merely *dis*place but *re*place individual national political choices',[41] which may hinder the exercise and accountability of public power, especially in the context of a greater intention to contain EU expansion by Member States.

Others argue that these articles, particularly article 352 TFEU, are important instruments to bridge the divide between attributed objectives and powers and to provide the necessary flexibility to perform the required adaptations in a dynamic and continuously integrating Union.[42] Given the wording used and the jurisprudential rulings, which 'allowed the Union legislator – almost – complete freedom to interpret its own competences', the articles may be considered partial kompetenz-kompetenz.[43] The expansion of Union's competences cannot be separated from Member States' own actions, since they themselves have consciously attributed new competences to the Union through successive Treaty amendments.[44]

Therefore, the imbalance in the EU does not derive from a lack of protection of individual rights or the existence of institutions to enforce them. What made European

[40] Gráinne de Búrca and Bruno De Witte, 'The Delimitation of Powers between the EU and Its Member States' in Anthony Arnull and Daniel Wincott (eds), *Accountability and Legitimacy in the European Union* (Oxford University Press 2002) 202, 204.
[41] Michael Dougan, 'Legal Developments' (2010) 48 Journal of Common Market Studies 163, 178. Indeed, the author affirms that in Case C-376/98*, Federal Republic of Germany v European Parliament and Council of the European Union* [2000] ECR I-8419, regarding the Tobacco Advertising Directive the Court tried to address this concern by clarifying that article 95 EC Treaty (current 114 TFEU) could not be built to confer the Union legislature a general power to regulate the internal market in the public interest. However, subsequent rulings confirmed that this case was interpreted in a way that seldom constrained the exercise of competences by the Union legislature.
[42] Antonio Tizzano, 'The Powers of the Community' in Commission of the European Communities (ed), *Thirty Years of Community Law* (Office for Official Publications of the European Communities 1981) 43, 50.
[43] Schütze, 'EU Competences: Existence and Exercise' (n 29) 80.
[44] Paul Craig, 'Competence: Clarity, Conferral, Containment and Consideration' (2004) 29 European Law Review 323.

integration possible was Member States' feeling of control over the process. That sense is gradually eroding.[45]

Nevertheless, Member States remain capable to define, reduce or increase Union's competences by using the ratification process (article 48 (2) and (5) TEU).[46] Another way to reclaim relinquished competences is to exit the EU. Moreover, Member States' exclusive competences are embedded in some national Constitutions, developed by some constitutional courts,[47] namely, regarding the principle of democracy and national constitutional identity,[48] and potentially declaring EU actions ultra vires.[49]

1.3. Retained competences of Member States

Retained powers are those that were not conferred to the Union for exclusive or shared exercise. In other words, they correspond to areas in which EU regulatory powers are either non-existent (ie citizenship (article 20 (1) TFEU), the right to strike (article 153 (5) TFEU)) or limited (ie by excluding harmonisation at the EU level, such as education

[45] EU Law Live, 'A Conversation with Joseph Weiler (Part 1), on the Past, Present and Future of European Integration' (2021) <https://eulawlive.com/podcast/a-conversation-with-joseph-weiler-part-1-on-the-past-present-and-future-of-european-integration/> accessed 5 November 2021.

[46] Bruno De Witte, 'Exclusive Member State Competences - Is There Such a Thing?' in Sacha Garben and Inge Govaere (eds), *The Division of Competences between the EU and the Member States* (Hart Publishing 2017) 59, 73.

[47] See for instance, German BVerfG, Judgment of the Second Senate (2020) 2 BvR 859/15; polish Trybunał Konstytucyjny, Assessment of the conformity to the Polish Constitution of selected provisions of the Treaty on European Union (2021) K 3/21.

[48] Of the several contributions on the *BVerfG*'s decisions see, for instance, Matthias Goldmann, 'Adjudicating Economics? Central Bank Independence and the Appropriate Standard of Judicial Review' (2014) 15 German Law Journal 265; Matias Kumm, 'Rebel Without a Good Cause: Karlsruhe's Misguided Attempt to Draw the CJEU into a Game of "Chicken" and What the CJEU Might to About It' (2014) 15 German Law Journal 203; Marijn Van Der Sluis, 'Similar, Therefore Different: Judicial Review of Another Unconventional Monetary Policy in Weiss (C-493/17)' (2019) 46 Legal Issues of Economic Integration 263. On the Polish Constitutional Court's decisions, see Jakub Jaraczewski, 'Gazing into the Abyss: The K 3/21 Decision of the Polish Constitutional Tribunal' (*VerfBlog,* 12 October 2021) <https://verfassungsblog.de/gazing-into-the-abyss/> accessed 8 December 2021; Paul Craig, 'The Rule of Law, Breach and Consequence' (*EU Law Live*, 21 October 2021) <https://eulawlive.com/op-ed-the-rule-of-law-breach-and-consequence-by-paul-craig/> accessed 8 December 2021; David Krappitz and Niels Kirst, 'The Primacy of EU Law Does Not Depend on the Existence of a Legislative Competence — Debunking the Flawed Analysis of the Polish Constitutional Court' (*EU Law Live*, 20 October 2021) <https://eulawlive.com/op-ed-the-primacy-of-eu-law-does-not-depend-on-the-division-of-legislative-competences-debunking-the-flawed-analysis-of-the-polish-constitutional-court-by-david-krappitz-a/#> accessed 8 December 2021.

[49] For various national and supranational courts applying principles of democracy and national constitutional identity, see Wojciech Sadurski, ''Solange, Chapter 3′: Constitutional Courts in Central Europe – Democracy – European Union' (2008) 14 European Law Journal 1. See also Monica Claes and Jan-Herman Reestman, 'The Protection of National Constitutional Identity and the Limits of European Integration at the Occasion of the Gauweiler Case' (2015) 16 German Law Journal 917.

(article 165 and 166 TFEU) and cross-border health (article 168 TFEU)).[50] Like the US constitutional construction (as introduced by the tenth amendment under the Bill of Rights), originally these powers can also be considered as discretionary. This means that, from inception, they were excluded from the scope of EU Law and free for Member States to exercise as they saw fit.[51]

However, the Court has consistently placed restraints on their use. It has done this in negative integration cases but also in other areas that are, for instance, an expression of national sovereignty (ie fiscal issues) or related to welfare (ie social security). It has done so by resorting to what Boucon calls the 'formula', as well as the dissociation between the scope of EU law and scope of EU power.[52] Take the *Schumacher* case as an example of the former, in which the CJEU addressed the question of whether article 48 of the EEC Treaty restricted the Member State's right to levy tax on the income on a citizen of another Member State. Importantly, the national court noted that direct taxation falls within the exclusive powers of Member States, thus expressing doubts on the applicability of such provision to national legislation in this area.[53] In its decision, the Court noted that, '[a]lthough, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law'.[54]

The applicability of EU law has been broadened by way of dissociating its scope and the scope of EU powers, as attested by the opinions of AG Kokott[55] and AG

[50] See Lena Boucon, 'EU Law and Retained Powers of Member States' in Loïc Azoulai (ed), *The Question of Competence in the European Union* (Oxford University Press 2014) 169; Loïc Azoulai, 'The "Retained Powers" Formula in the Case Law of the European Court of Justice: EU Law as Total Law' (2011) 4 European Journal of Legal Studies 192.

[51] The refusal to enumerate the powers of the States was clearly understood, by the US constitutional framers, as endowing them with substantial power. As James Madison argues in the Federalist papers, 'The powers reserved to the several States will extend to all the objects which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, improvement, and prosperity of the State'. See James Madison, 'No 45: A Further Discussion of the Supposed Danger from the Powers of the Union, to the State Governments' in George Carey and James McClellan (eds), *The Federalist* (Liberty Fund 2001) 241.

[52] Boucon (n 50) 171. See also Christiaan Timmermans, 'The Competence Divide of the Lisbon Treaty Six Years After' in Sacha Garben and Inge Govaere (eds), *The Division of Competences between the EU and the Member States* (Hart Publishing 2017) 19, 20-22; Witte, 'Exclusive Member State Competences - Is There Such a Thing?' (n 46) 60-63.

[53] Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker* [1995] ECR I-225, Opinion of AG Léger, para 16.

[54] Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker* [1995] ECR I-225, para 21. See also Case 35-76, *Simmenthal SpA v Ministero delle Finanze italiano* [1976] ECR 1871, paras 13 and 14.

[55] Case C-192/05, *K Tas-Hagen and R A Tas v Raadskamer WUBO van de Pensioen- en Uitkeringsraad* [2006] ECR I-104511, Opinion of AG Kokott, paras 32-36.

Colomer.[56] In *Tas-Hagen*, AG Kokott argued that a certain matter pertaining to the Union's objectives can be, at most, considered an additional factor in the appraisal of a particular case and that it is not an imperative requirement for the application of relevant Treaty provisions (in the case at hand, free movement law). This leads to the conclusion that Union citizens can assert their right to free movement, even if the matter is not governed by EU law. For that reason, the scope of fundamental freedoms cannot be restricted to matters in which the Union has already exercised its powers. Moreover, this makes the application of a fundamental freedom subject to the existence of a harmonising measure, which would ultimately deprive it of its direct effect.

Similarly, using economic grounds as a justification to introduce restrictions prohibited by the Treaty (for instance, limiting free trade), would defeat the Treaty's objective to replace purely national markets with one, more efficient European market.[57] However, on matters connected with national sovereignty, such as direct taxation, social security or education, the Court is more likely to accept economic justifications[58] or the preservation of purely national interests.[59] Most prominently, in the field of social security, the Court has not forced Member States to abandon the principles of their sickness insurance schemes, or the freedom to set up and operate the social security system of their choice. Instead, States are required to make adjustments to those systems.[60]

In a word: retained powers are both constrained and enabled by context (ie legal or economic). While these limitations do not equate to centralised Union action, they set boundaries and provide criteria that must be taken into consideration in order to internalise the transnational effects that most national policies have within an integrated market. These hold a dual function: first, to take the interest of other Member States into

[56] Joined cases C-11/06 & 12/06, *Rhiannon Morgan v Bezirksregierung Köln and Iris Bucher v Landrat des Kreises Düren* [2007] ECR I-9161, Opinion of AG Colomer, paras 85-86.
[57] Case C-367/98, *Commission of the European Communities v Portuguese Republic* [2002] ECR I-4731, para 52.
[58] Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* [2005] ECR I-10837.
[59] For instance, on the preservation of the cohesion of the tax system see Case C-204/90, *Hanns-Martin Bachmann v Belgian State* [1992] ECR I-249; on national constitutional identity see Case C-208/09, *Ilonka Sayn-Wittgenstein v Landeshauptmann von Wien* [2010] ECR I-13693.
[60] Case C-490/09, *European Commission v Grand Duchy of Luxemburg* [2011] ECR I-247, para 45. See also Case C-385/99, *VG Müller-Fauré v Onderlinge Waarborgmaatschappij OZ Zorgverzekeringen UA and EEM van Riet v OnderlingeWaarborgmaatschappij ZAO Zorgverzekeringen* [2003] ECR I-4509, para 102. In literature, see Jukka Snell and Jussi Jaakkola, 'Economic Mobility and Fiscal Federalism: Taxation and European Responses in a Changing Constitutional Context' (2016) 22 European Law Journal 772.

account in the national decision-making process (review function); second, to adapt national policies to the objectives of EU integration (re-programming function).[61] The existence and exercise of Member State powers are, therefore, two different concepts, as AG Mischo stated.[62] What cannot be reasonably argued is that EU law does not detract from Member States retained powers, as the Court affirmed, since, indeed, they are limited by EU law obligations. Notwithstanding, this outcome should not be considered shocking as these limitations are like those derived from the conclusion of international treaties.[63]

Member States' powers are also emboldened by context. Indeed, the economic, social and cultural diversity within the EU is so significant that, as Snell stated, 'sometimes the only reasonable practical way of discharging these responsibilities involves the adoption of measures the immediate aim of which is economic but that ultimately serve as a means for pursuing a legitimate public interest aim'.[64]

1.4. Exercise of EU competences: principles of subsidiarity and proportionality

In the exercise of EU competences, two principles need to be respected: subsidiarity and proportionality. These are different, but intricate principles.[65] Article 5 (1) TFEU establishes that '[t]he limits of Union competences are governed by the principle of conferral. The use of Union competences is governed by the principles of subsidiarity and proportionality'.

In general terms, the principle of subsidiarity establishes that a central authority should hold a subsidiary function, performing only the tasks that cannot the better pursued at a lower level of government. In this vein, article 5 (3) TEU states the following:

[61] Loïc Azoulai, 'The Court of Justice and the Social Market Economy: The Emergence of an Ideal and Conditions for Its Realization' (2008) 45 Common Market Law Review 1335, 1342.
[62] Case C-246/89, *Commission of the European Communities v United Kingdom of Great Britain and Northern Ireland* [1991] ECR I-4585.
[63] Witte, 'Exclusive Member State Competences - Is There Such a Thing?' (n 46) 62.
[64] Jukka Snell, 'Economic Aims as Justification of Restrictions on Free Movement' in Annette Schrauwen (ed), *Rule of Reason: Rethinking another classic of European legal doctrine* (Europa Law Publishing 2005) 37, 48.
[65] Silva (n 16) 638. On the ancientness of the principle of subsidiarity, see Antonio Estella, *The EU Principle of Subsidiarity and Its Critique* (Oxford University Press 2002).

> Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.

As mentioned by Schütze, this definition applies only to non-exclusive powers and, thus, within a legal order based on cooperative federalism. The wording is, however, ambivalent. On the one hand, it is clear that Union action is allowed when the objectives cannot be sufficiently achieved at the national level (national insufficiency test) and when its action delivers a better outcome from an efficiency standpoint (comparative efficiency test). On the other hand, it is unclear whether action is permitted if the centre is better placed to tackle a certain problem but Member States can, nevertheless, achieve the objective.[66] As I will show in this thesis, this is a problem that occurs regarding economic policy. Member States can conduct their policies autonomously and have the means to achieve financial, economic and social stability and growth. However, ensuing developments, explained in Part III, may reasonably lead to the conclusion that (some) Union action may produce better outcomes. As AG Miguel Maduro stated:

> '(…) the judgment to be made under the principle of subsidiarity is not about the objective pursued but whether the pursuit of that objective requires Community action. Certain Community objectives (which in themselves justify the existence of a Community competence) may be better pursued by the Member States (with the consequence that the exercise of that competence is not justified)'[67]

[66] Schütze, 'EU Competences: Existence and Exercise' (n 29) 90. Within such a system, two legislators can act within the same areas. On the contrary, dual federalism is based on the idea that the Union and Member States can only act within mutually exclusive spheres.

[67] Case C-58/08, *The Queen, on the application of Vodafone Ltd and Others v Secretary of State for Business, Enterprise and Regulatory Reform* [2010] ECR I-04999, Opinion of AG Maduro, para 30.

In any case, some authors consider subsidiarity as the most relevant principle of EU integration, given its decentralising role and capability to safeguard national competences and nation-State identity.[68] However, caution is warranted with this approach given that subsidiarity can 'have as much of a centralising tendency as a localising one'.[69] Indeed, subsidiarity is not an unbalanced or biased principle in favour of regional or local action. On the contrary, it is 'a constitutional settlement that operates with the full acknowledgement of the simultaneous necessity of national and supranational regulation and on the need for a fair balancing of conflicting interests'.[70]

Importantly, in this regard, the CJEU does not easily overturn EU action on the grounds of a legislative breach of the principle of subsidiarity – this has yet to occur.[71] Importantly, this prompted another approach to gain prominence in this matter, namely Protocol (No 2), on the application of the principles of subsidiarity and proportionality, annex to the TFEU. This political safeguard of federalism[72] intends to involve national parliaments in the subsidiarity review of the Union's legislative competences. According to the Protocol, each national parliament may produce a reasoned opinion objecting to draft legislation within eight weeks due to a breach of the subsidiarity principle. Depending on the number of national parliaments flagging the issue, a warning mechanism system (yellow and orange cards) can correct flaws. However, this system has been described as ineffective for a number of reasons, chiefly because there are limited chances for national parliaments to check the amended legislation. This is due to the fact that there is no obligation of EU institutions to make such amendments available[73] and because no veto power (red card) was foreseen.[74] Others have supported this outcome, arguing that vesting national parliaments with such power would distort the EU's system

[68] Silva (n 16) 638; Fausto de Quadros, *O Princípio Da Subsidiariedade No Direito Comunitário após o Tratado Da União Europeia* (Almedina 1995).
[69] Denis J Edwards, 'Fearing Federalism's Failure: Subsidiarity in the European Union' (1996) 44 The American Journal of Comparative Law 537, 582.
[70] Andrea Biondi, 'Subsidiarity in the Courtroom' in Andrea Biondi, Piet Eeckhout and Stefanie Ripley (eds), *EU Law After Lisbon* (Oxford University Press 2012) 213, 214.
[71] See Xavier Groussot and Sanja Bogojevic, 'Subsidiarity as a Procedural Safeguard of Federalism' in Loïc Azoulai (ed), *The Question of Competence in the European Union* (Oxford University Press 2014) 234, 244; See also European Commission's subsidiarity and proportionality annual reports at https://ec.europa.eu/info/law/law-making-process/adopting-eu-law/relations-national-parliaments/annual-reports-application-principles-subsidiarity-and-proportionality-and-relations-national-parliaments_en and https://ec.europa.eu/dgs/secretariat_general/relations/relations_other/npo/subsidiarity_reports_en.htm.
[72] Schütze, 'EU Competences: Existence and Exercise' (n 29) 94.
[73] Silva (n 16) 642.
[74] House of Commons, 'Thirty-Third Report of House of Commons European Scrutiny Committee: Subsidiarity, National Parliaments and the Lisbon Treaty' <https://publications.parliament.uk/pa/cm200708/cmselect/cmeuleg/563/563.pdf> accessed 12 April 2024.

of transnational governance (further deepening the joint decision traps of EU and national layers),[75] while simultaneously fostering inter-parliamentary dialogue.[76]

While the principle of subsidiarity intends to frame the Union's action outside its exclusive competences, the principle of proportionality deals with the intensity of action at the EU level. In essence, the principle of proportionality aims to protect liberal and federal values. In the protection of liberal values, the objective is to prevent excessive public power in order to provide fundamental rights with protection.[77]

Proportionality also intends to regulate relations between EU institutions and national authorities and moderate EU intervention.[78] Article 5 (4) TEU provides that '[u]nder the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties'. Regarding the content or the substantive intensity of Union intervention, the Court usually confers a wide margin of appreciation for policy choices, limiting judicial reviews to manifest error, misuse of powers or manifestly exceeding limits of discretion.[79]

The form of Union intervention is also regulated in article 296, which states '[w]here the Treaties do not specify the type of act to be adopted, the institutions shall select it on a case-by-case basis, in compliance with the applicable procedures and with the principle of proportionality'. Again, the Court leans towards granting the Union a wide margin of appreciation regarding the action considered necessary and the appropriate means for that purpose. For instance, in choosing between a directive or a decision, the criterion should not be the number of addressees but whether the 'objective

[75] Schütze, 'EU Competences: Existence and Exercise' (n 29) 95; Stephen Weatherill, 'Using National Parliaments to Improve Scrutiny of the Limits of EU Action' (2003) 28 European Law Review 909.
[76] María José Iglesias, 'The Lisbon Treaty's Competence Arrangement Viewed by the European Parliament' in Sacha Garben and Inge Govaere (eds), *The Division of Competences between the EU and the Member States* (Hart Publishing 2017) 198, 204.
[77] Protection for liberal values emerged in the case law of the Court in case 11/70, *Internationale Handelsgesellschaft mbH v Einfuhr- und Vorratsstelle für Getreide und Futtermittel* [1970] ECR 1125. Today, fundamental rights find legal expression in article 52 of the EU Charter of Fundamental Rights stating that '(…) limitations may be made only if they are necessary and genuinely meet objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others'.
[78] For the view that this aspect is a second subsidiarity and, therefore, misplaced by the Court, see Robert Schütze, *From Dual to Cooperative Federalism: The Changing Structure of European Law* (Oxford University Press 2009) and Gareth Davies, 'Subsidiarity: The Wrong Ideia, in the Wrong Place, at the Wrong Time' (2006) 43 Common Market Law Review 63.
[79] Case C-233/94, *Federal Republic of Germany v European Parliament and Council of the European Union* [1997] ECR I-2405, paras 77-84.

is to specify in general terms the obligations arising under the Treaty, or to assess a specific situation in one or more Member States'.[80]

The proportionality review entails a test in which one must try to strike a balance of values underlying a certain Union measure. The Court has applied a tripartite approach, analysing suitability, necessity and proportionality stricto sensu. Firstly, the Court assesses whether the European measure was suitable for achieving their objective. A causality relation must, thus, be established with the intended goal. Secondly, the assessment turns to whether the adopted act represents the least restrictive means to achieve the Union's given objective. Lastly, the Court performs a substantive assessment of the intervention by reviewing whether the Union disproportionately interferes with the rights of Union citizens by imposing excessive burdens on individuals. It also requires a standard, which refers to the degree of justiciability of a certain measure and whether the Court is willing to substitute a political decision with a judicial one.[81]

1.5. Distribution of competences

1.5.1. Exclusive competence

Article 2 (1) TFEU stipulates that '[w]hen the Treaties confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts'.

Accordingly, areas of exclusive competence of the Union are those that are constitutionally guaranteed. In this domain, Member States action is dependent upon specific habilitation to that effect or to execution of Union's acts, pursuant to their general competence under article 291 (1) TFEU. Catalogued exclusive Union competences are, according to article 3 (1) TFEU: areas of customs union; the establishment of the necessary competition rules for the internal market's function; monetary policy for Member States with the euro as their official currency; the conservation of marine

[80] Case C-163/99, *Portuguese Republic v Commission of the European Communities* [2001] ECR I-2613, para 28.
[81] Schütze, 'EU Competences: Existence and Exercise' (n 29) 100.

biological resources under the common fisheries policy; and the common commercial policy.[82]

The Court has also stated that these are areas in which concurrent competence by Member States should be excluded, given that 'any steps taken outside the framework of the community institutions would be incompatible with the unity of the common market and the uniform application of community law'.[83] In this vein, it has also established exclusive Union competence regarding the conclusion of an international agreement when its conclusion is provided in a legislative act of the Union or is necessary to enable it to exercise its internal competence, or in so far as its conclusion may affect common rules or alter their scope,[84] as currently enshrined in article 3 (2) TFEU.

1.5.2. Shared competences

Concerning shared competences, article 2 (2) TFEU establishes that:

> When the Treaties confer on the Union a competence shared with the Member States in a specific area, the Union and the Member States may legislate and adopt legally binding acts in that area. The Member States shall exercise their competence to the extent that the Union has not exercised its competence. The Member States shall again exercise their competence to the extent that the Union has decided to cease exercising its competence.

It is a residual category of competences. In accordance with article 4 (1) TFEU, in which the Treaties confer the Union a competence unrelated to the exclusive or complementary catalogue, competences are considered to be shared. Not without

[82] There are, however, caveats to the exercise of exclusive Union competences. As mentioned in article 2 (6) TFEU, '[t]he scope of and arrangements for exercising the Union's competences shall be determined by the provisions of the Treaties relating to each area'. For instance, article 207 (6) TFEU establishes that the exercise of common commercial policy does not affect the delimitation of competences between the Union and the Member States. It does not lead to the harmonisation of national legislative or regulatory provisions in so far as the Treaties exclude this harmonisation. For a commentary, see Vital Moreira, 'Anotação Ao Artigo 207.º Do TFUE' in Manuel Porto and Gonçalo Anastácio (eds), *Tratado de Lisboa anotado e comentado* (Almedina 2012) 812.

[83] Case 22/70, Commission of the European Communities v Council of the European Communities [1971] ECR 263, para 31.

[84] ibid. 27-31.

criticism,[85] the Treaty enumerates the main areas shared by the Union and Member States: internal market; social policy, for the aspects defined in the Treaty; economic, social and territorial cohesion; agricultural and fisheries, excluding the conservation of marine biological resources; environment; consumer protection; transport; trans-European networks; energy; areas of freedom, security and justice; common safety concerns in public health matters, for the aspects defined in the Treaty.

In these areas, both the Union and Member States are allowed to intervene, albeit not at the same time, since the exercise of a competence by the Union preempts Member State action. Consequently, Union normative action in these areas effectively converts them into exclusive competences.[86]

Differently, article 4 (3) and (4) TFEU stipulate that in the areas of research, technological development and space, development of cooperation and humanitarian aid, the Union holds competence to carry out activities and conduct a common policy, the exercise of which does not result in Member States being prevented from exercising their competences, with respect to the principles of loyal cooperation and primacy of EU law.

1.5.3. Complementary and coordination competences

Article 2 (5) TFEU states that:

> In certain areas and under the conditions laid down in the Treaties, the Union shall have competence to carry out actions to support, coordinate or supplement the actions of the Member States, without thereby superseding their competence in these areas.
>
> Legally binding acts of the Union adopted on the basis of the provisions of the Treaties relating to these areas shall not entail harmonisation of Member States' laws or regulations.

[85] Silva (n 16) 649.
[86] Laetitia Guilloud, *La Loi Dans l'Union Européenne : Contribution À La Définition Des Actes Législatifs Dans Un Ordre Juridique d'intégration* (LGDJ 2010), 101; Silva (n 16) 649.

This article is then operationalised in a two-pronged way, in what can be distinguished between complementary and coordination competences. Although the term 'complementary' is not used in the Treaty, it seems the best way to, on the one hand, convey article 6 TFEU's underlying reasoning 'to support, coordinate or supplement' and, on the other hand, perform a starker distinction with more intense coordination competences of the Union.[87]

Article 6 TFEU mentions seven relevant areas for the Union to complement Member States' action: the protection and improvement of human health; industry; culture; tourism; education, vocational training, youth and sport; civil protection; and administrative cooperation. This should be an exhaustive list in light of the residual character of shared competences and it cannot entail the harmonisation of Member States' laws or regulations.

Article 5 TFEU, on the other hand, places an exclusive emphasis on coordination, for instance, on economic, employment and social policies, which should be coordinated between the Union and Member States.[88] Substantively, however, the article 5 TFEU seems to create a vague and imprecise tripartite distinction on the degree or intensity of Union intervention between them.

On economic and employment policies, it is clear that there must be supranational coordination. However, the former specifically requires the Council to adopt broad guidelines, while the guidelines of employment policies are left to the Union to define with no further qualification. One can deduce that they should be stricter than the economic guidelines, given the differences.

Who, then, is responsible for enacting employment guidelines and what is the procedure? The answer can be found in article 148 TFEU, whereby, each year, the Council and the European Commission deliver a joint report to the European Council. The conclusions drawn will serve as the basis for the Council to draw up guidelines, pursuant to a proposal from the European Commission and consulting the EP, the Economic and Social Committee, the Committee of the Regions and the Employment Committee. Moreover, these guidelines should be consistent with the broad guidelines on

[87] Schütze, 'EU Competences: Existence and Exercise' (n 29) 87.
[88] As referred by Schütze, one group wished to place economic and employment coordination within the category of shared competences. An opposing view advocated for their classification as complementary competence. Schütze, 'EU Competences: Existence and Exercise' (n 29) 87.

economic policy (articles 146 (1) and 148 (2) TFEU), which makes sense given that employment policy is both influenced by and influences economic policy and growth.

It may be unusual that the European Council has the most important word on employment but not on economic policy – a conclusion that seems to derive from the joint reading of articles 5 and 148 TFEU. However, this is not the case. Indeed, unlike employment guidelines, the European Commission shall issue the Council with a recommendation, which formulates a draft for the broad economic policy guidelines of the Member States and the Union. A draft with these findings is then delivered to the European Council, which discusses and draws conclusions. Based on these, the Council adopts a recommendation, establishing the broad economic guidelines and informs the EP.

Regarding social policies, Union coordination is listed only as a possibility, not an obligation.

2. Bifurcation of the European Union

2.1. Supranational monetary policy

According to articles 119 (2) and 127 TFEU, the EU is competent for the definition and implementation of monetary policy, with the primary objective of maintaining price stability.

The EU monetary policy system is unique[89] in the sense that the ESCB and the Eurosystem are comprised of NCBs (institutions that retain their legal personality) and, as a result, remain legally separate from the ECB and the systems they belong to.[90] In this regard, the CJEU states that:

> The ESCB represents a novel legal construct in EU law which brings together national institutions, namely the national central banks, and an EU institution, namely the ECB, and causes them to cooperate closely with each other, and

[89] Tommaso Padoa-Schioppa, 'Economic Federalism and the European Union' in Karen Knop and others (eds), *Rethinking Federalism: Citizens, Markets, and Governments in a Changing World* (UBC Press 1995) 162.
[90] Michael Ioannidis, 'The European Central Bank' in Fabian Amtenbrink and Christoph Herrmann (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 353, 358.

within which a different structure and a less marked distinction between the EU legal order and national legal orders prevails.[91]

However, this competence has certain caveats. These caveats do not refer to the exclusive nature,[92] but to the fact that it has to observe certain principles: hierarchical subordination of the NCBs to the ECB; decentralised implementation; and what may be designated as the principle of consistent standard of application.

2.1.1. Principle of hierarchical subordination of the NCBs to the ECB

The Eurosystem is a structure that is governed by the ECB and its decision-making bodies (article 8 of the ESCB and ECB Statute). The ECB has the power to issue legal instruments by which it subjects the NCBs to its instructions and, thereby, governs the Eurosystem (article 14.3 of the ESCB and ECB Statute). By exercising this power of direction, the ECB ensures that the tasks conferred upon the ESCB are implemented either by its own activities or through national central banks (article 9.2 of the ESCB and ECB Statute).

Moreover, article 14.3 of the ESCB and ECB Statute establishes that NCBs are an integral part of the system and must act in accordance with the guidelines and instructions of the ECB: in this sense, the NCBs are considered hierarchically integrated. This provision foresees that compliance with ECB guidelines and instructions is a competence and responsibility of the ECB Governing Council. If the ECB considers that a national central bank has failed to comply with its obligations, it may bring the case before the CJEU.

Another example is found in article 31.2 of the ESCB and ECB Statute. In order to ensure consistency with the exchange rate and monetary policies of the Union, the ECB

[91] Joined Cases C-202/18 and C-238/18, *Ilmārs Rimšēvičs and European Central Bank v Republic of Latvia* [2019] ECLI:EU:C:2019:139, para 69.

[92] Although exclusivity has been questioned. See Michael Waibel, 'Monetary Policy: An Exclusive Competence Only in Name?' in Sacha Garben and Inge Govaere (eds), *The Division of Competences between the EU and the Member States* (Hart Publishing 2017) 90, 106.

is entrusted with the power of prior approval of transactions. The scope of such action is limited by quantitative[93] and qualitative criteria.[94]

Regarding non-Eurosystem NCBs, article 14.1 entrusts the ECB with the power to find that certain actions unacceptably interfere with its objectives and tasks, which is a manifestation of the hierarchical subordination principle.[95]

2.1.2. Principle of decentralised implementation

Monetary policy is defined, conducted and implemented by the ECB with the NCBs of Member States with the euro as their official currency (Article 282 (1) TFEU). As Zilioli and Athanassiou state, the decentralisation – or deconcentration – of operations 'pervades every aspect of the Eurosystem's day-to-day operation'.[96] In this sense, the Eurosystem is also an institution with a decentralised structure.

The Court considered this structure a 'highly integrated system'. In fact, when considering the suspension of the Governor of a national central bank,[97] the CJEU was clear in that:

> Article 14.2 of the Statute of the ESCB and of the ECB reflects the logic of this highly integrated system (…) and, in particular, of the dual professional role of the governor of a national central bank, who is certainly a national authority but who acts within the framework of the ESCB and sits, where he is the governor of a national central bank of a Member State whose currency is the euro, on the main decision-making body of the ECB. It is because of this hybrid status and (…) to guarantee the functional independence of the governors of the national central banks within the ESCB that, by way of

[93] It only applies above a certain threshold as defined by the Governing Council, pursuant to article 31.3 of the ESCB and ECB Statute.
[94] It covers operations related to foreign reserve assets with national central banks (thus exempting transactions intended to comply with the obligations of international organisations) and transactions of Member States with their foreign exchange working balances.
[95] Ioannidis 'The European Central Bank' (n 90) 359. See also Christos V. Gortsos, *European Central Banking Law: The Role of the European Central Bank and National Central Banks under European Law* (Palgrave Macmillan 2020) 188.
[96] Chiara Zilioli and Phoebus Athanassiou, 'The European Central Bank' in Robert Schütze and Takis Tridimas (eds), *Oxford Principles of European Union Law* (Oxford University Press 2018) 610, 626.
[97] Joined Cases C-202/18 and C-238/18, *Ilmārs Rimšēvičs and European Central Bank v Republic of Latvia* [2019] ECLI:EU:C:2019:139 (n 91), para 70.

exception, a decision taken by a national authority relieving one of those governors from office may be referred to the Court.[98]

Crucially, the ESCB relies on NCBs to implement the decisions taken by the Governing Council. However, this reliance does not change the nature of the (exclusive) competence. Indeed, the ESCB is not based on a vertical division of power but, rather, a decentralised *exercise* of competence.[99] Many statutory provisions reflect this principle. For instance, article 12.1 of the ESCB and ECB Statute states that, to a possible and appropriate extent, the ECB shall rely on NCBs to carry out operations that are part of ESCB's tasks. This reliance allows the ECB to count on national authorities to perform centrally decided policies, ie monetary policy operations, payment settlement facilities or euro banknote circulation, subject to the authorization of the ECB.[100] This means that, in the absence of specific tasks attributed to the ECB, a preference for decentralised execution operations does not hinder the ECB's legal capacity to directly perform Eurosystem-related tasks.[101]

Significantly, this principle also enables practicality and legal flexibility. Indeed, article 9.2 of the ESCB and ECB Statute is relevant for decentralised implementation as well. In this context, relevance derives from the fact the ECB may rely on a disseminated structure in order to achieve its goals, rather than pursuing centralised implementation.

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[98] ibid.

[99] The principle of decentralised implementation also embodies prudential supervision of financial institutions. The SSM comprises the ECB (via the Supervisory Board) and national supervisory authorities of the participating countries. In this regard, the ECB is responsible for the supervision of significant banks, amounting to roughly 80% of banking assets in the respective participating countries. National supervisors continue to supervise less significant institutions, although the ECB can decide to directly supervise one of these banks at any time in order to ensure consistency. On this matter, see Christoph Ohler, 'Banking Supervision' in Fabian Amtenbrink and Christoph Herrmann (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 1103; Raffaele D'Ambrosio, 'Single Supervision Mechanism: Organs and Procedures' in Mario Chiti and Vittorio Santoro (eds), *The Palgrave Handbook of European Banking Union Law* (Palgrave Macmillan) 157.

[100] The principle of decentralised implementation allows for differentiated involvement. For instance, certain tasks may be implemented by some national central banks, such as those related to TARGET2, banknote production or the purchase of bonds issued by international organisations in the context of the quantitative easing programme of the ECB, which is carried out by Banco de España and Banque de France. On this topic, see Ioannidis 'The European Central Bank' (n 90) 359.

[101] Zilioli and Athanassiou (n 96) 626.

Article 31.2 of the ESCB and ECB Statute also highlights the decentralised nature of the system. Regardless of the power of approval by the ECB in certain situations, NCBs are, indeed, entrusted with the conduction of foreign reserve assets-related operations and Member States remain empowered to execute transactions with their foreign exchange working balances.

Given the above, it is clear that the Treaty creates a system whereby there is cooperation between the ECB and NCBs, under the presumption of favouring decentralised execution but within an integrated supranational framework of centralised decision-making. This system is under the discretion of the ECB to resort to the NCBs for the performance of Eurosystem tasks.[102]

2.1.3. Principle of consistent standard

According to article 3 (1) (c) TFEU the Union's monetary competence is circumscribed to Member States that use the euro as their official currency. The remaining Member States are free to pursue an autonomous monetary policy. This has led to the creation of a dual circle system, also known as a horizontal division, whereby the outer circle encompasses the ECB and all NCBs of EU Member States (designated by ESCB) and the inner circle, which is comprised of NCBs of euro area countries (designated by the Eurosystem).[103]

The coexistence of multiple authorities renders this system unnecessarily intricate. However, complexity is reduced via the legal relationship established between the Eurosystem and the ESCB. Importantly, the duty of sincere cooperation with the Union, established by article 4 (3) TEU, restricts the use of the autonomy of Member States without the euro as their official currency, providing them with a derogation, including Denmark.[104]

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[102] For a discussion whether NCBs are national authorities or agents executing EU monetary policy decisions see Zilioli and Athanassiou (n 96) 628-630; Rosa Maria Lastra, 'The Division of Responsibilities between the European Central Bank and the National Central Banks within the European System of Central Banks' (2000) 6 Columbia Journal of European Law 167, 168.

[103] See Cornelia Manger-Nestler, 'The Architecture of EMU' in Fabian Amtenbrink and Christoph Herrmann (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 181, 194. Bruno De Witte, 'EMU as Constitutional Law' in Fabian Amtenbrink and Christoph Herrmann (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 278; Alberto Santa Maria, *European Economic Law* (Wolter Kluwer 2014) 294.

[104] All EU Member States are part of EMU and coordinate their economic policymaking to support the economic aims of the Union. However, several Member States have gone a step further by replacing their

Specifically, article 131 TFEU and Article 14 of the ESCB and ECB Statute (which cover all Member States) require that NCBs structure must be compatible with the Treaties and the ESCB and ECB Statute. Therefore, national central banks should act in accordance with the guidelines and instructions of the ECB (Article 14 (3) ESCB and ECB Statute). They may perform functions other than those specified by the EU, providing that they do not interfere with the objectives and tasks of the ESCB.

Moreover, Article 141 (2) TFEU establishes various powers of the ECB, for instance, strengthening cooperation between NCBs and strengthening coordination of Member States' monetary policies with the aim of ensuring price stability or monitoring the functionality of the exchange-rate mechanism. Although article 14 (3) of the ESCB and ECB Statute does not apply to them (via derogation of article 42 (1) of the same Statute), they still have to observe the principle of loyal cooperation. This means that their relevant legislation, including the one structuring their NCB, needs to be aligned with the Treaties and ESCB and ECB Statute.[105]

Crucially, the principle of price stability cannot be disregarded by non-euro area NCBs. On the contrary, it needs to be taken into consideration. Although article 139 (2) (c) TFEU establishes that Member States with a derogation are not bound by the objectives and tasks of the ESCB, article 142 TFEU states that '[e]ach Member State with a derogation shall treat its exchange-rate policy as a matter of common interest' and, as previously mentioned, article 141 (2) TFEU requires strengthening coordination to ensure price stability.

This means that the principle of price stability as the overriding principle of monetary policy must be followed by the NCBs of all Member States, thus ensuring the integrity and homogeneity of both the legal system and the standard of implementation

national currencies with the single currency (the euro). Of the Member States outside the euro area, Denmark has an 'opt-out' from joining, laid down on Protocol (no 16) on certain provisions relating to Denmark, annexed to the Treaty. Although it can join in the future, paragraph one of the referred Protocol states that the exemption has the effect of making all Treaty provisions and the ESCB and ECB Statute referring to a derogation applicable. Conversely, Sweden is required to join the eurozone. However, the Swedish chose not to adopt the euro in a 2003 referendum and, since then, the country has not joined ERM II, which is voluntary and an essential step in adopting the euro. The remaining non-euro area Member States are among those which acceded to the Union in 2004, 2007 and 2013, after the euro was created. At the time of their accession, they did not meet the conditions necessary for entry to the euro area but have committed to joining when they meet them. Currently, there are six of these States: Bulgaria, Czech Republic; Hungary; Poland and Romania. See https://ec.europa.eu/info/business-economy-euro/euro-area/what-euro-area_en.

[105] See Roland Bieber, 'The Allocation of Economic Policy Competences in the European Union' in Loïc Azoulai (ed), *The Question of Competence in the European Union* (Oxford University Press 2014) 86, 97.

of monetary policy. Seen from this perspective, the monetary policy divide between euro area and non-euro area countries may have been prescribed more importance than it should.

Naturally, for consistency purposes it would be preferable to have a single institution implementing policy for the whole Union. As Padoa-Schioppa best explains, '(…) in an area with free trade and complete capital mobility, fixed exchange rates cannot coexist with the independent execution of monetary policy by member states' because '[t]he attempt by any national authority to adopt a monetary stance different from that of other countries would immediately be defeated by capital movements that would equalize rates of return across borders',[106] highlighting its indivisibility.

However, in the absence of the first-best scenario, the Treaty is devised in a way that ensures that its principles and monetary policy standard of implementation are as similar as possible, thus reducing the risk of significant monetary policy deviations. Such deviations would also be inconsistent with the progressive transition towards the monetary union of the countries with a derogation, except for Denmark.

2.2. Coordination of economic policies of Member States

The Union shall work towards a sustainable development of Europe, based on balanced economic growth (article 3 (3) TEU). In order to achieve this objective, the activities of the Union and Member States include the adoption of an economic policy compliant with the principle of sound public finances and sustainable balance of payments (article 119 (3) TFEU), based on the coordination of Member States' individual economic policies in the spirit of common concern (articles 2 (3), 119 (1) and 121 (1) TFEU). Moreover, they must be conducted in accordance with the Council's broad economic guidelines (article 120 TFEU).

The main objectives were to promote fiscal prudence and national budgetary ownership by resorting to the disciplining effect of financial markets.[107] To this end, the

[106] Padoa-Schioppa (n 89) 162. In fact, the author notes that the early experience of the US Federal Reserve system showed that while, in theory, reserve banks had the power to change the discount rate in their jurisdictions, in practice they were unable to create 'local' monetary conditions that differed from those that prevailed in the rest of the country.

[107] In Portuguese literature, see seminal contribution of João Calvão da Silva, *Titularização de Créditos – Securitization* (3rd ed., Almedina 2013). In the international literature see Manuel Sanchis Marco, *The Economics of the Monetary Union and the Eurozone Crisis* (Springer 2014) and Philip Arestis and Malcom

Maastricht Treaty established two important principles impacting EU economic policy: the prohibition of monetary financing (article 123 TFEU) and the no-bailout clause (article 125 TFEU).[108] The former specifies that neither the ECB nor NCBs are allowed to purchase Member States' debt directly. The latter states that neither the Union nor Member States are liable for or assume the commitments of any (or another) State. Accordingly, particular attention was paid to the surveillance of the fiscal situation of the Member States through the EDP, established in article 126 TFEU. This provision was implemented by the SGP and complemented by Protocol (No 12) on the excessive deficit procedure, which was attached to the Treaty.

The SGP came into force in 1997[109] and was subsequently revised in 2005. The pact sets out convergence criteria as entry conditions in EMU,[110] approved in the Treaty of Maastricht, and they are enshrined in article 126 TFEU and Protocol (No 12) on the excessive deficit procedure. In order to reduce macroeconomic imbalances, two important rules on coordination are established: first, an obligation to maintain national budgets in balance or at a surplus in the medium term; second, a prohibition to surpass a public deficit of 3% GDP.

There are some problems with both rules. On the one hand, the so-called medium-term rule is executed in accordance with the open method of coordination by establishing a multilateral surveillance procedure, therefore, lacking capacity to discipline non-compliance.[111] As a matter of fact, the effectiveness of the SGP was undermined when France and Germany breached it in 2002 and the respective excessive deficit procedures were suspended in 2003.[112] In addition, economic coordination relied on Member States'

Sawyer, *Economic and Monetary Union Macroeconomic Policies: Current Practices and Alternatives* (Palgrave Macmillan 2013).

[108] These articles apply to all Member States, since they are expected to join the euro area at some point, with the already mentioned exceptions.

[109] See Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies [1997] OJ L209/1.

[110] The convergence criteria establish limits on national budget deficit and public debt of 3% and 60% of Gross Domestic Product, respectively.

[111] See Dermot Hodson, 'Macroeconomic Co-Ordination in the Euro-Area: The Scope and Limits of the Open Method' (2004) 2 Journal of European Public Policy 232, 236. In the case of Portugal, Hodson exemplifies that, in 2002, it became the first country to become subject to an EDP due to failing to consolidate its public finances during periods of economic growth, namely between 1998 and 2001, by an average of 4% in nominal terms.

[112] See Dermot Hodson and Imelda Maher, 'Soft Law and Sanctions: Economic Policy Co-Ordination and Reform of the SGPS Pact' (2004) 5 Journal of European Public Policy 799. See also Eurostat statistics concerning budgetary deficits in EU Member States, available at http://epp.eurostat.ec.europa.eu/portal/page/portal/euroindicators/peeis. From the data it is possible to conclude that a significant number of Member States were systematically in breach of what was established

individual actions, without taking into account the economic conditions of others.[113] On the other hand, the medium-term rule does not take into account past, present and expectable fiscal policy of Member States and the monetary policy of the Eurosystem.[114]

Therefore, the SGP intends to prevent certain macroeconomic shocks affecting individual Member States (or small groups of Member States) instead of addressing horizontal issues. The underlying ratio of the Pact is to avoid the implementation of harmful divergent national fiscal policies,[115] not to manage macroeconomic policy in the EU or within a monetary union. However, Member States considered this framework to provide adequate protection against fiscal risks and the possibility of excessive borrowing.[116]

Apart from the inclusion of article 136 TFEU, which applies specifically to the euro area, the Lisbon Treaty did not bring about significant changes to this setup. This is understandable, as financial pressure did not affect the period leading up to the agreement in December 2007.[117] Accordingly, there were fewer incentives to perform a comprehensive reform.

As Member States' influence predominated, the Treaties are based on the assumption that the EU is only competent for coordinating national choices and that the most important decisions should be taken at a national level.[118] On the one hand,

in the SGP, even excluding the years of 2009 and 2010 (during which budget deficits substantially increased in response to the financial crisis).

[113] See Willem Buiter, 'The "Sense and Nonsense of Maastricht" Revisited: What Have We Learnt about Stabilization in EMU' (2006) 4 Journal of Common Market Studies 688.

[114] ibid. 698.

[115] See Jacques Le Cacheux, 'How to Herd Cats: Economic Policy Coordination in the Euro Zone in Tough Times' (2010) 32 Journal of European Integration 41, 44. The author also argues that the theory that supported this choice was that common shocks could be resolved by resorting to the only common instrument in a monetary union, which is monetary policy. Specific shocks, on the other hand, would be more problematic since Member States no longer have the possibility of devaluing national currencies.

[116] Mark Baimbridge and Philip Whyman, *Crisis in the Eurozone: Causes, Dilemmas and Solutions* (Palgrave Macmillan 2015) 55. Especially taking into account that the introduction of the euro created new conditions according to which its Member States could borrow.

[117] The first stage of the global financial crisis started in August 2007, when the ECB set liquidity operations in motion. A more acute phase took place in September 2008 with the collapse of investment bank Lehman Brothers. For an overview see Philip Lane, 'The European Sovereign Debt Crisis' (2012) 26 Journal of Economic Perspectives 49, 55. Silva (n 16); João Calvão da Silva, *Banca, Bolsa e Seguros* (5th ed., Almedina 2017).

[118] Jean-Paul Keppenne, 'Economic Policy Coordination: Foundations, Structures, and Objectives' in Fabian Amtenbrink and Christoph Herrmann (eds), *EU Law of Economic & Monetary Union* (Oxford University Press 2020) 787, 792. This framework was analysed by the CJEU in *Pringle*, where it stated that '[a]rticles 2(3) and 5(1) TFEU restrict the role of the Union in the area of economic policy to the adoption of coordinating measures'. See Case C-370/12, *Thomas Pringle v Government of Ireland and Others*, ECLI:EU:C:2012:756, para 64.

coordination responsibilities are carried out by soft law instruments within the Council. On the other hand, the Treaties maintain that fundamental budgetary, economic and fiscal competences are a national prerogative. This framework is typically referred to as the asymmetry of EMU. Economic policy is characterised by decentralised competences, which contrasts with centralised monetary policy.

Importantly, stability in the legal framework was followed by positive financial indicators. While some countries' financial conditions did not undergo crucial changes, others registered significant improvement. Member States in this latter category were able to borrow money to cover what they perceived to be necessary and what others later perceived as excessive consumption.[119]

The deficit and credit spree in the years following the introduction of the euro[120] were related to the reduction in transaction costs and the enhancement of capital circulation[121] – two factors fostered by the single currency. For instance, countries considered within the eurozone's periphery (namely Portugal, Italy, Ireland, Greece and Spain) experienced strong credit booms, partly because joining the eurozone meant that banks and national public debt agencies could raise funds in their new domestic currency.[122] Importantly, a key predictor of a banking crisis is the scale of preceding domestic credit.[123]

Although the aggregate euro area public debt was not a pressing problem until the mid-2000s,[124] the national predominance of budgetary, economic and fiscal competences

[119] Julius Horváth and Martin Šuster, 'European Sovereign Debt Crisis and the Euro' in Daniel Daianu and others (eds), *The Eurozone Crisis and the Future of Europe: The Political Economy of Further Integration and Governance* (Palgrave Macmillan 2014) 40, 41.
[120] ibid.
[121] This was facilitated by the Court's case law regarding free movement of capital. In this vein, see Barnard (n 39). See also Gabriel Fagan and Vítor Gaspar, 'Adjusting to the Euro' (2007) ECB Working Paper No 716 <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp716.pdf> accessed 13 December 2021, 4. These authors argue that participation in the euro area, financial liberalisation and integration fostered access to international financing by domestic economic agents. Such a development gave an impulse to a sharp increase in households' expenditures and a corresponding fall in the savings ratio.
[122] Lane (n 117) 52. This is a much more comfortable position. As argued by the author, before adopting the euro, countries did not borrow in their own currency (ie in US dollars, German marks or British pounds) and then hoped that exchange rates would not move against them. Consequently, lower interest rates and easier availability of credit stimulated consumption and property-related borrowing.
[123] Pierre-Olivier Gourinchas and Maurice Obstfeld, 'Stories of the Twentieth Century for the Twenty-First' (2012) 4 American Economic Journal: Macroeconomics 226.
[124] Lane (n 117) 51. In fact, in 1995, the ratio of gross public debt to GDP was 60% in the US and 70% for countries that would later integrate the eurozone. However, in the decade before the recent crisis (from 1998 to 2007) Greece, Ireland and Spain more than doubled their share of credit relative to GDP, closely followed by Portugal and Italy. The author also demonstrates that this credit growth and the current account imbalances occurred from 2003 until 2007.

highlights the importance of individual readings, concomitantly reducing the significance of aggregate indicators.

Current account imbalances are also a related phenomenon. While these were not significant in the 1993–1997 period, the picture changed later. In the 2003–2007 period, Portugal (-9.2 percent), Greece (-9.1 percent) and Spain (-7 percent) all registered large external deficits. In contrast, Germany had a large external surplus averaging 5.1 percent of GDP, while the overall euro current account balance was close to zero.[125]

2.3. Effects of centralised monetary policy and decentralised economic policy

Interest rates are decided by the central bank and change only if the ECB decides that aggregate economic conditions permit, as opposed to being determined by an economic shock experienced by an individual State or group of States.[126] In other words, the interest rate is set by the central bank and applies across the whole economy, regardless of differences in the economic position of the various regions and of the degree of regional integration.[127]

Differences among regions are significant. Yet, they would not represent a major problem in a relatively small country if a common set of institutional arrangements was in place and fluctuations in economic activity were closely coordinated.[128] However, in a large area, such as the eurozone, a uniform interest rate policy faces a 'one size fits all' approach. This essentially means that the single monetary policy may not fit the domestic needs of all participating Member States.[129] In this vein, the former Bank of England Governor argues that if the risks of divergent monetary policy needs between members materialised to a significant extent, the resulting tensions could be serious because

[125] ibid. Lane considers that these imbalances could have been considered an acceptable outcome, had they fostered income convergence, ie by reallocating resources from capital-abundant countries to capital-scarce countries. Notwithstanding, the accumulation of external imbalances poses significant risks if capital inflows generate low productivity investment and delayed adjustment to structural shocks.
[126] Baimbridge and Whyman (n 116) 121.
[127] Bela Balassa, *The Theory of Economic Integration* (3rd edn, George Allen & Unwin 1969) 268.
[128] Arestis and Sawyer (n 107) 82. See also Frank McDonald and Stephen Dearden, *European Economic Integration* (FT Prentice Hall 2005) 109; Miroslav Jovanovic, *The Economics of European Integration* (2nd edn, Edward Elgar 2014) 443; Richard Baldwin and Charles Wyplosz, *The Economics of European Integration* (6th edn, McGraw-Hill 2020) 405.
[129] Edward George, 'Future of Central Banking – Speech by The Rt Hon Eddie George, Governor' (2000) <https://www.bankofengland.co.uk/-/media/boe/files/speech/2000/future-of-central-banking.pdf?la=en&hash=80766DA57146AE8D651D7D96672D7A02429742CB> accessed 12 January 2022.

alternative mechanisms – such as labour mobility, migration or fiscal redistribution through a central budget – are less developed at the supranational level.[130] Consequently, no eurozone member can offset the undesirable effects of an interest rate set by the ECB, which is either too high or too low for the economic needs of that country.

In the euro area, there have been, and remain, relatively small but persistent differences in the inflation rate of Member States. A comparison between the evolution of eurozone inflation since 1997 reveals significant asymmetry:[131] while France, Italy and Germany generally follow the average rates of the eurozone,[132] the same cannot be said regarding other eurozone Member States (such as Portugal, Spain, Ireland, Greece, Lithuania, The Netherlands or Finland) and non-eurozone countries (such as Poland and Bulgaria). In all of these States, an occasionally tighter (in order to lower a high inflation rate) or looser (in order to increase a low inflation rate) monetary policy would have been more adequate. Interestingly, these mismatches often coincide (ie in May 2001, June 2008, July 2013 and October 2021), which makes it impossible to attain an optimal situation for every Member State at once. Since inflation can affect the pace of economic growth and impact public revenue and expenditure, it can impact the conduction of economic policy, making it more challenging to have generally homogeneous public finance indicators without significant supranational budgetary activity.

Inflation rate differences among eurozone countries would not be as problematic if they were to alternate in their respective positions, as occurs in broad regions in the US.[133] However, over the period of 1999-2008, the same countries have persistently registered lower or higher inflation rates. As Baldwin and Wyplosz highlight:

> A country that faces continuously higher inflation than others is bound to face a loss in competitiveness as its real exchange rate appreciates. If this process persists, the country would then have to undergo several years of lower inflation to restore competitiveness. (…) inflation has been lower than average in Germany, Finland and France, and higher than average in Ireland,

[130] ibid.
[131] See https://www.ecb.europa.eu/stats/macroeconomic_and_sectoral/hicp/html/index.en.html.
[132] With two periods of exception: from 2002 to 2004 (regarding Germany); and from 2011 to 2012 (regarding Italy).
[133] Baldwin and Wyplosz (n 128) 405.

Spain, Portugal, the Netherlands and Italy. Not surprisingly, the four countries with the highest inflation rates are those that eventually faced a crisis.[134]

Divergent inflation rates can also have a decisive impact on external accounts. In the eurozone, States experiencing higher inflation face a reduction in their exports and an increase in their imports. This occurred until the financial crisis, whereby surpluses in Germany and the Netherlands continued to grow while other countries experienced deficits, particularly in Greece, Italy, Spain, Ireland and Portugal. However, the so-called Hume mechanism[135] did not work preventively, as it took a major crisis to correct imbalances in deficit countries.

Economic policy decisions are in the national realm. In the absence of supranational tools of economic stabilisation, using fiscal policies counter-cyclically may be the only tool available for national governments. Yet, there are challenges to this approach, notably due to negative externalities and free-rider effects.[136] Regarding externalities, let us assume that some Member States run large budget deficits over a prolonged period. This could bring about some unintended effects. First, the effects that were intended to impact a national market could produce effects elsewhere as capital moves freely within the Union. For instance, if the demand side of the economy is prioritised in an expansive public budget, the potential short-term effects of enhancing economic activity and private consumption could occur in other countries and, thus, not benefit the national economy and public budget accordingly.

A second effect is related to the unsustainability of the fiscal position. If debt-issued revenue does not entail a productive effect (or at least not to the expected degree), eventually, public finance sustainability may be questioned by financial markets, resulting in higher interest rates on sovereign debt. Increasing indebtment may also reduce

[134] ibid. This can be due to several factors. For instance, (i) the Balassa-Samuelson effect, which essentially explains that, in catch-up countries, real exchange rate appreciates due to rising productivity. Within a currency area, such appreciation can only occur through higher-than-average inflation; (ii) wrong initial conversion rates, which the authors consider to be the case regarding the German Mark (overvalued) and the Greek Drachma (undervalued); (iii) autonomous wage and price pressure, whereby wage increases in excess of productivity hinders competitiveness; (iv) policy mistakes, ie by pursuing expansionary fiscal policies is excess, or (v) asymmetric shocks.

[135] Such a mechanism presupposes that stabilisation is achieved by an adjustment process of demand, economic activity, unemployment, wages and prices, until inflation is corrected. ibid. 406.

[136] Sanchis Marco (n 107) 83; Ricardo Aláez-Aller and Carlos Gil-Canaleta, 'The Eurozone, Challenging the Institutional Framework for Economic Policy' in Javier Bilbao-Ubillos (ed), *The Economic Crisis and Governance in the European Union* (Routledge 2013) 52.

the availability of liquidity and be another factor to increase interest rates. These issues may affect other Member States (known as the externality effect) because sovereign debt refinancing may become more expensive.

There is another event that takes place when a country cannot meet the repayment of its outstanding debt, which is related to the free-rider effect. Countries may reduce the real value of debt by devaluing their currency and generating inflation. However, for eurozone members (and, to a significant extent, non-eurozone members, as seen above in Part II, Point 2.1.3) these solutions are no longer available, thus increasing the possibility of default. With the integration of financial markets and free movement of capital in the EU, a default on debt repayment could harm not only domestic bondholders but also other government and private investors.[137]

The issues identified are frequent in integrated economic blocs, regardless of the political nature of governance adopted, ie confederation or federation.[138] However, in the EU, the repercussions are fully absorbed by national budgets, as there is no supranational mechanism to internalise consequences that derive from transnational activity. As a result, deflation has become the eurozone's main adjustment mechanism.[139] The main response has been to increase budgetary surveillance and fiscal constraints as well as the creation of several financing bodies, which address 'symptoms rather than the fundamental causes of the euro's structural weaknesses'.[140]

Ultimately, the mismatch between the distribution of competences to conduct monetary and economic policies resulted in the adjustment costs being borne by specific members. As Eichengreen argues, this approach has never worked as a long-term option, which the collapse of the gold standard exemplifies.[141]

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[137] Baimbridge and Whyman (n 116) 130.

[138] On the distinction, see Armin Cuyvers, 'The EU as a Confederal Union of Sovereign Member Peoples: Exploring the Potential of American (Con)Federalism and Popular Sovereignty for a Constitutional Theory of the EU' (Leiden University 2013).

[139] See https://www.ecb.europa.eu/stats/macroeconomic_and_sectoral/hicp/html/index.en.html. With differences among countries, deflation in southern Europe and Ireland was generally steep in certain periods, particularly in 2009-2011, 2013-2015 and 2020-2021.

[140] Baimbridge and Whyman (n 116) 131.

[141] Barry Eichengreen, *Golden Fetters: The Gold Standard and the Great Depression 1919-1939* (Oxford University Press 1996) 222-258. One of the disadvantages of the gold standard is that the unequal distribution of gold deposits makes the system more advantageous for gold-producing countries. As Eichengreen explains, in the 1920s a common characteristic of the regions that were the first to experience economic slowdown was that they imported capital on a large scale. Heavily indebted countries could choose among three courses of action. First, by boosting exports and limiting imports, cutting public spending and raising taxes, especially import duties. This was the option pursued by virtually every debtor nation until 1929. Indeed, Argentina, Austria, Australia, Brazil, Bulgaria, Colombia, Germany, Greece,

3. Evolution of the European Union budget

In this part, I will shortly describe the revenues and expenditures of the EU budget before and after the financial crisis. This important component, which connects monetary and economic policies, has not shown significant progress, having been considered as an historical relic.[142] Therefore, the approach to the EU budget differs from the one adopted regarding economic and monetary policies.

The evolution of the main budgetary items – the EU's own resources and expenditures – can be broadly divided into three periods: from 1958 to 1970; from 1971 to 1988; and from 1989 to the present. These adopted differing perspectives on the Union's resources, expenditures and institutional setting, which shaped the current EU budgetary composition and approval process.

3.1. Initial period (1958-1970)

This initial period of European integration included the founding six Member States, which financed the budgets of the EEC and the Euratom with national contributions based on a percentage defined in article 200 of the EEC Treaty.[143] The budget was required to be in balance (article 199 EEC Treaty).

Significantly, the founding Member States did not consider a system of financing based on national contributions to be equivalent to one of own resources. This is clearly shown by article 201 EEC Treaty, whereby '[l]a Commission étudiera dans quelles conditions les contributions financières des États membres […] pourraient être remplacées par des ressources propres, notamment par des recettes provenant du tarif douanier commun lorsque celui-ci aura été définitivement mis en place'.

Hungary, Poland, and Venezuela all used these devices to significantly strengthen their trade balances. A second option was to suspend the external debt service. This was the option debtors ultimately chose starting in 1931. A third option was to suspend the gold standard. If they were willing to allow the exchange rate to depreciate, governments could elect to pursue policies other than domestic spending reduction. This was the alternative to which policymakers in the most heavily-indebted, primary-producing countries were ultimately forced to turn (for instance Australia, Argentina, Brazil and Canada).

[142] Stephan Lehner, 'The Dual Nature of the EU Multiannual Financial Framework' in Brigid Laffan and Alfredo De Feo (eds), *EU Financing for Next Decade: Beyond the MFF 2021-2027 and the Next Generation EU* (European University Institute 2020) 21.

[143] Germany, France and Italy would pay 28%, Belgium and The Netherlands would pay 7.9% and Luxembourg would pay 0.2%.

Regarding expenditure, they were mainly focused on administrative and operational matters. For instance, the administrative budgets had a crucial role given that the development of European policies, their implementation and control, was dependent on Union institutions recruiting qualified staff.

Furthermore, in 1958, the first policy on Community expenditure (the European Social Fund) was established, investing in vocational training and the re-insertion of unemployed citizens into the labour market. The CAP emerged as an area of expenditure in 1962. Interestingly, it was established to address agricultural subsidies being granted in other countries, such as the US.[144] Other expenditures included the promotion of information on European activities, initiatives for young people and research and development projects.

Concerning the distribution of institutional competences, article 203 EEC Treaty established that budgetary authority was attributed to the Council. The Assembly played a role in the procedure through consultation and proposing budgetary amendments. However, there was no obligation for the Council to take them into consideration and, in practice, it always confirmed its first reading decisions. Be that as it may, the fact that the Assembly was composed of members elected in their national parliaments fostered the introduction of parliamentary features at the supranational level.[145]

3.2. Interim period (1970-1988)

[144] See Giacomo Benedetto, 'The History of the EU Budget' (2019) <https://www.europarl.europa.eu/RegData/etudes/IDAN/2019/636475/IPOL_IDA(2019)636475_EN.pdf > accessed 26 January 2023; Alfredo De Feo, 'History of Budgetary Powers and Politics in the EU: The Role of the European Parliament. Part II: The Non-Elected Parliament 1957-1978' (2016) <https://www.europarl.europa.eu/thinktank/en/document/EPRS_STU(2015)563508> accessed 26 January 2023.

[145] Johannes Lindner and Sander Tordoir, 'Euro Area Macroeconomic Stabilisation and the EU Budget: A Primer' in Brigid Laffan and Alfredo De Feo (eds), *EU Financing for Next Decade: Beyond the MFF 2021-2027 and the Next Generation EU* (European University Institute 2020). Feo, 'History of Budgetary Powers and Politics in the EU: The Role of the European Parliament. Part II: The Non-Elected Parliament 1957-1978' (n 144) 14. For example, they did this by criticising the Council's absence of dialogue with the Assembly, lacking respect for the Treaty's provisions regarding the budgetary calendar, having an absence of political representation in the Assembly's plenary meetings and creating of internal committees without legal basis, among others.

This second period was preceded by a crisis related to the development of Union policies, notably the funding of the CAP, which motivated the enactment of the Treaty of Luxembourg (1970)[146] and the Treaty of Brussels (1975).[147]

Regarding revenues, the Treaty of Luxembourg aimed to progressively replace national contributions so that the Community could avoid a state of budgetary and political dependence on the Member States. To this end, it introduced a system of own resources for the Community budget, which included customs duties, agricultural levies and VAT-based revenue (initially limited to a rate of 1%). However, financial contributions from Member States were still required to ensure a smooth transition and balanced budget.[148]

Concerning expenditure, the Treaty of Luxembourg introduced a division between compulsory and non-compulsory expenditure. The former was seen as 'dépenses découlant obligatoirement du traité ou des actes arrêtés en vertu de celui-ci', which the Community was obliged to pay. The latter was a residual category, encompassing the remaining segments. For instance, direct grants in agriculture and fisheries, as well as expenditure related to international agreements, were considered compulsory, while nearly everything else was non-compulsory. This distinction lasted until the Treaty of Lisbon.

One of the most relevant consequences was related to competences on procedure, given that each type of expenditure gave the Council or Assembly different powers. Under the new procedure, if the Council and Assembly disagreed, the former would be able to impose its preference for compulsory expenditure by a qualified majority vote. The Assembly could do the same with non-compulsory expenditure.

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[146] Traité portant modification de certaines dispositions budgétaires des Traités instituant les communautés européennes et du Traité instituant un Conseil unique et une Commission unique des Communautés Européennes [1971] OJ L 02/1.

[147] Treaty amending certain financial provisions of the Treaties establishing the European Communities and of the Treaty establishing a single Council and a single Commission of the European Communities [1977] OJ L359/1.

[148] See Décision, du 21 avril 1970, relative au remplacement des contributions financières des États membres par des ressources propres aux Communautés [1970] OJ L094/19; European Commission, 'European Union Public Finance' (2014) <https://op.europa.eu/pt/publication-detail/-/publication/8bc08dd0-f1ed-4f45-bab4-75ac2a63d048> accessed 24 January 2023, 22; Richard Crowe, 'The European Budgetary Galaxy' (2017) 13 European Constitutional Law Review 428, 431. Member States paid transitional contributions to balance the Community budget between 1971–1978, then very small residual contributions between 1979-1981, and exceptionally reimbursable and non-reimbursable advances in 1984 and 1985 (before the GNI-based own resource was introduced in 1988).

Importantly, the Treaty of Brussels entrusted the Assembly with the power to reject the budget. However, this situation created the conditions to increase conflict between both Community institutions, especially considering the institutional and budgetary characteristics. Institutionally, the Council remained the sole legislative authority. Nevertheless, the Assembly's competences were increasing and, in 1979, its legitimacy was strengthened by the first elections, further emboldening it.[149] In fact, the elected Assembly demanded more influence and, as a result, failed to agree the budgets of 1980, 1985, 1986 and 1988.

From a budgetary standpoint, revenue shortages and expenditure increases led to fiscal imbalances. On the one hand, customs duties were affected by the General Agreement on Tariffs and Trade and national contributions were reduced by successive rebates, correction and compensation mechanisms. On the other hand, there was an unsatisfactory control of agricultural expenses, new EU policies were being fostered (for instance, the European Regional Development Fund) and the enlargement process was put in motion.

3.3. Present period (1989-onwards)

The third and present period is also a period of transformations. From the point of view of institutional competences, the Treaty of Lisbon introduced important changes to the budgetary procedure. First, the distinction between compulsory and non-compulsory expenditure was revoked. Moreover, article 312 TFEU transformed the MFF into a Council regulation subject to the consent of the EP. Finally, article 314 TFEU provides a timetable and set of stages related to the annual budget, similar to a co-decision procedure. Decisions on the resources of the Union remain in the exclusive purview of the Council (article 311 TFEU).

From a public finance standpoint, this period was underpinned by the Delors package in 1988, which included a reform of the Union's finances.[150] In line with the European Commission's proposal, in February 1988, the European Council agreed that

[149] Alberto de Feo, 'A History of Budgetary Powers and Politics in the EU: The Role of the European Parliament. Part I: European Coal and Steal Community 1952-2002' (2015) <https://op.europa.eu/en/publication-detail/-/publication/8fa07fa6-06bb-11e6-b713-01aa75ed71a1/language-en> accessed 27 January 2023.

[150] European Commission, 'Report by the Commission to the Council and Parliament on the Financing of the Community Budget' COM (1987) 101 final <https://aei.pitt.edu/1370/> accessed 27 December 2023.

the Community should dispose of additional resources to enable it to operate properly. Moreover, they agreed that priority should be given to cohesion policies, and budgetary discipline arrangements were introduced to effectively halt agricultural expenditure.[151]

In addition, legal certainty was increased by the introduction of the long-term financial perspective, which was renamed MFF by article 312 TFEU. These multiannual programmes set maximum levels of expenditure, which must be respected by the annual budgetary procedure.

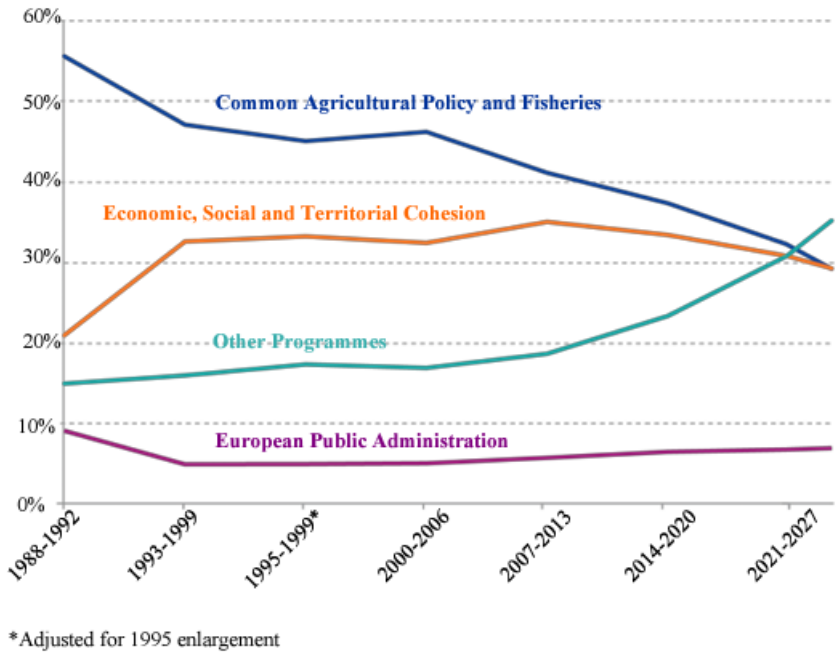
Concerning the type of expenditure, the budget focuses mainly on the CAP and cohesion policy. Alongside them is a range of other programmes with more prominent EU-added value, such as investments in research and development (ie Horizon Europe), competitiveness (ie Connecting Europe Facility and Competitiveness of Enterprises and Small and Medium-Sized Enterprises), space (ie Galileo and Copernicus), youth (ie Erasmus), asylum and migration and health, among others.[152]

As shown in Figure 1, the allocation of resources has also undergone significant changes. Despite the fact that the CAP continues to be the most important individual expenditure item, it is clear that there is a declining trend not only in the CAP but also in the cohesion policy, in favour of other programmes. Nevertheless, both redistributive segments still account for around two-thirds of the budget.

[151] European Council, 'Making a success of the Single European Act - Consolidated conclusions of the European Council Meeting', 19 February 1988 <https://www.consilium.europa.eu/media/20614/1988_february_-_brussels__eng_.pdf> accessed 27 January 2023.

[152] European Commission, 'Communication from the Commission to the European Parliament, the European Council, the European Economic and Social Committee and the Committee of the Regions, A Modern Budget for a Union That Protects, Empowers and Defends – The Multiannual Financial Framework' COM (2018) 321 final <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2018%3A321%3AFIN> accessed 27 December 2023.

Figure 1: Evolution of main policy areas in the EU budget



Source: European Commission (n 193) 23

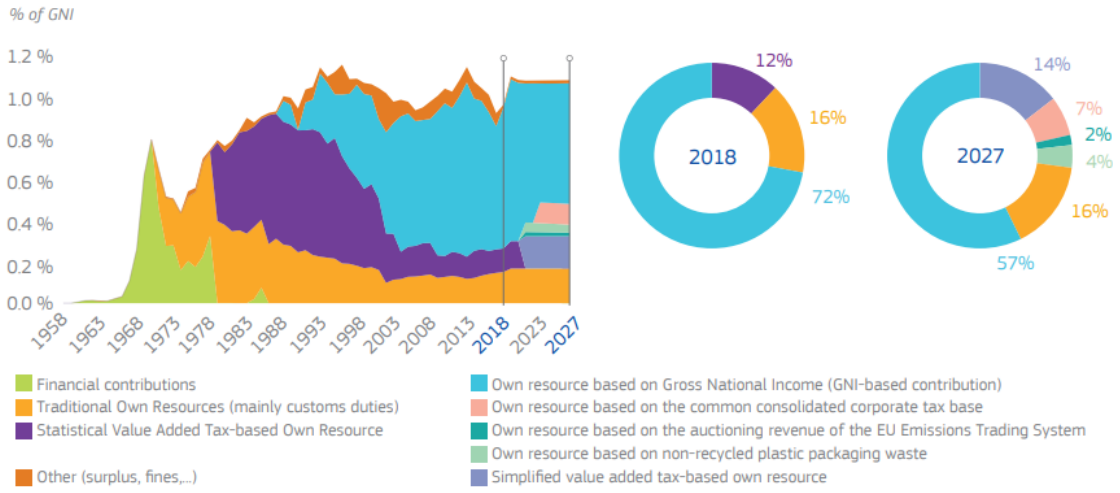
Concurrently, the gradual rise in own resources was reformed towards the establishment of a ceiling: own resources available for all EU obligations could be no larger than 1.30% of GNP, providing payments of 1.15% GNP in 1988, which rose to 1.20% by 1992.[153]

Unlike in other periods, the own resources system from 1989-onwards is hybrid, combining customs duties, agricultural and sugar levies, a 1.4% VAT rate capped at 55% of GNP of each Member State, and national contributions, which are based on each State's GNP, therefore, aligning with each State's ability to pay. The total amount of available resources was determined by a percentage of Community's total GNP, later replaced by GNI.

Figure 2 illustrates the evolution of revenue streams. Almost since its adoption, the GNI has been the primary source of budgetary revenue. However, it has carried disproportionate weight from 2003 until the present. In fact, 84% of revenue for 2018 consists of GNI (72%) and VAT (12%). Only 16% of revenue from the year 2018 genuinely qualifies as the EU's own resources.

[153] Benedetto (n 144) 17.

Figure 2: Evolution of the revenue resources of the EU budget



Source: European Commission (n 198) 1

Currently, article 311 (1) TFEU stipulates that '[t]he Union shall provide itself with the means necessary to attain its objectives and carry through its policies', which should be achieved '[w]ithout prejudice to other revenue, wholly from own resources'. However, in contrast with previous periods, all revenue streams (including national contributions) were considered by the European Council as the own resources of the Community. This is an important and consequential feature that decisively shaped EU public finances, as explained below (Part III, Chapter 1, Point 3.1).

The own resources system has been difficult to reform. In fact, during this period, the decisions of the Council on this matter mostly focused on adjusting existing categories and correction mechanisms for some Member States.[154] The most significant attempt for a possible reform was conducted by the High-Level Group on Own Resources, created as part of the final agreement on the MFF 2014-2020, in 2013.[155] In its report, the group analyses and proposes new revenue streams of European nature, such as a tax on CO2 emissions; revenue from the auctions carried out under the Emissions Trading System; a tax on fossil fuels; a tax on the electricity sector, including consumers; revenue from the

[154] ibid. 17.
[155] European Commission, 'Future Financing of the EU, Final Report and Recommendations of the High Level Group on Own Resources' (2016) <https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2014-2020/revenue/high-level-group-own-resources_en> accessed 30 January 2023.

Common Consolidated Corporate Tax Base; a tax on financial transactions; and the simplification of the current VAT regime and revenue accruing from seigniorage.

The report argued that there was a strong case for an own resources reform in the 2021-2027 MFF. Not only was this due to greater pressure to reform expenditure towards more added value, but also to the exit of the UK from the EU (which was an important net contributor). Moreover, the group found that revenue reform should be pursued in parallel with significant reform of expenditure.

In 2017, the European Commission issued a reflection paper on EU finances.[156] Building on the arguments of the High-Level Group on Own Resources, the paper discussed how to conceptualise European-added value and whether the own resources system should be reformed. The European Commission argued that the EU budget should address several current and future challenges, such as economic and social divergences between and within Member States, and whether it should incorporate some form of stabilisation function or provide financial incentives to support structural reforms in each Member State. The policies that govern EU expenditure are proposed to increase levels of national co-financing.

Revenue sources are due to change in 2027, notably by reducing the dependency of national transfers. In fact, 71% of revenue is foreseen to come from GNI (57%) and VAT (14%). To cover the shortfall, the European Commission proposed to introduce three new own resources either based on profits deriving from the existence of the internal market (such as the Common Consolidated Corporate Tax Base) or the EU environmental policy (such as the EU Emissions Trading System) and the amount of waste from non-recycled plastic packaging.[157]

Significantly, because of the COVID-19 pandemic, the Union adopted two main programmes, SURE and NGEU. The former entailed assistance to support Member States in financing work schemes and similar measures to protect workers against the risks of unemployment and loss of income during the pandemic. The SURE Regulation[158] was

[156] European Commission, 'Reflection Paper on the Future of EU Finances' (2017) <https://op.europa.eu/en/publication-detail/-/publication/5f9c0e27-6519-11e7-b2f2-01aa75ed71a1> accessed 30 January 2023.
[157] European Commission, 'EU Budget for the Future: Modernising the EU Budget's Revenue Side' (2018) <https://op.europa.eu/en/publication-detail/-/publication/d94c9a87-5269-11e8-be1d-01aa75ed71a1> accessed 30 January 2023.
[158] Council Regulation (EU) 2020/672 of 19 May 2020 on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) following the COVID-19 outbreak [2020] OJ L 159/1.

proposed on the legal basis of article 122 TFEU and empowered the European Commission to borrow up to €100 billion on the capital market on behalf of the Union.

NGEU is a package consisting of three[159] [160] different components. First, the Council Regulation (EU) 2020/2094 (EURI Regulation),[161] which distributes up to €750 billion between Member States in need of loans (up to €360 billion) and grants (up to €384.4 billion). Most of the funding (€312.5 billion) is allocated to financing recovery, economic and social resilience via support to reforms and investments, as established by article 2 of EURI Regulation.

The second component is the RRF.[162] This facility is a new instrument intended to fund national programmes subsumed to the matters mentioned above, with a total of €672.5 billion. The remaining budget is split between structural and cohesion programmes, civil protection, research and innovation, supporting territories transitioning towards a climate-neutral economy and rural areas.

The third component of the package is an amendment of the ORD. This amendment allows for the raising of EU funds by borrowing from the financial markets by the European Commission on behalf of the Union. Repayment of NGEU is made by the Union's own resources. Specifically, the European Council issued a multi-step plan to be developed over the years. One of these steps related to the resource based on non-recycled plastic waste, which came into force in January 2021, which should be accompanied by the introduction of other new own resources, such as a Carbon Border Adjustment Mechanism and a digital levy. Moreover, the European Council invited the European

[159] There is a solid body of literature on NGEU. See, especially, Martin Nettesheim, 'Next Generation EU: The Transformation of the EU Financial Constitution' in Hanno Kube and Ekkehart Reimer (eds), *Solid Financing of the EU* (Institut für Finanz- und Steuerrecht 2021) 9, 17; Federico Fabbrini, *EU Fiscal Capacity: Legal Integration After Covid-19 and the War in Ukraine* (Oxford University Press 2022) 69; Antonio-Martín Porras-Gómez, 'The EU Recovery Instrument and the Constitutional Implications of Its Expenditure' [2022] European Constitutional Law Review 1, 9; Bruno De Witte, 'The European Union's Covid-19 Recovery Plan: The Legal Engineering of an Economic Policy Shift' (2021) 58 Common Market Law Review 635; Päivi Leino-Sandberg, 'Constitutional Imaginaries of Solidarity: Framing Fiscal Integration Post-NGEU' in Ruth Weber (ed), *The Financial Constitution of European Integration* (Bloomsbury Publishing 2023) 161.

[160] Another NGEU component not considered in this thesis is the Regulation of the European Parliament and Council Regulation (EU, EURATOM) 2020/2092 of 16 December 2020 on a general regime of conditionality for the protection of the Union budget [2020] OJ LI 433/1. On this topic see Fabbrini, *EU Fiscal Capacity: Legal Integration After Covid-19 and the War in Ukraine* (n 159) 78; Alberto de Gregorio Merino, 'Follow the Money, Follow the Values' in Ruth Weber (ed), *The Financial Constitution of European Integration* (Bloomsbury Publishing 2023) 113.

[161] 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 [2020] OJ L 433I/23.

[162] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility [2020] OJ L 57/17.

Commission to revise the EU Emission Trading System. Finally, the introduction of other own resources should be considered, such as a financial transaction tax. It also authorised an increase in commitment appropriations and expenditure by 0.6% GNI until the repayment of NGEU bonds.

In December 2021, the European Commission proposed the first basket of new own resources. It was comprised of an extended EU Emissions Trading System, a carbon border adjustment mechanism and a share of the reallocated profits of large multinational companies (based on Pillar 1 of the OECD/G20 agreement). Under this proposal, new own resources would be gradually introduced as of 1 January 2023.[163] In June 2023, the European Commission published an adjusted package for the next generation of own resources, which updated the previous proposal.[164] In particular, it introduced a new statistical-based own resource linked to the corporate sector. This new own resource is temporary, possibly to be replaced by 'Business in Europe: Framework for Income Taxation (BEFIT)', once proposed and agreed to by Member States. Moreover, it proposes to increase the call rate for the own resource based on the EU Emissions Trading System from 25% to 30% (5% more than originally proposed). The call rate for EU Carbon Border Adjustment Mechanism remains unchanged (75% from revenues generated, as initially proposed).

[163] See European Commission, 'Proposal for a Council Decision Amending Decision (EU, Euratom) 2020/2053 on the System of Own Resources of the European Union' COM (2021) 570 final < https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0570> accessed 27 December 2023.

[164] European Commission, 'Amended proposal for a Council Regulation amending Regulation (EU, Euratom) 2021/768 of 30 April 2021 as regards implementing measures for new own resources of the European Union' COM (2022) 102 final <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52022PC0102> accessed 27 December 2023.

PART III

DEVELOPMENTS SINCE THE 2007/2008 FINANCIAL CRISIS AND THEIR CONSEQUENCES FROM A COMPARATIVE INSTITUTIONAL PERSPECTIVE

CHAPTER 1

EUROPEAN UNION POLITICAL INSTITUTIONS

1. Changing nature of executive action

1.1. Supranational action by the European Central Bank

1.1.1. Impact of the financial crisis in monetary policy

The first years of the ECB's existence were characterised by market stability, therefore, allowing its mandate to be conducted discreetly. However, this situation changed with the worst financial crisis since the Great Depression.[165] Unlike other central banks, this circumstantial shift did not induce the ECB to rapidly change course. In fact, it took a few years for the central bank to adjust.[166] [167]

The transformation of the ECB took place gradually[168] by adopting non-conventional measures during the eurozone crisis. In 2010, the ECB announced the adoption of the SMP,[169] when they implemented measures to address the 'severe tensions in certain market segments which are hampering the monetary policy transmission mechanism and thereby the effective conduct of monetary policy oriented towards price

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[165] See, for instance, Paul Krugman, 'The Lesser Depression' *The New York Times* (New York, 21 July 2011) <https://www.nytimes.com/2011/07/22/opinion/22krugman.html> accessed 20 January 2023; Josh Bivens, 'Worst Economic Crisis since the Great Depression? By a Long Shot' (Economic Policy Institute 27 January 2010) <https://www.epi.org/publication/snapshot_20100127/> accessed 11 April 2024.

[166] After Lehman Brothers filed for bankruptcy in September 2008, the US Federal Reserve quickly decreased the interest rate for 1.50% (on October 8th), 1% (on October 29th) and 0-0.25% (on December 16th). In contrast, the ECB had interest rates set at 4.75% (on October 8th), 4.25% (on October 9th and 15th) and ended 2008 at 3%. On this matter, see https://www.federalreserve.gov/monetarypolicy/openmarket.htm and https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.html, both accessed 20 June 2020.

[167] For a thorough analysis of the institutional evolution spurred by the financial crisis, see Silva (n 16) 384; Thomas Beukers, 'The New ECB and Its Relationship with the Eurozone Member States: Between Central Bank Independence and Central Bank Intervention' (2013) 50 Common Market Law Review 1579; Klaus Tuori, *The European Central Bank and the European Macroeconomic Constitution: From Ensuring Stability to Fighting Crises* (Cambridge University Press 2022).

[168] For an overview of ECB intervention, see Beukers (n 167).

[169] See Decision of the European Central Bank of 14 May 2010 establishing a securities market programme (ECB/2010/5) [2010] OJ L124/8.

stability in the medium term'.[170] The objective of the programme was 'to address the malfunctioning of securities markets and restore an appropriate monetary policy transmission mechanism'[171] and the scope of the interventions was determined by the Governing Council. Importantly, the ECB stated that this adoption was taken on the condition of fiscal frugality.[172] This programme was essentially active in the first half of 2010 and second half of 2011. Despite positive short-term effects, it did not prove effective in the long-term, possibly due to its limited scope.[173]

As a result, in 2012, the SMP was replaced by OMT. The ECB considered that the programme was within its mandate to 'define and implement the monetary policy of the Union', in line with article 127 (2) TFEU and article 3 of the ESCB and ECB Statute. The objective was to restore an appropriate monetary policy transmission and to safeguard the singleness of monetary policy by lowering bond yields. By reassuring investors in the sovereign-bond markets, borrowing costs for Member States were expected to reduce.

There are several features characterising OMT. First, the conditionality principle. This principle meant that the ECB could only purchase government-issued bonds with a one-to-three-year duration after requesting financial assistance from the EFSF and ESM.[174] Conditions must not only be agreed but also effectively implemented to enable eligibility. Second, in contrast with the previous programme, there were no *ex ante* quantitative limits on the size of transactions. Third, there was no preferential treatment principle, which required the ECB to accept the same (*pari passu*) treatment as private or alternative creditors regarding bonds issued by euro area countries and purchased by the Eurosystem. Fourth, in order to prevent potential inflationary pressures, the liquidity would be sterilised (by conducting operations to absorb the corresponding amount to counter any effects on money supply). Finally, there had to be transparency and this required the publication of aggregate outright monetary transaction holdings and their market values on a weekly basis.[175]

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[170] ibid. recital 2.
[171] ibid. recital 3.
[172] ibid. recital 4.
[173] Ioannidis, 'The European Central Bank' (n 90) 1255. *See also* Matteo Falagiarda and Stefan Reitz, 'Announcements of ECB unconventional programs: Implications for the sovereign spreads of stressed euro area countries' (2015) 53 *Journal of International Money and Finance* 280.
[174] For an overview, see Mauro Megliani, 'From the European Stability Mechanism to the European Monetary Fund: There and Back Again' (2020) 21 German Law Journal 674.
[175] European Central Bank, 'Technical Features of Outright Monetary Transactions' (Press Release, 6 September 2012) <https://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html> accessed 18 May 2020. In the literature, Falagiarda and Reitz (n 173) 1453.

The PSPP was adopted by the ECB in 2015. It involved large-scale purchases of bonds issued by public entities in the eurozone, mostly central governments, with the objective of increasing inflation. The ECB considered that this decision was within its mandate, affirming that it was taken 'as part of the single monetary policy in view of a number of factors that have materially increased the downside risk to the medium-term outlook on price developments, thus jeopardising the achievement of the ECB's primary objective of maintaining price stability'.[176]

On the topic of the proportionality of these decisions, although no bonds have been purchased under this program, the ECB considered that the monetary policy required them to not only to address the shortcomings in EMU's structure, namely the mismatch with decentralised fiscal policy,[177] but also criticism from the *BVerfG.* OMT was largely seen as a tipping point in the management of the EU sovereign debt crisis, particularly as a result of the way in which President Draghi managed market expectations. In a way, the *whatever it takes* moment showed that flexibility was paramount in opposition to a rigid, a priori-defined system.

In order to justify the PSPP's necessity, the ECB was careful to provide context and describe the increasing steps it had taken leading up to the decision regarding its adoption:

> In an environment where key ECB interest rates are at their lower bound, and purchase programmes focusing on private sector assets are judged to have provided measurable, but insufficient, scope to address the prevailing downside risks to price stability, it is necessary to add to the Eurosystem's monetary policy measures the PSPP as an instrument that features a high transmission potential to the real economy.[178]

The ECB considered the measure adequate, given its effect of re-balancing the portfolio and the sizable volume of the PSPP:

[176] Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme, OJ L 121/20, recital 3.
[177] See Dariusz Adamski, 'Economic Constitution of the Euro Area after the Gauweiler Preliminary Ruling' (2015) 52 Common Market Law Review 1451, 1455.
[178] Decision (EU) 2015/774 (n 176) recital 4.

> (…) will further ease monetary and financial conditions, including those relevant to the borrowing conditions of euro area non-financial corporations and households, thereby supporting aggregate consumption and investment spending in the euro area and ultimately contributing to a return of inflation rates to levels below but close to 2% over the medium term.[179]

This programme is, therefore, an extension of OMT in terms of its conception and foundation. The substantive difference between the two is, of course, the magnitude of intervention that the former entailed.[180]

In March 2020, the ECB announced the PEPP.[181] According to the Governing Council, this programme would be a 'new temporary asset purchase programme of private and public sector securities to counter the serious risks to the monetary policy transmission mechanism and the outlook for the euro area posed by the outbreak and escalating diffusion of the coronavirus, COVID-19'.[182] It would permit the purchase of private and public sector securities up to €750 billion, including a waiver of the eligibility requirements for securities issued by the Greek Government. The programme was subsequently reinforced, first, with an additional €600 billion in June 2020 and, second, with an additional €500 billion in December 2020, totalling €1,850 trillion. One year later, in December 2021, the Governing Council decided to discontinue net asset purchases under the PEPP at the end of March 2022. The maturing principal payments from securities purchased under the PEPP would, however, be reinvested until at least the end of 2024.[183] The money acquired would, later, be anticipated to its first half[184] in an effort to further counter inflation.

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[179] ibid.
[180] For instance, at the end of May 2020, PSPP holdings accounted for over two trillion euros, representing around 16% of Eurozone's GDP in 2019 according to Eurostat, available at https://data.europa.eu/data/datasets/bnmktsrdchmfxxw1vdwvww?locale=en, accessed 5 June 2020.
[181] Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a Temporary Pandemic Emergency Purchase Programme [2020] OJ L 91/1.
[182] European Central Bank, 'ECB Announces €750 Billion Pandemic Emergency Purchase Programme (PEPP)' (*Press Release*, 18 March 2020) < https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html> accessed 17 May 2022.
[183] See, generally, on the implementation of PEPP at https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html.
[184] European Central Bank, 'Monetary Policy Decisions 14 December 2023' <https://www.ecb.europa.eu/press/pr/date/2023/html/ecb.mp231214~9846e62f62.en.html> accessed 5 March 2024.

Similar to other programmes, the aim of the PEPP was to protect the monetary policy transmission mechanism as well as counter any serious risks to the euro area. The ECB also used its capital key to guide its allocative strategy. In contrast with other programmes, PEPP was not designed to focus on the financial distress of a few Member States. Rather, it targeted a much wider, horizontal situation.

Finally, the ECB's Governing Council set up the TPI.[185] The Governing Council assessed the necessity of this new monetary policy tool and concluded that it was required to support the effective transmission of monetary policy across all eurozone countries. Activation of the programme was conditional: it could only be triggered by the existence of unwarranted, disorderly market dynamics that posed a serious threat to the transmission of monetary policy across the euro area.[186]

This refers to the purchases made under TPI target public sector securities with remaining maturity between one and ten years, as well as private sector securities, if appropriate. Moreover, they are not restricted a priori and their scale is intended to match the severity of the risks faced by monetary policy transmission. However, this seems to be contradicted by the fact that implications of TPI 'on aggregate Eurosystem monetary policy debt security portfolio and the amount of excess liquidity' will be considered and addressed by the Governing Council. Therefore, 'purchases under the TPI would be conducted such that they cause no persistent impact on the overall Eurosystem balance sheet and hence on the monetary policy stance'.[187]

Concerning eligibility, the ECB considers a cumulative list of four criteria. First, Member States must comply with the EU fiscal framework, which means not being subject to EDP. If an EDP is in place, the Member State(s) must have complied with EU Council recommendations under Article 126 (7) TFEU. Second, Member State(s) must not be subject to EIP. Again, if an EIP is in place, Member States must have complied with EU Council recommendations under Article 121 (4) TFEU. Third, the ECB will consider fiscal sustainability, which entails ascertaining that the trajectory of public debt is sustainable. Finally, the ECB will consider whether there are sound and sustainable macroeconomic policies, which are defined as 'complying with the commitments

[185] European Central Bank, 'The Transmission Protection Instrument' (Press Release, 21 July 2022) <https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220721~973e6e7273.en.html> accessed 21 July 2022.
[186] ibid.
[187] ibid.

submitted in the recovery and resilience plans for the RRF and with the European Commission's country-specific recommendations in the fiscal sphere under the European Semester'.[188]

Intervention occurs on the basis of 'a comprehensive assessment of market and transmission indicators' as well as an 'evaluation of the eligibility criteria and a judgement that the activation of purchases under the TPI is proportionate to the achievement of the ECB's primary objective', therefore, conducting a proportionality exercise. Intervention can be terminated either 'upon a durable improvement in transmission, or based on an assessment that persistent tensions are due to country fundamentals'.[189]

1.1.2. Compatibility with the principle of prohibition of monetary financing

One of the main shortcomings of the Union is the lack of an EU budget that funds the pursuit of stabilisation objectives to internalise the effects of transnational activity. Proposals for these funds vary, although a minimum was suggested to be between 5%-7% EU GDP.[190] A targeted alternative has been suggested by Whyman. His proposal aimed to stabilise the growing divergence in unemployment rates and economic growth. The author estimated a cost of between 0.2%-1.9% of GDP, depending on the degree of stabilisation the Union intended to achieve.[191]

In the absence of such an instrument, the fiscal framework previously described increases the pressure on monetary policy to react to economic shocks, even before they have fully materialised, in order to produce fiscal effects (even if indirectly).[192] This phenomenon seems to have occurred in the eurozone as looser monetary decisions were taken in the 2010-2022 period, regardless of the economic recovery and inflation rates.

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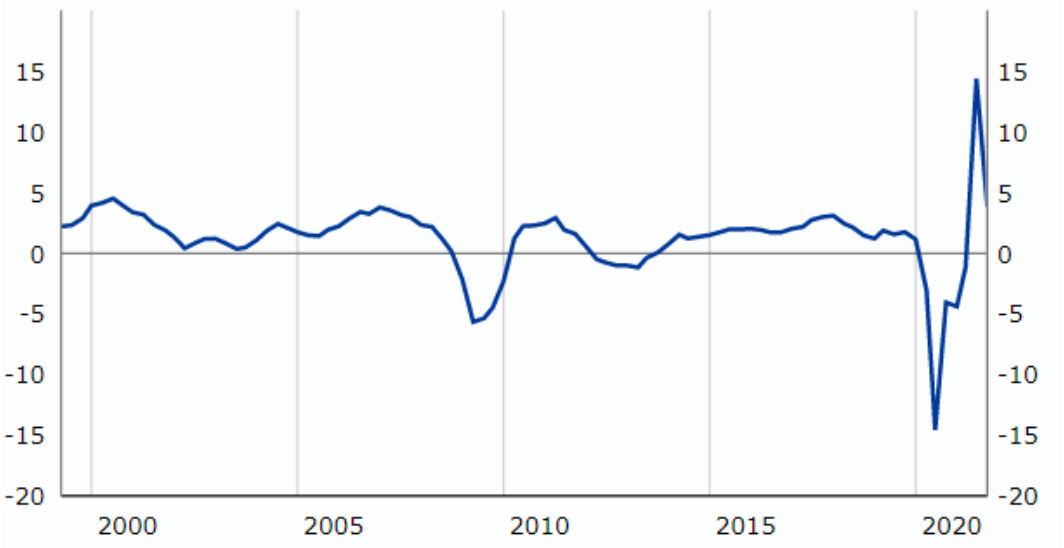
[188] ibid.
[189] ibid.
[190] Commission of the European Communities, 'Report of the Study Group on the Role of Public Finance in European Integration. Volume I. General Report' (n 1).
[191] Philip Whyman, 'Stabilising Economic and Monetary Union in Europe: The Potential for a Semi-Automatic Stabilisation Mechanism' (2010) 18 Progress in Economic Research 1.
[192] Baimbridge and Whyman (n 116) 121; Corrado Macchiarelli and others, *The European Central Bank between the Financial Crisis and Populisms* (Palgrave Macmillan 2020) 82; Barry Eichengreen and others, 'The Stability Pact: More than a Minor Nuisance?' (1998) 13 Economic Policy 65, 71.

Figure 3: Euro area real GDP growth: Annual percent change



Source: European Central Bank[193]

From Figure 3, it is reasonable to conclude that the eurozone has had relatively stable economic growth with two exceptions: the financial and the pandemic crisis. Regarding the former, the euro area experienced economic contraction between Q4 (Quarter 4) of 2008 until Q4 2009, with -5.65% in Q1 2009. Regarding the latter, there was a steeper economic recession between Q1 2020 and Q1 2021, with a reduction of -14.54% in Q2 2020, recovering significantly at the beginning of 2021.

[193] Available at https://sdw.ecb.europa.eu/.

Figure 4: Evolution of the euro area inflation rate

Source: European Central Bank[194]

The TFEU does not define the concept of price stability. In literature, it is disputed whether it should be interpreted strictly (absolute stability, meaning the absence of inflation) or loosely (relative stability, which allows some inflation).[195] In 1988,[196] the ECB defined price stability as a year-on-year increase of below 2% in the Harmonised Index of Consumer Prices for the euro area over the medium term. The ECB did this to offset short-term price disturbances. In 2003, the monetary policy strategy was revised to redefine price stability as a rate below but close to 2%. This development underlined the ECB's commitment to provide a sufficient safety margin to guard against the risks of deflation. It also addressed the issue of the possible presence of a measurement bias in the Harmonised Index of Consumer Prices and the implications of inflation differentials within the euro area.[197] The monetary policy strategy was updated in 2021, when the

[194] Available at https://www.ecb.europa.eu/stats/macroeconomic_and_sectoral/hicp/html/index.en.html.
[195] Helmut Siekmann, 'Article 119 [Economic and Monetary Policy]' in Helmut Siekmann (ed), *The European Monetary Union* (Hart Publishing 2022) 75, 91. To be sure, an absolute conception of price stability would entail an inflation rate of 0% at all times.
[196] See European Central Bank, 'The ESCB's Stability-Oriented Monetary Policy Strategy'' (*1998*) <https://www.ecb.europa.eu/press/key/date/1998/html/sp981110.en.html> accessed 2 May 2022, which shows that controlling inflation is a top ECB priority. In its speech, President of the European Central Bank, Willem Duisenberg, stated that 'the Governing Council of the ECB is very concerned about the unacceptably high rate of unemployment in the euro area. However, an inflationary monetary policy would not solve Europe's serious unemployment problem'.
[197] See European Central Bank, 'The ECB's Monetary Policy Strategy' (2003), <https://www.ecb.europa.eu/press/pr/date/2003/html/pr030508_2.en.html> accessed 2 May 2022.

ECB's Governing Council decided that price stability was best maintained by aiming for a 2% inflation target over the medium term.[198]

Regarding inflation variation, Figure 4 shows a relatively stable trend until November 2007. From that point on, it has been unstable, ranging from 4.1% in July 2008 to -0.6% in July 2009; then 3% in October 2011 and -0.6% in January 2015; negative from August (-0.2%) until December 2020 (-0.3%); and then 5.9% in February 2022 (before the war in Ukraine), reaching a maximum of 10.6% in October 2022.

When comparing these figures, we can see a pattern emerge between economic growth and inflation. Indeed, there is significant symmetry between the evolution of indicators in the eurozone, which signals that economic cycles were connected to the inflation rate.

However, interest rates only followed the economic cycle and inflation rate until the end of 2008.[199] From then on, the ECB expanded its balance sheet, similar to the FED and the BoJ. The dimension of their market intervention has been of such scale that they have been labelled 'market whales', with combined market assets of $24 trillion.[200] Central banks of non-eurozone Member States followed the same expansionary pattern.[201]

Crucially, Scott, Jackson and Wu report that a lot of that money was invested in the form of bond-buying, facilitating funding for governmental stimulus programs. Due to the real estate market meltdown in 2008, the FED purchased a higher proportion of mortgage-backed securities than its counterparts. Conversely, the ECB and BoJ provided

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[198] European Central Bank, 'The ECB's Monetary Policy Strategy Statement' (2021) <https://www.ecb.europa.eu/home/search/review/html/ecb.strategyreview_monpol_strategy_statement.en.html> accessed 7 May 2022.

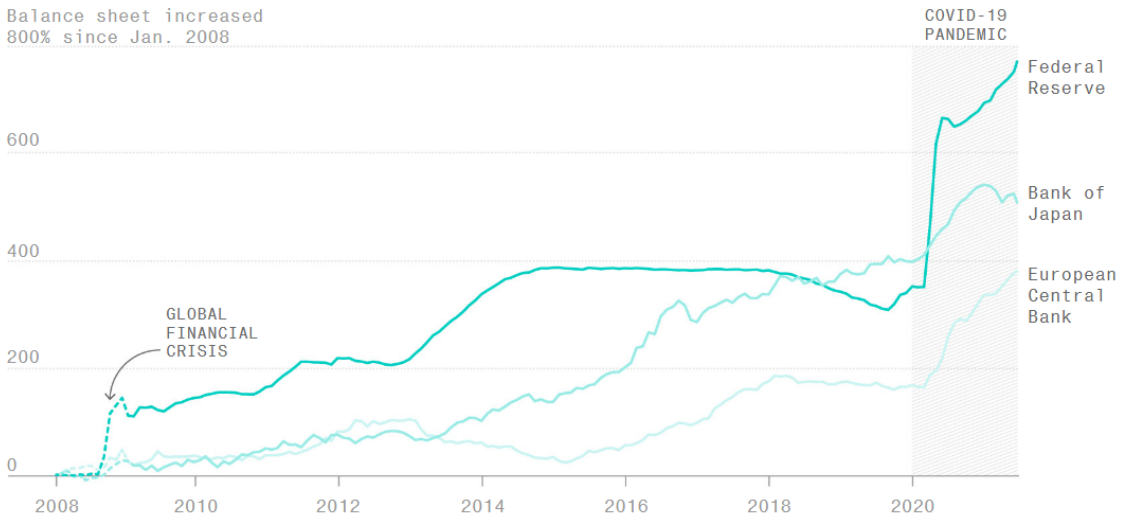
[199] Available at https://sdw.ecb.europa.eu/browse.do?node=9691107.

[200] Malcolm Scott, Paul Jackson and Jin Wu, 'A $9 Trillion Binge Turns Central Banks Into the Market's Biggest Whales' *Bloomberg* (7 July 2021) <https://www.bloomberg.com/graphics/2021-central-banks-binge/> accessed 17 January 2022.

[201] For instance, the Central Bank of Poland more than trebled its balance sheet from 2010-2021: see https://www.nbp.pl/homen.aspx?f=/en/statystyka/bilans_nbp_mon/bilans_nbp.html. The Swedish Central Bank informs that '[t]he monetary policy assets mostly consist of securities in Swedish kronor. This item has grown substantially since 2015 due to the purchases of government bonds initiated by the Riksbank at that time for monetary policy purposes. In conjunction with the coronavirus pandemic, this item has increased further as, in addition to Swedish Government bonds, the Riksbank has also purchased Swedish covered bonds, municipal bonds and commercial paper': see https://www.riksbank.se/en-gb/statistics/riksbanks-balance-sheet/. Or the Central Bank of Bulgaria, which also almost trebled its balance sheet in the 2010-2021 period. See https://www.bnb.bg/Statistics/StBNBBalances/StBalancesIssueDepartment/StBIDMonthly/index.htm.

loans to businesses and workers in order to prevent unemployment from rising and bad debts from damaging banks' balance sheets.[202]

Figure 5: Evolution of selected central banks' balance sheets



Source: Scott, Jackson and Wu (n 295)

Figure 5 shows that the ECB's behaviour in financial markets resembles that of the FED and the BoJ. However, the legal framework under which the ECB operates is dissimilar because it expressly establishes the prohibition of monetary financing of Member States and price stability as its main objective.[203] In contrast, article 2A of the Federal Reserve Act stipulates that the central bank 'shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates'.[204]

Similarly to the ECB, the BoJ Act foresees that '[t]he purpose of the Bank of Japan (…) is to issue banknotes and to carry out currency and monetary control' (article 1 (1)), which is defined as 'aiming at achieving price stability, thereby contributing to the sound

[202] Scott, Jackson and Wu (n 200).
[203] This comparison does not completely match both from administrative and financial perspectives. This is because the US Federal Reserve and the BoJ focus on the Federal Government (which does not exist in the EU).
[204] For a comparison between the ECB and the US Federal Reserve see Rosa Maria Lastra, 'The Role of Central Banks in Monetary Affairs: A Comparative Perspective' in Thomas Cottier and others (eds), *The Rule of Law in Monetary Affairs* (Cambridge University Press 2014) 78.,

development of the national economy' (article 2). Importantly, however, the BoJ is legally obliged to consider overall economic policy. Given the close interaction between both policies, article 4 establishes that 'the Bank of Japan must always maintain close contact with the government and exchange views sufficiently, so that its currency and monetary control and the basic stance of the government's economic policy are mutually compatible'.

It could be argued that, in practice, these definitions are not overly important: on the one hand, the FED's growth-enhancement mandate is often largely rhetoric and, at times, acts determinedly against inflation. Conversely, ECB officials often convey that they pursue their secondary objectives whenever possible.[205]

Be that as it may, substantial wording differences between the ECB and other central bank mandates exist, which deliberately express a different teleology of what central banks' priorities should be. Respect for common principles of law can be considered existential for EMU, especially considering the history of other monetary unions whereby they are created and dissolved according to the existing degree of political unity around a common set of values, principles of which legal norms are an expression of.[206]

Furthering this view, the President of the *Bundesbank* during EMU preparations, Karl Pöhl, stated that '[o]ur partners in the EMS, and particularly those participating in the Exchange Rate Mechanism, have recognised all along that anchoring to the D-Mark does not amount to a soft option'. As a result, he warns that 'all temptations to incorporate into the project of European Economic and Monetary Union elements that would amount to a soft option'.[207] As for what a soft option means, references are made not only to fiscal

[205] Nicolas Jabko, 'The Politics of Central Banking in the United States and in the European Union' in Anand Menon and Martin Schain (eds), *Comparative Federalism: The European Union and the United States in Comparative Perspective* (Oxford University Press 2007) 275, 286. There are, however, increasing calls for the ECB to pursue its secondary mandate more prominently. See, in general, Jens van 't Klooster and Nik de Boer, 'What to Do with the ECB's Secondary Mandate' (2023) 61 Journal of Common Market Studies 730; Chiara Zilioli and Michael Ioannidis, 'Climate Change and the Mandate of the ECB: Potential and Limits of Monetary Contribution to European Green Policies' (2022) 59 Common Market Law Review 363.

[206] Michael Bordo and Lars Jonung, 'The Future of EMU: What Does the History of Monetary Unions Tell Us?' (1999) <https://www.nber.org/system/files/working_papers/w7365/w7365.pdf> accessed 30 September 2022, 24.

[207] Karl Otto Pöhl, 'Two Monetary Unions - The Bundesbank's View' in James Buchanan and others (eds), *Europe's Constitutional Future* (Goron Pro-Print 1990) 21, 26 and 32. For a discussion on the monetary stability in Germany while monetary union was being formed see Christian Waldhoff, 'Article 127 (Ex Article 105 TEC) [Objectives, Tasks and Competences of the ESCB]' in Helmut Siekmann (ed), *The European Monetary Union* (Hart Publishing 2022) 253.

discipline but also, most prominently, to price stability as a primary objective. This gathered a 'wide measure of agreement among the Governors that the ESCB',[208] since inflation is 'democracy's enemy No. 1'.[209] Pascal Salin is equally emphatic when affirming that '[l]'intégration monétaire européenne ne va pas engendrer une sorte de politique moyenne qui se satisferait d'un objectif d'inflation moyenne. L'inflation la plus basse possible sera l'objectif'.[210]

There are arguments in favour of and against the various ECB programmes regarding their compatibility with the principle of prohibition of monetary financing. At the heart of this discussion is not only the intention to avoid moral hazard but also to secure price stability.[211] After all, the Delors Report had already signalled that EMS participants had succeeded in creating a zone of increasing monetary stability while simultaneously relaxing capital controls. Furthermore, the exchange rate constraint imposed by the EMS helped countries with relatively high rates of inflation to adjust their internal policies towards lower inflation rates and stabler prices, thereby improving their economic performance.[212]

Accordingly, an important issue to be considered is whether the ECB acted in a conservative manner to ensure compliance with the principle of price stability, notably by comparing its conduct to the Federal Reserve's. In fact, by looking at the way both central banks have tackled past economic and financial crises, Paul de Grauwe finds that the Federal Reserve has used the interest rate more actively. Crucially, in 2001 it reacted decisively by cutting the rate from a 6.5% peak at the end of 2000 to less than 2% one year later. From 2004 onwards, it gradually tightened monetary policy, setting the interest

[208] Pöhl (n 207) 27.
[209] ibid. 29. On the substantive differences between the *Bundesbank* and the ECB, namely regarding accountability of both the legislative and the executive branches, see Marijn Van Der Sluis, 'Maastricht Revisited: Economic Constitutionalism, the ECB and the Bundesbank' in Maurice Adams, Federico Fabbrini and Pierre Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Bloomsbury Publishing 2014) 105.
[210] Pascal Salin, 'Quelles Monnaies Pour Le Marché Unique Européen?' (1991) 101 Revue d'Économie Politique 99, 103.
[211] Massimo Rostagno and others, *Monetary Policy in Times of Crisis: A Tale of Two Decades of the European Central Bank* (Oxford University Press 2021) 188.
[212] The Delors Report is somehow the epilogue of a long intellectual and political Franco-German debate on a prominent principle of EMU, where the German-backed view on monetary policy prevailed. See Jacques Delors, 'Report on Economic and Monetary Union in the European Community' (1989) <https://aei.pitt.edu/1007/1/monetary_delors.pdf> accessed 8 March 2023; Ivo Maes, 'On the Origins of the Franco-German EMU Controversies' (2004) 17 European Journal of Law and Economics 21; Paul de Grauwe, *Economics of Monetary Union* (12th edn, Oxford University Press 2018) 165.

rate above 5%, before it was severely reduced again in August 2007 to address the financial crisis (set at near 0% at the end of 2008).[213]

In contrast, the ECB acted more cautiously. During both economic events, it lowered the interest rate less aggressively, for instance, the ECB near-zero policy came into effect almost five years later than the Federal Reserve's. Moreover, from a holistic point of view, between 1999-2020, the average yearly inflation rate was 2.1% in the US and 1.8% in the eurozone.[214] Therefore, greater inflation risks do not appear to support the ECB's more cautious approach. Rather, justification of this approach should be attributed to the importance of price stability.

However, a shift appears to have occurred with the outbreak of the financial crisis. In fact, when providing justification for OMT, Draghi stated that the Euro was irreversible and that the ECB could intervene in bond markets to price out investors' fears of a eurozone break up.[215] This meant that it would be within its mandate to ensure that eurozone Member States did not leave the currency union. Problematically, in the absence of an unchanged EU budget, the only way to do that was for the central bank to act like a lender-of-last-resort,[216] thereby easing Member States' public debt costs and avoiding a scenario where one or more would have to leave the currency union.

Naturaliter, account should be taken of the evolving nature of institutions within different societal contexts, namely economic, cultural, legal and political. The ECB has been no stranger to these, particularly during the unprecedented situation the ECB found itself in after the financial crisis. Moreover, the Treaty provision regarding the mandate is less determinable when compared to a more prescriptive Treaty and, as such, 'a legal

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[213] Grauwe (n 212) 169-170.

[214] See World Bank data at https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG.

[215] Mario Draghi, 'Speech at the Global Investment Conference' (London, 26 July 2012) < https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html> accessed 27 December 2023.

[216] I have used this in the improper sense of the concept. As explained by former Bank of England Governor, Sir Mervyn King, the definition of 'lender of last resort' is frequently misunderstood. His view is that it is intended to mean lending to individual banking institutions and to institutions that are clearly regarded as solvent, against good collateral and at a penalty rate. This contrasts with the ECB buying sovereign debt of Member States, which is used and seen as a mechanism for financing current-account deficits. In fact, it could become a mechanism of transfer from the surplus to the deficit countries in case Member States experience fiscal crisis. This transfer of resources is a task for a government to decide, not a central bank. The problem is that there is no government particularly keen to admit so doing. See Nils Pratley, 'Hard Truths about the Euro from Mervyn King' *The Guardian* (16 November 2011) <https://www.theguardian.com/business/nils-pratley-on-finance/2011/nov/16/mervyn-king-ecb-intervene> accessed 10 March 2022. With a different view, supporting that central banks cannot fail, as suggested by King, see Grauwe (n 215) 165. Weighing on both lending of last resort to the private and public sectors see Daniel Wilsher, 'Ready to Do Whatever It Takes? The Legal Mandate of the European Central Bank and the Economic Crisis' (2013) 15 Cambridge Yearbook of European Legal Studies 503.

review that respects the discretionary powers of the ECB by necessity requires accepting that different positions on the economic merits of the OMT Programme are legally permissible'.[217]

Nevertheless, the argument in favour of grey-area legality regarding the ECB's action, since OMT[218] is legitimate. Since the nature and teleology of the Treaties did not change, legal interpretation needs to adhere to its letter and spirit. Indeed, why did Member States agree to amend article 136 TFEU and not agree to amend article 127 TFEU, in order to align it with other central banks' legal framework and the potential needs of the eurozone? Crucially, Member States decided to create an intergovernmental body to ring-fence Member States experiencing difficulties accessing bond markets but did not even discuss the possibility of explicitly widening the ECB's mandate. One reason might have been that they considered the provision to be broad enough to encompass the asset-purchase programmes in order to secure an adequate transmission of monetary policy: this is the ECB's reasoning. However, another reason might be that the Maastricht Treaty's conservative view is still predominant and, therefore, it would be impossible to achieve a compromise.[219]

Both views have a degree of plausibility. It is certainly true that, in challenging economic conditions and with the interest rate instrument having limited effectiveness, other measures would be necessary in order to increase inflation, notably expanding the monetary base. However, given the historical element of Treaty provisions, its teleology

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[217] Matthias Goldmann, 'Discretion, Not Rules: Postunitary Constitutional Pluralism in the Economic and Monetary Union' in Gareth Davies and Matej Avbelj (eds), *Research Handbook on Legal Pluralism and EU Law* (Edward Elgar 2018) 335, 346; Francesco Martucci, 'La Court de Justice Face à La Politique Monétaire En Temps de Crise de Dettes Souveraines: L'arret Gauweiler Entre Droit et Marché' (2015) 2–3 Cahiers de Droit Européen 493. Annelieke Mooij, 'The Legality of the ECB Responses to COVID-19' (2020) 45 European Law Review 713, considers that the agility the ECB has shown in managing the eurocrisis and the pandemic is proof that it is changing into a central bank with a broader mandate. However, the author also states that the high level of independence and the level of judicial review are not changing, demonstrating the need to rethink the institutional structure of EMU.

[218] Paul Yowell, 'Why the ECB Cannot Save the Euro' in Wolf-Georg Ringe and Peter Huber (eds), *Legal Challenges in the Global Financial Crisis: Bail-outs, the Euro and Regulation* (Hart Publishing 2014) 81, 102.

[219] Vestert Borger, 'The ESM and the European Court's Predicament in Pringle' (2013) 14 German Law Journal 113. See also Pratley (n 216), in which Sir Mervyn King considers that while it is 'important to recognise that there are circumstances where governments will try and put pressure on central banks to do things that they would like central banks to do in order to avoid their having to own up to the actions that they actually would like someone else to carry out (…) [t]he only circumstance in which looking at the data for the euro area as a whole has merit is in realising that actually the euro area does have the resources, if you were to regard it as a single country, to make appropriate transfers within itself. It doesn't actually need transfers from the rest of the world. But the whole issue is, do they wish to make transfers within the euro area or not? That is not something that a central bank can decide for itself. It is something that only the governments of the euro area can come to a conclusion on'.

as well as the current practice of the *BVerfG*, it is reasonable to argue that the issue is legally controversial. Clearly, the intention of article 123 (1) TFEU is to prevent Member States from using the central bank, in order to preserve the incentive for national fiscal responsibility and sustainability. Allowing Member States indirect financing by ensuring a certain level of liquidity in the secondary bond market has nearly the same effect. In practical terms, financial institutions appear in bond auctions, purchasing public debt bonds, which they subsequently sell to the ECB. The point to make is that market liquidity is being guaranteed by the ECB, irrespective of it taking the front or back seat. In brief: the Treaty intended that market liquidity for bonds would be the result of prudent and sound national fiscal policies, rather than the consequence of demand artificially created or fostered by a supranational institution.

As a result, when referring to the singleness of monetary policy, article 119 (2) TFEU should not be interpreted considering the (largely) homogeneous effects produced by each Member State. Rather, it should be understood to mean the existence of a homogeneous policy for the Union as a whole. This is suggested by the experience of US States. Interestingly, a comparison between them and EU Member States reveals a similar situation, as their bond yields[220] and inflation rates[221] also vary. However, despite both being lower-level units within a larger governance space, this financial differentiation does not prompt sub-national bond-buying by the US Federal Reserve as no fear exists of dollar disintegration.

Also, the ECB's competences do not include the determination of the political fate of the Eurozone – whether it should be intact, fragmented or dissolved. This is a responsibility of Member States: for instance, if negative consequences should arise from compliance with the ECB current mandate to primarily maintain price stability, then a revision could be envisioned. In the same vein, the ECB is not competent to prevent sovereign defaults, as confirmed by Draghi, which stated that pricing out a sovereign-default premium would be a breach of the ECB mandate.[222] If this is the case, how is pricing out a premium for eurozone reversibility different?[223] In fact, if to prevent

[220] See https://emma.msrb.org/Home/Index.
[221] See https://eig.org/the-geography-of-u-s-inflation-prices-are-rising-faster-in-lower-cost-states/.
[222] Draghi, 'Speech at the Global Investment Conference' (London, 26 July 2012) (n 215).
[223] Yowell (n 218) 103. The author also disagrees with the distinction introduced by Draghi between default and convertibility risk. In fact, the latter means risk that a State would adopt a new (weaker) currency and redenominate its liabilities in that currency or use capital controls to prevent money outflows. According to Draghi, this risk is covered by the ECB's mandate. However, fears regarding convertibility are

reversibility one needs to avoid currency exit and, to this end, impede a sovereign default, then we would be placed in breach of mandate territory as defined by Draghi.

Moreover, fiscal responsibility is also present in almost every aspect of EU economic integration and has justified increased supranational intrusion in the matter of national competence. Thus, it would, indeed, be a paradox to, on the one hand, be stringent with the EU fiscal framework in order to bolster fiscal sustainability and, on the other hand, implement relatively lenient monetary policy to ease Member States' fiscal paths, which could hinder the intended objective.

Therefore, it seems reasonable to consider that the Maastricht Treaty and its subsequent revisions, did not intend to attribute such depth of power or flexibility of mandate to the ECB. The foregoing would also be tantamount to integration through the back door, as designated by Garben, the consequences of which I have already discussed: hindering institutional credibility and, consequently, decreasing the level of trust between the EU people and their respective Member States vis-a-vis EU institutions. This is also why the ECB should not exceed its mandate, even though it is the only institution with the financial capacity to implement a limit on sovereign bond prices and control eurozone integrity. In this sense, the ECB can be seen as an 'opportunistic' institution, which responds to an unexpected event by re-interpreting its mandate, leading to a 'covert deepening of integration'.[224]

1.1.3. Compatibility with the principle of central bank independence

The problems identified regarding the principle of prohibition of monetary financing may hinder the principle of central bank independence.[225] This principle is at the core of central banking credibility and was essential during the negotiations leading

inextricably linked to sovereign default and, even if that were not the case, there is nothing special about this particular risk that would make it within the remit of the ECB.

[224] Adrienne Héritier, 'Covert Integration in the European Union' in Jeremy Richardson and Sonia Mazey (eds), *European Union: Power and policy-making* (4th edn, Routledge 2015) 351. With an economic appraisal of TPI conditionality, concluding that the programme may exceed the ECB mandate, see Ivo Arnold, 'The Activation Conditions of the Transmission Protection Instrument: Flawed by Design?' (2023) 58 Intereconomics 254. With a different view, arguing for the legality of ECB's intervention, see Mooij (n 217).

[225] Rosa Maria Lastra, 'The Independence of the European System of Central Banks' (1992) 33 Harvard International Law Journal 475; Rosa Maria Lastra, 'The Institutional Path of Central Bank Independence' in Peter Conti-Brown and Rosa Maria Lastra (eds), *Research Handbook on Central Banking* (Edward Elgar 2018) 296; Jörn Axel Kämmerer, 'Article 123 (Ex Article 101 TEC) [Prohibition of Credit Facilities]' in Helmut Siekmann (ed), *The European Monetary Union* (Hart Publishing 2022) 155, 158.

up to the creation of the ECB.[226] The concept of independence in Article 282 (3) TFEU is used to describe the position of the central bank in relation to other EU institutions and bodies, as well as Member States' governments. Amtenbrink considers that the term 'autonomy' better depicts the position of the central bank in the EU's legal order, as it fulfils its monetary policy mandate, isolated from external influences.[227] One of the effects brought about by independence (or autonomy) is that markets receive more assurances that decisions broadly reflect technical expertise, which fosters investors' foreseeability, confidence and, thus, stability and growth. Without the assurances, however, there is an element of unpredictability, which hinders foreseeability and affects capital allocation.[228]

As seen above (Part III, Chapter 1, Point 1.1.3), monetary policies implemented by both the FED and the BoJ have entailed significant market intervention. Interestingly, this level of involvement occurred despite the existence of supranational competence for economic policies in the US and Japan, which is illustrative of the need to develop a transnational economic policy in the EU. However, it also goes to demonstrate the immense pressure the ECB is under to occasionally disregard aggregate or average (according to the eurozone as a whole) figures, since they average-out discrepancies in public finance indicators that can only be internalised nationally.

As Martin Arnold and Tommy Stubbington argued in 2021:

> [t]he hardest challenge for the ECB still lies ahead. Having overseen the biggest injection of monetary stimulus in the history of Europe's single currency, including the €2.2tn purchase of mostly government bonds and a similar amount of heavily subsidised loans to banks, the central bank is now preparing to start scaling back its support for the economy.[229]

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[226] Jean-Victor Louis, 'L'indépendance de La Banque Centrale Européenne' (2020) 12 Revue Trimestrielle de Droit Européen 797.
[227] Fabian Amtenbrink, 'Economic and Monetary Union' in Pieter Jan Kuijper and others (eds), *The Law of the European Union* (5th edn, Wolters Kluwer 2019) 883, 935.
[228] However, the consensus over the added value of central bank independence is waning over time, especially during periods of low inflation expectations, as explained by Summers. See Lawrence Summers, 'Central Bank Independence' (2017) <http://larrysummers.com/2017/09/28/central-bank-independence.%0D> accessed 8 April 2022.
[229] Martin Arnold and Tommy Stubbington, 'The Return of Inflation: Crunch Time for the European Central Bank' *Financial Times* (14 December 2021) <https://www.ft.com/content/e01ce60c-f602-4110-bb64-7fd60689b099> accessed 17 January 2022.

These authors seem to imply that the ECB's task of gradually withdrawing its intervention from the market, although similar to other central banks, will be challenging for two reasons. The first is related to the way in which the central bank handled the financial crisis. In fact, the generous stimulus policies many central banks introduced to lower borrowing costs and shield economies from the effects of the pandemic have been reduced or withdrawn earlier than the ECB's policies. According to the authors, the reason for this is that the institution is still affected by the criticism it received following its decision to quickly raise interest rates during the financial crisis and the fact that it struggled with years of uncomfortably low inflation and growth. The second relates to the mismatch of monetary and economic policy competences. Unlike the FED or the Bank of England, the ECB has no 'economic counterpart' at the EU level. Hence, it decides policies knowing they will be internalised by twenty different States, each with their own economy and bond market. As such, a shift towards a more demanding monetary policy risks reviving previous financial tensions by increasing financing costs for less financially sound countries.[230]

It is clear that economic and financial risks existed when the ECB changed its course of action in 2010 and that political risks can be inferred to follow. In this vein, Claire Jones explains why the ECB seems so reluctant to act:

> We think the answer might be a fear that the political consequences of trying to bring down inflation aggressively might exceed the economic consequences of continued inaction. And behind this, we sense a fundamental change in the ECB itself…
>
> One of the key features of the pandemic has been a surge in EA government debt […] France's debt/GDP ratio is currently 118%; Spain's is 120%; and Portugal's is 135%. Much more worryingly, Italy's is 155% and Greece's debt/GDP ratio, after repeated restructurings and write-offs, is 206%!

[230] ibid. See also Andrew Moravcsik, 'Europe After the Crisis: How to Sustain a Common Currency' (2012) 91 Foreign Affairs 54.

> These are alarming figures, and even more concerning for the ECB will be the contrast with northern Europe, where most notably, Germany's debt to GDP has risen just 4 percentage points in the same period, from 65% to 69%.
>
> As a result the ECB is basically trying to provide one monetary policy for two very different economies, one very heavily indebted and one rather less so.[231]

As the monetary authority of the eurozone as a whole, the ECB should make its decisions based on eurozone average indicators and not on the indicators of specific Member States.[232] However, doing so entails taking risks of a financial and political nature. First, the ECB's expansionary activity comes with a caveat: by holding so much Member States' debt, the ECB may increasingly, if not definitely, turn into a stakeholder or even a political actor. By stakeholder, it is understood that the ECB may be affected by the outcome of its actions and, therefore, has a stake in the process. In other words, it holds interests that elude but influence monetary policy, for instance, to protect its balance sheet and capital reserves.

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[231] Claire Jones, 'Is the ECB Really That Much of an Outlier?' Financial Times (5 January 2022) <https://www.ft.com/content/c8247504-46e1-4ab9-ad34-1c4af1522ff9> accessed 18 January 2022. On the potential decrease of political independence of the ECB, see Kaarlo Tuori and Klaus Tuori, The Eurozone Crisis: A Constitutional Analysis (Cambridge University Press 2014) 221. By holding so much of Member States debt, the authors argue that the ECB may increasingly be turning into a stakeholder. This means that monetary policy choices may be constrained by their potential impact on Member States. Moreover, those interests may elude the protection of the financial integrity of the ECB (ie by significantly hindering its balance sheet and capital reserves).

[232] In the same vein see Adamski, (n 177) 1473. As an example of fragmented monetary policy design, see European Central Bank, 'Monetary Policy Decisions' (Press Release, 9 June 2022) <https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.mp220609~122666c272.en.html> accessed 9 June 2022, where reference is explicitly made to 'transmission of monetary policy to the Greek economy'. Stefania Baroncelli, 'The Independence of the ECB after the Economic Crisis' in Maurice Adams, Federico Fabbrini and Pierre Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Bloomsbury Publishing 2014) 125, 135, argues that the context in which OMT purchases were made implied an agreement between the Government and the ECB, in the sense that large debt issuance was only made on the assumption that the central bank would provide the necessary liquidity on the secondary market, effectively enhancing Member States' public debt refinancing operations. In the author's view, this relationship is of a different nature to the one that existed before the financial crisis. During this period, the ECB conducted its monetary policy independently of Member States public finance needs and focused on the target of inflation and setting interest rates. See also Jerome Powell's US Senate hearing, on 7 March 2023. The response to a question on whether the Federal Reserve had the level of US public debt into account in the interest rate decision making process was swiftly negative. Powell argued that such a scenario should be characterised as fiscal dominance, which could ultimately hinder the FED's ability to fulfill its mandate. United States Senate Committee on Banking, Housing, and Urban Affairs 'The Semiannual Monetary Policy Report to the Congress' (2023) <https://www.banking.senate.gov/hearings/02/28/2023/the-semiannual-monetary-policy-report-to-the-congress> accessed 27 December 2023, at 02h:07m:40s.

Regarding the political aspect, it is argued that the ECB has increasingly interfered in Member States' political decisions, such as sending letters to governments advising them on which line of policy they recommend and being involved in troika missions. It is reasonable to argue that political decisions imply value judgements in a range of areas, which are not consensual or scientifically univocal. For instance, public revenue and expenditure decisions lie at the core of national politics and are part of national identity.[233]

This attitude regarding Member States' governments may be related to the fact that the ECB is increasingly dependent on economic policy coordination to work in tandem with monetary policy. As Draghi stated, while monetary policy is built on the principle of 'monetary dominance, which requires monetary policy to be single-minded in its focus on price stability and never to be subordinate to fiscal policy', such a feature 'does not preclude communicating with governments when it is clear that mutually aligned policies would deliver a faster return to price stability'.[234] This statement has multiple meanings. First, it proposes that monetary policy decisions should be preferred over fiscal policy decisions. Second, while monetary policy limits national economic policies when alignment is desirable, such alignment is dependent on national decision-making processes and democratic processes, as they are under the national competence sphere. This acts as a hurdle to ECB independence, notably regarding enforcement issues. While it is easier to enforce a given economic policy in countries within a financial assistance programme, it is difficult to achieve something that resembles coordinated economic policy within 27 Member States, not least because, although the European Semester has quasi-coercive traits, its binding nature remains controversial.[235]

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[233] Tuori and Tuori (n 231) 226; Beukers (n 167); Kämmerer (n 225) 158. See also Vivien Schmidt, 'The Forgotten Problem of Democratic Legitimacy: "Governing by the Rules" and "Ruling by the Numbers"' in Matthias Matthijs and Mark Blyth (eds), *The Future of the Euro* (Oxford University Press 2015) 90. But see Sara Dietz, 'Central Banks and Inequality' (2023) 60 Common Market Law Review 1349, where the author argues that central banks can and must take equality considerations into account within its secondary mandate to support the economic policies in the Union.

[234] Mario Draghi, 'Remarks by Mario Draghi, President of the ECB, at the Farewell Event in His Honour' (2019) <https://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp191028~7e8b444d6f.en.html> accessed 8 April 2022.

[235] Arguing against the binding nature, see Sacha Garben, 'From Sneaking to Striding: Combatting Competence Creep and Consolidating the EU Legislative Process' (2020) 26 European Law Journal 429, 434 and Elisabeth Lentsch, 'EMU Integration against the Backdrop of EU Law and Jurisprudence' in Stefan Griller and Elisabeth Lentsch (eds), *EMU Integration and Member States' Constitutions* (Hart Publishing 2021) 33, 57. Some evidence of this may be found in the fact that only 6% of the CSRs issued between 2011 and 2019 have been fully implemented under the European Semester. See Maximilian Freier and others, 'Next Generation EU: A Euro Area Perspective' in European Central Bank, Economic Bulletin - Issue 1/2022 <https://www.ecb.europa.eu/pub/economic-bulletin/html/eb202201.en.html> accessed 9 April 2022, 93, 105. Arguing in favour of the binding nature see Miguel Poiares Maduro, António Frada and Leonardo Pierdominici, 'A Crisis Between Crises: Placing the Portuguese Constitutional Jurisprudence

Draghi further states that monetary dominance means 'that alignment between policies, where needed, must serve the objective of monetary stability and should not work to the detriment of it'.[236] In light of the monetary dominance principle, as understood by Draghi, this means that national economic policy decisions must conform with the ECB's monetary policy decisions and outlook, in order to not hinder it. From a legal standpoint, such an assertion is doubtful, even taking the principle of sincere cooperation between institutions into account. At best, monetary and economic policies could be coordinated on equal terms, given the current distribution of competences and wording of Treaties. There is no indication that monetary policy should overshadow national economic policies. Therefore, the principle of central bank independence certainly went through a significant challenge during the second decade of EMU and it risks further hindrance in the future.

One may conclude that the ECB, coupled with the ESM, form a dual institutional structure with fiscal impact. However, rather than taking a holistic and aggregate perspective, the problem is that the focus is placed on individual Member States and, therefore, on the stability of the eurozone as a whole.[237] By interpreting its mandate in a flexible way, the *current* ECB transformed into a lender of last resort[238] for Member States. While these are the only two entities with competences that have the power to create a fiscal stabilisation effect in a timely manner, this approach, coupled with the ECB's previously expressed concerns regarding protecting the integrity of the eurozone, has a significant impact on the central bank's degree of independence.[239]

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of Crisis In Context' (2017) 4 e-Pública 5; Christian Calliess, 'The Governance Framework of the Eurozone and the Need for a Treaty Reform' in Federico Fabbrini, Ernst Hirsch Ballin and Han Somsen (eds), *What Form of Government for the European Union and the Eurozone?* (Bloomsbury Publishing 2016) 37, 49, and Brady Gordon, *The Constitutional Boundaries of European Fiscal Federalism* (Cambridge University Press 2022) 283-287. The latter author argues that the binding nature of these specific recommendations infringes Member States fiscal sovereignty. In the author's words, 'these instruments are manifestly beyond the boundaries of the EU legal order and may perhaps exist only in so far as they are not actually enforced like the binding EU law instruments appear to be. This is not only constitutional illegitimate but (…) utterly ineffective and furthermore injurious to good principles of fiscal federalism'.

[236] Draghi, 'Remarks by Mario Draghi, President of the ECB, at the Farewell Event in His Honour' (n 234).

[237] On the stability-oriented policies pursued by the Union since the financial crisis, see Luca Lionello, *The Objective of Stability of the Euro Area as a Whole: The Reform of the European Economic Union and Perspectives of Fiscal Integration* (Springer 2020).

[238] With the shortcoming pointed by Grauwe (n 215) 182.

[239] Beukers (n 167) 1608. The politisation trend of the ECB (and the concomitant decrease in its independence) is also visible in the 'green activism', as forcefully argued by Sara Dietz, 'Green Monetary Policy Between Market Neutrality and Market Efficiency' (2022) 59 Common Market Law Review 395. See also Antonio Estella, *Legal Foundations of EU Economic Governance* (Cambridge University Press 2018) 130, arguing that it is possible that the ECB's legitimacy and credibility were seriously put into question. With a different view, defending the legality of ECB's action, see Zilioli and Ioannidis (n 205).

1.2. Intergovernmentalism

Executive dominance is not only visible in the ECB but also in the rise of the role and responsibilities of the European Council and, indirectly, the European Commission.[240]

1.2.1. European Council

Before the Maastricht Treaty, the EU inter-institutional dynamic was different. Alongside the CJEU, the European Commission focused on promoting and enforcing internal market and competition policies.[241] With economic and monetary policies still being considered competences of the Member States, the European Council mainly provided long-term political guidance and achieved compromises over institutional questions. Milward and Sorensen argue that what, at the time, may have seemed like a fundamental reversal of EU integration, instead signalled the wish to 'extend Community decision-making to new areas in response to changes in national policy objectives arising from the fundamental change in economic circumstances of the western European countries after 1974'.[242] On the other hand, alongside the EP, the Council was the EU institution responsible for discussing and approving legislation. It was also seen as being at the heart of the EU decision-making process.[243]

Crucially, the mismatch between monetary and economic policy competences, introduced by the Treaty of Maastricht, created space for what was labelled *new intergovernmentalism*.[244] In fact, since 1992, the European Council has come to the

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Arguing that central banks are responsive to political developments, see Nicolas Jabko and Nils Kupzok, 'Indirect responsiveness and green central banking' (2024) 31 Journal of European Public Policy 1026.

[240] For an overview on all EU political institutions see DM Curtin, P.J.Kuijper and RH van Ooik, 'The Political Institutions' in Pieter Jan Kuijper and others (eds), *The Law of the European Union* (5th edn, Wolters Kluwer 2019) 128.

[241] Maduro, *We The Court: The European Court of Justice and The European Economic Constitution* (n 6); Giandomenico Majone, 'The Rise of Statutory Regulation in Europe' in Giandomenico Majone (ed), *Regulating Europe* (Routledge 1996) 47; Giandomenico Majone, 'The European Commission as Regulator' in Giandomenico Majone (ed), *Regulating Europe* (Routledge 1996) 61.

[242] See Alan Milward and Vibeke Sørensen, 'Interdependence or Integration? A National Choice' in Alan Milward and others (eds), *The Frontier of National Sovereignty: History and Theory 1945-1992* (Routledge 1993) 1, 24.

[243] Jan Werts, *The European Council* (John Haper Publishing 2008) 1-21; Uwe Puetter, *The European Council and the Council* (Oxford University Press 2014) 148.

[244] Uwe Puetter, 'The European Council' in Christopher Bickerton, Dermot Hodson and Uwe Puetter (eds), *The New Intergovernmentalism: States and Supranational Actors in the Post-Maastricht Era* (Oxford University Press 2015) 165; Diane Fromage, 'Towards Increasing Unity and Continuing Executive Predominance Within the E(M)U Post-COVID?' (2020) 47 Legal Issues of Economic Integration 385. For

forefront of the EU institutional landscape, assuming a coordinating role in sensitive areas, such as foreign policy, justice and home affairs and, most importantly to this thesis, economic governance.[245]

This is notable in its meetings' frequency and agenda, both of which focus on economic policy issues.[246] In this context, Curtin argues that '[c]risis management in the European Council has shifted from economic governance, in the sense of a rules-based normative system to economic government entailing discretionary executive decisions'.[247]

One may question how the European Council's competence to define the general political directions and priorities of the Union (article 15 (1) TEU), and the European Commission's power to promote the general interest of the Union (article 17 TEU) can be reconciled. Alternatively, one may question how the European Council's influence on legislative processes with the Treaty rule that this institution cannot exercise legislative functions (article 15(1) TEU) can be reconciled.[248] One of the answers to these questions might lie in the democratic disconnect. As Lindseth observes, after three decades of post-war technocratic integration, clear political backing was needed if there was to be any hope for the EU in the ensuing decades. Ministerial 'supervision' by the Council would

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a different view, noting that intergovernmentalism is not a novelty, see Frank Schimmelfennig, 'What's the News in "New Intergovernmentalism"? A Critique of Bickerton, Hodson and Puetter' (2015) 53 Journal of Common Market Studies 723.

[245] After the Treaty of Maastricht, the Treaty of Amsterdam entrusted the European Council with the competence to oversee employment policy coordination. The Treaty of Lisbon not only formalised it as an EU institution but also created a full-time president.

[246] Puetter, 'The European Council' (n 244) 168. Before the Maastricht Treaty was enacted, the European Council met three times a year. After its adoption, yearly meetings have increased totaling eleven times in 2011 (if taking into account Euro Summits), eight in 2019 and 2021 (if taking into account formal and informal meetings). Regarding the substance of the agenda, Puetter highlights that economic governance has always been an important topic for the European Council in the post-Maastricht period, with the negotiation, implementation and amendment of the SGP and also the review of the proceedings of the Eurogroup and the Economic and Financial Affairs Council. Indeed, more than 65% of the overall number of European Council agenda items in this period are attributed to the areas related to new EU competences. For instance, economic governance issues alone account for 50–65% of the time spent.

[247] Deirdre Curtin, 'Challenging Executive Dominance in European Democracy' (2014) 77 The Modern Law Review 1, 6.

[248] In this vein see Adina Akbik and Mark Dawson, 'The Role of the European Council in the EU Constitutional Structure' (2024) <https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2024)760125> accessed 15 March 2024. On the possible reconfiguration of the European Council into a sort of EU Senate, vested with legislative functions to be exercised with the European Parliament, see Federico Fabbrini, 'The Relation Between the European Council and the Council: Institutional Arguments in Favour of an EU Senate' (2016) 22 European Public Law 489. Criticising the 'invasion' of other institutions' competences see Alain Lamassoure, 'Le Conseil Européen : Un "Souverain" Auto-Proclamé à La Dérive' (*Fondation Robert Schuman*, 2020) <https://www.robert-schuman.eu/fr/questions-d-europe/0574-le-conseil-europeen-un-souverain-auto-proclame-a-la-derive> accessed 18 April 2022.

not be enough. As such, it is in this context that the rise of the European Council and its prominence in dealing with the crisis since 2008, should be understood. We can look at this within the framework of a principal-agent relationship, whereby Member States continue to be the masters.[249] A different view is taken by Alain Lamassoure, who argues that the existence of the European Council 'constitue une excroissance du système et de l'équilibre institutionnels originels'. Although welcome at the outset, it is difficult to reconcile with the increasing diversity of the Union. In this vein, reforms should be envisaged with the avoidance of incertitude and stalemates in mind.[250]

1.2.2. European Commission

Not all executive institutions experienced a rise in competences and importance. In fact, new intergovernmentalism impacted the European Commission in a way that diluted its role regarding European economic integration. First, while preserving its importance in areas of traditionally prominent EU action (for instance, internal market or competition policies) and formal legislative initiative, its relationship with the European Council had a spillover effect regarding its effectiveness in this context, notably due to lax enforcement. Indeed, since the European Commission's ability to define the EU's economic agenda is largely dependent on the European Council, it has adopted what is known as a strategy of forbearance in order to advance EU integration. It also implemented this strategy in areas where Member States retain competence and coordinated them under the European Council.[251]

Secondly, in economic policy matters, as became apparent during the sovereign debt crisis response, the European Commission was mainly tasked with the preparation of European Council's meetings and the implementation of ensuing decisions, making use of its bureaucracy.[252] This could be seen as a positive development since, without the

[249] Peter Lindseth, 'The Democratic Disconnect, the Power-Legitimacy Nexus, and the Future of EU Governance' in Francesca Bignami (ed), *EU Law in Populist Times: Crises and Prospects* (Cambridge University Press 2020) 505, 521.
[250] Lamassoure (n 248).
[251] Roger Kelemen and Tommaso Pavone, 'Where Have the Guardians Gone?: Law Enforcement and the Politics of Supranational Forbearance in the European Union' (2021) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3994918> accessed 14 March 2022.
[252] Federico Fabbrini, 'Austerity, the European Council, and the Institutional Future of the European Union: A Proposal to Strengthen the Presidency of the European Council' (2015) 22 Indiana Journal of Global Studies 269, 286. With a different view, stating that the European Commission plays a very significant role, see Alicia Hinarejos, *The Euro Crisis in Constitutional Perspective* (Oxford University Press 2015) 88.

European Commission's intervention, the European Council's workability and effectiveness would be seriously undermined.[253]

In addition, the European Commission's exclusive competence on legislative initiative is progressively and informally eroding – a process that started in the pre-Maastricht period. Indeed, in 1982, the European Commission argued that the creation of the European Council created a 'shift in the balance of powers from the European Commission to the Council', a predominance which grew to the point that the Council, acting both as a community body and as a forum of Member State alignment and concert, became the 'sole effective centre of power in the system', compromising the European Commission's function.[254] In the past, overall action frequently occurred upon request from other EU institutions and less so of its own motion. In fact, in 1998, less than 10% of all proposals appeared to have originated as spontaneous European Commission initiatives, while considerably more came from requests by Member States or the Council.[255] *A fortiori*, the trend should be more pronounced in economic policy matters, where intergovernmentalism prevails, which further changes the primary role of the European Commission to one that manages EU policies.[256]

A good example of this is the new set of competences given to the European Commission within the European Semester. The six-pack and two-pack increased not only its oversight and enforcement authority regarding Member States' budgets, but also the assessment of macroeconomic imbalances. Reversing a decision to impose a financial sanction to euro area Member States that did not respect their obligations, now required reverse qualified majority voting in the Council (article 6 of Regulation (EU) No 1173/2011). This revamped economic governance framework was influenced by the European Council, which makes the European Commission a powerful enforcement body of legislation tailored by intergovernmental views.

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[253] Werts (n 243) 185; Curtin (n 247) 10.

[254] Commission of the European Communities, 'The Institutional System of the Community: Restoring the Balance' (Bulleting of the European Communities 3/82) 8; Kees van Duin, 'The European Commission' in Fabian Amtenbrink and Christoph Herrmann (eds), *EU Law of Economic & Monetary Union* (Oxford University Press 2020) 507; Matteo Scotto, 'Towards a Closer Intergovernmental Union? The Political Implications of the 2021-2027 Multiannual Financial Framework Negotiations' in Luca Zamparini and Ubaldo Villani-Lubelli (eds), *Features and Challenges of the EU Budget: A Multidisciplinary Analysis* (Edward Elgar 2018) 93, 95.

[255] John Peterson, 'The Santer Era: The European Commission in Normative, Historical and Theoretical Perspective' (1999) 6 Journal of European Public Policy 46, 59.

[256] Frédéric Mérand, 'The European Commission: The Cabinets and the Services' in Dermot Hodson and others (eds), *The Institutions of the European Union* (5th edn, Oxford University Press 2022) 177.

Thus, intergovernmentalism is well embedded in the Union, in particular on economic policy, which is prominent following the financial crisis.[257] The most clear expression of intergovernmentalism is the adoption of international agreements outside of the EU legal framework, ie the EFSF, ESM, TSCG, Euro Plus Pact and certain aspects of the Single Resolution Fund.[258] The reasons for this are many-fold, such as the political significance and sensitivity of the potential solutions, the limited competences attributed to the Community method regarding economic policy, different integration speeds or degrees between eurozone and non-eurozone countries, as well as the high level of flexibility and control it grants Member States.[259]

Apart from the causes and limits,[260] at this point it is important to state that the approach and method of intergovernmentalism resembles the one taken by the ECB. Crucially, the focus is placed on the Union's relationship with Member States and, secondarily, the Union as a whole. Such an approach is even more visible in the European Council given that it is not a *regular* EU institution, in the sense that it promotes the general interest of the Union or integrating the Community legislative method. Despite being designated as such, it is, in effect, a forum where Heads of State or Government meet and attempt to accommodate national interests.[261] Therefore, each of them has an incentive to reason along, not past, national lines to achieve the best possible outcome for their respective States. As such, the Union's priorities, which the European Council is competent to define, are, generally, a sum of national priorities.

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[257] Hinarejos, *The Euro Crisis in Constitutional Perspective* (n 252) 85. See also Fromage, 'Towards Increasing Unity and Continuing Executive Predominance Within the E(M)U Post-COVID?' (n 244).

[258] Council of the European Union, 'Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund' (14 May 2014) <https://data.consilium.europa.eu/doc/document/ST-8457-2014-INIT/en/pdf> accessed 27 December 2023). This agreement complements Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 [2014] OJ L225/1.

[259] Hinarejos, *The Euro Crisis in Constitutional Perspective* (n 252) 90.

[260] On the limits of intergovernmentalism, see Sergio Fabbrini, 'Intergovernmentalism and Its Limits: Assessing the European Union's Answer to the Euro Crisis' (2013) 46 Comparative Political Studies 1003.

[261] With a similar understanding see Federico Fabbrini, *Brexit and the Future of the European Union: The Case for Constitutional Reforms* (Oxford University Press 2020) 88; Petya Alexandrova and Arco Timmermans, 'National Interest versus the Common Good: The Presidency in European Council Agenda Setting' (2012) 52 European Journal of Political Research 316. With a different view, arguing that, despite nationalism in the European Council, the institution is capable to reconcile those interest through deliberation, see Luuk van Middelaar, *The Passage to Europe: How a Continent Became a Union* (Yale University Press 2013) 80.

1.3. Paradox of executive legitimacy

From a decision-making point of view, EU integration has split from the community to the intergovernmental method, along the lines of certain Treaty-based policies, such as fostering the internal market or competition policy, on the one hand, and economic policy on the other. Executive dominance in the EU can be explained by the nature, reach and intensity of EU governance evolution.[262] The financial crisis enhanced decision-making by national executives at the European level, which often had, as a result, a fast, wide-reaching impact on the national sphere, with the EU's new role as it relates to the adoption of national budgets being the most visible example.[263]

The phenomenon of executive dominance in the context of the EU should not be seen as exceptional or sui generis in comparative terms. Rather, it should be understood as part of a wider phenomenon of migration of executive power towards types of decision-making that eschews forms of electoral legitimacy and popular democratic control. In this regard, there are three major findings for such control on the rise of new intergovernmentalism.

At the outset, the integration paradox points to reservations held by Member States' governments towards the further empowerment of supranational actors. It is not possible to conceptualise the integration paradox without mentioning its functionalist tradition. As stated above (Part II, Point 1), the rise of intergovernmentalism can be primarily traced to the way competence creep evolved during the early decades of EU integration: Member States' rejection of major transfers of ultimate decision-making authority since the Maastricht Treaty was a result of the continuous self-empowerment of supranational institutions. Without acknowledging this dynamic, which entailed the ability of supranational institutions to shift competences towards the centre and to shape policies independently of Member States' original conceptions, it is difficult to fully understand

[262] Curtin (n 247) 1.

[263] It is important to state that intergovernmentalism had a major impact regarding policies that produce visible results. For instance, it is easy for citizens to acknowledge and perceive the impact of EU economic policy on their daily lives, especially in (but not restricted to) Member States experiencing some degree of financial distress. Even in Member States without such constraints, citizens perceive EU public finance limitations as EU-induced. Moreover, transfers to the EU budget, albeit small, hold an important status in national public (political) spaces, as shown by the juste retour dynamics. Be that as it may, other EU policies have major impacts on Member States too, albeit less directly and, therefore, not as perceptible to the public. Take internal market and competition policies as examples. Both policies are aimed at reducing protectionist practices by national governments. Indeed, principles such as non-discrimination and mutual recognition, as well as prohibitions of cartels, abuses of dominant positions or granting financial aid specifically targeted at national undertakings, has a huge impact on Member States, some of which may face competitiveness issues despite the benefits to consumers.

the dualism implemented at Maastricht. Without this incremental process, EU integration would never have reached a point where Member States were pushed to reflect on the ultimate goal of integration.[264] Therefore, on the one hand, there are concerns that citizens would reject further formal transfers of power to supranational (or community method based) institutions. On the other hand, by portraying direct control of EU decision-making, EU Heads of State or Government are understood to be responding to the EU's perceived deficits in accountability and legitimacy.[265]

Moreover, the European Council, the Eurogroup and the Economic and Financial Affairs Council increasingly deal with issues that have major national implications. Contrary to Andrew Moravscik's argument[266] (that reduced EU democratic legitimacy is countered by low-level issues), EU policies and decisions increasingly impact national political systems, as well as competences and policies.[267] For instance, the financial crisis is abundant with examples of national governments being ousted from power, curtailed economic and financial autonomy (sometimes to a severe extent) and the introduction of tight surveillance.

This has spurred calls for increased control of the activities of the Heads of State or Government by national parliaments. As President Sarkozy argued:

> L'Europe sans politique, l'Europe en pilotage automatique qui ne fait qu'appliquer aveuglément les règles de la concurrence et du libre-échange est une Europe qui ne peut pas faire face aux crises. (…) La crise a **poussé les chefs d'États et de gouvernements à assumer des responsabilités croissantes parce qu'au fond eux seuls disposaient de la légitimité démocratique qui leur permettait de décider**. C'est par l'intergouvernemental que passera l'intégration européenne parce que

[264] With a similar view see Puetter, *The European Council and the Council* (n 243) 242.
[265] ibid, 236; Alberto de Gregorio Merino, 'The Intergovernmental Method as Source of Democratic Legitimacy of the Economic and Monetary Union: A Critical View' in Gregorio Garzón Clariana (ed), *La Democracia en la Nueva Gobernanza Económica de la Unión Europea* (Marcial Pons 2015) 61, 65.
[266] Andrew Moravcsik, 'Is There a "Democratic Deficit" in World Politics? A Framework for Analysis' (2004) 39 Government and Opposition 336, 360. With the same view, Raymond Aron, 'Old Nations, New Europe' (1964) 93 Daedalus 43, 65.
[267] Milward and Sørensen (n 242) 20.

l'Europe va devoir faire des choix stratégiques, des choix politiques. (my bold added).[268]

However, expanding the community method to new areas of EU activity has also been called for, particularly granting autonomy to the European Commission in the form of policy-initiating powers. This would constitute an institutional mechanism for addressing collective action problems.[269] Yet, identifying the European Commission as a sole institutional actor that might allow advancements beyond the lowest common denominator would disregard one of the strongest reasons in support of intergovernmentalisation: the perceived lack of EU legitimacy (community method) institutions,[270] which allowed space for mechanisms of open and informal policy dialogue. While it is legitimate to inquire which method is more efficient, it is reasonable to consider that the EU was not yet prepared to leap towards the full democratisation of an EU executive, as the one seen in other mature federations, such the US.[271]

Finally, the working methods adopted by the European Council and the Council run counter to the idea of a publicly accessible and scrutinised debate. Rather, in order to generate viable consensus, such governance setting depends on informal exchanges and the collective process of opinion formation, which would not be possible with publicity.[272]

2. Changing nature of legislative action

2.1. Supranational role of the European Parliament

[268] Sophie Guerrier, 'Le Discours de Nicolas Sarkozy à Toulon En 2011' *Le Figaro* (Paris, 27 March 2014) <https://www.lefigaro.fr/politique/le-scan/2014/03/27/25001-20140327ARTFIG00086-le-discours-de-nicolas-sarkozy-a-toulon-en-2011.php> accessed 27 December 2023.
[269] See Giacomo Delledonne and Giuseppe Martinico, 'Le Féderalisme Européen' (2016) 53 Politique Européenne 15, 19. The authors argue that the Canadian experience suggests intergovernmentalism is often used due to the institutional flexibility it offers.
[270] Puetter, *The European Council and the Council* (n 243) 237.
[271] Again, in the Toulon speech, Sarkozy stated that '[l]a refondation de l'Europe, ce n'est pas la marche vers plus de supranationalité'. See Guerrier (n 268).
[272] See Puetter, *The European Council and the Council* (n 244) 236. According to the author, many participants in Council meetings believe that opening up debates would lead to a situation in which ministers no longer engage in real discussions and are less ready to compromise. For a similar view, see Andrew Glencross, 'The European Council and the Legitimacy Paradox of New Intergovernmentalism: Constitutional Agency Meets Politicisation' (2016) 38 Journal of European Integration 497.

The role of the EP in the context of the rise of intergovernmentalism merits to be described autonomously. Indeed, like the European Commission, it is an institution that pursues the general interest of the Union by representing its citizens (articles 10 (2) and 14 (2) TEU).

In the post-Maastricht period, the EP has increased its legislative competences and accountability capacity in general terms.[273] In fact, it was the institution that not only gained the most with successive treaty reforms, but was considered, by some, as one of the most powerful institutions worldwide.[274] Importantly, the areas in which the EP is excluded are continuously declining. Regarding the form of intervention, the ordinary legislative procedure (where it legislates with the Council on an equal footing) is increasingly foreseen. Moreover, it has strengthened its ability to intervene in executive areas relating to intergovernmentalism, such as comitology, establishment and control of EU agencies, among others.[275]

This assertion does not, however, mean that the EP has enough competences or that it is on par with the Council. Co-decision has been extended but only, essentially, regarding areas that had already been transferred to the EU. Crucially, that did not happen through economic policy. In fact, the EP's competences on this matter remain essentially identical since 1992.[276] Conversely, new competence shifts to the supranational level, notably on economic policy, are being conducted in the realm of intergovernmental institutions. As shown below (Part III, Chapter 1, Point 2.2), the EU legislative branch split during the post-Maastricht intergovernmentalism. Consequently, for several reasons, it is considered that the EP was placed in a difficult position while the Council maintained prominence in its dual capacity (as co-legislator with the EP, on the one hand, and coordinating with the European Council, on the other).[277] The first reason derives from a

[273] For an overview, see René Repasi, 'European Parliament and National Parliaments' in Fabian Amtenbrink and Christoph Herrmann (eds), *EU Law of Economic & Monetary Union* (Oxford University Press 2020) 460; Johannes Pollak and Peter Slominski, 'The European Parliament: Adversary or Accomplice of the New Intergovernmentalism?' in Christopher Bickerton, Dermot Hodson and Uwe Puetter (eds), *The New Intergovernmentalism: States and Supranational Actors in the Post-Maastricht Era* (Oxford University Press 2015) 245.
[274] Paul Craig, 'The Role of the European Parliament under the Lisbon Treaty' in Stefan Griller and Jacques Ziller (eds), *The Lisbon Treaty: EU Constitutionalism without a Constitutional Treaty* (Springer 2008) 109; Ariadna Ripoll Servent and Olivier Costa, 'The European Parliament: Powerful but Fragmented' in Dermot Hodson and others (eds), *The Institutions of the European Union* (Oxford University Press 2022).
[275] Pollak and Slominski (n 273) 250. Silva (n 16).
[276] Merino, 'The Intergovernmental Method as Source of Democratic Legitimacy of the Economic and Monetary Union: A Critical View' (265) 64.
[277] Gavin Barrett, 'European Economic Governance: Deficient in Democratic Legitimacy?' (2018) 40 Journal of European Integration 249, 260.

conceptual perspective, given that differentiated integration, referred to below (Part III, Chapter 2, Point 6.2.5) places the EP in a challenging position to exert accountability to EU and eurozone Member States.[278]

The second reason relates to the fact that, from a legal perspective, the intergovernmental solutions adopted to tackle the financial crisis, ie ESM and TSCG, did not promote parliamentary involvement. At the outset, its relationship with the European Council does not promote accountability: the EP is limited to asking questions but restricted from engaging in meaningful debates about policies. Even this reduced role is difficult to discharge, as the European Council usually meets without formal documents. Similarly, the EP does not match the significance of the Eurogroup and the Euro Summit as important players in the eurozone's intergovernmental institutional setting.

An exception to this was the EP's major role in the debate and amendments[279] of the six-pack and two-pack legislation. However, paradoxically, the EP's role in the European Semester process is marginal and its accountability powers in banking, economic and monetary dialogues lack substance.[280] As indicated by Fasone, 'Economic Dialogue' is an ambiguous concept, since the consequences if this dialogue fails or if one of the institutions does not fulfil its obligations are unclear. Like the monetary dialogue, it is difficult to envisage a meaningful outcome, particularly because the execution seems left to voluntary commitment.[281]

If monetary dialogue experience should serve as a proxy on this particular point, there is some evidence that such a process made insignificant changes to the management of the financial crisis. Moreover, only 10% of MEPs consider that the ECB regularly takes their considerations into account, while 60% and 30% think it occasionally or never does,

[278] As challenging as it may be, there are significant reasons to carefully tread the line of the formalisation of a multi-speed EP. In this sense, see Cristina Fasone, 'European Economic Governance and Parliamentary Representation. What Place for the European Parliament?' (2014) 20 European Law Journal 164, 181.

[279] A good overview of the amendments the EP was able to muster is given by Menelaos Markakis, *Accountability in the Economic and Monetary Union: Foundations, Policy and Governance* (Oxford University Press 2020) 124.

[280] Fasone, 'European Economic Governance and Parliamentary Representation. What Place for the European Parliament?' (n 278); Berthold Rittberger, 'Democratic Control and Legitimacy in the Evolving EU Economic Governance Framework' (2023) <https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2023)733742> accessed 12 February 2024, 19.

[281] Fasone, 'European Economic Governance and Parliamentary Representation. What Place for the European Parliament?' (n 278) 175. For a critique of the monetary dialogue, see Rosa Maria Lastra, 'Accountability Mechanisms of the Bank of England and of the European Central Bank' (2020) <https://www.europarl.europa.eu/committees/en/econ/econ-policies/monetary-dialogue> accessed 28 December 2023.

respectively.[282] This contrasts with periods of financial stability, during which the monetary dialogue was described as successful, given that most EP recommendations were considered by the ECB.[283]

This is consistent with the Komesarian perspective that, in complex situations, institutions are put under strain and less able to deliver results. Therefore, given the current features of the monetary dialogue, it is logical that the effectiveness of the EP is inversely proportional to the complexity of the financial situation: it is most effective in contexts of less friction (ie, periods of financial stability) and least effective in high-stakes situations (ie periods of financial instability). Naturally, effectiveness works in both ways. In the first situation, both institutions are placed in a favourable environment, where MEPs will probably pose simpler questions and present generic proposals, which the ECB can (easily) accommodate. In the second situation, however, both institutions are in an adverse setting. Dealing with a financial crisis is extremely complex, frequently with volatile conditions. This makes it more difficult to accommodate parliamentarians' views of monetary policy, as the ECB perceives itself as the expert in the room and must adapt its policies to the fluidity of the situation.

Of course, this does not allow the opposite conclusion. Even if the EP's competences permitted it to enhance accountability in monetary policy (ie having a suitably prominent stance to choose or dismiss the ECB President or Executive Board; if the monetary dialogue process attributed the EP more parliamentary power), it would not necessarily mean that the ECB would act differently. Be that as it may, the EU legal system is built on democratic principles based on the division of power and the existence of checks and balances. Therefore, the EP could work as an institutional constraint, particularly in high-stake and complex contexts.

This also indicates that, during the financial crisis and in the ensuing years, the EU decided not to rely on decision-making through the Community method, therefore, hindering the EP's participation and voice. However, when it did rely on the EP it did so

[282] Stefan Collignon and Sebastian Diessner, 'The ECB's Monetary Dialogue with the European Parliament: Efficiency and Accountability during the Euro Crisis?' (2016) 54 Journal of Common Market Studies 1296.
[283] Sylvester Eijffinger and Edin Mujagic, 'An Assessment of the Effectiveness of the Monetary Dialogue on the ECB`s Accountability and Transparency: A Qualitative Approach' (2004) 39 Intereconomics 190. On democratic accountability, see António Leitão Amaro, 'Regulating Ex-Ante and Ex-Post Democratic Control of Independent Central Banks' (2022) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4517706> accessed 7 March 2024, 49.

to endow legislation with formal democratic legitimacy.[284] In particular, the six-pack reform was delivered when the EP was under enormous pressure to act in order to restore the EU's credibility vis-à-vis financial markets.[285] In addition, its provisions broadly aligned with the economic conditionality attached to the loans disbursed to Member States in financial distress by the EFSF since 2010, making those provisions a mere reflection of the distress. As Laffen explains, the SGP reform was undertaken not only to counteract the volatility of financial markets, but also 'to ensure that bailouts would pass muster in the creditor states'.[286] Moreover, the two-pack was also involved in the context of intergovernmentally-created bodies (such as the ESM) or international treaties (such as the TSCG). This was accompanied by pressure from the ECB on Member States to correct economic imbalances. All of these represent an idea of strict conditionality.[287]

The third reason relates to the increasing pragmatism of the EP from a policy-making perspective, therefore, accepting greater influence from intergovernmental institutions. As Pollak and Slominski argue:

> [I]t seems to be the case that the EP is more concerned with preserving and/or extending its influence by using its growing competences, as well as its legitimacy, as bargaining chips, rather than forcefully advocating a supranational mode of decision-making. This can also be observed with regard to its legislative function. Since the Treaty of Amsterdam, the EP has gradually 'informalized' its co-decision powers thereby strengthening formats such as trilogue meetings in which only a handful of Members of the European Parliament (MEPs) are involved at the expense of open and

[284] Conversely, the participation of the EP was enhanced in the realm of NGEU, in particular regarding the RRF regulation. See Cristina Fasone, 'Fighting Back? The Role of the European Parliament in the Adoption of Next Generation EU' (2022) 28 The Journal of Legislative Studies 368; Edoardo Bressanelli, 'Democratic Control and Legitimacy in the Evolving Economic Governance Framework' (2022) <https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2022)699553> accessed 14 February 2024.

[285] A rough comparison can be made with the US. For instance, to address both the 9/11 terrorist attacks and the 2008 financial crisis, the President requested Congress to approve a wide array of executive power. Although Congress acted swiftly and under pressure, it did not grant all requested powers. See Eric Posner and Adrian Vermeule, *The Executive Unbound: After the Madisonian Republic* (Oxford University Press 2010) 41.

[286] Brigid Laffan and Pierre Schlosser, 'Public Finances in Europe: Fortifying EU Economic Governance in the Shadow of the Crisis' (2016) 38 Journal of European Integration 237, 239.

[287] ibid. 241. See also Adrienne Héritier and others, *European Parliament Ascendant: Parliamentary Strategies of Self-Empowerment in the EU* (Palgrave Macmillan 2019) 113.

> transparent discussions in the plenary. The willingness to informalize and seclude its most important legislative procedure seems to confirm the EP's readiness to act as an accomplice to the new intergovernmentalism once it has secured its influence.[288]

This willingness of the EP to informalise co-decision is evident in the way the ordinary legislative procedure is used in practice. Since the Amsterdam Treaty, it has been possible for the EP to adopt a legal act at the first parliamentary reading (or early agreement), which had a significant impact on the EP's parliamentary relationship with the Council. While in the first period after Maastricht, from 1993 until 1999, nearly 40% of legislation under co-decision was approved at the third hearing (conciliation), this figure dropped to 22% for the period 1999–2004, further to 5% in the period 2004–2009, and became none thereon. Regarding the early agreement, the inverse trend is observed: while, in the 1999–2004 period, 28% of all co-decision legislation was adopted at the first reading, this figure increased consistently, achieving 89% between 2014-2019.[289]

2.2. Intergovernmentalism

2.2.1. Council of the European Union

This new centrality has impacted the Council. As Puetter states, 'the functional centrality of the Council in EU politics can no longer be understood without closely considering the relationship between the European Council's oversight in the new areas of EU activity and Council decision-making'.[290] As a matter of fact, the Council's activity in the post-Maastricht competence architecture has shifted from law-making to policy coordination. This shift had impactful implications given that it operated a transformation from an institution based on the so-called community method to an institution of deliberative intergovernmentalism. Again, with Puetter:

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[288] Pollak and Slominski (n 273) 247.
[289] European Parliament, 'Activity Report: Developments and Trends of the Ordinary Legislative Procedure' (2019) <https://www.europarl.europa.eu/cmsdata/198032/activity-report-2014-2019_en.pdf> accessed 27 April 2022.
[290] Puetter, *The European Council and the Council* (n 243). See also Curtin (n 247) 9.

> The growing importance of the European Council does not actually lead to a reduction in Council activity, but rather to an overall increase in intergovernmental exchanges. Yet with the rise of new intergovernmentalism, the relationship between the two institutions has become rebalanced, in the sense that some dossiers that were previously dealt mainly at the Council level have been increasingly influenced by European Council input. […] Thus, the process changes from bottom-up – with the Council formations coming up with proposals to the European Council – to top-down.[291]

The top-down approach is embodied in the conclusions drawn up by the European Council, which have become increasingly more specific, identifying concrete tasks and deadlines for the Council, sometimes countering or overruling it.[292] This practice shows that, concerning economic policy, the Council is less of an autonomous institution and more like a preparatory body of the European Council's meetings. In fact, it became visible during the financial crisis, where this institution's authority over finance ministers to adopt relevant legislation regarding EMU reform was not questioned.

A particularly good example of this new institutional balance was the decision-making process of NGEU's funding through a temporary increase of the Union's own resources. According to article 311 (3) TFEU, it is for the Council, acting in accordance with a special legislative procedure, to unanimously adopt an ORD after consulting with the EP, which will then enter into force as soon as it is approved by Member States, in accordance with their respective constitutional requirements. However, the agreement on the EU recovery plan and, concomitantly, on the MFF 2021-2027, was only achieved

[291] Puetter, *The European Council and the Council* (n 243) 149. See also Luuk van Middelaar and Uwe Puetter, 'The European Council: The Union's Supreme Decision-Maker' in Dermot Hodson and others (eds), *The Institutions of the European Union* (5th edn, Oxford University Press 2022) 51, in which the European Council is described as being crisis manager, impasse-breaker, strategist, shaper and collective Head of State.

[292] Although this feature is more prominent in intergovernmental policy areas, such as economic policy, it is also visible in the realm of the community method, in which the European Council instructs the Council to pursue both a given direction and its precise terms, ie the banking union. See Werts (n 243) 58; Alberto de Gregorio Merino and Eurgenia Dumutriu, 'EU Institutions Representing Member States' Governments' in Fabian Amtenbrink and Christoph Herrmann (eds), *EU Law of Economic & Monetary Union* (Oxford University Press 2020) 428, 454, state that 'the European Council and the Euro Summit have 'funneled' the powers of the European Parliament and the Council as co-legislators, marking their tempos and, in some way, guiding their legislative choice'. In this vein, see also Dermot Hodson and Uwe Puetter, 'The Euro Crisis and European Integration' in Michelle Cini and Nieves Borragán (eds), *European Union Politics* (7th edn, Oxford University Press 2022) 373.

after a five-day European Council meeting (17-21 July 2020), after which the topic had to be further discussed before it was finally settled in December 2020.[293]

The rise of the European Council has received some praise, not only as a high-level institution, where the impetus for Union development would be provided and the general political directions would be defined, but also as a deliberative body. In fact, this shift of power does not necessarily hinder the community method of decision-making, as the European Commission seeks to influence the European Council on issues where it has failed agreement in the Council. In this sense, the European Council may be a 'valuable partner' and an 'indispensable'[294] addition to the community method.

This advantage notwithstanding, it seems to be somehow misaligned with article 15 (1) TEU. Member States had several intentions when drafting this provision. First, they sought to draw a line between EU institutions by preserving each other's functional integrity, which is clear in the literal element of the provision when it states that the European Council 'shall not exercise legislative functions'. The point in play here is obviously not to say that the European Council is now engaged in law-making with the EP, but it is difficult not to regard the described *tasking* method vis-à-vis the Council as an indirect way of interfering in the legislative process. While it is true that Ministers in the Council have always been subject to political directives from their Heads of State or Government, there seems to be a qualitative difference between reconciling different preferences within the legislative process, and a European Council decision before or during such a process, which, in practice, restricts the freedom of action of another institution.

Moreover, the problem may not only lie in cases where the European Council acts on its own motion. Indeed, Ministers in the Council now know that they do not necessarily need to reach an agreement because the solutions to existing issues will eventually be

[293] This was due to Polish and Hungarian veto threats. In a remarkable showing of force and competence overreach, the European Council issued a declaration on the rule of law, where it mentioned the way in which the declaration ought to be interpreted and mandated the European Commission to adopt guidelines on its application. This approach was severely criticised by the EP, highlighting that the European Council does not have legislative and interpretative functions: those are attributed to the Council and EP, as well as CJEU, respectively. Moreover, the European Commission is independent and politically accountable before the EP, therefore, those conclusions cannot be made binding on the European Commission in applying legal acts. See European Parliament resolution of 17 December 2020 on the Multiannual Financial Framework 2021-2027, the Interinstitutional Agreement, the EU Recovery Instrument and the Rule of Law Regulation [2020] OJ C 445/15.
[294] Werts (n 243) 184.

agreed at a higher level,[295] which further illustrates the institutional dependency the Council developed in relation to the European Council in the new areas of EU intervention, namely economic policy, which has already been designated as a 'fused' institution EU executive.[296]

2.2.2. National parliaments

National parliaments have an important role to play in the various functions they carry out at the national level, namely legislative, political control, budgetary and inter-parliamentary cooperation.[297] However, it is usually considered that more involvement from national parliaments in EU affairs, whatever the form,[298] is important for a variety of reasons, such as democratic legitimacy and accountability.[299] National parliaments are still perceived as being close to citizens. First, EU economic policy coordination at a supranational level affects budgetary policy, which is close to national sovereignty. In fact, even if Member States formally retain such competence, the limitations imposed are so significant and surveillance for compliance is so strict, that one could question whether countries are indeed capable of devising national budgets with meaningful autonomy.

Second, as referred in the previous section, empowerment of national executives in the European Council warrants more national parliamentary scrutiny, precisely because such an institution lacks an acceptable accountability framework, either collectively or at the level of each individual Head of State or Government.[300] But also because the EU's democratic deficit may be understood as a relative inability by the European Parliament to offset the reduction of national parliamentary powers.[301]

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[295] ibid. Werts mentions this issue as a positive outcome.
[296] Uwe Puetter, 'The Council of the European Union' in Dermot Hodson and others (eds), *The Institutions of the European Union* (5th edn, Oxford University Press 2022) 78, 101.
[297] For a development of these functions, see Repasi (n 273) 498.
[298] The kind of national parliament participation may take many forms, namely: traditional scrutiniser, policy shaper, government watchdog, public forum, expert and European player. On this matter, see Valentin Kreilinger, 'National Parliaments in Europe's Post-Crisis Economic Governance' (Doctoral thesis, Hertie School of Governance 2019) <https://opus4.kobv.de/opus4-hsog/frontdoor/index/index/docId/2730> accessed 20 December 2022.
[299] Diane Fromage, 'How to Ensure That National Parliaments (Truly) "Contribute Actively to the Good Functioning of (Tomorrow's) EU"?' (2020) 26 European Law Journal 472; Tom van den Brink, 'National Parliaments and EU Economic Performance Policies. Impact Defines Involvement?' (2018) 40 Journal of European Integration 309.
[300] Markakis (n 279) 130. See also Sergio Fabbrini, 'Who Holds the Elephant to Account? Executive Power Political Accountability in the EU' (2021) 43 Journal of European Integration 923 and Curtin (n 247) 23.
[301] Ben Crum, 'Parliamentary Accountability in Multilevel Governance: What Role for Parliaments in Post-Crisis EU Economic Governance' (2017) 25 Journal of European Public Policy 268. In the same vein, see

National parliament participation in the legitimation of EU affairs, namely economic policy, is based on the concept of *demoicracy*.[302] Rather than creating (or assuming the existence of) a supranational people, it acknowledges the need to build an international governance system based on the existence of multiple people. Consequently, instead of sustaining the idea that the EU can be legitimated by institutions composed of directly-elected representatives, such as the EP, the Union would need to be a system legitimised by Member States' democracies.[303] As such, the problem would not be one of democratic deficit (in the sense of resulting from a shortfall within EU institutions and processes) but of democratic disconnect (understood as a mismatch between the delegation of power to the EU and the national experience of democratic self-government), which was particularly acute regarding the EU's role in responding to the financial crisis.[304] Therefore, EU integration should focus on further enhancing a vertical model of accountability, whereby Member States' democracies play a pivotal role by providing democratic control from the bottom-up. According to Lindseth, this was nothing more than the maturing of a process that began with the establishment of the European Council, which already suggested that EU governance required more than democratic deficit fixes, namely the development of mechanisms of legitimacy mediated through national institutions to address the democratic disconnect.[305]

Before the Treaty of Lisbon, national parliaments were not entitled to any prerogative or direct right of information, as no direct channel of information between the EU institutions and national parliaments had been established. Moreover, the Treaties only urged national governments to forward information promptly and recommended that they make legislative proposals available in a timely manner so that each Member State government could ensure that its own national parliament would receive them.

Joseph Weiler, Ulrich Haltern and Franz Mayer, 'European Democracy and Its Critique' (1995) 18 West European Politics 4.

[302] This concept is developed by Kalypso Nicolaïdis, '"We, the Peoples of Europe ..."' (2004) 83 Foreign Affairs 97. More recently, Kalypso Nicolaïdis, 'The Idea of European Demoicracy' in Julie Dickson and Pavlos Eleftheriadis (eds), *Philosophical Foundations of European Union Law* (Oxford University Press 2012) 247. For a critique offering alternatives, see Robert Schütze, 'Demoicracy in Europe: Some Preliminary Thoughts' (2022) 47 European Law Review 24.

[303] Richard Bellamy, *A Republican Europe of States: Cosmopolitanism, Intergovernmentalism and Democracy in the EU* (Cambridge University Press 2019) 12.

[304] Lindseth, 'The Democratic Disconnect, the Power-Legitimacy Nexus, and the Future of EU Governance' (n 249) 506-514.

[305] Milward and Sørensen (n 242) 24.

The Treaty of Lisbon brought about a renewed sense of urgency regarding democratic legitimacy, namely with the new prerogatives national parliaments were endowed with, notably in article 12 TEU and Protocols No 1 and 2, ie information rights, EMU-related powers, subsidiarity and political scrutiny or interparliamentary conferences.

Among the main novelties, national parliaments' information rights are significantly relevant, as some information must be directly brought to their attention by Union institutions, including draft legislative acts, consultation and planning documents, in addition to their previous ability to request information from respective governments. Importantly, this practice is seen as increasing participation and independence, as national parliaments get the same information at the same time without needing to rely on the institution they are tasked to check.[306]

However, Fromage argues that, regarding highly sensitive topics, such as economic policy coordination, national parliaments are not involved to an acceptable extent. During the European Semester cycle, they can only receive draft CSRs directly,[307] meaning that they are involved almost until the procedure's epilogue, with little-to-no ability to influence the final outcome. For instance, country reports assessing the implementation progress of previous CSRs are not delivered to national parliaments, neither is, more recently, the RRF Scoreboard, which tracks execution of individual recovery and resilience plans.

According to another line of reasoning, national parliament under-involvement is not only justified by issue-sensitivity, but also by the current distribution of competences. In fact, by failing to exercise any formal transfer of sovereignty regarding economic and fiscal policies, Member States created what is designated a hybrid structure, where national and EU interests are mixed and blurred. Therefore, dual accountability should be introduced, with both the EP and national parliaments performing this role.[308] Indeed, the exclusion of national parliaments from the definition of policy choices at the EU level becomes difficult to sustain the more these choices impact national political choices. This

[306] On numerous deficiencies and delays in information sharing between national governments and their respective parliaments, see Adam Cygan, 'Democracy and Accountability in the European Union - The View from the House of Commons' (2003) 66 The Modern Law Review 384.
[307] On the shortcomings of the procedure, see Fromage, 'How to Ensure That National Parliaments (Truly) "Contribute Actively to the Good Functioning of (Tomorrow's) EU"?' (n 299) 475; Rittberger (n 280) 22.
[308] Barrett, 'European Economic Governance: Deficient in Democratic Legitimacy?' (n 277) 260.

is of particular concern given that national choices are severely constrained if they are misaligned from European choices, as is the case when a Member State is in a situation of financial distress and must request funding from the ESM. Such policy-definition is not syndicated by the EP, but only by the main creditor countries within the ESM.[309]

Subsidiarity and political scrutiny, as well as interparliamentary conferences, are other instruments made available to national parliaments to foster democratic scrutiny and participation in EU affairs. But Fromage also demonstrates that these instruments have several shortcomings, are rarely used or are mostly inconsequential. Therefore, only in theory could the proponents of such an approach argue that EU democratic legitimacy would be increased.[310] Knowing this, some authors have advocated for the establishment of minimum standards for parliamentary involvement.[311] In any event, the fact remains that, unless all national parliaments abide by the proposed baseline scenario, which would be unlikely given the large heterogeneity of scrutiny, voice and influence disparity would remain, as would the problem of differentiated democratic (throughput) legitimacy.[312]

To heterogeneous scrutiny, it is necessary to add decisional weight, particularly regarding international treaties or agreements, where national parliamentary ratification is warranted. In the context of ESM scrutiny, Varela highlights the *BVerfG* decision in that, according to the democratic and constitutional identity principles, national parliaments are required to confirm national transfers. However, as clarified by the ESM governance procedures developed infra (Part III, Chapter 1, Point 4.2.1), the author claims that decisions taken by national parliaments of net contributor countries carry more weight than the others, given the ESM's nature of funding body.[313] A similar feature is

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[309] Repasi (n 273) 498. For a similar view, see Barrett, 'European Economic Governance: Deficient in Democratic Legitimacy?' (n 277) 261.

[310] Fromage, 'How to Ensure That National Parliaments (Truly) "Contribute Actively to the Good Functioning of (Tomorrow's) EU"?' (n 299) 476. This is also shown by Mette Buskjær Rasmussen, 'Accountability Challenges in EU Economic Governance? Parliamentary Scrutiny of the European Semester' (2018) 40 Journal of European Integration 341. Specifically on the early warning system, see Federico Fabbrini and Katarzyna Granat, '"Yellow Card, but No Foul": The Role of the National Parliaments under the Subsidiarity Protocol and the Commission Proposal for an EU Regulation on the Right to Strike' (2013) 50 Common Market Law Review 115.

[311] Valentin Kreilinger, 'Scrutinising the European Semester in National Parliaments: What Are the Drivers of Parliamentary Involvement?' (2018) 40 Journal of European Integration 325.

[312] A view shared by Rasmussen (n 310) and Amy Verdun and Jonathan Zeitlin, 'Introduction: The European Semester as a New Architecture of EU Socioeconomic Governance in Theory and Practice' (2018) 25 Journal of European Public Policy 137. On a comprehensive study of national parliamentary involvement see Claudia Hefftler and others (eds), *The Palgrave Handbook of National Parliaments and the European Union* (Palgrave Macmillan 2015).

[313] Justo Corti Varela, 'Condicionalidad En Los Estabilizadores Macroeconómicos. Una Visión Jurídica a Un Problema Político' in Luis Hinojosa Martínez and Pablo Martín Rodríguez (eds), *La Regulación*

also apparent in the *BVerfG*'s decision regarding the PSPP, which grants the ECB's unconventional monetary policy, developed infra (Part III, Chapter 3, Point 8.4), significant accountability power.

Apart from Treaty-based prerogatives, the national parliaments of the eurozone also derive power from EU secondary laws, such as the two-pack.[314] In this context, they are allowed to directly interact with the European Commission in a number of circumstances, namely requesting it to present an opinion on draft budgetary plans, recommending it to a Member State to correct excessive deficits, adopting precautionary corrective measures or preparing a draft macroeconomic adjustment programme when needed. An exchange of views with the European Commission can also take place during enhanced surveillance and during the implementation of a macroeconomic adjustment programme. However, these mechanisms are not part of an accountability framework, but of a duty for the European Commission to provide reasons. Therefore the consequentiality of these mechanisms are limited to what this institution is willing to incorporate in its policy choices.

In the framework of the banking union, the ECB and the SRB are also elected as an institution/body for national parliaments to interact with directly.[315] First, they must receive annual reports on the SSM and SRM and may convey their concerns. Moreover, national parliaments may request the ECB and the SRB to reply in writing to questions it submits, as well as extending an invite to the Chairs of the SSM and SRB to participate in an exchange of views with a representative of the national competent authority. However, such interactions seldom occur and, when they do, they involve a limited number of national parliaments,[316] which does not increase the democratic legitimacy. If

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Internacional de los Mercados y la Erosión del Modelo Polílito y Social Europeo (Editorial Arandazi 2019) 67, 83. In the same vein, see Hoai-Thu Nguyen, *An Uneven Balance?:A Legal Analysis of Power Asymmetries between National Parliaments in the EU* (Eleven International Publishing 2018).

[314] Repasi (n 273) 502.

[315] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L 287/63 and Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (n 258).
For an overview of Banking and Monetary Dialogues see Diane Fromage and Renato Ibrido, 'The "Banking Dialogue" as a Model to Improve Parliamentary Involvement in the Monetary Dialogue?' (2018) 40 Journal of European Integration 295.

[316] Fromage, 'How to Ensure That National Parliaments (Truly) "Contribute Actively to the Good Functioning of (Tomorrow's) EU"?' (n 299) 480.

anything, it decreases such legitimacy since segmented participation allows only a few to be heard.

Regarding monetary policy, national parliaments have no such prerogative. According to the ECB, national parliaments lack the legitimacy to judge on such a matter. Notwithstanding, the President of the ECB has entered into informal exchanges with national parliaments, which were deemed politically sensitive but, as in supervision, these interactions rarely took place.[317] Nevertheless, they have been considered 'peripheral entities'[318] in relation to the ECB in this regard.

Fromage is of the view that these tools 'undoubtedly have the possibility to be more closely involved than before, but that these participatory channels are unlikely to allow them to provide regular or positive political input'. Therefore, '[t]he active participation in the good functioning of the Union that Article 12 TEU prescribes for national parliaments thus remains focused on the domestic level rather than on the European level' and should be improved accordingly.[319]

The ECB's intention to democratically legitimise the EU through national parliaments raises the issue of whether the principle according to which accountability should be guaranteed at the same institutional level is well suited for the EU, particularly given the changes that occurred since the financial crisis. In this regard, Fromage argues that current monetary policy's impacts on Member States' fiscal policies justifies the creation of a formal dialogue between the ECB and some national parliaments and being made available to them on an equal basis.[320] For this purpose, the framework used regarding supervision (so-called banking dialogue) could be applied to monetary dialogue.[321]

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[317] Davor Jančić, 'Accountability of the European Central Bank in a Deepening Economic Monetary Union' in Davor Jančić (ed), *National Parliaments after the Lisbon Treaty and the Euro Crisis* (Oxford University Press 2017) 141, 150.
[318] Barrett, 'European Economic Governance: Deficient in Democratic Legitimacy?' (n 277) 260.
[319] Fromage, 'How to Ensure That National Parliaments (Truly) "Contribute Actively to the Good Functioning of (Tomorrow's) EU"?' (n 299) 481. To tackle some of the issues, she proposes some changes in order to enhance the process, such as conveying all relevant documents, introducing standing of national parliaments in the legislative cycles, creating parliamentary chambers composed of MPs only or of both MPs and MEPs, as well as levelling the playing field between national parliaments and EU institutions and bodies.
[320] ibid. 483.
[321] Fromage and Ibrido (n 315). For a similar view, see Barrett, 'European Economic Governance: Deficient in Democratic Legitimacy?' (n 277) 260.

Be that as it may, Repasi strikes a note of caution, considering that a banking dialogue with national parliaments could be understood as a mechanism to provide for accountability, 'albeit being a weak one, given the particular kind of mixed administration between European and national authorities in the Banking Union, which is a departure from the principle that institutions can only be held to account by parliaments which are at the same level as they are located'.[322]

This layer-mismatch problem can be coupled with the issue of a political match. Reasoning regarding the European Council, Sergio Fabbrini is of the view that it is unlikely that national parliaments, even those that network with the EP, could collectively exercise a scrutinising role because the latter's decisions are made by Heads of State or Government that mirror national parliaments' majorities. Problematically, the reverse emerged, with national leaders using intergovernmental constraints to impose their views on their own legislative majorities.[323]

2.3. Importance of parliaments for EU legitimacy and accountability

Much was discussed about the importance of national parliamentary accountability vis-à-vis their respective national governments. The first argument is that it would enhance national parliamentary democratic legitimacy vis-a-vis their respective national governments in the context of intergovernmentalism.

However, given the vertical nature of the system, national parliaments face the same shortcomings previously identified regarding the executive branch. Indeed, although the European Council can benefit from the fact that its members are held individually accountable for their own national legislatures, the idea of legitimation via nationally-elected governments is far from a guarantee that the EU will be more responsive politically.[324] As the European Council is a sum of 27 electoral 'validations' (given that

[322] Repasi (n 273) 503.
[323] Fabbrini, 'Who Holds the Elephant to Account? Executive Power Political Accountability in the EU' (n 300) 934.
[324] In the same vein see Armin von Bogdandy, 'The Euro Is Forcing the Realization of Political Union - and Perhaps a New Community' (2001) 2 German Law Journal 7; Merino, 'The Intergovernmental Method as Source of Democratic Legitimacy of the Economic and Monetary Union: A Critical View' (n 265) 75; Mark Dawson and Floris de Witte, 'Constitutional Balance in the EU after the Euro-Crisis' (2013) 76 The Modern Law Review 817, 842. A view also shared by Schmidt, 'The Forgotten Problem of Democratic Legitimacy: "Governing by the Rules" and "Ruling by the Numbers"' (n 233) 99.

each government has only national legitimacy) every collective decision made in this realm will be characterised by incomplete legitimacy.

In addition, each government and parliament naturally focuses on the interests of its own country and is, consequently, less able or willing to take into account the interest of the Union as a whole.[325] Therefore, they will be able to provide only partial and inadequate accountability.[326]

Moreover, national parliaments have different working capacities and competences, meaning that their rise may deepen inequalities between the State and legitimacy.[327] For instance, national governments supported by a highly capable national parliament may be legitimised prior to every European Council meeting and, thus, be decisive in the defence of their public.

The second argument is that no institution, most notably the EP, has the ability to impose any form of sanction on the European Council if dissatisfied with the justifications or solutions presented.[328] It is possible that this institutional feature has allowed the European Council to expand beyond its Treaty-based competences. In fact, it is not clear that the EU's response to the financial crisis strengthened its ability to be held politically accountable, given the rise of executive prominence, coupled with the increasing ease of making treaty reforms that bypass smaller Member States.[329]

In theory, national parliaments retain such competences vis-à-vis their national governments, in which case the argument of partial accountability applies. The areas in which national parliaments have power regarding supranational institutions, such as regarding intergovernmental financial funds, there is significant asymmetry on individual

[325] Delledonne and Martinico (n 269) 19.
[326] For the same view see Elena Griglio, *Parliamentary Oversight of the Executives: Tools and Procedures in Europe* (Hart Publishing 2020) 193. This also justifies the fact that national central bank governors should not be held accountable by the EP nor national parliaments. Regarding the former, this is because no EU body plays a role in their appointment. Regarding the latter, this is because national parliaments lack the legitimacy to assess how they perform duties which explicitly preclude standing for national interests. As such, the ECB has argued that it is for the President of the ECB and the other members of the Executive Board to justify and explain the decisions, taken collectively, to the European Parliament. See European Central Bank, 'Monthly Bulletin' (2002) <https://www.ecb.europa.eu/pub/pdf/mobu/mb200211en.pdf> accessed 6 May 2022, 49.
[327] As an example, Jovani criticises the deficient parliamentary accountability delivered by the Spanish parliament. See Juan Jovani, 'La Gobernanza Presupuestaria Surgida de La Crisis y Sus Implicaciones Para El Parlamento' in Elviro Aranda Álvarez (ed), *Las Implicaciones Constitucionales de la Gobernanza Económica Europea* (Tirant lo Blanch 2020) 161, 192. See also Lentsch (n 235) 40.
[328] Fabbrini, 'Who Holds the Elephant to Account? Executive Power Political Accountability in the EU' (n 300) 934.
[329] Dawson and Witte (n 324) 99.

effectiveness. However, as already observed regarding the Memoranda of Understanding underpinning public loans to countries, such power is rather fictitious, since 'conditionality takes the form of a package deal (…) between the Troika and the government (…) presented to other actors, such as parliaments and courts, as a fait accompli'. National institutions find themselves with the dilemma of either 'approving the deal, despite their potential disagreements with some parts of it, or face the possibility of losing access to official lending', which makes it an unrealistic alternative.[330]

In this vein, it was argued that national parliaments could also be empowered at the level of the decision-making process of international bodies, such as the ESM. However, the ESM's voting framework favours richer Member States not only because 'they are based on capital contributions (…) but also because in practice the richer States are the key players'. Crucially, this hinders democratic accountability at a national level, given that the influence (and, therefore, incentive) for each parliament to deliver accountability efforts is 'dramatically different depending on the weight and richness of the concerned Member State'.[331]

This was one of the reasons why the European Commission, in article 5 of the EMF proposal, established that accountability of this potentially new body should be held by the EP and the Council, as well as national parliaments (article 6).[332] This proposal has been received with some scepticism, particularly regarding EP involvement, on fears that it would empower MEPs from countries outside of the eurozone to have undue influence, hence, the suggestion of creating mixed chambers in the EP, composed of both MPs and MEPs.[333] There are some problems with this proposal. Not only does it run the risk of (once again) compartmentalising the EP along national lines, but also further

[330] Michael Ioannidis, 'EU Financial Assistance Conditionality after "Two Pack"' (2014) 74 Zeitschrift für ausländisches öffentliches Recht und Völkerrecht 61, 102. In the same vein see Weiler, 'The Transformation of Europe' (n 35) 2430. The author states that tight *ex ante* control by national parliaments on the activities of ministers in Community affairs has proven largely unfeasible. For a different view, see Merino, 'The Intergovernmental Method as Source of Democratic Legitimacy of the Economic and Monetary Union: A Critical View' (n 265) 69. Although arguing it is not senseless to state that sovereignty ends when solvency disappears, the author argues that governments and national parliaments have a say in negotiations and in choosing specific fiscal adjustment measures.

[331] Jean-Paul Keppenne, 'Democracy and the Role of the Commission in the European Fiscal Union: Some Considerations on the Recent Evolutions' in Gregorio Garzón Clariana (ed), *La Democracia en la Nueva Gobernanza Económica de la Unión Europea* (Marcial Pons 2015) 85, 104.

[332] European Commission, 'Proposal for a Council Regulation on the establishment of the European Monetary Fund' COM (2017) 827 final <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52017PC0827> accessed 27 December 2023, 2.

[333] Matthias Ruffert, 'The Future of the European Economic and Monetary Union' in Francesca Bignami (ed), *EU Law in Populist Times: Crises and Prospects* (Cambridge University Press 2020) 33, 63.

differentiating EU integration, needlessly. As shown below (Part III, Chapter 2, Point 6.2.5), the differences between eurozone and non-eurozone members are not significant, both in terms of monetary and economic policies.

National parliaments, either individually or by way of interparliamentary cooperation, *de facto* lack consequential action.[334] Most importantly, partial legitimacy as well as national parliaments' inherent inability to deliver EU-wide accountability or envision EU-wide interests are, in my view, powerful driving forces that are key to understand the failures to democratise the EU from this starting point. Therefore, the conclusion to be drawn is that current attempts to involve national parliaments both with EU institutions and between each other are bound to be unsuccessful.

The third argument is to ease some pressure regarding the lack of transparency in the working methods of EU institutions and intergovernmental funding bodies. However, in order to achieve a consensus in the European Council and Council, the referred opacity cannot be justified by national electoral legitimacy alone. In my view, if the electoral process is essential to control the 'entrance' and 'exit' of the political process, transparency and accountability ensure democratic values within this process in-between elections. This is true at a national level and there is no forceful reason it should differ at a supranational or intergovernmental level.

Deficient transparency in intergovernmental (executive) institutions naturally spills-over to intergovernmental funding bodies. This was visible during the management of the financial crisis, especially in relation to Member States in financial distress. Indeed, not only was the power distribution within the troika unclear (although the European Commission retained a central role, as asserted by Regulation (EU) 412/2013), but the legal form of conditionality (notably the one following Memoranda of Understanding) received conflicting judicial decisions from upper national courts, since this power distribution was an instrument dissimilar to other EU laws. The lack of necessary transparency in the negotiations and reduced national ownership were equally concerning.[335]

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[334] Despite the lack of consequential action, Griglio argues that interparliamentary cooperation can provide the EP with a complete and exhaustive vision of the political directions defined at the national level. See Elena Griglio, 'Divided Accountability of the Council and the European Council' in Diane Fromage and Anna Herranz-Surrallés (eds), *Executive–Legislative (Im)balance in the European Union* (Bloomsbury Publishing 2020) 51.

[335] Ioannidis, 'EU Financial Assistance Conditionality after "Two Pack"' (n 330) 99 and Keppenne, 'Democracy and the Role of the Commission in the European Fiscal Union: Some Considerations on the

Last but not the least, the ECB significantly influences economic policies while being an institution with a reduced degree of (ex-post) accountability from political institutions.[336] According to Schedler, accountability should be two-pronged. On the one hand, central banks should be obliged to inform citizen representatives about their policy decisions and be required to justify them. On the other hand, parliaments (or similar institutions) should be able to impose sanctions in case they fail to fulfil their mandates.[337]

Importantly, the ECB has reporting obligations. According to article 284 (3) TFEU, it must provide an annual activity report of the ESCB and on the monetary policy to the EP, the Council, the European Commission, and the European Council. The President of the European Central Bank must present this report to the Council and to the EP, which may hold a general debate on the subject. In addition, article 15 of Protocol No 4 establishes the obligation to publish quarterly reports on the ESCB's activities, as well as a weekly-consolidated financial statement of the ESCB. Although this interaction between the ECB and political institutions may come as surprise considering that the principle of independence aims to, in a way, protect the ECB from political pressure, Goodhart explains that an independent central bank will fail to attain its goals unless it obtains broad-based public support.[338]

Notwithstanding, not only is the EP incapable of imposing sanctions on the ECB in case it fails to fulfil its mandate,[339] but the monetary dialogue does not deliver meaningful results. After analysing ten years of monetary dialogue, Amtenbrink and Van Duin conclude that it is more of a general forum for discussions on: economic policy, the need

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Recent Evolutions' (n 331) 105. Defending the normativity of memoranda of understanding in general, and those regarding financial assistance to EU Member States in particular, see Alberto de Gregorio Merino, 'Memoranda of Understanding: A Critical Taxonomy', *Building bridges: central banking law in an interconnected world: ECB Legal Conference 2019* (European Central Bank 2020) 253, 258.

[336] Schmidt, 'The Forgotten Problem of Democratic Legitimacy: "Governing by the Rules" and "Ruling by the Numbers"' (n 233) 101. See also Lastra, 'Accountability Mechanisms of the Bank of England and of the European Central Bank' (n 281); Fabian Amtenbrink, 'The European Central Bank's Intricate Independence versus Accountability Conundrum in the Post-Crisis Governance Framework' (2019) 26 Maastricht Journal of European and Comparative Law 165, 176.

[337] Andreas Schedler, 'Conceptualizing Accountability' in Andreas Schedler, Larry Diamond and Marc Plattner (eds), *The Self-Restraining State: Power and Accountability in New Democracies* (Lynne Rienner Publishers 1999) 13, 14.

[338] Charles Goodhart, *The Central Bank and the Financial System* (Palgrave Macmillan 1995) 70. See also Amtenbrink, 'Economic and Monetary Union' (n 227) 938.

[339] Board members of the US Federal Reserve can be removed by the US President (Section 10 (2) Federal Reserve Act). In contrast, a member of the ECB Executive Board can only be removed by the CJEU, pursuant to an application by the ECB Governing Council or the Executive Board, if he no longer fulfils the conditions required for the performance of his duties or has been found guilty of serious misconduct (article 11.4 of Protocol no 4 TFEU).

to reform the SGP and broader issues of EU integration.[340] Crucially, when MEPs ask targeted and in-scope questions, the ECB usually either refuses to disclose the information, invoking professional secrecy, or replies in general terms.[341]

These dialogues contrast with the hearings of the Chair of the FED in both chambers of Congress, which are more adversarial, assertive and focused on relevant policy issues. Be that as it may, Amtenbrink considers that the mere existence of monetary dialogue, the reporting requirements and the publication of the Governing Council's meeting minutes partly offsets an overall deficient ECB accountability framework.[342] While I would not disagree with this assertion, it is important to note that central banks hold immense power, which, in the eurozone, has become visible since the sovereign debt crisis. As such, the system's shortcomings need to be balanced against each institution's importance. In this light, what could otherwise constitute a flawed accountability framework with relatively little importance may not be acceptable when considering the magnitude of influence held by the ECB.[343]

Additionally, accountability issues may be a consequence of the degree of the ECB's independence. There is nothing preventing the accountability of an institution established at a Treaty (or constitutional) level. However, while other institutions'

[340] Fabian Amtenbrink and Kees van Duin, 'The European Central Bank before the European Parliament: Theory and Practice after Ten Years of Monetary Dialogue' (2009) 34 European Law Review 561. This is also confirmed by Adina Akbik, *The European Parliament as an Accountability Forum: Overseeing the Economic and Monetary Union* (Cambridge University Press 2022) 179, and Lastra, 'Accountability Mechanisms of the Bank of England and of the European Central Bank' (n 281), by proposing to change the name of 'monetary dialogue' to 'monetary hearings', in order to better convey the spirit of scrutiny. On improvements to this procedure, see Grégory Claeys, Mark Hallerberg and Olga Tschekassin, 'European Central Bank Accountability: How the Monetary Dialogue Could Evolve' (2014) <https://www.bruegel.org/wp-content/uploads/imported/publications/pc_2014_04_monetary_dialogue.pdf> accessed 11 May 2022, 6, and Jean-Victor Louis, 'Democracy and the European Central Bank: Some Comments on Independence and Accountability' in Gregorio Garzón Clariana (ed), *La Democracia en la Nueva Gobernanza Económica de la Unión Europea* (Marcial Pons 2015) 109, 129.

[341] Mark Dawson, Adina Maricut-Akbik and Ana Bobić, 'Reconciling Independence and Accountability at the European Central Bank: The False Promise of Proceduralism' (2019) 25 European Law Journal 75. See also Weiler, 'The Transformation of Europe' (n 35) 2467, in which the author argues that asking questions and receive answers from the Commission are accountability instruments 'illusory at best and misdirected at worst'.

[342] Amtenbrink, 'Economic and Monetary Union' (n 227) 938.

[343] In this vein, see Seraina Grünewald and Jens Van 'T Klooster, 'New Strategy, New Accountability? The European Central Bank and the European Parliament after the Strategy Review' (2023) 60 Common Market Law Review 959. Amtenbrink considers that the importance of the ECB is the reason why its actions must be subject to full judicial review. ibid. 940. I will address this issue regarding the judicial process in Part 3, Chapter 3, where I will endeavour to show that courts may not be the best (or even a good) way to hold the ECB accountable.

independence provisions only encompass their respective members,[344] the TFEU also displays numerous well-developed provisions (ie articles 130, 282 (3) TFEU, as well as article 7 of the ESCB and ECB Statute) concerning the ECB as an institution. This difference is important as it influences the legal interpretation of the Treaties, especially considering that the literal element is reinforced by the historical element. As Rosa Lastra states, Treaty-based independence gives the ECB strong legal protection – stronger, indeed, than that afforded to other central banks with statutory independence.[345]

Moreover, I would concur with Amtenbrink in that the (over) constitutionalisation of the ECB's legal framework makes it very challenging, even unrealistic, to conduct Treaty amendment. Therefore, the accountability capacity of the EU legislative branch is significantly diminished.[346] This scenario contrasts with the FED, since it is not a constitutionally-created institution. In fact, the US central bank was created by Congress, which retains the power to change the US Federal Reserve Act by gaining majority in both chambers (ie withdrawing powers from the FED, abolishing it and subjecting it to controls). Importantly, it is clear that FED's chairs believe they need the support of Congress and the executive branch in order to maintain their authority.[347] Consequently, the political branch acts as a focal-point of political accountability, instead of disperse, arguably less-effective frameworks such as those in the EU.[348]

Crucially, though, as will be further developed below regarding the judicial process (Part III, Chapter 3), the classic perspective according to which central bank

[344] Article 245 TFEU and Article 17 (3) TEU, on members of the European Commission. Although mentioning independence of the European Commission as an institution, this latter provision does so in the context of its members and very briefly; Articles 253 and 254 TFEU, Article 19 (2) TEU on the Judges and AGs of the CJEU and Judges of the General Court; Article 228 (3) TFEU on the Ombudsman; Articles 285 and 286 TFEU on the Court of Auditors.

[345] Lastra, 'Accountability Mechanisms of the Bank of England and of the European Central Bank' (n 281) 23.

[346] Amtenbrink, 'Economic and Monetary Union' (n 227) 937.

[347] See Posner and Vermeule (n 285) 85. For instance, the authors argue that, during the financial crisis, Chair Bernanke worried that the US Federal Reserve could not go too far without sacrificing its democratic legitimacy, which led him and Paulson to seek legislation from Congress.

[348] This is a view shared by Mark Dawson and Ana Bobić, 'Quantitative Easing at the Court of Justice – Doing Whatever It Takes to Save the Euro: Weiss and Others' (2019) 56 Common Market Law Review 1005, 1030. For another example of political accountability see the Reserve Bank of Australia, where a major review was announced by federal Treasurer Jim Chalmers in July 2022. According to the Treasurer, the 'culture, appointments to its board and inflation targets' are formally under review, although he does not 'want it to be primarily about second-guessing decisions that the board has taken, particularly in the recent past'. On the contrary, the goal is to improve the institution's long-term operation. See Tom Stayner, 'Mortgages, Wages and Inflation: Why a Review of the Reserve Bank Matters' *SBS News* (20 July 2022) <https://www.sbs.com.au/news/article/mortgages-wages-and-inflation-why-a-review-of-the-reserve-bank-matters/1q4towq1q> accessed 20 July 2022.

accountability is bolstered by attributing them a high degree of independence, transparency and a narrow mandate is being increasingly challenged.[349] In fact, as appears to have been the case with the ECB, such features may have fostered the institution's integration by stealth, as we have seen previously regarding the CJEU.

3. Adequacy of the European Union budget

From a public finance perspective, an EU budget representing 1% of GNI is considered inadequate. Even adopting a view that the principle of subsidiarity would allow public expenditure to remain largely at national level, the Union budget should rise to 2-2.5% of GNI, to allow for the exercise of a stabilisation function and growth policy.[350] This is not the case for any of the EU's budgets.

There is a strong contrast between this situation and that of mature federations, such as the US or Germany, where several of the main functions, ie those of a social nature, are attached to the federal government and there is a substantial degree of direct connection with citizens of their respective States or regions. Accordingly, these federations are characterised by the predominance of federal over state taxes and relatively large federal public spending, ranging from 36% to 49% of GDP,[351] respectively.

However, this section will focus on the adequacy of the EU budget from the perspective of its reliance on Member States. Unlike the foregoing, whereby the vertical relation established with the Union resulted in a substantial degree of top-down dependence on economic and monetary policies, the budget is dependent and focused on

[349] For the same view see Dawson, Akbik and Bobić (n 341). As the authors explain, 'action in one area often requires extensive intervention in other policy fields, with each intervention carrying high risks of unintended or even contradictory effects. Faced with such problems, the independent institution faces an unattractive choice: it must either decide to stretch its mandate explicitly (and face the associated reputational damage) or seek to do so by stealth, subsuming regulatory interventions in wider policy fields within the language and requirements of the original mission'. This stretching does not need to encompass an 'institutional power grab but merely an effort to meet regulatory tasks originally conceptualised as clear but later revealed to require a complex balancing of mechanisms and interests (precisely the type of balancing that 'narrow mandates' are meant to avoid and place in the hands of more democratic bodies). In this sense, narrow mandates, rather than providing 'clarity' may simply encourage independent decision-makers to hide and re-frame their activities in increasingly convoluted way'. With a different view, see Rosa Maria Lastra and Heba Shams, 'Public Accountability in the Financial Sector' in Eilís Ferran and Charles Goodhart (eds), *Regulating Financial Services and Markets in the 21st Century* (Hart Publishing 2001) 165.

[350] Commission of the European Communities, 'Report of the Study Group on the Role of Public Finance in European Integration. Volume I. General Report' (n 1) 14.

[351] Figures for 2022. See International Monetary Fund, 'Government Expenditure, Percent of GDP' (n 2).

its constituent units. In a way, the federal structure in the EU considerably resembles that which existed in the US before the civil war, whereby the States enjoyed broad autonomous authority over the 'classic trinity of sovereign powers: taxation, the police power, and eminent domain'. Therefore, the federalism in the US in the nineteenth century provided 'a receptive structure for expressions of state autonomy and pursuit of state-oriented economic objectives',[352] just as in the EU in the twenty-first century.

3.1. Reliance on Member States for revenue

Member States have the competence to define the system of the Union's own resources, subject to unanimity. This means that the States choose which revenue sources the supranational level of governance should have at its disposal. It is possible to take a critical view of this situation and consider that this institutional architecture and its dynamic are imbalanced. Indeed, why do European citizens elect EP representatives if the institution has no effective competence on revenue matters, as national parliaments do regarding national budgets?

In order to address this question, it is necessary to look at the nature and evolution of the Union's own resources. Importantly, Member States finance the EU budget and, as such, hold the power of the purse. In turn, this power brings a degree of legitimacy to the current competence distribution in budgetary matters.

Moreover, we can learn from the own resources' evolution, described above (Part II, Point 3). Significantly, the period that recorded the most institutional conflict was the one between 1970 and 1988. During this time, the Union experienced significant transformation and instability, as it was transitioning from a system of national contributions to a system in which an increasing share of genuine own resources would fund the budget. Simultaneously, while the Assembly gained prominence in the decision-making process, Member States in the Council remained the sole legislative authority and were entitled to impose their preferences on most expenditures.

This competence teaches a valuable lesson for the future. Importantly, the source of income and source of authority/legitimacy are two essential components that must be considered in tandem. When both are aligned, as they were in the EU's earlier period and

[352] Harry Scheiber, 'State Law and "Industrial Policy" in American Development, 1790-1987' (1987) 75 California Law Review 419.

from 1989 until the present, budgetary stability emerges and endures. However, the consequence for matching source of income and authority in Member States is that a consensus is difficult to reach both on the quantitative and qualitative streams. On the one hand, Member States' agreement on the 1% GNI budget not only reflects what they are willing to directly provide but also, to an extent, the amount they are unwilling to surpass.

The EU budget is primarily financed by national contributions, but it would be useful to focus on NGEU as the largest EU-level funding programme, which runs with it in tandem.[353] Repayment of the programme in the long-term will rely on the Union's own resources, rather than State transfers. From the perspective of reducing dependence on Member States, this is a positive development. However, a scenario in which funding comes primarily from GNI cannot be excluded. In fact, this was foreseen by the European Council, as the amendment to the ORD allowed the ceiling for commitment appropriations and expenditure to be raised by 0.6% of EU27 GNI until the repayment of NGEU bonds. As Nettesheim states, 'the financial leeway is necessary in case the EU does not succeed in raising the funds necessary for the continuous repayment of the NGEU subsidy and at the same time the EU Member States do not repay the NGEU loans granted to them'.[354] One can infer from this possibility that Member States consider the potential new own resources, such as taxes based on environmental concerns or financial transactions, will either not be adopted or will not raise enough revenue.

Interestingly, this situation has certain similarities to a situation that existed in two periods of US constitutional history up to 1913. First, during the period during which the Articles of Confederation were adopted, the central government was very limited and lacked taxation power. Revenue derived from States' requisitions and were rarely complied with. This is well described by Hamilton, who argued that the confederation, whilst having expressed an intention to provide the Union with unlimited power of providing for its pecuniary necessities, had relied on the erroneous principle of State intermediation. For although, from a constitutional standpoint, States were not permitted to question federal financial demands and had no discretion regarding the end but only the means, in practice, they frequently did.[355] There are more similarities with the EU.

[353] Apart from intergovernmental mechanisms, there are many EU-level funds. They can either be financed exclusively by the EU budget or adopt a hybrid system where Member States also participate. See Crowe, 'The European Budgetary Galaxy' (n 148).
[354] Nettesheim, 'Next Generation EU: The Transformation of the EU Financial Constitution' (n 159) 17.
[355] Alexander Hamilton, 'No 30: Concerning Taxation' in George Carey and James McClellan (eds), *The Federalist* (Liberty Fund 2001) 145, 147.

Both in the US Confederation and in the EU, sub-national units were/are constitutionally required[356] to fund the supranational budget. Although, counterintuitively, States' willingness to fund a larger budget is the crucial element. In fact, in the early stages of development of both political unions, US States refused to pay federal requisitions they considered excessive, whereas EU Member States have not been willing to fund the EU budget over 1%.

Second, there was the notion that the insufficiency of custom duties should be compensated by States' contributions. As seen above (Part II, Point 3), in the EU this was the distinctive feature of its transition to the third period of the EU budget, whereby scarcity of income from customs, other levies and VAT propelled a return to a system where Member States' contributions represented the main source of revenue. There were some problems with such a system. At the outset, it was not equitable. While national contributions were broadly equivalent on relative terms, national tax policies differed, which meant that citizens could have contributed unevenly to the EU. Moreover, it was perceived as an additional burden on national budgets while not providing the Union with sufficient revenue to adequately fund current and, mainly, future policies.[357]

Likewise, during the discussions leading up to the US Constitution, such a system was considered. However, it failed the sufficiency and autonomy requirements of federal revenue while, at the same time, enabling the continuation of the feebleness of the Union. As Hamilton argued, '[w]ho can pretend that commercial imposts are, or would be, alone equal to the present and future exigencies of the union?' If this is so, to rely on State contributions would generate an 'inevitable tendency (…) to enfeeble the union, and sow the seeds of discord and contention between the federal head and its members, and between the members themselves'.[358] In a word: in the US confederation, the nationalistic mindset regarding revenue was also in full display.[359] Eventually, indirect taxes prevailed

[356] In the case of the EU, whether this obligation is of constitutional nature will depend on whether the ORD, as well as its amendments, are considered to be of primary or secondary law nature. For an overview, see Nettesheim, 'Next Generation EU: The Transformation of the EU Financial Constitution' (n 159) 18.
[357] Iain Begg and others, 'Financing of the European Union Budget' (2008) <https://sciencespo.hal.science/view/index/identifiant/hal-03459814> accessed 17 February 2023, 67.
[358] Hamilton, 'No 30: Concerning Taxation' (n 355) 147-48.
[359] In the constitutional convention of Philadelphia, Hamilton argued that States were 'incapable of embracing the general interests of the Union' and 'have almost uniformly weighed the requisitions by their own local interests; and have only executed them so far as answered their particular conveniency or advantage'. See Alexander Hamilton and Francis Childs, 'New York Ratifying Convention. Remarks (Francis Childs's Version), [20 June 1788]' (1788) <https://founders.archives.gov/documents/Hamilton/01-05-02-0012-0005> accessed 15 February 2023.

and States contributions were discontinued. Consequently, prior to the Civil War, the US revenue stream was essentially limited to customs duty. Following the Civil War, until 1913, federal revenue was divided almost equally between customs duties and excises on alcohol and tobacco.

Hence, national contributions are efficient and sufficient within less complex, nascent integration stages. As a result, as EU integration progresses and deepens, claims to maintain GNI contribution due to their efficiency and simplicity[360] should be rejected, as the EU is already at an evolutionary stage whereby convenience must not be the main factor when deciding how to fund the EU budget.

3.2. Expenditure focused on Member States

3.2.1. General considerations

Like revenues, Member States have the competence to define expenditures in the framework of the MFF. However, in this realm, the EP has a more visible and consequential role, since its consent is required. In fact, in the absence of agreement between the EP and the Council, article 312 (4) TFEU determines that the ceilings and other provisions of the previous framework are extended until a new one is adopted. This indeed grants the EP more power to negotiate given that, in a way, it holds veto power over the MFF.

However, there are shortcomings that essentially reduce the EP to a passive role. Crucially, budgetary leadership remains with Member States, as the Treaty establishes that it is up to the Council to adopt the MFF under the special legislative procedure (article 312 (2) TFEU). Therefore, from an institutional standpoint, the role of the EP is not placed on an equal footing but is rather attributed ancillary or secondary importance.[361]

The only procedure in which the EP is on equal footing with Member States is on the adoption of the Union annual budget (article 313 TFEU and seq.), whereby the European Commission is tasked to make a proposal so that the Council and EP can debate and negotiate. However, this presumed institutional equality is already conditioned by the

[360] European Commission, 'Future Financing of the EU, Final Report and Recommendations of the High Level Group on Own Resources' (n 155) 37; Friedrich Heinemann, Philipp Mohl and Steffen Osterloh, *Reform Options for the EU Own Resources System* (Physica-Verlag 2008) 125; Begg and others (n 357) consider GNI as one option among others. They also conducted a survey on Member States, which showed, unsurprisingly, that GNI is their preferred method going forward.
[361] Dieter Grimm, *Constitutionalism: Past, Present and Future* (Oxford University Press 2016) 278.

nature of own resources and the revenue and expenditure agreed by Member States beforehand.

To better grasp the causes of the predominance of Member States in expenditure, it is necessary to consider it in the context of sources of revenue.[362] In other words, rather than a one-sided understanding of the EU budget, a holistic approach will better address the issue. The fact that the EU budget's revenue is mainly composed of Member State contributions favours a nationalistic mindset – a practice known as *juste retour*.[363]

This feature is consequential for expenditure allocation. In the EU, the reflection of this feature is the overwhelming weight of the CAP and cohesion policy[364] in the supranational budget.[365] Although these policies have some features that deliver EU-wide benefits,[366] most funding is geographically pre-allocated,[367] ie for (specific) Member States or sub-national regions. It is less commonly allocated to policies inducing transnational benefits (European public goods), therefore, hindering policies that would benefit Member States even in the absence of spending. Moreover, CAP and cohesion are

[362] Heinemann, Mohl and Osterloh (n 360) 75; Alain Lamassoure, 'Report on the Future of the European Union's Own Resources' (2007) <https://www.europarl.europa.eu/doceo/document/A-6-2007-0066_EN.html> accessed 24 February 2023, 10.

[363] Manuel Porto, *O Orçamento Da União Europeia - As Perspectivas Financeiras Para 2007-2013* (Almedina 2006); Sándor Richter, 'Facing the Monster "Juste Retour": On the Net Financial Position of Member States Vis-à-Vis the EU Budget and a Proposal for Reform' (2008) wiiw Research Reports 348 <https://wiiw.ac.at/facing-the-monster-juste-retour-on-the-net-financial-position-of-member-states-vis-a-vis-the-eu-budget-and-a-proposal-for-reform-dlp-456.pdf> accessed 12 February 2024; Peter Becker, 'The European Budget and the Principles of Solidarity and Added Value' (2012) 47 International Spectator 116.

[364] For instance, the agricultural sector is a traditional French request. However, its economic and social importance in the EU has declined overtime. Moreover, while regional policy has successfully compensated potential losers from the internal market, it has internalised pork-barrel spending in fund distribution, delivering results that are not commensurate to its objective, such as the needless funding of regions within wealthier Member States. See Sergio Fabbrini, 'Representation without Taxation: An Association or Union of States?' in Alfredo De Feo and Brigid Laffan (eds), *EU Own Resources: Momentum for a Reform?* (European University Institute 2016) 19, 22; Giacomo Benedetto (n 144).

[365] Meanwhile, other programmes share the remaining MFF resources. In fact, the MFF 2014-2020 allocated 7% of its resources to the remaining programmes. For 20 of those programmes, yearly funds were small, having varied from €18 million to €185 million. See Gabriele Cipriani, *Financing the EU Budget – Moving Forward or Backwards?* (Centre of European Policy Studies 2014) 79. The MFF 2021-2027 does not change the situation significantly. See European Commission, 'Multiannual Financial Framework 2021-2027 (in Commitments) - 2018 Prices' (2020) <https://commission.europa.eu/system/files/2021-01/mff_2021-2027_breakdown_2018_prices.pdf> accessed 23 February 2023.

[366] Lehner (n 142) 25. The author argues that the centralisation of a large part of public support for agriculture at the EU level represents EU-added value in itself, which is seldom reflected upon. Importantly, it defines a level playing field in a sector highly prone to political pressure and, as a result, vulnerable to subsidy competition. Ultimately, the decentralisation of agricultural subsidies could not only represent a higher burden on EU citizens but also the EU single market. Similarly, cohesion policy supports the regional development of the EU as a whole, particularly if combined with cross-border infrastructure investments.

[367] More than 2/3 of expenditure is directly or de facto pre-allocated on a country basis as part of the MFF. Cipriani (n 365) 80.

policies that resemble political priorities developed within the framework of the EEC Treaty. While retaining some relevance, they do not fully match the dynamic societal progress as argued infra (Part IV, Chapter 1, Point 1.2.2).

However, this methodology embodies two main issues: one of a conceptual nature and another of an operational nature. The former is related to the mismatch of revenue sources and expenditure destinations, which are essential for a balanced budgetary system. Interestingly, from the late eighteenth to early twentieth centuries, US federal revenue was mainly based on indirect taxes and, in contrast with the EU in the interim budgetary period, the model was stable and uncontentious. The key difference was the alignment between the nature of expenditure and source of revenue. In the US, most revenue was allocated to the payment of States' debt related to the revolutionary war and military purposes.[368] This allocation was considered a way to counter both internal and external threats to the US federation survival[369] and deliver a federation-wide public good. As a result, what the experiences of the EU and US demonstrate is that, as interconnection between sub-national units increases and supranational expenditure becomes increasingly warranted, there is tension between those who fund and the nature of spending.

From an operational point of view, the decommitment rule makes spending EU funds mandatory within a specific timeframe, otherwise funding will not be carried over to the next fiscal year. Consequently, success in implementing EU policies is directly proportional to the amount of funds spent and not necessarily related to the quality of spending or the link to transnational effects.[370]

3.2.2. Next Generation EU

NGEU is considered a pivotal programme in European integration,[371] given that it attempts to shift the focus of the political process from Member State coordination to EU-

[368] Tomasz P Woźniakowski, 'The Fiscal Origins of American Power: Federal Tax Policy and US Territorial Expansion in the Nineteenth Century' (2020) <https://cadmus.eui.eu/handle/1814/69360> accessed 14 February 2023.
[369] The internal threat was due to the large social unrest in the States, caused by the high level of direct taxation needed to pay for such debts. The external threat was related to the military context of the time, whereby independence had been conquered but had to be maintained. Eventually, this military investment was used for US territorial expansion. See Tomasz P Woźniakowski, *Fiscal Unions: Economic Integration in Europe and the United States* (Oxford University Press 2022).
[370] Cipriani (n 365) 80.
[371] See, for instance, Marco Buti and Sergio Fabbrini, 'Next Generation EU and the Future of Economic Governance: Towards a Paradigm Change or Just a Big One-Off?' (2023) 30 Journal of European Public Policy 676. Fabbrini, *EU Fiscal Capacity: Legal Integration After Covid-19 and the War in Ukraine* (n

led fiscal funding.[372] The importance of the latter became clear with the various crises recently experienced in the EU, namely on sanitary, security and energy matters. Crucially, the limits of inter-State coordination became clear when the EU faced asymmetric national fiscal capacity, namely through the difficulty in reconciling weaker and stronger links.

Regarding expenditure, article 3 of the RRF Regulation stipulates that NGEU should be allocated to several predefined policy areas of European relevance, such as the green transition, digital transformation, smart, sustainable and inclusive growth, social and territorial cohesion, health, economic, social and institutional resilience, and policies for the next generation: children and youth. To fund these priorities, NGEU empowered the European Commission to borrow funds on the capital markets on behalf of the Union, rather than Member States individually.[373] This was similar to what had previously occurred with SURE. In contrast, SURE not only relied on Member State guarantees to a certain extent, which conditioned the availability of the instrument (article 11 and 12 of the SURE Regulation), but also assistance, which came in the form of loans, not grants.

To a certain extent, NGEU shifted the nature of Union expenditure, which focused on redistributive policies since its inception. Interestingly, it appears to have started a transition towards investing in policies[374] capable of delivering greater transnational benefits, such as mitigating the socio-economic effects brought about by the pandemic,

159); Gavin Barrett, 'Coronavirus and EU Law: Driving the Next Stage of Economic and Monetary Union?' in Gavin Barrett and others (eds), *The Future of Legal Europe: Will We Trust in It?* (Springer 2021) 55; Armin Steinbach, 'The Next Generation EU - are we having a Hamiltonian moment?' (2020) 23 EU Law Live Weekend Edition 2; Maria Antonia Panasci, 'Unravelling Next Generation EU as a Transformative Moment: From Market Integration to Redistribution' (2024) 61 Common Market Law Review 13.

[372] Or a paradigm shift from 'negative fiscal integration' to 'positive fiscal integration'. See Paul Dermine, 'The EU's Response to the COVID-19 Crisis and the Trajectory of Fiscal Integration in Europe: Between Continuity and Rupture' (2020) 47 Legal Issues of Economic Integration 337. See also Dermot Hodson and David Howarth, 'The EU's Recovery and Resilience Facility: An Exceptional Borrowing Instrument? (2024) 46 Journal of European Integration 69. Explaining that NGEU occurred through successive episodes of reinterpreting the rules and layering on new instruments, see Amandine Crespy, 'How the impossible became possible: evolving frames and narratives on responsibility and responsiveness from the Eurocrisis to NextGenerationEU' (2024) 31 Journal of European Public Policy 950.

[373] This also took place in the European Stability Mechanism, when Member States signed an international treaty and were entrusted with specific obligations, such as directly providing for its funding.

[374] The link between funding and policy areas was key for the Council's Legal Service to conclude that no financial assistance existed and, therefore, the requirements of article 122 (1) TFEU were fulfilled, as opposed to those of article 122 (2). See Council of the European Union, 'Opinion of the Legal Service on the Proposals on Next Generation EU (2020) 9062/20' (2020) <https://data.consilium.europa.eu/doc/document/ST-9062-2020-INIT/en/pdf> accessed 10 December 2022, para 120-122.

preparing the Union for future sanitary catastrophes, as well as investing in efforts towards the EU climate targets.[375]

Despite these positive features, several issues remain that blur the transnational dimension of the programme. First, Member States are considered to be the sole beneficiaries of the RRF, directly managing the funds, which means that the European Commission's legal responsibility stops at Member States' borders.[376] As a result, States bear the responsibility of formulating and implementing their specific programmes.[377]

Second, NGEU was predominantly established by intergovernmental institutions. In fact, the European Council and the Council had an important role regarding the decision on own resources as well as the approval of the recovery and resilience plans and their monitoring, respectively. This is problematic given the dysfunction characterising these EU institutions and the ensuing legitimacy issues.

Finally, by linking these plans to the country specific challenges and priorities identified in the European Semester, as well as those identified in the Council's recommendations on the economic policy of euro area Member States, article 17 (3) of the RRF Regulation reinforces the national footprint and the vertical relationship, as described.

For these reasons and considering the timeline of implementation, NGEU is a programme designed to fit a redistributive role rather than a role of stabilisation.[378] [379] Although funding allocation took important factors into account for this latter role,[380] the

[375] However, funding disbursement along national lines has been criticised, given that most of it is going to countries that have had problems before or are poorer. In this vein see Clemens Fuest, 'Panel Discussion' in Hanno Kube and Ekkehart Reimer (eds), *Solid Financing of the EU* (Institut für Finanz- und Steuerrecht 2021) 79, 92.

[376] Articles 8 and 22 (1) of the RRF Regulation. This significantly differs from the shared management modality adopted regarding EU cohesion policy, whereby the European Commission retains powers throughout the whole process, from conception until disbursement and the implementation of funding. See Gómez (n 159) 9.

[377] Mariana Mazzucato, Marco Carreras and Olga Mikheeva, 'Steering Economic Recovery in Europe' (2023) <https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2023)699556> accessed 14 February 2024.

[378] This follows the traditional perspective of public economic policy's role, proposed by Musgrave in Richard Musgrave, *The Theory of Public Finance* (McGraw-Hill 1959).

[379] In this vein, see Pilar Más Rodríguez, 'The EU Budget: The New MFF and the Recovery Instrument: Next Generation EU' in Fernando Fernández Méndez de Andés (ed), *The Euro in 2021* (Fundación de Estudios Financieros 2021) 169. A sobering account of the importance of NGEU, especially in comparison with US history, see Christakis Georgiou, 'Europe's "Hamiltonian Moment"? On the Political Uses and Explanatory Usefulness of a Recurrent Historical Comparison' (2022) 51 Economy and Society 138.

[380] Annex I of the RRF Regulation establishes factors with a stabilising nature, namely inverse per capita GDP; average unemployment rate over the past five years compared to the Union average in the 2015-2019 period, the fall in real GDP in 2020 as well as the fall in real GDP in 2020 and 2021 combined.

first national programmes were approved in July 2021, more than a year after the first lockdown, when many EU Member States had, or had nearly, recovered pre-pandemic economic levels. Moreover, around three quarters of RRF payouts become effective from 2023 onwards. Importantly, it is possible that the investments fostered may result in more resilient economies in each Member State and in the EU as a whole, therefore, providing a stabilisation effect for future crises. However, budgetary stabilisation instruments are primarily designed to deliver during economic downturns,[381] not after.

A comparison with the response of the US will put NGEU in perspective. In the US, there was significant investment from the outset of the pandemic with the enactment of the Coronavirus Aid, Relief, and Economic Security Act, a $2.2 trillion economic stimulus bill signed into law on March 27th 2020, $339.8 billion of which was assigned to State and Local governments.[382] Furthermore, the American Rescue Plan Act of 2021 totalled $1.9 trillion,[383] $360 billion of which was granted as additional emergency funding for State and Local governments.[384] As a result, the American response's overall total increased to $4.1 trillion, the majority of which was allocated to natural and legal persons directly.[385]

Be that as it may, US federal expenditure is, generally, much higher than the EU's, which means that raw comparisons may not be as useful as they seem. In this regard, comparative usefulness is dependent on other factors, such as Member States' expenditure to counter the pandemic, in addition to NGEU. According to the European Commission, Member States granted state aid a total of roughly €535.16 billion in 2020.[386] France granted €158.03 billion (29.52%), followed by Germany with €111.46 billion (20.82%) and Italy with €111.04 billion (20.74%). Relative to GDP, France was

[381] Arjan Lejour and Willem Molle, 'The Value Added of the EU Budget: Subsidiarity and Effectiveness', *The EU Budget: What should go in? What should go out?* (Swedish Institute for European Policy Studies 2011) 87.
[382] H.R.748 - Coronavirus Aid, Relief, and Economic Security Act, available at https://www.congress.gov/bill/116th-congress/house-bill/748.
[383] H.R.1319 - American Rescue Plan Act of 2021, available at https://www.congress.gov/bill/117th-congress/house-bill/1319/text.
[384] Fabbrini, *EU Fiscal Capacity: Legal Integration After Covid-19 and the War in Ukraine* (n 159) 96.
[385] For instance, cash payments or increased unemployment benefits. See H.R.748 - Coronavirus Aid, Relief, and Economic Security Act (n 382) and H.R.1319 - American Rescue Plan Act of 2021 (n 383).
[386] See European Commission, 'State Aid Scoreboard 2021' (2022) <https://competition-policy.ec.europa.eu/system/files/2022-09/state_aid_scoreboard_note_2021.pdf> accessed 27 February 2023, 35. These figures do not include the UK. Therefore, some nominal figures and percentages (except figures relative to GDP) are out of the author's own calculations.

the country that provided the most (6.9%), followed by Italy (6.7%), Poland (6.0%) and Spain (4.39%). Germany provided the lowest aid (3.3%).

Crucially, regarding the aid element of the measures,[387] Member States granted a total of €182.64 billion in COVID-19-related funding in 2020, an equivalent of 1.36% of EU GDP. However, there was significant variation between them, either relating to relative or absolute terms.[388] For instance, on the top-end of the spectrum, Poland and Greece spent 3.8% and 3.6% of national GDP, respectively, while Germany stood at around 1.8% and Ireland and Sweden were the ones who spent the least. As important as relative indicators may be, a high percentage of a small figure has limited impact at the EU level. Conversely, a smaller percentage of bigger figures may have a comparatively higher impact. That is the reason why nominal values are also relevant indicators. In this regard, the Member State that spent the most in 2020 was Germany with a total of €63.66 billion (34.85%), followed by Italy with €29.64 billion (16.22%), France with €28.96 billion (15.86%) and Poland with €19.9 billion (10.4%).[389]

From this snapshot, it is possible to conclude that there is a huge differentiation in aid provision (as opposed to funding availability) in the EU, therefore, demonstrating the limits of a national approach. In fact, not only did Germany account for over one third of aid element, but over 77% was accounted for by just four Member States.

This outcome is also relevant to highlight the purpose of State aid law. Crucially, State aid rules were adopted mainly to prevent distortions to competition in the internal market. Indeed, State aid is prohibited as a rule (Article 107 (1) TFEU), except when Member States are expressly authorised to grant it by the European Commission. Therefore, there is a prominent negative nature underlying State aid law, as its objective

[387] It represents the difference between nominal amounts of aid granted and the corresponding aid elements. While for some types of aid, such as direct grants, the nominal amount coincides with the aid element, for other instruments, such as repayable instruments, the nominal amount represents the nominal value of the underlying credit contract (ie loan or guarantee), while the aid element quantifies the advantage to the beneficiary and the cost to government (ie the lower interest rate for a subsidised loan or the reduced guarantee fee). ibid. 34.

[388] ibid. 22-23.

[389] These figures are roughly similar to those of 2021. In fact, Member States granted a total of €190.65 billion in COVID-19-related funding. In absolute values, Germany remained the Member State that provided the most aid in absolute terms, with an amount of €64.30 billion, significantly higher than the ones granted in other Member States. France followed with €39.92 billion. Italy and Spain showed much lower amounts as aid elements, €22.94 billion and €12.48 billion, respectively. This was due to a large share of aid having been channelled through repayable instruments. The same occurred with the Netherlands, with €8.84 billion. See European Commission, 'State Aid Scoreboard 2022' (2023) <https://competition-policy.ec.europa.eu/document/download/16b908d6-5319-4d11-9c56-d26ffc65ada8_en?filename=state_aid_scoreboard_note_2022.pdf> accessed 27 February 2023, 38

is directed to hinder Member States' ability to adopt economic policies purely based on national concerns, rather than to foster the European economy. Understandably, this rationale was put on hold during the COVID-19 pandemic,[390] particularly due to the inadequacy of the EU instruments, which had developed since the financial crisis. Their rationale was to counter asymmetric and small-scale crises, not a situation of overall distress. However, in a way, economic policy through State aid is the antithesis of NGEU, which began to pave the way to the end of fragmented integration in EU economic policy and eased the cycle of state domination over state equality that emerged during the euro crisis.

This significantly contrasts with the response of the US, which was more robust and integrated. More robust, not only given that it substantially outweighed the financial total of the EU response, but also because it impacted fewer citizens.[391] More integrated, because more funding was centralised and allocated according to a single rationale.

4. Problem of participation

In February 2010, the Heads of State or Government of the EU issued a statement[392] in which eurozone Member States pledge to 'take determined and coordinated action, if needed, to safeguard financial stability in the euro area as a whole'. In the literature, this statement has been interpreted as a watershed moment for the EU, one that shaped all ensuing policies and constrained future action by the ECB and the CJEU (even *de facto* mandating the course of action).[393]

From the analysis in Part II, Chapter I, it is possible to conclude that competence creep, the certainty that legitimacy lies with national governments and the belief that the market-based process failed, led to a deficient choice of institutions in order to achieve

[390] Regarding state aid and COVID-19, specifically, see Irene Agnolucci, 'Will COVID-19 Make or Break EU State Aid Control? An Analysis of Commission Decisions Authorising Pandemic State Aid Measures' (2022) 13 Journal of Competition Law & Practice 3; Petar Petrov, 'State Aid and COVID-19: With a Particular Focus on the Air Transport Sector' (2021) 20 European State Aid Law Quarterly 461; Carole Maczkovics, 'How Flexible Should State Aid Control Be in Times of Crisis?' (2020) 3 European State Aid Law Quarterly 271.

[391] Specifically, it impacted around 3/4 of the EU's population in 2021. See https://data.worldbank.org/indicator/SP.POP.TOTL.

[392] European Council, 'Statement by the Heads of State or Government of the European Union' (11 February 2010) <https://www.consilium.europa.eu/media/20485/112856.pdf> accessed 9 May 2022.

[393] Vestert Borger, *The Currency of Solidarity: Constitutional Transformation during the Euro Crisis* (Cambridge University Press 2020).

an identified social goal (financial stability of the eurozone as a whole).[394] Such a decision did not take into account that goal choice and institutional choice are inextricably linked, not only because institutional performance has to be assessed against a set of goals but also because it is 'institutional choice that connects goals with their legal or public policy results'.[395]

Consequently, Heads of State or Government of the EU may have ignored the alternatives. To an extent, the apparent high level of legitimacy and swifter solution-crafter feature of the European Council benefited from the assumption that intergovernmentalism would be frictionless. Therefore, Member States seemingly did not take into full consideration the potentials and perils of the political process (in this case, executive dominance), in comparison with the pros and cons of a market-based process. However, as taught by Komesar, '[t]he choice is always a choice among highly imperfect alternatives',[396] especially in complex situations, such as crisis management (either of an economic nature or another sort).

4.1. Power of the many in European Union monetary policy

The Komesarian two-force model admits a situation where the majority dominates political outcomes, even in a lower-stakes scenario. This majoritarian influence can, in fact, represent a countervailing force to minoritarian skews.

Should the ECB be seen as a countervailing force to the previously mentioned minoritarian bias in economic policy? There is no definitive answer. For instance, Antonio Estella considers that, despite the high degree of legal independence, the ECB acts under what could be called 'the shadow' of the *Bundesbank*. Importantly, the ECB's underlying principles are all depicted from the *Bundesbank* as either a culture of independence (which the establishment, at the highest normative hierarchical level of the EU's legal order, is a testament of), with the emphasis placed on the control of inflation as primary focus, or as the prohibition of Member State bailouts. Moreover, the ECB's legitimacy feeds on that of the *Bundesbank* and its support.[397]

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[394] See Lionello (n 237) for an extensive study on the ramifications of the definition of financial stability as an overarching objective of EU law.
[395] Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics and Public Policy* (n 3) 5.
[396] ibid.
[397] Estella, *Legal Foundations of EU Economic Governance* (n 239) 84. See also Harold James, 'The Reichsbank and the Bundesbank: The Legacy of the German Tradition of Central Banking' in Peter Conti-

This statement may have been true during the first decade of the monetary union, during which Member States went without any particularly strong financial crisis. As such, the EU was in a context of low(er) complexity and low(er) stakes, where institutions were less strained and a consensus was easier to reach. This meant that the alignment of Governors within the ECB Governing Council was a simpler task. Making an opposite decision would run the risk of breaching Treaty provisions with no significant conjunctural justification, and with little benefits in reverse. Moreover, it could hinder the ECB's credentials, which were still recent at the time and in-need of establishing credibility. Therefore, under this period, there is some basis to say that, regardless of the majoritarian voting system, minoritarian bias could have existed within the Governing Council of the ECB, given the intellectual hegemony of the *Bundesbank*.

However, the situation changed with the financial crisis. In this situation, costs and benefits of ECB intervention rose, as well as the incentive to participate. It is in this context that the ECB should be seen as a countervailing force to the previously mentioned minoritarian bias in economic policy. Unlike the ESM Treaty's voting rules, Article 10.2 of the Protocol No 4 states that the ECB Governing Council makes decisions by simple majority, as a rule, including monetary policy decisions, either conventional or unconventional – no distinction is made.

This voting rule changes the power dynamics because, by definition, it is not possible for a small group to impose certain preferences on others. However, as Komesar explains, the majority may decide without considering the 'severity of impact or the intensity of feeling about the issue'. Therefore, 'a low-impact majority can prevail over a high-impact minority even though the majority will gain little and the minority is harmed greatly'.[398]

It is clear that majoritarian influence has taken place since the ECB's decision to create SMP in 2010. Although the voting distribution is not disclosed, it seems to be the

Brown and Rosa Maria Lastra (eds), *Research Handbook on Central Banking* (Edward Elgar 2018) 229, 239.

[398] Neil Komesar, 'A Job for the Judges: The Judiciary and the Constitution in a Massive and Complex Society' (1988) 86 Michigan Law Review 657, 671. Closely following Komesar, see Maduro, *We The Court: The European Court of Justice and The European Economic Constitution* (n 6) 119. Discussing potential central bank's biases see António Leitão Amaro, 'The Post-Pandemic Inflation and Central Bank Independence' (2022) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4499194> accessed 7 March 2024, 16.

case that the *Bundesbank* was one of the few (or, indeed, the only institution) to vote against the OMT.[399]

Whether there was majoritarian bias is more difficult to ascertain, although there is some evidence pointing to the affirmative. Komesar considers that in order for a bias of this nature to occur, it is necessary to evaluate whether the gains obtained by the majority are less than the harm inflicted upon the minority. As previously stated, the ECB was designed to mirror the *Bundesbank*, to an extent. Therefore, it is unsurprising that the latter institution and, likely, the majority of German society, holds strong views against asset purchases, including sovereign bonds, due to the presence of several risks. For instance, it may endanger the principle of price stability, given that more central bank liquidity placed into the economy creates fiscal space, thus excessively increasing private and public demand.

Moreover, it may distort risk perception and asset allocation. Robust central bank intervention has an immediate effect on markets because it adds liquidity. Interest rates reduce as a result of this financial intervention (not necessarily due to other reasons, such as improving budgetary indicators), thus creating a wider disconnect between financial conditions and economic performance. Risk reduction will immediately be reflected in interest rates on public debt, benefitting Member States. Overtime, it creates the opportunity to reduce the interest burden on debt stock, by exchanging old coupons for new ones. This will create fiscal space, especially in more indebted Member States. On the one hand, if eased financial conditions favour fiscal consolidation in the short-term, incentives to pursue this strategy in the long-term may reduce.

Regarding the advantages, the programmes were designed to ensure the stability of the eurozone as a whole. During the sovereign debt crisis, achieving this objective meant controlling Member States' sovereign debt yields. However, the distribution of benefits was disproportionate. In my view, as the ECB developed a vertical relationship with Member States, it started tailoring measures with individual States in mind. For instance, the eligibility of the SMP and OMT was restricted to countries implementing an economic

[399] See Danhong Zhang, 'German Court to Rule in ECB Fight' *Deutsche Welle* (Bonn, 16 February 2016) <https://www.dw.com/en/fight-over-ecb-bond-buying-returns-to-german-court/a-19050494> accessed 10 May 2022. However, the foundational authority of the ECB regarding the adoption of expansionary monetary policy was, increasingly, derived from the people of Europe, as argued by Hjalte Lokdam, '"We Serve the People of Europe": Reimagining the ECB's Political Master in the Wake of Its Emergency Politics' (2020) 58 Journal of Common Market Studies 978.

adjustment programme. However, the PSPP was open to all eurozone Member States. Nevertheless, although one can only speculate about the ECB's intention, purchasing sovereign bonds from the secondary market had the effect of creating an artificial demand for national public debts, thus lowering its costs. In this regard too, some Member States benefitted more than others. It was, arguably, lifesaving for States like Greece, Portugal and Italy, which have very large debt-to-GDP ratios,[400] although significantly less impactful for the majority.

From this perspective we can conclude that some elements of majoritarian bias can be found in ECB's action, as it is possible that the benefits secured by the majority of States may not surmount the intensity of opinion and costs of the minority.[401]

4.2. Power of the few in intergovernmentalism

4.2.1. In economic policy

Intergovernmentalism in EU economic policy may be a source of minoritarian bias. There are many kinds of intergovernmentalism.[402] In order to focus on the most important strands from the financial crisis onwards, one must highlight liberal and new intergovernmentalism. For the former, the responses adopted by the EU were a form of coercive power – an effort to shift costs to weaker Member States in order to avoid eurozone breakup.[403] Differently, the latter adopts an 'ideational power' approach, essentially to argue that Member States agreed with the restrictive economic measures that some had to implement, as well as the reinforcement of the SGP, EDP, as well as adoption of TSCG, in exchange for financial assistance. Therefore, for this line of reasoning, intergovernmentalism relies on consensual agreement[404] among national

[400] See debt-to-GDP levels for 2011-2012, date of approval of OMT, in Eurostat, 'Maastricht Debt as a Percentage of GDP, 2011–2012' (2013) <https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Archive:Structure_of_government_debt_-_data_2011-2012> accessed 28 December 2023.

[401] This assertion is also supported by the ECB's intrusion in domestic economic policy, as evidenced by letters sent to Spanish and Italian governments demanding structural reforms. See Vivien Schmidt, 'Rethinking EU Governance: From "Old" to "New" Approaches to Who Steers Integration' in Ramona Coman, Amandine Crespy and Vivien Schmidt (eds), *Governance and Politics in the Post-Crisis European Union* (Cambridge University Press 2020) 94.

[402] ibid, 99.

[403] Frank Schimmelfennig, 'Liberal Intergovernmentalism and the Euro Area Crisis' (2015) 22 Journal of European Public Policy 177.

[404] Puetter, 'The European Council' (n 244). The view that the EU in general was based on Member States decision to establish a democracy of consensus, instead of a majoritarian democracy is defended by Armin Von Bogdandy in Armin von Bogdandy and Joseph Weiler, 'La Democracia En Europa' in Armin von Bogdandy and others (eds), *El futuro de la Unión Europea. Retos y desafíos* (Instituto Vasco de la

executives, even though the Council's decision-making can be conducted largely by qualified majority voting.

My understanding is that neither of these approaches correctly depict reality. Member States did not agree to the implementation of economic policy measures at a national level because they were (financially) coerced. After all, the Maastricht entry criteria was clear regarding the indicators that needed to be met in order to join the common currency, which included sound public finances. In addition, the SGP and EDP were approved under a context of financial stability, which goes to show that the reasoning behind them was well understood and freely accepted by all Member States, including those that joined subsequently. The point here is that sound public finances have been a prerequisite for EMU since 1992; it was not agreed in the midst of a crisis.

However, it would also be unreasonable to consider that Member States easily agreed to adopt harsh economic measures at the national level, sometimes within a demanding timeframe.[405] In this regard, I share Schmidt's view that, despite the European Council and Council's consensus-seeking rule or methodology, respectively, it is necessary to recognise that unanimous deliberations were not made among *de facto* equals.[406] Rather, a creditor-debtor relationship emerged, hindering the general principle of equality between States[407] and establishing a dual public perception: for some, EU economic policy meant a transfer of wealth between Member States and, for others, it meant externally-imposed economic adjustment programmes.[408]

Such disproportion is possible due to the ESM's governance regime. Article 4 (2) ESM Treaty establishes that the decisions of the Board of Governors and Board of Directors are made through a mutual agreement, qualified majority or simple majority. The joint reading of article 4 (2) and (3) ESM Treaty allows one to draw the conclusion

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Administración Pública 2021) 211, and also Arend Lijphart, *Patterns of Democracy* (Yale University Press 1999) 42.

[405] Greece is the most notable. See, for instance, Markakis (n 279) 85.

[406] Schmidt, 'Rethinking EU Governance: From "Old" to "New" Approaches to Who Steers Integration' (n 401) 99.

[407] In this regard, see Federico Fabbrini, 'States' Equality v States' Power: The Euro-Crisis, Inter-State Relations and the Paradox of Domination' (2015) 17 Cambridge Yearbook of European Legal Studies 3.

[408] Miguel Poiares Maduro, 'A New Governance for the European Union and the Euro: Democracy and Justice' (2012) <https://cadmus.eui.eu/bitstream/handle/1814/24295/RSCAS_PP_2012_11rev.pdf?sequence=1&isAllowed=y> accessed 10 May 2022; Fabbrini, 'States' Equality v States' Power: The Euro-Crisis, Inter-State Relations and the Paradox of Domination' (n 407) 15.

that mutual agreement means the unanimity of members participating in a vote when there is a quorum of 2/3 of members with voting rights representing at least 2/3 of such rights.[409]

Article 5 (6) ESM Treaty establishes a non-exemplificatory list of decisions requiring mutual agreement, namely 'to provide stability support by the ESM, including the economic policy conditionality as stated in the memorandum of understanding referred to in Article 13 (3) ESM Treaty, and to establish the choice of instruments and the financial terms and conditions (…)' (indent f) and 'to give a mandate to the European Commission to negotiate, in liaison with the ECB, the economic policy conditionality attached to each financial assistance (…)' (indent g).

Crucially, article 4 (4) ESM Treaty introduces a derogation to both referred indents. Accordingly, if the European Commission and the ECB conclude that failure to urgently adopt a decision on financial assistance would threaten the economic and financial sustainability of the euro area, an emergency procedure is triggered whereby the voting threshold is set at 85% of the votes cast. Considering the capital key, which is held by each ESM Member, attached in Annex I of the ESM Treaty, this means that Germany, France and Italy may individually block a decision regarding financial assistance. Moreover, article 5 (7) ESM Treaty provides an exemplificatory list of decisions to be taken by a qualified majority of 80% voting threshold. In this case, Germany and France can individually block decisions.

Economic might is reflected not only regarding the ability to obstruct but also to promote decision-making. In fact, a small minority of countries would be able to meet the 80% or the 85% threshold and could, for instance, choose the managing director or approve a financial assistance plan.

The SRF followed a similar rationale, both in form (via the international agreement)[410] and substance (favouring wealthier Member States). The funding of the SRF is based on the contributions Member States collect from national credit institutions (article 3 SFR Agreement), which are stored in national compartments and would, progressively, become mutualised (article 4 SRF Agreement). Once a resolution needs to

[409] According to article 11 (1) ESM Treaty, eurozone Member States contribute to the capital of the ESM on the basis of the subscription by their national central banks to the capital of the ECB. Given that the source of ESM funding are contributions from its members, more prosperous Member States transfer more money to the ESM capital and, thus, have more influence. Annex 1 of the ESM Treaty stipulates that each Member contribution key.

[410] See Council of the European Union, 'Agreement on the Transfer and Mutualisation of Contributions to the Single Resolution Fund' (n 258).

be funded by the SRF, funds are drawn from the respective compartment. If the national compartment is insufficient, additional funds may be requested from the financial means available in other compartments (article 5). In case further funding is necessary, Member States may temporarily make use of the financial means available to them in the compartments of the Fund that have not yet been mutualised, corresponding to the other parties of the SRF Agreement. In this case, concerned parties must transfer additional resources to the Fund (article 7 (1) SRF Agreement) unless they object on the grounds established in article 7 (4). As Fabbrini argues, '[t]his rule effectively vests in the wealthier states – and ultimately in Germany, as the most prosperous one in financial terms – the real decision-making power relating to the SRF'.[411]

The outcome of these governance frameworks is that financial resources are primarily sourced from wealthier Member States. As much as Member States in financial distress benefit from such assistance, the costs are concentrated on a small number of countries and their individual interests.

Arguably, intergovernmentalism made matters worse. It is known that imbalances that favour the occurrence of a minoritarian bias are visible in the formal decision-making process of the Council. According to article 16 (3) TEU, the general rule for voting is attaining a qualified majority via a procedure known as a 'double majority', foreseen in article 16 (4) TEU: when the Council votes on a proposal by the European Commission or the High Representative of the Union for Foreign Affairs and Security Policy, a qualified majority is reached if 55% of Member States vote in favour and the proposal is supported by Member States representing at least 65% of the total EU population. If the proposal does not come from the referred proponents, a decision is only adopted if the so-called 'reinforced qualified majority' is reached, meaning at least 72% of Council members vote in favour, representing at least 65% of the EU population. A blocking minority must include at least four Council members representing more than 35% of the EU population (article 238 (3) (a) TFEU).

This procedure already awards a disproportionately high(er) incentive to the most populous Member States, which correspond to those that are larger and wealthier. However, since the ordinary legislative procedure includes the EP, an institution that

[411] Fabbrini, 'States' Equality v States' Power: The Euro-Crisis, Inter-State Relations and the Paradox of Domination' (n 407) 21.

takes most of its decisions through a simple majority and with a different focus than the Council, Member States' power gets diluted, fostering compromise solutions.

Having compared different procedures, the conclusion is that the thresholds of the ESM and SRF are higher than the Council's. Most worryingly, it does not permit negotiations with other institutions, which attests that one of the effects of intergovernmental solutions outside of the Treaty framework is that it exacerbates the risk of a minoritarian bias, at least regarding economic policy.

A different approach was taken by Member States in response to the COVID-19 pandemic. NGEU effectively endowed the Union with a budgetary instrument funded by its genuine own resources to support its spending programs. This solution contrasts with the one adopted to address the financial crisis (the ESM). First, the RRF was adopted in accordance with the ordinary legislative procedure. As such, it reduces[412] the prospect of minoritarian bias.

Second, and in my view most importantly, COVID-19 was characterised as an event that affected all Member States (a so-called symmetric shock) and from a natural cause. Unlike the financial crisis, during which responsibility was attributed to selected Member States, COVID-19 was outside the control of any public authority. However, the features for the occurrence of a minoritarian bias were established, notably the unanimity rule in ORD, which allowed a decision on NGEU to be blocked by a small group of countries.[413]

All in all, a few States dominate the decision-making process in EU economic policy and may impose their preferences on others. While it is true that majoritarian bias could be considered if viewed in the context of State power, the fact remains that the prevailing views are those of a small number of Member States. It is noteworthy that the adoption of fiscal responsibility policies follows the views supported by some European countries, notably Germany. Concomitantly, these Member States limit the mechanisms with the potential to improve their methods of dealing with externalities derived from EU integration.

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[412] Maduro mentions that one cannot rule out minoritarian bias, for instance, in the EP, especially regarding lower intensity political issues. This, according to the author and to Komesar, is ideal ground for interest groups. Maduro, *We The Court: The European Court of Justice and The European Economic Constitution* (n 6) 120. However, this hypothesis does not apply to the MFF (and, accordingly, own resources), which is arguably the most important political event in EU economic and fiscal policy, not least because it occurs once every seven years, making it a relatively debated issue in the national context.

[413] Caroline de la Porte and Mads Dagnis Jensen, 'The Next Generation EU: An Analysis of the Dimensions of Conflict behind the Deal' (2021) 55 Social Policy Administration 388.

However, as previously stated, the practical effect was to reinforce the most important pieces of EMU law, which it had possessed since its inception, albeit mostly outside the Treaty framework and from a position of power. Moreover, during the financial crisis, the EU's fiscal framework consolidated a top-down approach, during which rules were imposed by a few Member States via the use of supranational and international institutions, while not fully exploring the possibility of alternatives in the medium-term.

4.2.2. In the budget of the European Union

4.2.2.1. Public awareness

In 2014, the EP carried out a survey[414] involving 22 Member States, having concluded that, in their respective national budgets, only four States mentioned VAT and GNI-related transfers as funds reverting to the Union budget as their own resources. In other words, most Member States considered these revenue streams of the EU budget as being of a national nature and, therefore, considered them another type of public expenditure.

The corollary is spelled within the framework of the MFF's negotiations. As national contributions are perceived mainly as a cost, Member States focus on demanding funding back (*juste retour)*, which creates a dynamic of national 'entanglement' with the EU budget.

This perspective of the role of EU budget hinders social awareness about each Member State's contribution and is detrimental to the acceptance of more significant contributions. On the one hand, national voters are seldom acquainted with how much, and in what form, their Member State contributes to the EU budget. On the other hand, the EU budget's small size and fragmented nature does not hinder the awareness regarding the existence of EU policies, whereas their impact and effectiveness does. For instance, while citizens are generally aware of the existence of a cohesion policy or EU macro-regional strategies, most prominently in net recipient States or participating States, respectively, they are overwhelmingly unaware of specific projects that have directly

[414] European Parliament, 'How Do Member States Handle Contributions to the EU Budget in Their National Budgets?' (2014) <https://www.europarl.europa.eu/RegData/etudes/STUD/2014/490686/IPOL_STU(2014)490686_EN.pdf > accessed 3 February 2023.

benefited them, even including major spending programmes. *A fortiori*, it will be even more challenging for smaller programmes to demonstrate the actual outcomes and impacts of EU expenditure.[415]

Lacking information leads to a lack of significant participation[416] and, consequently, a distribution of stakes unlike that which would have taken place had such awareness occurred. Thus, national governments have fewer incentives to adequately assess and communicate the positive effects of EU resources.

4.2.2.2. Expectations of Member States and European citizens

The EU's current federal structure resembles that of the US before the Civil War (during the antebellum period), in which the States enjoyed broad autonomous authority over the 'classic trinity of sovereign powers: taxation, the police power, and eminent domain'. Therefore, the federalism that emerged in the US in the nineteenth century provided 'a receptive structure for expressions of state autonomy and pursuit of state-oriented economic objectives',[417] just as in the EU in the twenty-first century.

European citizens are increasingly certain of what they want from the EU. In fact, citizens' preferences vary more regarding national than supranational policies and priorities. As Buti explains, there is increasing popular convergence: 'In the non-economic area you have defence and security policies and policies for immigration. In the economic area there is transnational investment and other types of internal investments and goods where you have a critical mass and large spillovers'.[418]

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[415] European Commission, 'Flash Eurobarometer 497: Citizens' Awareness and Perception of EU Regional Policy' (2021) <https://ec.europa.eu/regional_policy/sources/studies/eurobarometer_2021_report_en.pdf> accessed 6 February 2023, 36-75.

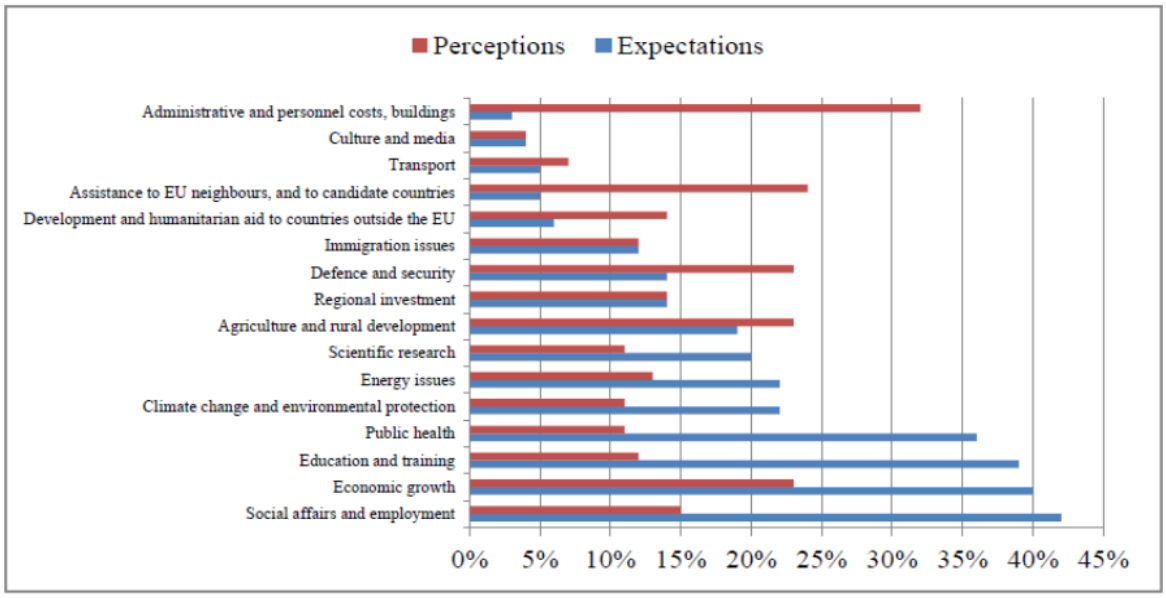
[416] Despite its increasing competences, every election to the EP has had a consistent reduction in turnout, except for 2019. Higher turnout in the first elections may be explained by a number of reasons, notably compulsory voting in some States, first voting effect, or the enlargement of Eastern European countries with lower turnout tradition, as explained by Madeleine Hosli and others, 'Turnout in European Parliament Elections 1979–2019' (2022) 25 European Politics and Society 1. Significantly, on average, participation in EP elections is about 30% lower than in national elections (roughly 50% in countries without compulsory voting). In fact, in the so-called second order elections, for most people the only reason to vote is the habit of voting. In this vein see Mark Franklin and Sara Hobolt, 'The Legacy of Lethargy: How Elections to the European Parliament Depress Turnout' (2011) 31 Electoral Studies 67.

[417] Scheiber (n 352).

[418] Marco Buti, 'Panel Discussion' in Hanno Kube and Ekkehart Reimer (eds), *Solid Financing of the EU* (Institut für Finanz- und Steuerrecht 2021) 79, 108. See also European Parliament, 'Communicating and Perceiving the EU Budget: Challenges and Outcomes' (2021) <https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/690585/EPRS_IDA(2021)690585_EN.pdf > accessed 8 March 2023, 26.

In addition to the convergence in areas of expenditure, there is a wide gap between what people expect from the EU budget and what they perceive as actual EU spending (Figure 6). In public health, education, social affairs or economic growth, citizens expect significantly more spending. Figure 6 depicts a gap that has remained remarkably constant over time.[419]

Figure 6: European expectations and perceptions of the EU Budget (2011)



Source: Bordignon and Scabrosetti (n 504) 72

The paradox of legitimacy is prominent in this realm given that Member States are the main financiers of the EU budget and responsible for the most spending in the referred areas. Consequently, *juste retour* reflects the legitimacy issue, which, inevitably, increases conflicts and breeds mistrust.

This dynamic was displayed during the July 2020 European Council,[420] even within the pivotal context that led to the establishment of NGEU. In fact, despite numerous surveys in all Member States showing majoritarian support for increased EU involvement

[419] European Parliament, 'Communicating and Perceiving the EU Budget: Challenges and Outcomes' (n 418) 31; Yana Myachenkova, 'EU Budget: Expectations vs Reality' (*Bruegel Blog*, 2018) <https://www.bruegel.org/blog-post/eu-budget-expectations-vs-reality> accessed 8 March 2023; Massimo Bordignon and Simona Scabrosetti, 'The Political Economy of Financing the EU Budget' in Thiess Büttner and Michael Thöne (eds), *The Future of EU-Finances* (Mohr Siebeck 2016) 63, 72.

[420] This is despite the fact that the budgetary issues largely pertain to the realm of the Council, pursuant to article 311 (3) and 313 (2) TFEU. On the emergence of the European Council as a dominant institution of EU budgetary matters see Richard Crowe, 'The European Council and the Multiannual Financial Framework' (2016) 18 Cambridge Yearbook of European Legal Studies 69.

in health-related issues (such as cooperation with vaccinations, strategies, purchasing of medicine and strengthening European supply chains) Member States drastically cut EU budgetary programmes to which resources were not directly allocated, such as EU Health, Solvency Support, InvestEU or Horizon Europe, arguably due to less direct visibility.[421] In Buti's words, 'the natural political reflex is to look at how much they (the national governments) get directly rather than the focus on common goods. In economic terms, one could say that policymakers in EU negotiations, instead of optimising overall EU welfare, optimise the sum of national welfare functions'.[422] In this regard, about 90% of NGEU funds are to be managed under the RRF, which took precedence over components directly related to EU public goods. Hence, fragmentation endures, as expenditure continues to be based on national boundaries. Although individual Member States must define their respective investment plans under supranationally defined priorities and objectives, this framework is a reflection of Member States themselves. Indeed, the scope of investments was largely decided in the Council with the EURI Regulation,[423] based on a proposal made by the European Commission.

Member State predominance is also visible in the reduced role played by the EP under the RRF and, concomitantly, the adoption of an approach with a procedure centred around the European Commission. General funding approval is dependent on the development of national plans that meet an eligibility threshold, while disbursements are made progressively available, in accordance with an ongoing assessment of compliance. However, in practice, it would be difficult to understand that much needed EU funding, consistently called for since the euro crisis by several presidents of EU institutions, would not be disbursed on administrative impediments. The *juste retour* logic made the negotiation process with the European Commission more of an administrative issue than a genuine political negotiation.[424] As a result, irrespective of the quality of the national plan, the very legitimacy of NGEU (and its effectiveness) would be called into question.[425]

[421] Franziska Brantner, 'Panel Discussion' in Hanno Kube and Ekkehart Reimer (eds), *Solid Financing of the EU* (Institut für Finanz- und Steuerrecht 2021) 79, 106.
[422] Buti (n 418) 109.
[423] See recitals 4-7 and article 1 (2) of EURI Regulation.
[424] Joan Miró, 'Debating Fiscal Solidarity in the EU: Interests, Values and Identities in the Legitimation of the Next Generation EU Plan' (2022) 44 Journal of European Integration 307.
[425] Nettesheim, 'Next Generation EU: The Transformation of the EU Financial Constitution' (n 159) 44.

Therefore, there is an increasing disconnect between what citizens' demand from the EU and what their national governments are willing to provide through intergovernmentalism in the European Council and Council. In my view, this occurs because there is a silent majority in the EU citizenry, which has limited incentives to participate in the EU political process. There are three main reasons why this may be the case. First, EU issues are seldom, if ever, the central topic in national elections and for good reason: national elections should be based on national, rather than EU, policies and priorities. Therefore, national governments' mandates in the EU are mainly to find a common denominator of national interests, rather than to address issues from an EU-wide perspective.

Second, the only direct election to a supranational institution is to the EP, which holds limited involvement in the EU budgetary process. Notably, it only held consultation competence prior to the decision on own resources (article 311 (3) TFEU) and consent competence regarding the MFF (article 312 (2) TFEU) – the two main pillars of EU finances that broadly define the annual budget, where the EP does share power with the Council (article 314 TFEU).

Third, citizens pay taxes to their national budgets, thereby establishing a direct link with their own borders and broadly interpreting national contributions to the EU budget as a loss of national revenue.

CHAPTER 2

FISCAL DISCIPLINE AND MARKET INCENTIVES

5. Fiscal discipline in multi-level governance systems

Fiscal discipline is an issue that is frequently discussed in multi-layered systems, especially within a dynamic of incomplete information.[426] When lower-level governments face serious and long-term revenue shortages requiring fiscal adjustment, they may be tempted to avoid expenditure cuts or tax increases for political purposes with the belief that a higher-level government can assume its debts. Accordingly, even if local authorities know their decisions are not fiscally sustainable, they can avoid adjustment because of an implicit or expected guarantee by the latter.[427]

However, in most cases, the lower-level government is not certain of this guarantee, because there is usually some sort of no-bailout pledge, a legal requirement in place or both. This does not take into account whether these instruments are credible. In other words, regardless of the rules in place (formal or informal), do lower-level governments believe it is probable that, on brink of default, the higher-level government will prefer to bail them out?

Markets follow the same processes as governments. As Rodden clearly explains:

> Market actors like fund managers, banks, and credit rating agencies also attempt to look down the game tree and evaluate the higher-level government's likely reaction at the moment of default. They look for a variety of clues to the central government's likely behavior. They evaluate the process through which a bailout would be decided and the political incentives of the actors. If the legislature must vote for a bailout, what is the probability that the requisite majority would favor a bailout? This is driven in part by the number of insolvent provinces and the nature of their legislative

[426] Jonathan Rodden, *Hamilton's Paradox: The Promise and Peril of Fiscal Federalism* (Cambridge University Press 2005) 50, refers to this practice as the 'bailout game'. See also Gordon (n 235) 337.

[427] Siekmann (n 195) 86. The author notes that this is the reason why it is important that the component parts of a federal system not pursuing a viable budgetary policy must bear the financial consequences of their policy choices, as evidenced by Germany and the US. Therefore, Siekmann highlights that there must be no prospect of shifting the burden of unsustainable fiscal policy to the Union. This course of action not only does not bear a significant impact on the stability of the currency but it is also a necessary requirement for it. See also Christoph Ohler, 'Article 125 (Ex Article 103 TEC) [Prohibition to Assume Liabilities]' in Helmut Siekmann (ed), *The European Monetary Union* (Hart Publishing 2022) 181.

> representation. If the executive has wide-ranging authority to provide a bailout unilaterally, how might the chief executive contrast the political pain associated with bailouts with that associated with default? This trade-off is shaped by the nature of the chief executive's regional support base.[428]

The way in which the allocation of powers is devised impacts the likelihood of stakeholders perceiving a bailout. For instance, if politically sensitive services like health care or unemployment benefits are provided by States but funded by supranationally levied and collected taxes, voters are likely to hold higher-level governments responsible for disruptions.[429] As such, the degree of policy connection with the central government is indirectly proportional to the credibility of a no-bailout pledge or clause: the higher the connection of the policy, the lower the credibility of the clause.

Consequently, perceptions of the credibility of no-bailout pledges are key. If nobody believes in the central government's commitment, no incentives will be in place for public authorities to adjust or for markets to rigorously distinguish between the creditworthiness of the various national governments. On the contrary, if the supranational government is credible then there will be adequate incentives for public authorities to keep their public finances under control and for market actors to monitor their creditworthiness because default is a real possibility. The point here is that stakeholders must take decisions based on a degree of uncertainty.

This has been acknowledged by the CJEU in *Gauweiler* and *Weiss* cases: in order to comply with the prohibition of monetary financing, a degree of secrecy from the ECB is necessary to ensure markets cannot anticipate its action. However, in my view, if the programme was designed to keep interest rates on sovereign bonds at a reasonable level, then action would not be a matter of *if*, but *when*, therefore, hindering the core reasoning on economic incentives underlying the Treaties. The entire EMU legal architecture was built upon the former perspective, not the latter. Therefore, this detail makes a significant difference in the relationship between the legal principles of monetary policy (strict independence and mandate, pursuant to Articles 127 and 130 TFEU, respectively) and

[428] Jonathan Rodden, 'Market Discipline and U.S. Federalism' in Peter Conti-Brown and David Skeel (eds), *When States Go Broke: The Origins, Context, and Solutions for the American States in Fiscal Crisis* (Cambridge University Press 2012) 126.
[429] ibid.

economic policy (the prohibition of monetary financing and bailouts, as well as Member States fiscal responsibility, pursuant to Articles 123, 125 and 126 TFEU, respectively).

Likewise, several EU institutions have warned that the establishment of an EU-wide fiscal capacity would have to comply with some of the Treaties' principles, such as the no-bailout clause and Member States' fiscal discipline. For instance, the Four Presidents' Report expressly stated that such an instrument should 'neither undermine the incentives for sound fiscal policy making at the national level, nor the incentives to address national structural weaknesses'.[430] The same can be said for the Five Presidents' Report, which describes responsible budgetary policies 'as EMU's cornerstone'.[431] The European Commission made fiscal responsibility an important objective for the Union,[432] apart from its enforcement of the six-pack and two-pack.

5.1. Different paths to fiscal discipline

There are essentially two major paths to fiscal discipline within a federation or monetary union: through markets or through hierarchy.

We can typically find the latter approach in a unitary European Member State, where tax competences and the provision of public services are assigned to the central government. In this situation, lower-level governments are channels for delivering what was centrally decided, causing a bailout waiver to lack credibility. That is why, in fiscally centralised settings, a regulation on the borrowing of lower-level governments is usually established, either by restricting access to the bond and banking markets or by centrally undertaking, borrowing and then allocating funding to the lower levels of the government. In this vein, limiting local government expenditures are in the domain of the central

[430] Herman Van Rompuy and others, 'Towards a Genuine Economic and Monetary Union' (2012) <https://www.consilium.europa.eu/media/23818/134069.pdf> accessed 15 May 2022, 12.
[431] Jean-Claude Juncker and others, 'Completing Europe's Economic and Monetary Union' (2015) <https://wayback.archive-it.org/12090/20191231140925/https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf> accessed 12 May 2022, 14.
[432] European Commission, 'Proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States' COM (2017) 824 final <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52017PC0824> accessed 27 December 2023.

government.[433] This type of system has been in place in relatively homogeneous unitary countries of the EU, where local governments are not viewed as sovereign borrowers.[434]

Differently, in some federations, the powers of the central government are limited, even after centralization, and the constituent units hold significant taxing competences. When States and municipalities hold significant power, the central government might credibly allow them to default. Consequently, on the one hand, lower-level governments approach credit markets as sovereign borrowers and, on the other hand, creditors face incentives to collect information about the sustainability of their finances. Favourable borrowing conditions coupled with inter-state competition over citizens and companies, would provide an adequate incentive framework towards sound public finances.

5.2. Reasons for fiscal centralisation

There are several reasons why higher-level governments try to establish a hierarchy-based system, whereby financial provisions and the decision-making process relegate lower-level governments, primarily as administrators of policies that are conceived and funded by the centre.[435]

First, let us consider the identities of creditors. When creditors are mostly foreigners to a certain economic bloc, the central government's incentive to intervene is reduced. This is evident from the US and EU's past experiences. Regarding the former, the fact that the British held most of the debt of US States is considered an important reason why a majority was formed in Congress to oppose their bailout in 1840, given that the risk of causing major internal disruptions was low. On the contrary, in the EU, it is consensual that sovereign debt-related bailouts were particularly driven by concerns of exposing German and French banks to southern indebted countries. The identities of creditors can demonstrate another centralising factor, which is related to the possibility of the occurrence of externalities. In fact, one of the reasons bailouts occurred in the EU was due to a fear of country-to-country contagion.

Another reason for fiscal centralisation is regional inequality and economic geography, mainly caused by an uneven allocation of productive capital. Interregional

[433] Jürgen Von Hagen and Barry Eichengreen, 'Federalism, Fiscal Restraints, and European Monetary Union' (1996) 86 American Economic Review 134.
[434] Rodden, 'Market Discipline and U.S. Federalism' (n 428) 128.
[435] Rodden, *Hamilton's Paradox: The Promise and Peril of Fiscal Federalism* (n 426) 64.

disparities are common features within monetary unions, even within individual countries. If a significant part of a country's (or bloc's) wealth is generated and concentrated in a certain space (or a certain group of countries), tax bases would differ between the core and periphery, affecting the capacity to provide public goods. It would be possible to ease these differences through a form of tax centralisation, in order to redistribute wealth between richer and poorer regions.

Morality and justice, in other words, the idea that there is a common cause for indebtment that morally justifies its assumption, also contribute to centralisation. This feature was a driving factor in the acceptance of Revolutionary War-related debt in the United States (as shown in this chapter), because the most indebted States had borne a disproportionately larger share of expenditures when conducting the war.

The functions conducted by the central government also justify a hierarchical relationship. Indeed, the more important the central government's role in State's economies, the more likely it is for a bailout to occur, since it is likely the centre would be interested in continuing the provision of federal-funded services. To illustrate, in the US states, federal grants are pro-cyclical, which means that in economic downturns, grants are reduced, thus placing lower-level government's budgets under strain. On the contrary, in the EU, this risk is residual given the small EU budget.

Finally, we can consider the States' lack of revenue autonomy. Crucially, when there is no link between collected taxes and received benefits, there is a sort of fiscal illusion. This occurred in the US States in the 1840s, when governments got accustomed to providing public benefits by resorting to debt and the little revenue they received from their tax base.

5.3. Reasons for fiscal decentralisation

Enthusiasm for fiscal decentralisation as the engine for growth and societal prosperity started in the 1990s. It emerged from a perspective founded on competitive federalism, which has been supported by many authors.

For instance, Hayek argued in favour of proximity in the decision-making process to justify fiscal decentralisation. Stating that society's main economic problem is one of rapid adaptation to changes in a certain time and place, Hayek concluded that it would be better for ultimate decisions to be left to the people most familiar with these circumstances

– people who are directly acquainted with the relevant changes and resources that are immediately available to meet them. As the author notes, 'we cannot expect that this problem will be solved by first communicating all this knowledge to a central board which, after integrating all knowledge, issues its orders'.[436]

Similarly, Weingast considers that when lower-level governments depend on their own revenue-generation rather than transfers, they become more responsible for their actions and more responsive to their citizens' needs. Crucially, by awarding them a stake in the economic development of their jurisdiction, decentralised taxation fosters accountability.[437] This is what may be referred to as 'traditional public finance' and it primarily seeks to address the question of the optimal provision and financing of public goods and services in a polity with several tiers of government. The allocation of responsibilities among each level of government is determined by the nature of the goods and services provided, ie the existence of regional externalities of public goods or taxes, the extent of fiscal externalities, economies of scale, the mobility of individuals and capital.[438]

Fiscal decentralisation is also utilised in the reduction of poverty. Although increasing resource transfers from the higher levels of government might appear effective to alleviate poverty and support lagging regions to converge, there is a body of evidence suggesting that the results are the opposite. At the same time, it generates subsidy dependence, decreases the governments' motivation to engage with their citizens on how to produce wealth and hinders innovation.[439]

Buchanan offers two further reasons. First, he considered fiscal competition a means to correct government failures. If individuals move freely between jurisdictions, they reveal their preferences for certain public goods and for their efficient provision. This process would allow the detection and adjustment of inefficiencies in the provision

[436] Friedrich Hayek, 'The Use of Knowledge in Society' (1945) 35 American Economic Review 519, 531.
[437] Caroline Pöschl and Barry Weingast, 'A Fiscal Interest Approach to Subnational Government Incentives: Implications for the Design of Tax and Transfer Systems' in Jean-Paul Faguet and Caroline Pöschl (eds), *Is Decentralization Good for Development* (Oxford University Press 2015) 162.
[438] John Douglas Wilson, 'Theories of Tax Competition' (1999) 52 National Tax Journal 269; See also Wallace E Oates, 'An Essay on Fiscal Federalism' (1999) 37 Journal of Economic Literature 1120.
[439] Pöschl and Weingast (n 437) 174.

of public services. Consequently, the extent to which a government can tax its citizens is constrained by the possibility that they may exit the country.[440]

In addition, Buchanan argues that fiscal decentralisation adds value to controlling excessive taxation and the so-called Leviathan State. In his view, governments pursue revenue-maximising practices by resorting to a monopoly position: the exercise of *ius imperii*. Therefore, it can generate the necessary revenue to finance the public goods and services demanded by its citizens. However, like a monopolist, the government can also charge higher taxes in order to maximise its gains, leading to excessive taxation. Connecting this to fiscal competition, the author is of the view that if political voice is unable to avoid excessive taxation, the exit option would allow citizens to find jurisdictions in which they can get the same utility from the public goods provided for lower tax prices.[441]

6. Fiscal discipline and surveillance in the aftermath of the financial crisis in the European Union

The financial crisis originated in the US in 2007. One of its main features was the significant mismatch between the interest rates of the credit granted for real estate purchasing and household indebtedness capacity. Another feature was that this banking practice became widespread by selling aggregated securities, so-called securitisation, and sold top-quality assets worldwide, exporting the problem to other countries.[442]

When the property market collapsed, the spiral of payment breaches that followed converted those securitised assets into low quality holdings, generating a confidence crisis and leading to a sharp reduction of asset prices. The uncertainty on the level of leverage each bank held on its balance sheet fostered distrust in the sector, causing an inter-bank lending freeze (banks raising interest rates to discourage the demand for new loans and,

[440] James Buchanan, 'Federalism as an Ideal Political Order and an Objective for Constitutional Reform' (1995) 25 The Journal of Federalism 19, 21; James Buchanan and Richard Musgrave, *Public Finance and Public Choice: Two Contrasting Visions of the State* (MIT Press 1998) 179.

[441] Geoffrey Brennan and James Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge University Press 1980); George Crowley and Russell Sobel, 'Does Fiscal Decentralization Constrain Leviathan? New Evidence from Local Property Tax Competition' (2011) 149 Public Choice 5.

[442] See Joseph Stiglitz, 'Lessons from the Global Financial Crisis of 2008' (2010) 23 Seoul Journal of Economics 321; Martin Wolf, *The Shifts and the Shocks: What We've Learned – and Have Still to Learn – from the Financial Crisis* (Penguin Books 2015); Estella, *Legal Foundations of EU Economic Governance* (n 239).

at the same time, persuading debtors to reimburse debts by refinancing their loans with other banks).

How, then, did a financial crisis turn into a (eurozone) sovereign debt crisis? To stop the spread of the financial crisis, States came to the rescue of financial institutions, particularly banks. As these bailout operations became larger than expected, public debt levels increased substantially, prompting investors to adjust the risk premium on bonds, reflecting doubts on certain States' repayment capacities.[443] Higher risks lead to higher costs, which increase the risk of default, creating a vicious circle. All this eventually ends in State insolvency and the need of external assistance, debt default or both.[444]

This is what happened in the EU when markets doubted the ability of certain Member States to reimburse public debt, the most prominent examples being Greece, Portugal and Ireland. In fact, the financial crisis triggered a major reassessment by investors of the sustainability of the eurozone periphery's rapid credit growth and large external deficits. Therefore, it became clear that market discipline, purported in the Maastricht Treaty, had not succeeded as expected[445] and this pressed the Union to evolve from a market-based to surveillance-based paradigm in economic policy, as I describe below (Part III, Chapter 2, Point 6.2). The underlying assumption of this evolution is that, in the absence of a common economic policy supported by a robust EU budget, the interdependence between Member States, especially in the eurozone, is better addressed through an enhanced, surveillance-based economic policy coordination.[446]

All countries mentioned received loans from the International Monetary Fund (IMF) and two European Funds in exchange for the implementation of national programmes of fiscal consolidation: the EFSF and the European Financial Stability Mechanism. These loans were granted for at least two reasons. First, because these countries presented more economic weaknesses than other EMU Member States, particularly their solvability, but also, and most importantly, financial contagion presented a systemic risk for the EMU as a whole.

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[443] This contrasts with the period prior to the crisis, when funding costs for most eurozone States were similar. For instance, Greece paid a small risk premium compared to Germany.
[444] Stiglitz (n 442); Wolf (n 442); Estella, *Legal Foundations of EU Economic Governance* (n 239).
[445] Constantinos Kombos, 'Constitutional Review and the Economic Crisis: In the Courts We Trust?' (2019) 25 European Public Law 105, 115;
[446] Hinarejos, *The Euro Crisis in Constitutional Perspective* (n 252) 68; Keppenne, 'Economic Policy Coordination: Foundations, Structures, and Objectives' (n 118).

How could countries with no monetary policy competences handle such challenging economic conditions? In the absence of the power to erode the value of currency to correct the balance of payments (by increasing exports and decreasing imports) and to increase inflation (to help reduce the public debt burden), States are in a substantially weaker position to address adverse expectations on liquidity and/or solvency.

Furthermore, in a shared regional space, monetary policy centralisation affects Member States economic policy autonomy. In fact, national stabilisation policies are restricted either because the legal framework of this space constrains its budgetary capacity or due to market pressure. Moreover, when such stabilisation efforts are taken, the risk of externalities (the probability of positive effects being experienced by a country that did not make such efforts) exists, thus reducing their national effectiveness.

This situation is, indeed, a paradox. Economic policy is an area to which Member States originally attributed much importance and were keen to maintain in the national sphere. However, in a matter of extensive national autonomy, the Union can strongly intervene, signalling a relative dilution of Member States' powers in this regard. Indeed, if a Member State finds itself with an excessive ratio of public debt and deficit, as provided by article 126 (2) TFEU, a competence-shift is triggered, enabling the Union to adopt significant measures on national economic policy.

Hence, the financial crisis has sparked a dynamic that has made economic policy autonomy dependent on the fulfilment of certain criteria. From an institutional perspective, the intergovernmental method prevails, with the European Council and Council gathering most competences in this regard, while the European Commission gains prominence as an enforcer.[447] However, it is increasingly difficult to maintain that economic governance is based on mere coordination as it is clear that there is a shift from soft law towards a binding framework.[448]

6.1. Conditional financial assistance

[447] Hinarejos, *The Euro Crisis in Constitutional Perspective* (n 252) 85.
[448] Keppenne, 'Economic Policy Coordination: Foundations, Structures, and Objectives' (n 118) 793.

The EFSF was the first main governance development in the Union, in accordance with decisions taken by the Council in May 2010.[449] Its mandate was limited to providing loans to members in financial difficulties.[450] Loans need to be requested by a eurozone Member State and are made available once a memorandum of understanding containing policy conditionality is signed with the European Commission.

However, this mandate was deemed too narrow in scope and was significantly increased by the European Council in July 2011, particularly by permitting the financing of recapitalisation of financial institutions and non-programme members. The former, through lending to governments, the latter through intervention in the primary and secondary markets, on the basis of an ECB analysis recognising the existence of exceptional financial market circumstances and risks to financial stability and on the basis of a decision made through mutual agreement of the Member States, to avoid contagion.[451]

Furthermore, on 26 October 2011, it was agreed to leverage the resources of the fund. To this end, Member States introduced credit enhancement to new debt issued by them, as well as maximising EFSF funding arrangements with a combination of resources from private and public financial institutions and investors.[452]

This temporary instrument was replaced with the ESM,[453] a permanent mechanism. In fact, as interrelation within the euro area would endure (if not intensify), severe risks to the financial stability of eurozone Member States would remain, thus threatening the financial stability of the euro area as a whole.[454] This is why the purpose of the ESM is

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[449] See the EFSF articles of incorporation at https://www.esm.europa.eu/system/files?file=document/efsf_status_coordonnes_23avrl2014.pdf.

[450] The eurozone Member States committed to guarantee an amount of €780 billion although its effective lending capacity was limited to €440 billion. Agreements on financial support were entered into with Greece, Ireland and Portugal. For details on the terms of the financial assistance programs see https://www.esm.europa.eu/financial-assistance.

[451] See Council of the European Union, 'Statement by the Heads of State or Government of the Euro Area and EU Institutions' (21 July 2011) <https://www.consilium.europa.eu/media/21426/20110721-statement-by-the-heads-of-state-or-government-of-the-euro-area-and-eu-institutions-en.pdf> accessed 27 December 2023, 3.

[452] Council of the European Union, 'Statement by the Heads of State or Government of the Euro Area and EU Institutions' (26 October 2011) <https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/125644.pdf> accessed 27 December 2023 , 6.

[453] The financial capacity of the ESM goes up to €700 billion. According to article 8 (2), capital shall be divided into paid-in-shares and callable shares, the former being of the amount of €80 billion.

[454] See Treaty establishing the European Stability Mechanism (2012) < https://www.esm.europa.eu/system/files/document/2023-10/05-TESM2-HR1.en12.pdf> accessed 27 December 2023, paragraph 6.

to provide funding support if and when Member States experience, or are threatened by, severe financing problems that have the potential to destabilise the eurozone as a whole (article 3 of the TESM). In order to incorporate this decision, Member States amended the Treaties, by adding the following paragraph to article 136 TFEU: 'The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality'.

The scope of the ESM's activity is wider than that of its temporary predecessor. In particular, it is competent to grant financial assistance on a precautionary basis (article 14); provide financial assistance to an ESM Member in order to re-capitalise financial institutions (article 15); grant financial assistance in the form of a loan to an ESM Member (article 16); arrange for the purchase of bonds of an ESM Member on the primary market, if this intervention maximises the cost efficiency of the financial assistance; and, finally, arrange operations on the secondary market, in relation to the bonds of an ESM Member, depending on a prior analysis undertaken by the ECB, which recognises the existence of exceptional financial market circumstances and risks to financial stability.[455]

6.2. Budgetary and macroeconomic surveillance

Public financial assistance was accompanied by public control through the implementation of a budgetary surveillance model, particularly for the eurozone.[456] The framework of this model can be divided according to the nature of legislation: intergovernmental agreements (the Treaty on Stability, Coordination and Governance), EU soft law (the Euro Plus Pact) and EU binding legislation (the six-pack and two-pack).

6.2.1. Treaty on Stability, Coordination and Governance

[455] For an assessment of the ESM see Sebastian Dullien and Daniela Schwarzer, 'Dealing with Debt Crises in the Eurozone: Evaluation and Limits of the European Stability Mechanism' (2011) SWP Research Paper 11/2011 <https://www.swp-berlin.org/publications/products/research_papers/2011_RP11_Dullien_swd_ks.pdf> accessed 26 December 2023, 18.

[456] See, generally, European Commission, 'Commission Staff Working Document: Review of the Suitability of the Council Directive 2011/85/EU on Requirements for Budgetary Frameworks of the Member States' SWD (2020) 211 final < https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020SC0211> accessed 27 December 2023.

The TSCG was signed in March 2012.[457] Given the UK's refusal to support it, it was agreed that it would be an intergovernmental instrument adopted outside of the EU framework, although with institutional ties to it. It aims at strengthening the economic pillar of the EMU. In order to achieve this objective, the treaty establishes rules related to budgetary discipline, economic coordination and governance of the euro area.

Concerning budgetary discipline, Member States agreed to place limits on structural deficit and public debt. The former authorises a structural deficit of 0.5% if it is in line with the medium-term objective, or up to 1% in cases where the ratio of general government debt to GDP is significantly below 60% and where risks of long-term sustainability of public finances are low. Member States may temporarily deviate from their medium-term objective due to exceptional circumstances. However, a correction mechanism may be automatically triggered. Member States are also obliged to adopt legislative provisions to incorporate these obligations. Failure to comply enables the European Commission and/or other Member States to bring a case before the CJEU. Regarding national debt, issuance plans are reported to the Council and the European Commission prior to their execution, in order to achieve improved coordination.

On the topic of economic policy coordination and convergence, Member States were not as detailed. It is emphasised that economic coordination plays an important role in promoting competitiveness, employment, sustainability of public finances and financial stability. All major policy reforms should be discussed prior to their adoption and, if necessary, coordinated with the involvement of EU institutions.

6.2.2. Euro Plus Pact

In addition, at the European Council of March 2011, the Heads of State or Government of the euro area, plus six other Member States, agreed to adopt a Euro Plus Pact.[458] In order to enhance economic policy coordination, the Pact focuses on four areas: competitiveness, public finance, employment and financial stability. While it does not impose enforceable legal obligations, signatory Member States commit to enhance

[457] Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (2012) < https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:42012A0302(01)> accessed 22 November 2023.

[458] European Council, 'Conclusions', 24/25 March 2011 <https://data.consilium.europa.eu/doc/document/ST-10-2011-INIT/en/pdf> accessed 3 April 2024.

economic coordination in these areas – matters that remain within national competence – and agreed upon economic objectives.

6.2.3. EU legislation: six-pack and two-pack

The six-pack is a legislative package comprising of five Regulations and one Directive. Although applicable to all 27 EU Member States, it contains specific provisions for eurozone Member States, especially concerning financial sanctions. Member States have agreed to address not only fiscal but also macroeconomic surveillance.

On the fiscal side, in order to effectively enforce budgetary surveillance in the euro area, Regulation (EU) 1173/2011[459] establishes additional sanctions to provide incentives for adjusting to and maintaining the medium-term budgetary objective. Regulations (EU) 1175/2011[460] and 1177/2011[461] amend both the SGP and EDP, with the objective of strengthening compliance with the budgetary surveillance framework for eurozone Member States, as well as expediting the EDP. In particular, Regulation (EU) 1175/2011 aims to prevent the occurrence of excessive deficits at an early stage and promote the surveillance and coordination of economic policies. In order to achieve these goals, the Council conducts the European Semester for economic policy coordination (article 2-a), intensifying EU institutions interaction on economic issues (article 2-ab) and establishing a principle of statistical independence to expedite and clarify the EDP (article 10a). Council Directive 2011/85/EU[462] establishes a detailed set of rules concerning characteristics of Member States' budgetary frameworks to ensure compliance with obligations under the TFEU and avoid excessive government deficits.

[459] Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area [2011] OJ L 306/1.
[460] 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 [2011] OJ L 306/12.
[461] Regulation (EU) No 1177/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on speeding up and clarifying the implementation of the excessive deficit procedure [2011] OJ L 306/33.
[462] Council Directive 2011/85/EU, of 8 November 2011, on requirements for budgetary frameworks of the Member States [2011] OJ L 306/41.

Regulations (EU) 1174/2011[463] and 1176/2011[464] focus on prevention and correction mechanisms of macroeconomic imbalances. With the objective of facilitating early identification and monitoring of imbalances, an alert mechanism was created, through which the European Commission could prepare annual reports containing qualitative economic and financial assessments to be discussed by the Council and the Eurogroup. Following these discussions or in the event of unexpected and significant economic developments, the European Commission would open an in-depth review, which could result in the adoption of preventive or corrective action to address imbalances.

To further strengthen surveillance of eurozone countries, in 2013, the two-pack was adopted, consisting of two regulations. Building on the preventive arm of the SGP and on the aforementioned national budgetary limitations, Regulation (EU) 473/2013 further restricts national autonomy by establishing an enhanced surveillance mechanism of draft budgetary plans. In particular, it requires eurozone Member States to introduce and adhere to a common budgetary timeline and to create independent fiscal bodies that monitor compliance with fiscal rules.

The second instrument of the two-pack, Regulation (EU) 472/2013, establishes a system of enhanced surveillance for eurozone Member States that face financial difficulties. This regulation aims to clarify the relationship between EU law and ESM/EFSF assistance provided under the framework of Memoranda of Understanding. For instance, the Regulation automatically applies to countries receiving certain types of financial assistance, for instance, from the ESM. It also contains provisions to coordinate this enhanced monitoring with the European Semester.

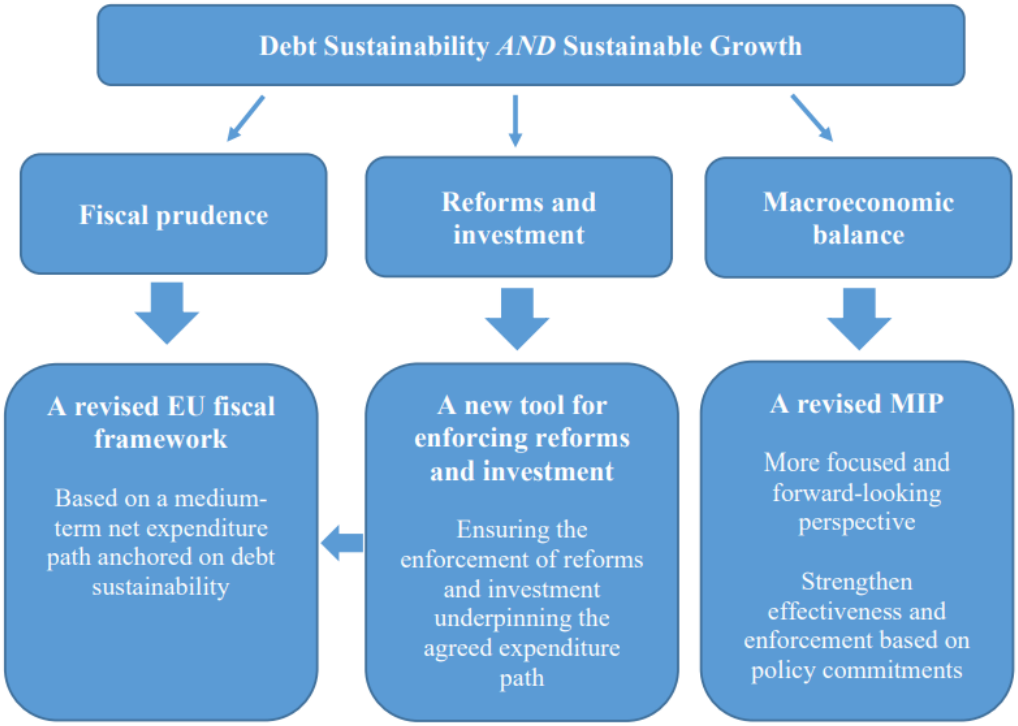
6.2.4. Reform of the Stability and Growth Pact

In April 2023, the European Commission presented legislative proposals to reform EU economic governance.[465] According to the institution, the central objective was to

[463] Regulation (EU) No 1174/2011 of the European Parliament and of the Council, of 16 November 2011, on enforcement measures to correct excessive macroeconomic imbalances in the euro area [2011] OJ L 306/8.
[464] Regulation (EU) No 1176/2011 of the European Parliament and of the Council, of 16 November 2011, on the prevention and correction of macroeconomic imbalances [2011] OJ L 306/25.
[465] See European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: Communication on Orientations for a Reform of the EU Economic Governance Framework'

strengthen the sustainability of Member States' public debt while promoting sustainable and inclusive growth through reforms and investment.

Figure 7: New economic governance architecture



Source: European Commission (n 123) 2

In order to deliver on this goal, the European Commission intended to build on lessons learned from the financial crisis and COVID-19, while supporting the EU in the energy and digital transitions. To that end, the reform is structured along four key pillars: stronger national ownership; the simplification of rules; facilitating reforms and investment for EU priorities; and effective enforcement.

On national ownership, while the Treaties' reference figures for public deficits and debt remain unchanged, the European Commission proposes that Member States should design and present plans by setting out their fiscal targets, measures to address macroeconomic imbalances and priority reforms and investments over a period of at least

COM (2022) 583 final <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022DC0583> accessed 27 December 2023.

four years (known as national medium-term fiscal-structural plans). These plans will be assessed by the European Commission and endorsed by the Council. The assessment will be based on common EU criteria and take into consideration the way they incorporate the priorities identified in the country-specific recommendations issued in the European Semester.

The European Commission also recognizes the need to simplify, as EU fiscal rules became complex, 'with multiple indicators and reliance on unobservable variables, undermining transparency and hampering ownership and predictability'.[466] Hence, it proposed to adopt a single operational indicator for fiscal adjustment and surveillance: the nationally-financed net primary expenditure. This indicator expressed the expenditure net of discretionary revenue measures and excluded interest as well as cyclical unemployment expenditure. The objective was to allow automatic stabilisers to work while promoting debt sustainability.

Moreover, since fiscal positions and economic risks vary significantly across Member States, a one-size-fits-all approach does not work. However, according to the European Commission, this framework was not adequately captured in previous reforms, give that:

> National fiscal policies had often remained pro-cyclical and Member States had not used good economic times to build fiscal buffers. The ability to steer the euro area fiscal stance was hampered by the lack of prudent policies in good times and remained limited in the absence of a central fiscal capacity with stabilisation features (…) The composition of public finances had not become more growth-friendly and national governments had not prioritised spending that enhances growth and economic and social resilience.[467]

Accordingly, the reform proposes to adopt a risk-based surveillance that puts public debt sustainability at its core, while simultaneously promoting sustainable and inclusive growth. In this regard, the European Commission proposes to allow a more gradual fiscal adjustment path if Member States commit to investment and a set of reforms that comply with specific, transparent criteria.

[466] ibid. 4.
[467] ibid.

While more scope would be given to Member States for the design of their fiscal medium-term path, a more stringent EU enforcement regime would take place to ensure compliance.

6.2.5. Differentiated integration

The second subparagraph of Article 5 (1) TFEU clearly states that '[s]pecific provisions shall apply to those Member States whose currency is the euro'. These provisions are found in articles 136-138 TFEU. Protocol No 14 on the Eurogroup is also relevant in this regard.[468]

This framework expresses the need to respond to the financial crisis by adopting several differentiated measures. Although non-euro countries were also affected by the crisis, there was a deeper disfunction in eurozone sovereign debt, as market operators feared non-compliance in the absence of a lender of last resort.[469]

Consequently, a distinction needs to be drawn between legal acts that are applicable to all Member States and those that are only applicable in the eurozone.[470] Some elements of the six-pack are horizontally applicable, such as the Council Directive 2011/85/EU and Regulation (EU) 1176/201. Likewise, the broad guidelines issued under article 121 (2) TFEU are adopted by the Council on an annual basis, permitting its intervention in the case of non-compliance.

Other acts show that a more severe stance is adopted regarding eurozone countries when compared to those that have not yet adopted the euro, as established by article 136 (1) TFEU. On budgetary discipline, an important restriction is established by Protocol No. 12 on the excessive deficit procedure. In fact, it stipulates that the reference values

[468] For an overview on integration alternatives see Jean-Claude Piris, *The Future of Europe: Towards a Two-Speed EU?* (Cambridge University Press 2011). On the limits of differentiated integration, see Emanuela Pistoia, *Limiti All'integrazione Differenziata Dell'Unione Europea* (Cacucci Editore 2018) and Aikaterini Angelaki, *La Différentiation entre les États Membres de l'Union Européenne* (Bruylant 2020).
[469] Lender of last resort is a concept used in law and economics to refer to be ability of a central bank of a given country to provide liquidity to banks when asset prices fall in a crisis and inter-banking lending freezes. The ECB may perform this task, for instance, through the Emergency Liquidity Assistance, allowed by article 14.4 of Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank, in the TFEU. Conversely, the ECB is explicitly forbidden from doing this to Member States, due to the principle of prohibition of monetary financing foreseen in article 123 (1) TFEU. See Horst Tomann, *Monetary Integration in Europe: The European Monetary Union after the Financial Crisis* (Palgrave Macmillan 2017) 148.
[470] See Stefania Baroncelli, 'Differentiated Governance in European Economic and Monetary Union: From Maastricht to Next Generation EU' (2022) 7 European Papers 867.

mentioned in article 126 (2) TFEU are 3% for the ratio of planned or actual government deficit to GDP at market prices, and 60% for the ratio of government debt to GDP also at market prices. In contrast, for Member States with the euro as its official currency or States participating in ERM2, article 2a of Council Regulation (EC) 1466/97, as amended by Regulation (EU) No 1175/2011 (Council Regulation (EC) 1466/97), determines that the country-specific medium-term budgetary objectives must be specified between -1% of GDP and balance or surplus, in cyclically adjusted-terms, net of one-off and temporary measures. However, measures adopted under article 136 (1) TFEU should respect the 'relevant provisions of the Treaties', as mentioned in the Treaty provision. As a result, they should also respect the reference value established in Protocol No. 12 on the excessive deficit procedure, as it plays an integral role in the Treaties.[471]

Moreover, articles 3 and 4 of Council Regulation (EC) 1466/97, require that eurozone Member States submit stability programmes annually.[472] Forecasts should be based on the most likely or prudent scenario and should be compared against the forecast of the European Commission and other independent bodies. Significant differences between forecasts need to be properly justified, resembling the principle of 'comply or explain'. The Council and European Commission examine the stability programmes based on strict criteria and may request adjustments if the Council concludes that strengthening is required (article 5). The European Commission issues a warning, an in-depth review and country-specific recommendations if substantial deviations are detected during the monitoring of implementation.

Non-eurozone members must submit convergence reports on an annual basis, which are essentially subject to the same rules as the stability programmes. The difference between them is in the objectives. Specifically, convergence programmes should avoid real exchange rate misalignments and excessive nominal exchange rate fluctuations (article 10 of the referred Council Regulation (EC) 1466/97), in line with the principle of consistent standard of application of monetary policy, addressed above (Part II, Point 2.1.3).

[471] Bieber (n 105).

[472] According to article 3, the stability programme includes a wide range of information, such as: the medium-term budgetary objective and the adjustment path towards that objective; main assumptions about expected economic developments and economic variables relevant to the programme, ie public investment expenditure, real GDP growth, employment and inflation; quantitative assessment of budgetary and other economic policy measures; analysis of how such policies impact the budgetary and debt positions; and if applicable, the reasons for a deviation from the required adjustment path.

Regulation (EC) 1467/97, as amended by Council Regulation (EU) 1177/2011 (Regulation (EC) 1467/97), also introduces differentiation. However, there are common rules (articles 1 to 4), which detail the earlier stages of the EDP, namely the procedure laid down in article 126 (3) to (8) TFEU. This means that both eurozone and non-eurozone members are subject to the same framework from the moment an excessive deficit is established until the Council addresses its recommendations with the Member States (article 126 (7) TFEU) in addition to the non-compliance finding (article 126 (8) TFEU).

In article 5 of Regulation (EC) 1467/97, a bifurcation is set, attributing large discretion to the Council. For non-eurozone members, article 126 (9)-(14) TFEU apply. This *enables* the Council to make further requests to Member States and apply sanctions but does not *mandate* it. In contrast, for eurozone States, Regulation (EC) 1467/97 introduces a denser, mandatory framework within which non-compliance with Council recommendations can be found. In practice, the Council has two months to issue a notice requiring deficit reduction measures, to which concerned Member States must report any actions undertaken. The deadline for implementation may be extended by the Council but only if the European Commission issues this recommendation, on the basis that, despite effective action by the Member State, unexpected asymmetric (State level) or symmetric (Union level) adverse economic events occurred after the adoption of the original notice. Member States' failure to act will result in the application of sanctions, including fines.

Other forms of differentiation include the TSCG, which was not in force in all Member States for several years, although the ratification process was concluded in April 2019, therefore, covering all 27 countries.[473]

Originally without Treaty basis, article 136 TFEU was subsequently amended by the European Council to introduce paragraph three. This amendment was made to enhance the legality of the ESM and to prepare for a possible incorporation of the body in the realm of EU law. Attempts have already occurred, with proposals made by the European Commission to replace the ESM with a European Monetary Fund.[474]

[473] See European Commission, 'Proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States' COM (2017) 824 final (n 432). On the asymmetry introduced by TSCG see Giuseppe Martinico, 'The Asymmetric Turn of the New European Economic Governance: Some Remarks on the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union' (2013) 47 Revista Catalana de Dret Públic 128.

[474] However, after reluctance to incorporate the ESM into EU law, in November 2020 the finance ministers at the Eurogroup agreed to amend the ESM Treaty, which should be ratified by all eurozone Member States in 2021. The proposed amendments include (i) the establishment of the ESM as a backstop to the Single

Lastly, at the European Council in March 2011, the Heads of State or Government of the eurozone (including the subsequent accessions), plus Bulgaria, Denmark, Poland and Romania, agreed to adopt a Euro Plus Pact.

Differentiation also occurs in the way EU institutions implement the referred legal instruments, for example, the Union's long-standing focus on structural reforms, which is included in the European Semester.[475] The culmination of this process is the adoption of CSRs by the Council, which cover five broad policy areas: public finances and taxation; the financial sector; the labour market, social inclusion and education; structural policies; and public administration and the business environment. These recommendations cover a broad range of issues related to economic matters and others that can bear an indirect impact. On economic matters, reference can be made to the enhancement of productivity and increasing competition in the market, including the services sector;[476] the removal of obstacles preventing investment in transport, construction and energy infrastructure;[477] divestment in State assets[478] or governance improvement of State-owned companies.[479] The Council has already stressed the importance of legal certainty and educational outcomes on areas that can indirectly impact the economies of Member States.[480]

Notwithstanding the concentration of the economic and fiscal position of individual Member States, the eurozone as a whole and its unique intertwining is recognised by the issuance of euro area recommendations. For instance, in February 2020, the Council

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Resolution Fund, (ii) reform of ESM governance; (iii) the precautionary financial assistance instruments (iv) clarifications and expansions of the ESM mandate on economic governance. See Cristina Sofia Dias and Alice Zoppé, 'The Proposed Amendments to the Treaty Establishing the European Stability Mechanism' (2021) PE 634.357 <https://www.europarl.europa.eu/RegData/etudes/IDAN/2019/634357/IPOL_IDA(2019)634357_EN.pdf > accessed 26 December 2023.

[475] Leo Flynn, 'Non-Fiscal Surveillance of the Member-States' in Fabian Amtenbrink and Christoph Herrmann (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) 850, 853.

[476] Council Recommendation of 12 July 2016 on the 2016 National Reform Programme of Italy and delivering a Council opinion on the 2016 Stability Programme of Italy [2016] OJ C 299/1; Council Recommendation of 12 July 2016 on the 2016 National Reform Programme of Finland and delivering a Council opinion on the 2016 Stability Programme of Finland [2016] OJ C 299/79; Council Recommendation of 12 July 2016 on the 2016 National Reform Programme of Denmark and delivering a Council opinion on the 2016 Convergence Programme of Denmark [2016] OJ C 299/87.

[477] Council Recommendation of 12 July 2016 on the 2016 National Reform Programme of Poland and delivering a Council opinion on the 2016 Convergence Programme of Poland [2016] OJ C 299/15.

[478] Council Recommendation of 12 July 2016 on the 2016 National Reform Programme of Croatia and delivering a Council opinion on the 2016 Convergence Programme of Croatia [2016] OJ C 299/96.

[479] Council Recommendation of 12 July 2016 on the 2016 National Reform Programme of Slovenia and delivering a Council opinion on the 2016 Stability Programme of Slovenia [2016] OJ C 299/90.

[480] Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of Hungary and delivering a Council opinion on the 2018 Convergence Programme of Hungary [2018] OJ C 261/72.

recommended that euro area Member States act, individually and collectively within the Eurogroup, on several matters, according to their individual statuses during the 2020-2021 period.

In this vein, euro area Member States with current account deficits or high external debt were encouraged to pursue reforms to boost competitiveness and reduce external debt. Conversely, large current account surplus euro area countries were advised to strengthen the conditions that supported wage growth and implement measures that fostered public and private investment. High public debt levels should lead to fostering prudent policies that put public debt on a sustainable downward path. Countries in favourable fiscal positions should, then, use it to further boost high-quality investments, while preserving the long-term sustainability of public finances.[481]

Regarding horizontal measures, the Council encouraged strengthening the education and training systems as well as investment skills and the effectiveness of labour policies. At the EU level, reference was made to completing the banking union and making progress on the Budgetary Instrument for Convergence and Competitiveness.[482]

The common denominator of fiscal policy, macroeconomic imbalances and non-fiscal policy rules is the reduction of EU Member States' powers in matters of general economic policy when they find themselves in a situation of deficit or debt distress. Moreover, differentiation has increased through the use of article 136 TFEU. In this regard, the proliferation of secondary law circumscribed to the eurozone is intended to enhance enforcement measures and apply sanctions. In addition, the variation of reference values in the SGP is demanding in the case of eurozone Member States. It is, therefore, reasonable to draw the conclusion that eurozone States are subject to a more burdensome process and rules that are more restrictive.[483]

6.3. Compatibility of fiscal discipline with the principle of no-bailout

Wolfgang Schäuble once stated that 'We must not simply abandon interest rates as a disciplinary mechanism. Governments need the markets. Markets tell governments

[481] Council of the European Union, 'Council Recommendation on the Economic Policy of the Euro Area' (2020) <https://www.consilium.europa.eu/en/press/press-releases/2020/02/18/council-approves-its-recommendation-on-the-economic-policy-of-the-euro-area-for-2020/> accessed 12 January 2022.
[482] ibid.
[483] Editorial, 'Tinkering with Economic and Monetary Union' (2018) 55 Common Market Law Review 709, 710.

things that governments don't want to hear. And they force governments to do the right thing'.[484]

At the outset, the Maastricht framework was based on a consensus over the principle of market pressure: the idea that countries without monetary policy autonomy could only rely on fiscal policy for public debt management.[485] Members of a monetary union issue government debt in a currency they do not control and, as a result, they cannot always guarantee repayment to bondholders. Countries not participating in a monetary union, on the other hand, can provide a higher degree of trust because they have their own central bank. This contrast creates a situation where a liquidity crisis could take place within a monetary union and, because such a crisis leads to large increases in the public debt interest rate, it ends up in default. Given this framework, countries should be provided with an incentive to keep their debt at manageable levels, to prevent markets signalling a crisis by raising interest rates on bonds.

Notwithstanding, investors' perception was that eurozone Member States would eventually be bailed out, despite the principle established in EU primary law.[486] That perception disappeared in 2009, causing intense volatility in the EU debt market, rising interest rates and, eventually, leading to the so-called sovereign debt crisis.[487]

Indeed, having intensified macroeconomic instability, leading to a financial and non-financial asset overvaluation in years of economic prosperity and excessive austerity in years of economic recession, the market's role began being questioned due to a systematic mispricing of sovereign risk. In fact, De Grauwe states that 'the disconnection of the spreads from their fundamentals seems to have been the most pronounced in the

[484] Wolfgang Schäuble, 'A Comprehensive Strategy for the Stabilization of the Economic and Monetary Union: Speech at the Brussels Economic Forum' (18 May 2011) <https://ec.europa.eu/economy_finance/bef2011/media/files/speech-brussels-economic-forum-schauble.pdf> accessed 15 January 2022.

[485] Amtenbrink, 'Economic and Monetary Union' (n 227) 906.

[486] See, for instance, Marek Dabrowski, 'Fiscal or Bailout Union: Where Is the EU/EMU's Fiscal Integration Heading?' (2014) 1 Revue de l'OFCE 17, 38. For an opposing view, interpreting this as a market failure see, for instance, Fabian Amtenbrink and René Repasi, 'Compliance and Enforcement in Economic Policy Coordination in EMU' in András Jakab and Dimitry Kochenov (eds), *The Enforcement of EU Law and Values: Ensuring Member States' Compliance* (Oxford University Press 2017) 145, 173.

[487] For a background of the sovereign debt crisis, see Jerome Stein, 'The Diversity of Debt Crises in Europe' in Daniel Daianu and others (eds), The Eurozone Crisis and the Future of Europe: The Political Economy of Further Integration and Governance (Palgrave Macmillan 2014) 25; Horváth and Šuster (n 119); Xosé Carlos Arias and Antón Costas, 'The Great Recession and Economic Policy: Roots and Consequences' in Javier Bilbao-Ubillos (ed), *The Economic Crisis and Governance in the European Union* (Routledge 2014) 13; Hinarejos, *The Euro Crisis in Constitutional Perspective* (n 252).

countries where the spreads surged most'.[488] Importantly, while markets did not signal risk potentially emanating from sovereign debt of peripheral countries prior to the crisis, following the crisis, they exacerbated risks dramatically.[489]

Others do not view this chain of events as a market failure. In fact, the SGP was not enforced when it was originally breached – neither by Member States[490] nor by the Court.[491] Instead, the SGP sent a dual signal to the market and other institutions. The first signal communicated that fiscal discipline was not as valuable as previously assumed and, implicitly, a bailout perception gradually developed. The second signal communicated that the largest Member States had the political power to break the rules, while smaller countries engaged in creative accounting without sanctioning. These efforts undermined market discipline by implying that the central government lacked credibility. Indeed, how could a bailout be discarded if it was politically impossible to enforce the rules that were established to prevent the occurrence of a bailout? Consequently, a hierarchy failure transpired. In sum, 'weak or half-hearted regulations may have been worse than no regulations at all'.[492]

A holistic critique is advanced by Eichengreen and Hagen. In their view, the multiple principles foreseen by the Maastricht Treaty undermined the objective it

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[488] Paul de Grauwe and Yuemei Ji, 'Mispricing of Sovereign Risk and Macroeconomic Stability in the Eurozone' (2012) 50 Journal of Common Market Studies 866, 877.

[489] ibid. See also Olli Rehn, 'Economic Governance in a Changing Union: Fiscal Rules and Market Discipline in the Euro Area' in Koen Lenaerts and others (eds), *An Ever-Changing Union?Perspectives on the Future of EU Law in Honour of Allan Rosas* (Bloomsbury 2020) 83, 86-89. Rehn is of the view that markets were overly trusted to deliver Member States' budgetary discipline on their own.

[490] The first breach took place in 2003 by France and Germany. Strict implementation of the SGP was, however, blocked by some Member States – a situation that led to the first revision of the Pact. On this see Estella, *Legal Foundations of EU Economic Governance* (n 239) 134. Notwithstanding the revision, the SGP continued to be breached (ie in 2014 and 2016). On this particular point see Roger Kelemen, 'Commitment for Cowards: Why Judicialization of Austerity Is Bad Policy and Even Worse Politics' in Tom Ginsburg, Mark D Rosen and Georg Vanberg (eds), *Constitutions in Times of Financial Crisis* (Cambridge University Press 2019) 146, 157. Criticising the Court as a promoter of repeated fiscal indiscipline, see Gavin Barrett, 'The Role of Courts in the Eurozone' in Martin Belov (ed), *Judicial Dialogue* (Eleven International Publishing 2019) 127, 129. However, Barrett also states that budget discipline is often an area of high political salience and controversy, which can seldom be resolved with judicial decisions.

[491] Case C-27/04, *Commission of the European Communities v Council of the European Union* [2004] ECR I-6649.

[492] Rodden, 'Market Discipline and U.S. Federalism' (n 428) 130. The author highlights that the federal systems of Brazil and Argentina also had elaborate regulations and procedures for monitoring the debt of their States and provinces. Unfortunately, these regulations and procedures were undone by the politics of federalism. In Brazil, for instance, the Senate was responsible for approving and regulating the borrowing of States, and representatives of insolvent States found that approval for unsustainable borrowing was relatively easy to obtain as part of the game of legislative horse trading. Similarly to the Eurozone, if it was politically impossible to sanction São Paulo for its dubious loans from state-owned banks, how could it possibly gather political support to allow the State to default?

purported to achieve. At first glance, however, that seemed impossible: how could the prohibition of debt monetisation and bailouts, coupled with the EDP, not provide a robust legal framework or convey the adequate incentives for both markets and Member States? How could it not transmit the idea of State fiscal sovereignty and responsibility? By doing so, would it not strengthen Member States' incentive to anticipate problems and tackle them in an adequate and timely manner?[493]

This reading may have been plausible, but it was misleading. Indeed, none of the this explains the existence of a procedure allowing EU authorities to require Member States to perform fiscal adjustment in the event of excessive debts or deficits. In fact, excessive debt accumulation is only a problem if there is reason to expect that ensuing difficulties would be resolved by a bailout. Accordingly, '[b]y inference, the EDP reflects doubt on the part of the framers of the Maastricht Treaty that the no-bailout provision is credible'.[494]

Other, non-fiscal principles feed into the commitment problem, since permitting a Member State to endure a fiscal crisis on its own could breach Union principles. In fact, as foreseen in article 3 (3) TEU, the Union 'shall promote economic, social and territorial cohesion, and solidarity among Member States', which could be interpreted to mean financial assistance, including the monetisation of debts, hence the introduction of the EDP, to discourage hazardous behaviour.

Moreover, the act of regulating Member States' public finances at supranational and international levels signals a certain level of co-responsibility. Indeed, at the outset, the EU was a regulatory state in the sense that it acted as an independent agent of national democracies, in order to enact efficiency-enhancing regulation that boosted not only market integration but also the bloc's commitment to open markets.[495] In a way, it resembled the situation in the US before the New Deal and so-called fiscal revolution, in which the government played a dim role regarding both redistribution and macroeconomic stabilisation.[496] However, the Commerce Clause enshrined in the US

[493] Barry Eichengreen and Jürgen Von Hagen, 'Fiscal Restrictions and Monetary Union: Rationales, Repercussions, Reforms' (1996) 23 Empirica 3, 15.
[494] ibid. In the same vein, see Charles Blankart and Achim Klaiber, 'Subnational Government Organisation and Public Debt Crises' (2006) 26 Economic Affairs 48, 53; Calliess, 'The Governance Framework of the Eurozone and the Need for a Treaty Reform' (n 235) 39.
[495] Waltraud Schelkle, 'The Contentious Creation of the Regulatory State in Fiscal Surveillance' (2009) 32 West European Politics 829, 830.
[496] Which took place between the presidencies of Herbert Hoover and Lyndon Johnson. See Giandomenico Majone, 'The Rise of Statutory Regulation in Europe' (n 241) 55.

Constitution allowed the judiciary to create a single market by regulating interstate commerce,[497] which resembles the role of the CJEU in its early case law.[498]

The SGP revision in 2005, however, arguably activated the EU's transition from a regulatory state to a form of fiscal surveillance. In this context, Schelkle questions, '[w]hy was strengthening the economic underpinning necessary, given that its architects portrayed the original SGP as the triumph of good economics over bad politics?'[499] The idea that EMU needed tighter fiscal rules was rebutted by many, essentially because to restrict governments' fiscal policies while they lost monetary policy was illogical.[500]

In addition to the alluded rationale, the improvement of EU economic governance following the financial crisis was substantial. At a constitutional level, public finance restrictions were not only enshrined in the TFEU but also, pursuant to TSCG, in several EU Member States' Constitutions.[501] Constraints are extensively detailed in the six-pack and two-pack, in a process that has arguably evolved to become dysfunctional.[502] Moreover, it is difficult to reconcile the common constitutional principle of budgetary power attributed to national parliaments with the imposition of economic constraints from the European Semester and MoUs debtor, which States must approve.[503]

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[497] Akhil Reed Amar, *America's Constitution: A Biography* (Random House 2005) 114, argues that in 1787 the commerce clause encompassed a broader meaning, which is retained today, referring to all forms of intercourse in the affairs of life, regardless of whether or not it is narrowly economic or mediated by explicit markets. However, modern lawyers and judges typically refer to the commerce clause as applicable only to economic interactions. In this latter sense, see Richard Epstein, 'The Proper Scope of the Commerce Power' (1987) 73 Virginia Law Review 1387; Grant Nelson and Robert Pushaw, 'Rethinking the Commerce Clause: Applying First Principles to Uphold Federal Commercial Regulation but Preserve State Control Over Social Issues' (1999) 85 Iowa Law Review 1. In the jurisprudence see *United States v Lopez* [1995] 514 US 549.

[498] Maduro, *We The Court: The European Court of Justice and The European Economic Constitution* (n 6).

[499] Schelkle (n 495) 833.

[500] Textbook economics makes the case for either close fiscal policy coordination or for fiscal federalism. See Willem Buiter and others, 'Excessive Deficits: Sense and Nonsense in the Treaty of Maastricht' (1993) 8 Economic Policy 57; Charles Goodhart and Stephen Smith, 'Stabilization' in Commission of the European Communities, *The Economics of Community Public Finance, European Economy, Reports and Studies* (1993) <https://op.europa.eu/en/publication-detail/-/publication/ad33bb0a-5424-40c2-bd51-eec26b6edd65> accessed 11 April 2024, 417.

[501] European Commission, 'Report from the Commission Presented under Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union' C(2017) 1201 final <https://economy-finance.ec.europa.eu/system/files/2017-02/c20171201_en.pdf> accessed 27 December 2023. Although all Member States are considered to be compliant, a particular legal interpretation or governmental action is necessary under certain legal frameworks. See also Giacomo Delledonne, 'A Legalization of Financial Constitutions in the EU? Reflections on the German, Spanish, Italian and French Experiences' in Maurice Adams, Federico Fabbrini and Pierre Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Oxford University Press 2016) 181.

[502] Christian Joerges, 'Pereat Iustitia, Fiat Mundus: What Is Left of the European Economic Constitution after the Gauweiler Litigation?' (2016) 23 Maastricht Journal of European and Comparative Law 99, 113.

[503] ibid. 114.

A fortiori, the fact that Member States need their overall budgets (including forecasts, public finance figures, structural reforms, labour and economic guidelines) approved by the European Commission and other Member States in the Council deepens the issue. If Member States endure economic and financial hardship, it might be tempting to shift the blame to EU institutions and these, on the other hand, will be seen as co-responsible for economic instability and potential collapse, making a bailout inevitable.

Part of this bailout dynamic is well captured by Beukers while explaining and assessing central bank intervention in EU Member States' economic policy making. As the author states:

> A further explanation of ECB action focuses on the institutional reasons for both ECB action and Member State inaction (or slow action). Not only individual Member State inaction in the sense of postponing fiscal policy and structural reforms, but also collective Member State inaction when it comes to responding to the euro area crisis. The lack of action is often a consequence of a lack of political will at national level, the complex decision making procedures at EU level, or the limits to action set by the existing EU (and sometimes national constitutional) legal framework. When action does take place at EU level, it often – for good democratic reasons – takes time for decisions to enter into force. Member States therefore in a sense "force" the ECB to take decisions in their place.[504]

Thus, Beukers is of the view that one of the reasons for ECB's multifaceted intervention is States' fiscal consolidation protraction, which does not only suggest but compel central bank intervention. The issue with this outcome is that it intrinsically conflicts with principle central bank independence in pursuing its mandate. As the author notes, the eurozone financial crisis illustrates the tension between the need for a clear mandate and the need for flexibility in the application of this mandate in times of crisis.[505] In any event, it is hard to understand how a central bank could preserve its independence

[504] Beukers (n 167) 1608.
[505] ibid. 1611.

when it is forced to act due to certain Member States fiscal difficulties, instead of taking the whole eurozone into account.

These issues are coupled with the identities of lower-level governments' creditors, which are one of the most important aspects of assessing the credibility of the no-bailout commitment in the central government. In the eurozone, this meant dealing with the problem of over-exposure of the EU banking system to Member States' sovereign debt, particularly inter-state lending from German and French banks.[506] This practice was encouraged by the EU banking legal framework, which provided financial incentives for banks to purchase government debt, given that they were not required to set aside additional capital reserves. According to Rodden, this explicitly provided a bailout assurance by signalling to market actors that the default risk of Member States was zero. The signal was received not only by bankers but also by other creditors and Member States' governments, which came to understand that the strongest European economies implicitly guaranteed their debts. Consequently, this demonstrates that, in decentralised federations with strong Member States representation, both market and hierarchical forms of fiscal discipline can easily fail if institutions and incentives are not properly structured. As such, solutions combining markets and hierarchy are unlikely to succeed.[507]

Crucially, Member States' responded to the crisis by adopting several temporary rescue mechanisms and one permanent one, which consolidated the lack of credibility of the no-bailout clause. An example of this is a statement made by Lagarde, in December 2010, pursuant to the Greek bailout, whereby '[w]e violated all the rules because we wanted to close ranks and really rescue the eurozone. The Treaty of Lisbon was very straight-forward. No bailout'.[508]

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[506] Helen Thompson, 'The Dirty Little Secret of the Euro Zone Crisis: The German Banks' (*Sheffield Political Economy Research Institute*, 2013) <http://speri.dept.shef.ac.uk/2013/11/11/dirty-secret-euro-zone-crisis-german-banks/> accessed 26 January 2022; Benn Steil and Dinah Walker, 'Greece Fallout: Italy and Spain Have Funded a Massive Backdoor Bailout of French Banks' (*Council on Foreign Relations*, 2015) <https://www.cfr.org/blog/greece-fallout-italy-and-spain-have-funded-massive-backdoor-bailout-french-banks> accessed 26 January 2022; Martin Hellwig, 'Germany and the Financial Crises 2007 – 2017, Case Study on a Past Crisis: The Case of Germany', *Paper presented at the fourth Annual Macroprudential Conference of the Swedish Riksbank* (2018) <https://pure.mpg.de/pubman/faces/ViewItemFullPage.jsp?itemId=item_3069121_1> accessed 13 May 2022.

[507] Rodden, 'Market Discipline and U.S. Federalism' (n 428) 131.

[508] Reuters Staff, 'France's Lagarde: EU Rescues "Violated" Rules: Report' (Reuters, 18 December 2010) <https://www.reuters.com/article/us-france-lagarde-idUSTRE6BH0V020101218> accessed 13 May 2022. See also Nicolas Jabko, 'Politicized Integration: The Case of the Eurozone Crisis' in Francesca Bignami (ed), *EU Law in Populist Times: Crises and Prospects* (Cambridge University Press 2020) 91, 99. In

The stringent conditions of the assistance programmes loans do not invalidate this reasoning. When introducing these mechanisms, countries were presented with an alternate situation in which some of them would become unable to finance their public debts and deficits and be forced to adopt harsher conditions in order to make quick adjustments between revenues and expenditure. Additionally, the ESM can act in the primary bond market (article 17 ESM Treaty) and, like the ECB, in the secondary market (article 18 ESM Treaty).[509] From this point of view, one can take a less benign look at the relationship between conditionality (associated with the ESM and its precursors) and the no-bailout principle.

Moreover, the European Commission proposed to transform the TSCG into a Council Directive, laying down provisions to strengthen fiscal responsibility and medium-term budgetary orientation in Member States.[510] This formally followed article 16 TSCG. However, Directives provide some flexibility during the transposition into national law. Moreover, the European Commission does not fix a debt limit but rather flexible, 'political' targets,[511] resembling the early SGP experience in which it was left unenforced.

These developments render the no-bailout clause close to *lettre morte* in the sense that Member States, regardless of their size, know it is very likely they will be granted financial assistance in order to avoid potential spillover effects. Despite the fact that this is a paradox, given the harsh conditions some financial assistance programmes entail,[512] Member States are, in fact, more protected. While conditionality intends to somehow recreate a market default scenario to safeguard incentives for fiscal prudence, the fact remains that the uncertainty regarding financial assistance disappeared and, thus, Member States and markets became aware that a bailout would occur if needed.[513]

Jabko's view, there was a 'relaxation' of the no-bailout clause in exchange for the application of 'draconian economic reform conditions'.

[509] Adriano Evangelisti, 'Le Mécanisme Européen de Stabilité et Sa Réforme' (2020) 639 Revue de l'Union Européenne 349.

[510] European Commission, 'Proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States' COM (2017) 824 final (n 432). This diverges from the original intent, which was to place such provisions in primary law. This was one of the reasons that the UK and Czech Republic exercised the veto right.

[511] Paul Craig, 'The Stability, Coordination and Governance Treaty: Principle, Politics and Pragmatism' (2012) 37 European Law Review 231; Ruffert (n 333), 55.

[512] See https://www.esm.europa.eu/financial-assistance.

[513] In this sense, see Jabko, 'Politicized Integration: The Case of the Eurozone Crisis' (n 508) 102. The author notes that, in 2010, at the height of the financial crisis in the EU, the German and French

7. Comparative examples

There are examples of other non-unitary federal countries, which have adopted different approaches regarding bailouts of their component units. As such, I will outline the features of different types of federations in terms of size and degree of multi-level sovereignty.

7.1. Federalism with sub-national sovereignty: United States

I will focus on the US as an example of subnational sovereignty. In the US, constitutional limits on State borrowing go back to the early nineteenth century and can be divided into two different causes: funding of major public projects and civil war reconstruction. No-bailout, however, can be dated to the revolutionary war.[514]

7.1.1. Revolutionary war

I will start by briefly describing the latter. After the independence, a debate was held on whether the US Government should create a national bank and assume the war-related debts of States. Alexander Hamilton argued in favour of this assumption in the First Report on the Public Credit with two main arguments: morality and economics.[515] On morality, Hamilton asserted that States with the largest debts had borne a larger share of war-related expenditures. On economics, he argued that capital mobility and State politics placed constraints upon States' ability to tax. He feared for the creditworthiness of financially healthy States and of the US Government if States would be able to borrow significant amounts (by relying on their good credit) but easily defaulting when faced

governments realised that the eurozone could not continue with a strict no-bailout regime and loosely coordinated Member States budgets.

[514] A detailed description of historical events can be found in Cathy Matson, 'The Revolution, the Constitution and the New Nation', *The Cambridge Economic History of the United States: volume I, The Colonial Era* (Cambridge University Press 1996) 363 and Benjamin Ratchford, 'History of the Federal Debt in the United States' (1947) 37 The American Economic Review 131. See also Stewart Sterk and Elizabeth Goldman, 'Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations' (1991) Wisconsin Law Review 1301 and Pieter-Augustijn Van Malleghem, '(Un)Balanced Budget Rules in Europe and America' in Maurice Adams, Federico Fabbrini and Pierre Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Bloomsbury Publishing 2014) 151.

[515] Alexander Hamilton, 'Report Relative to a Provision for the Support of Public Credit' (1790) <https://founders.archives.gov/documents/Hamilton/01-06-02-0076-0002-0001> accessed 31 January 2022.

with negative shocks. Moreover, he feared undue influence in the federal policy process by indebted States pushing for federal bailouts. His hope was to establish the US Government as the States' sole creditor and cut off their independent access to credit markets. James Madison led Congressional opposition, arguing that the proposal was sectional because many of the northern states remained heavily indebted to public creditors while most southern States had repaid large portions.[516]

Hamilton ultimately succeeded and the US Government assumed the debts of the States in 1790. As noted by Rodden, this assumption created a dangerous precedent by encouraging States to believe this example would turn into rule. Notwithstanding, since the scheme did not foresee future independent borrowing by the States, he was not concerned with moral hazard. However, he passed away shortly after his success and the States resumed their independent borrowing.

7.1.2. Funding of major public projects

With the onset of the industrial revolution and expansion to the west, railroads and canals became critical modes of transportation. States borrowed significant sums to fund these projects. The private sector, unable to raise the necessary capital, gained subsidies to promote other related constructions. However, mounting costs and a reluctance to tax appropriately led New York to become the most extreme case, incurring the largest per-capita debt in the US. Other States followed and, in 1840, debt repudiations started.

The first severe shock to American credit occurred in February 1840, when Pennsylvania's payment of (semi-annual) dividends to (mostly) British creditors was briefly delayed. As one of the wealthiest States in the US, many persons of modest means invested in its securities and were dependent on correspondent interest.[517] As investors started worrying whether other, less wealthy States could meet their obligations, insecurities mounted. In this context, it is interesting to note the statement made by Nicholas Biddle, who was president of the Second Bank of the United States at the time:

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[516] Matson (n 514).

[517] This is astonishingly clear in the letter written by the former editor of the Edinburgh Review to the House of Congress, in which repudiation is described as an act of bad faith with no excuse: 'Little did the friends of America expect it, and sad is the spectacle, to see you rejected by every State in Europe, as a nation with whom no contract can be made, because none will be kept; unstable in the very foundations of the social life, deficient in the elements of good faith, men who prefer any load of infamy, however great, to any pressure of taxation, however light'. Reginald McGrane, *Foreign Bondholders and American State Debts* (The Mcmillan Company 1935) 58.

'[t]he stain which falls on the youngest member of the Confederacy spreads over the whole. The [S]tates are firmly linked, hand in hand with each, and the elective shock which touches one instantly thrills through the whole'.[518]

These fiscal crises sparked two-fold constitutional limitations. The first limitation was that nineteen States adopted the debt limitations in their Constitutions in the 1840-1855 period. Prior to that, none of them had these provisions. I will take New York as an example. Anticipating the danger that future legislatures would contract unmanageable debt, in their 1846 constitutional convention it was noted by the chairman that, unless some check was placed upon debt contraction, the representative government could not endure. Therefore, it was proposed to permit a certain amount of debt to meet casual deficits or failure in revenues as well as unlimited debt to counter invasion, insurrection or defence in time of war. For other purposes, new debt would have to be approved by citizens in a general election, which would bring the power of taxation closer to those who are subject to it.[519] The second limitation was that the convention enacted a prohibition on loans of State credit to individuals or corporations, due to severe losses derived from these practices in the State of New York. These constitutional provisions successfully limited further fiscal crises and, by 1893, the State was almost entirely out of debt.

Most importantly, States were regarded as sovereign, autonomous units in the federal system. This was confirmed by Daniel Webster, former senator of the State of Massachusetts, in a reply to financiers on whether State legislatures were empowered to contract loans at home and abroad. Webster argued that they did, indeed, possess authority, given that each was an independent and sovereign political community, except for the powers conferred to the Federal Government. Moreover, the security of those loans was the responsibility of the States themselves and they could not be discarded. In his words, '[a]ny failure to fulfill their undertakings would be an open violation of public faith, which would be followed by the penalty of dishonor and disgrace; a penalty no [S]tate would be likely to incur'.[520]

The challenge, however, would come into play when the amounts borrowed had to be paid. As the London Times inquired, would American citizens agree to submit to

[518] ibid. 42.
[519] Sterk and Goldman (n 514) 1309. One of the convention members argued that this practice would bring people closer to the power to tax, which is where it ultimately should reside as they are the tax subjects.
[520] McGrane (n 517) 22.

taxation to provide payments? Crucially, was the power to make loans coupled with the power to extinguish them? It was then realised that more would be needed than Webster's word, eventually there would have to be a more comprehensive guarantee than that of the individual States (like a national pledge), which ignited a debate for the federal assumption of debt.[521] When Congress assembled to discuss the matter, there was not, in fact, a consensus. Some Senators highlighted that debt assumption would compel non-indebted States to incur the debts of others, for which they were not liable. It would also establish a grave precedent for later assumptions, given that relieved States would, in all probability, incur more debts. Lastly, it would lay the foundation for new duties on imports, which would fall disproportionately across States and there was no constitutional right allowing the Federal Government to assume States' debts. On the other hand, this was not the first time the Federal Government had assumed States' debts, as precedent had been set by Hamilton: indeed, his fears about State borrowing seemed to be well founded.

Congress was authorised to pay US debt, but no reference was made regarding States' debt. Given the principle of delegation of powers, no competence existed to assume these obligations. This position sparked a significant revolt among European capitalists. To pressure the Federal Government to assume the payment of States' debts, they threatened to cease its funding until States had resumed their payments, which was supported by less indebted States. However, no assumption occurred, causing the ensuing period to be one of falling prices and financial difficulties.[522]

Crucially, this chain of events effectively broke with the precedent started with the revolutionary war. Nevertheless, this period saw a strong movement in favour of Federal

[521] According to the New York Herald, it was the only way to raise money easily. By issuing federal stocks, Americans could go to Europe and raise enough money to complete their projected public works. In the same vein, the New York American pointed out several advantages, like an immediate benefit to the States and the Community, and various things that could be achieved by substituting the credit of many states for that of one great nation. But this issue was very divisive, as John Quincy Adams argued in Congress that there would be war with Great Britain if State debts were not assumed. Other Congressmen, like the one from Mississippi, defiantly announced that, if the options were war or debt assumption, he and his constituents would vote for war.

[522] The difference between the US system back then and the current EU system is that, in the US, there was still no monetary union. Rather, a system of free banking existed from 1837 to 1863. This system allowed many State banks to issue their own bank notes, which were often traded at discounts. However, this difference is not as relevant as it may seem at first sight for several reasons. For instance, there was no significant inflation during the period and free banking typically did not mean freedom to issue bank notes without adequate collateral. Rather, it meant free access to operate in the market. In this vein see Hugh Rockoff, 'The Free Banking Era: A Reexamination' (1974) 6 Journal of Money, Credit and Banking 141; Arthur Rolnick and Warren Weber, 'New Evidence on the Free Banking Era' (1983) 73 The American Economic Review 1080.

Government assumption of States debt, especially because of the referred precedent. As Ratchford argues, had the move been successful, 'a second assumption would almost certainly have converted a precedent into a habit, the results of which are not pleasant to contemplate'.[523] Importantly, the debt crisis put the US States in the direction of market-based discipline.

7.1.3. US civil war

The civil war had severe consequences on the infrastructure of the southern States, which had to be rebuilt. Along with the misuse of public funds, this put pressure on State expenditure, which was met by issuing new debt, sometimes disregarding State restrictions on the matter. These events provided the necessary incentives for southern States to amend their Constitutions to include fiscal restrictions.[524]

Importantly, the underlying rationale was not interstate externalities caused by fiscal profligacy, as Hamilton and the Maastricht EMU founders feared. Rather, citizens were motivated by other reasons, such as the fact that they were against States' principal-agent problems, preventing the reduction of public expenditure. Consequently, new States that had been admitted to the Union following the civil war commonly included debt limits in their Constitutions. At the same time, however, several States repudiated their Reconstruction debt by unilaterally reducing interest and principal on their bonds.[525]

7.1.4. New Deal: the rise of countercyclical policy at State level

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[523] Benjamin Ratchford, *American State Debts* (AMS Press 1966) 104.

[524] Eichengreen and Hagen (n 493) 11. For instance, in 1873, South Carolina prohibited the legislature from incurring State debt either 'by the loan of the credit of the state by guaranty, indorsement, or otherwise, except for the ordinary or current business of the state' unless two-thirds of the voters approved. Texas imposed similar limitations in 1876, Georgia in 1877, and Louisiana in 1879.

[525] This practice was allowed by the US Supreme Court. By reinterpreting the Eleventh Amendment, the US Supreme Court refused complaints of holders of reconstruction bonds on grounds of institutional impropriety. Indeed, in *Davis v Gray* [1995] 83 US 203, Justice Samuel Miller argued that if any branch of the State Government has the power to give plaintiff relief it is the legislative. When asked, rhetorically, why he would not sue the legislature, he answered that the absurdity of the proposition shows the impossibility of compelling a State to pay its debts by judicial process. In other cases, the US Supreme Court claimed States' sovereign immunity in order to decide. In *Baltzer v North Carolina* [1896] 161 US 240, holders of North Carolina tax bonds sued the State, claiming that the amendment to the State Constitution prohibiting payment was a breach of contract. The US Supreme Court rejected the argument arguing that, according to North Carolina law that was in force before the amendment, the State Supreme Court had no power to issue a binding judgment against the State. As such, the constitutional amendment did not have an impairment. More cases can be found in John Orth, *The Judicial Power of The United States: The Eleventh Amendment in American History* (Oxford University Press 1987).

Countercyclical expenditure in the US was conducted at a State or local level until the New Deal was enacted in 1933, which was a sizeable financial package, encompassing several programmes, public works, financial reforms and regulations. In part, this legislation was a consequence of a reduction in the amount that States could allocate to stabilise their economies in times of hardship. Despite this, in order to address the Great Depression, States' debt-to-GDP ratio almost doubled between 1922 and 1932, representing 33% in the last year.[526] In fact, while the US Government was running surpluses until 1932,[527] some States found themselves in a situation similar to Greece during the sovereign debt crisis[528] and one of them defaulted on its debt payments.

In 1933, the US Government began assuming a prominent role in stabilisation policy and infrastructure. As Silvers states, 'although the Depression continued for another seven years (…) [S]tate and local borrowing rose only from $19.2 billion in 1932 to $20.2 billion in 1940. In its place, federal spending expanded dramatically – increasing from $4.6 billion in 1932 to $8.2 billion in 1936'[529] by subsidising the creation of States' unemployment insurance and Medicaid. This period saw the rise of necessary funding and cooperative federalism, whereby the tasks undertaken by States and the federal level became increasingly intermingled.

Financial resources flowing to the States continued to grow 'astronomically', according to Gerstle, to $19.3 billion in the 1960s and $61.9 billion in the 1970s, which accounted for a twenty-seven fold increase in twenty years.[530] From a financial perspective, the downside was that States became dependent on federal funding to provide these programmes, which meant that, in their absence, sub-national budgets became strained to the point that policy choices would have to be taken: they would either need to cut federally mandated programmes, cut other State-run programmes or refuse to pay interest or principal on debt. However, these features were also portrayed as a strategy

[526] United States Census Bureau, 'Bicentennial Edition: Historical Statistics of the United States, Colonial Times to 1970' (1975) <https://www.census.gov/library/publications/1975/compendia/hist_stats_colonial-1970.html> accessed 2 February 2022, 1127.
[527] United States Census Bureau, 'Historical Statistics of the United States: 1789 to 1945' (1949) <https://www.census.gov/library/publications/1949/compendia/hist_stats_1789-1945.html> accessed 2 February 2022, 297.
[528] Damon Silvers, 'Obligations without the Power to Fund Them' in Peter Conti-Brown and David Skeel (eds), *When States Go Broke: The Origins, Context, and Solutions for the American States in Fiscal Crisis* (Cambridge University Press 2012) 46. See also Gary Gerstle, *Liberty and Coercion: The Paradox of American Government from the Founding to the Present* (Princeton University Press 2018) 299.
[529] Silvers (n 528) 47.
[530] Gerstle (n 528) 299.

pursued by the US Government to tame States' power during the political process. As Gerstle points out:

> There was nothing new in the federal government relying on the states to administer its programs and carry out its policies. The central state had been doing this since the advent of the new federalism in the late nineteenth and early twentieth centuries. New Dealers, too, had relied heavily on the states for both political and administrative reasons. But in the 1960s, the federal government sought not only to involve the states in its programs but also to subdue them by making the flow of federal dollars dependent on the states' acquiescence to Washington-generated policies and standards.[531]

7.1.5. Different public finance limitations

Therefore, in the US States, debt and deficit limitations were introduced gradually and autonomously. In fact, restrictions were introduced pursuant to drastic events and, crucially, with support from their respective citizens.

BBRs are currently in place in all States, except Vermont, albeit with very different features. BBRs require States to balance their projected revenues with expenditures, although they must have varying flexibility when implementing these provisions. Balanced-budget requirements can be broadly divided into three groups depending on the stage in the budgetary process at which balance is required. Either the governor must submit a balanced budget (first group), the legislature must enact a balanced budget (second group) or there must be a combination of legislative-balanced budget enactment, a prohibition of a deficit carry-forward and a governor is legally obliged to sign a balanced budget (third group).[532] Although they have some scope limitations,[533] stricter BBRs are

[531] ibid. 300.
[532] James Poterba, 'Balanced Budget Rules and Fiscal Policy: Evidence from the States' (1995) 48 National Tax Journal 329.
[533] Frequently, BBR only apply to the so-called general fund or State operating fund. As such, they do not constrain the whole budget, which also encompasses special funds (ie having earmarked receipts, intergovernmental aid, capital spending or trust funds). ibid. 331.

associated with tighter fiscal outcomes, such as reduced spending, smaller deficits, larger surpluses and more rapid spending adjustments during recessions.[534]

Most States have debt restrictions established in their Constitutions, although they vary significantly in terms of scope. A few States prohibit debt as a general rule with very few exceptions (ie article 10, section 5, of Indiana's Constitution and article 10-4 of West Virginia's). Other possibilities include: defining a maximum amount by measuring in absolute (ie article 9, section 5, of Arizona's Constitution, limiting state's debt to $350.000) or relative figures (ie article 7, section 4, paragraph 2, of Georgia's Constitution, restricting debt service to 10 percent of state revenue); requiring a maximum amount as well as a referendum or legislative qualified majority, even for new debt not exceeding the previously mentioned ceiling; permitting unlimited new debt after a referendum or if approved by a qualified majority; requiring both a legislative qualified majority and approval by a referendum (ie section 213 of Alabama's Constitution, which provides the incursion of debt to be prohibited unless this framework is amended by a three-fifths qualified majority of all members of each house of the Legislature and approved by a majority of voters of the State in a referendum, although certain exceptions are possible; and also article 9, section 15, of the Constitution of Michigan).[535]

More recently, Tax and Expenditure Limits (TEL) have been introduced. TEL restrict the growth of government revenues or spending by capping them at a fixed amount or by limiting their growth to match increases of certain factors, ie population, inflation, personal income or a combination of several.

7.1.6. Perils on the effectiveness of public finance restrictions: judicial deference and constitutional exceptions

Caution is warranted while assessing these restrictions, for several reasons.[536] First, debt limits only apply to the financial instruments that are guaranteed by tax revenue. To

[534] Kim Rueben, Megan Randall and Aravind Boddupalli, 'Budget Processes and the Great Recessions' (2018) <https://www.urban.org/research/publication/budget-processes-and-great-recession> accessed 1 February 2022; Christopher Biolsi and H Youn Kim, 'Analyzing State Government Spending: Balanced Budget Rules or Forward-looking Decisions?' (2021) 28 International Tax and Public Finance 1.

[535] For instance, obligations incurred for current operating expenses payable during the current fiscal year, debts incurred by separate public corporations functioning as instrumentalities of the State or State debt incurred to repel invasion or suppress insurrection. The State may also make temporary loans that do not exceed $300,000 to cover deficits in the State Treasury. Limited obligation debt may be authorised by the Legislature without an amendment to the Constitution.

[536] Sterk and Goldman (n 514) 1315; Malleghem (n 514) 151, 165; Kelemen (n 490) 146.

avoid those limitations, States borrow without pledging their full-faith-and-credit – this is a practice known as contract-debt obligations. By committing sources of revenue other than taxes, creditors may have a protected claim towards that resource but not against the State's treasury. This practice is widespread and preeminent today.

This exercise of narrowing the apparent strength of the constitutional public finance framework has been accepted by State courts in what has been designated the special fund doctrine (or revenue-bond exception).[537] For instance, in *Ohio Turnpike Commission v Allen*, public authorities issued debt to fund the construction of a turnpike exceeding constitutional restrictions. However, the Ohio Supreme Court dismissed the challenge and upheld the bonds because the cost of construction would be repaid entirely from its revenue. Moreover, given that no State funds were committed, this debt would not qualify as such under the State Constitution.[538]

Another example of erosion by judicial interpretation can be seen in the Lonegan cases. In *Lonegan I*,[539] New Jersey's plan to finance repairs and construct new public schools by issuing $8.6 billion in debt under the referred exception was challenged in court. This amount (which was almost equivalent to the State's tax-backed debt) concerned the State's Supreme Court on the grounds of its legitimacy, given that voter-approval requirements were being circumvented. However, the Court was bound by its own precedent on cases with similar funding features, as well as school finance litigation. For instance, in *Abbot v Burke*, New Jersey's Supreme Court required Abbott districts to provide half-day preschool programs and directed the Commissioner to ensure that these programs were adequately funded.[540] In the case at hand, the Court declared funding for education as a special case, since the State Constitution obligated it to provide safe and adequate school infrastructures in every district.

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[537] The original idea was to apply the exception only to fund projects that were able to generate revenues that could be allocated to pay the respective debt. However, the concept broadened over time: the component of new revenues became more flexible and, at times, completely excluded. Be that as it may, debt limits may still be avoided if the State does not grant a legal claim to the general fund to creditors. See Richard Briffault, 'Courts, Constitutions, and Public Finance: Some Recent Experiences from the States' in Elizabeth Garrett, Elizabeth Graddy and Howell Jackson (eds), *Fiscal Challenges: An Interdisciplinary Approach to Budget Policy* (Cambridge University Press 2008) 425.

[538] *Ohio Turnpike Commission v Allen* [1952] 158 Ohio St 168. In other States, this theory was enlarged to encompassed specific taxes created for and assigned to specific projects. However, the application was not univocal or undisputed, due to opportunity costs, as can be seen in *Washington State Finance Committee v Martin* [1963] 62 Wn2d 645.

[539] *Lonegan v State* [2002] 174 NJ 435.

[540] *Abbott v Burke* [1998] 153 NJ 480.

Contract-debt obligations were subject to enhanced judicial attention in *Lonegan II*. In this case, the Court acknowledged a functional equivalence between these financial instruments and State-backed bonds: failure to pay the former would affect the credit rating of the latter. However, the Court stood by its precedent, considering the consequences of a potential deviation. First, it stated that past decisions guided present and future policy-funding choices. Moreover, restricting previously approved and implemented financial instruments would disrupt the State's financing schemes.[541]

Second, balanced-budget requirements are seldom enforced by courts. At the outset, courts are very rarely called to resolve disputes over these kinds of restrictions. When the judiciary is called, it is usually deferential to the executive. In *Wein v Carey*, the New York Court of Appeals heard a challenge to the State's plan to issue short-term debt to cover a deficit. This practice was in its third consecutive year when the State's Constitution only permitted a single year on the condition that such a deficit was unanticipated and that the debt was paid the following fiscal year. The Court disagreed to make this mechanical and automatic reading, stating that:

> The fact is that there may be an indefinite series of deficits honestly suffered. All that is necessary to produce the result are successive years of unpredictable shortfalls in revenues or rises in required spending beyond estimates. Depressed economic conditions can affect both sides of the balance. Catastrophies, emergencies, or, in smaller scale, significant needs may arise, which, if unanticipated, may upset the balance on one side or the other.[542]

For the court, the requirement, therefore, is not one of simple arithmetic (either regarding deficits or the number of elapsed years) but more substantive and subjective,

[541] *Lonegan v State* [2003] 176 NJ 2. According to Briffault, deference from the judicial branch to the legislature is a usual practice regarding contract-debt obligations, as these were upheld in at least 32 other States' courts. Briffault, 'Courts, Constitutions, and Public Finance: Some Recent Experiences from the States' (n 540) 427.

[542] *Wein v Carey* [1977] 41 NY2d 498, 504. As Briffault states, this outcome is connected to what constitutes a legitimate public purpose for governmental intervention. The public purpose theory has been expanding since the twentieth century and courts have increasingly considered that such definition is a deeply political one, which may appropriately be left to the political process. Richard Briffault, 'State and Local Finance, Volume 3' in G Alan Tarr and Robert F Williams (eds), *State Constitutions for the Twenty-first Century* (State University of New York Press 2006) 211, 230.

as '[i]t is only when the estimates are dishonest that fault may be found with the budget plan or that which is done pursuant to it. It is then that the use of anticipation notes to balance the imbalanced budget plan is an unconstitutional practice'. In this instance, judges tried to shed some light on what might objectively be considered unconstitutional:

> […] there are some estimates that could be demonstrated on their face to be unreasonable. An extreme example would be a tripling of the estimates of personal income tax revenue, without a change in the tax rate, in a period in which the economy appears to be on a plateau or in decline. Another would be an estimate of expenditures falling short of statute mandated expenses or constitutionally directed covering of maturing indebtedness. Still another would be an omission of estimated expenditures for judgments rendered in courts of law. There are many other possible examples.[543]

The examples provided propel a certain disbelief and powerlessness, given that the mix of concrete decisions and contexts that are alluded to seem unlikely to be found in practice.

Regarding the burden of proof, the plaintiffs argued that, given the successive deficits, the State should prove the authenticity of the revenue and expenditure estimates. The court found this argument to be 'a practical monstrosity'. In effect, even 'assuming it were feasible to convert a courtroom into a super-auditing office to receive and criticize the budget estimates of a State with an $11 billion budget', which is difficult to envision, it 'would duplicate exactly what the Legislature and the Governor do together, in harmony or in conflict, most often in conflict, for several months of each year'.[544] According to the court, this constitutionally-mandated process is enough to assume the prima facie validity of the approved budget. However, although the burden of proof is indeed 'formidable' and 'realistically, impossible in some categories of estimates', this does not justify a burden shift.

Interestingly, at this point, the court establishes a connection between the burden of proof and institutional choice of judiciary involvement. In this regard, it argues that a

[543] *Wein v Carey* [1977] 41 N.Y.2d 498 (n 542) 505.
[544] ibid.

judicial review cannot entail a direct assessment of the State's budget plan and should be invoked in the 'narrowest of instances'. To do the reverse would entail an enormous expenditure of 'time and money in the wrong forum to resolve the issue'. Therefore, in the context of a constitutional provision, the court dismissed itself as the most adequate institution (except in narrow, exceptional instances), concluding that dialectic between legislature and executive branches was the proper institutional setting. Moreover, it made this decision regarding a matter it considered exceptionally difficult and complex. Although the method they used has no parallel in US federal judiciary history, the Supreme Court has evaded adjudication in other areas through similarly evasive methods.[545] However, as Gunther noted, such prudential avoidance could lead to a variety of free-wheeling interventionism, given that such discretionary abstention offers little guidance for future decisions and risks losing legitimacy.[546]

In a rather unique ruling among State courts, New Jersey followed a different approach to its constitutional balanced-budget requirement just over a year after *Lonegan II*. In *Lance v McGreevey,* the State's Supreme Court once again assessed contract-debt obligations. The State authorised the Economic Development Authority to issue $1.9 billion in bonds, which would be serviced by anticipated cigarette-tax revenues and motor-vehicle surcharges, subject to appropriation. The proceeds would be turned over to the State to support any lawful purpose, including operating expenditures. Therefore, the State sought to close its operating deficit by securitising two ongoing revenue sources and borrowing against them. In defence of the plan, the State argued that the State Constitution required that appropriations should not exceed the total amount of revenue on hand or anticipated during the fiscal year and that debt-proceeds could be included in the definition of revenue. The court, however, found that treating bond proceeds as a way to fund the general expenses of States' governments was contrary to the notion of a balanced budget and to the framers' original intent, which was of the view 'that borrowed monies, which themselves are a form of expenditure when repaid, are not income (ie revenues) and cannot be used for the purpose of funding or balancing any portion of the budget pertaining to general costs without violating the Appropriations Clause'.[547]

[545] Gay Crosthwait, 'Article III Problems in Enforcing the Balanced Budget Amendment' (1983) 83 Columbia Law Review 1065, 1194.
[546] Gerald Gunther, 'The Subtle Vices of the "Passive Virtues"--A Comment on Principle and Expediency in Judicial Review' (1964) 64 Columbia Law Review 1, 25.
[547] *Lance v McGreevey* [2004] 180 NJ 590, 858-861.

Despite the less deferential approach and stricter conclusion, the court nonetheless permitted the bond sales to be conducted. Like *Lonegan II*, the adopted reasoning was to avoid disruption to the State and partly because the court was 'satisfied that the legislative and executive branches acted in good faith, relying on an honest, albeit erroneous, belief that the budget properly was balanced under existing constitutional standards'.[548] The court found that it was reasonable for the legislative and executive branches to assume that committing future revenues to fund current operating expenses would create a balanced budget that satisfied the State's Constitution, which was particularly striking.[549] This apparently relaxed conduct could be a consequence of the perils Gunther previously warned about, regarding a deferential judicial approach to BBR. Another interesting feature was the court's actual enforcement, even though it only had a prospective effect, of the balanced budget itself. Given the less deferential treatment, it would not be unreasonable to consider that this particular case did not deal with constitutionally-mandated programs and was, therefore, tailored in a simple manner, rather than requiring the court to assess complex economic forecasts or revenue and expenditure calculations as in *Lonegan II*.

In general, we may conclude that there is judicial deference and inconsistency in the enforcement of BBR. Moreover, this inconsistent interpretation of constitutional provisions also occurs regarding adjacent matters, such as budgetary processes and politics.[550]

Third, there are exceptions in several States' Constitutions that allow for the issuance of new debt for specific purposes, giving room for wide interpretation and overreliance on these provisions. Constitutional amendments can overcome any restriction, for instance, raising article VIII, section 1, of the Ohio Constitution limits State debt to $750.000. However, several amendments have been introduced to permit borrowing for specific needs (sections 2a-2s), broadly including highways, parks, natural resources projects and support for school classrooms and universities, albeit within a limited range. Another example is New York, in which disclosing borrowed amounts to the public referendum (general election) is permitted. Constitutional amendments have

[548] ibid. 861.
[549] Briffault, 'Courts, Constitutions, and Public Finance: Some Recent Experiences from the States' (n 537) 430.
[550] ibid. 442. See also Mario Iannella, 'U.S. States' Fiscal Constraints and Effects on Budget Policies' (2016) 8 Perspectives on Federalism 81, 104.

been used to authorise particular debts without such referendum, for instance, to eliminate railroad grade crossings, pay bonuses to veterans and expand state universities (article VII, sections 11, 14, 18 and 19). Consequently, constitutional amendments, despite requiring high voting standards to be successful, may, in fact, hinder the practical effects of the constitutional provisions that prohibit state debt.

7.2. Federalism without sub-national sovereignty: Germany

As explained above (Part III, Chapter 2, Point 7.1.1), Hamilton's assumption of debt related to the revolutionary war was the first of many attempts to use a fiscal crisis as an opportunity to centralise public finance. Debt assumptions and conditional bailouts in the wake of debt crises have been crucial, centralising moments in the history of other federations, notably Germany.

7.2.1. German constitutional renegotiation and problems of fiscal semi-sovereignty

Germany's federal fiscal system is built upon an attempt to reconcile conflicting constitutional principles.[551] The first principle is that sub-national units are autonomous and independent (from each other and the Federal Government) regarding their budgetary policies (article 109 of German Constitution). However, the centre can provide grants to financially weak *Länder* to assist them in meeting their general financial needs (article 107 German Constitution). The second principle requires States to provide services that ensure uniform living standards across the federation (article 106 (3) German Constitution). Tension, therefore, derives from the fact that there are large economic discrepancies between each State, which, in turn, affects their ability to raise revenue and their individual aptitudes to comply with the constitutional normative.

The paradigm shift away from dual federalism and towards shared responsibilities and tasks emerged in the 1969 renegotiation of the Constitution in which the *Länder*

[551] See, generally, Ralf Hepp and Jürgen von Hagen, 'Fiscal Federalism in Germany: Stabilization and Redistribution Before and After Unification' (2012) 42 Publius 234; Wolfgang Renzsch, 'German Federalism in Historical Perspective: Federalism as a Substitute for a National State' (1989) 19 Publius 17; Horst Zimmermann, 'Experiences with German Fiscal Federalism: How to Preserve the Decentral Content?' in Amedeo Fossati and Giorgio Panella (eds), *Fiscal Federalism in the European Union* (Routledge 1999) 159; Jonathan Rodden, 'Soft Budget Constraints and German Federalism' in Jonathan Rodden, Gunnar Eskeland and Jennie Litvack (eds), *Fiscal Decentralization and the Challenge of Hard Budget Constraints* (The MIT Press 2003) 161; and Rodden, *Hamilton's Paradox: The Promise and Peril of Fiscal Federalism* (n 426) 153.

agreed to abdicate from several of their exclusive competences in exchange for a complex multilevel cooperation. The Constitution (articles 91a-91e) assigns different tasks to the *Bund* (ie foreign affairs, defence or monetary policy) to the *Länder* (ie education, law and order or health), as well as Gemeinden (ie local health facilities, construction of schools, roads and public housing). There are few policy areas in which only one level of government is involved, as the *Länder* hold major responsibilities in both the legislative process (in the *Bundesrat*) and implementation of most policies, given the small federal government's administrative capacity. As a result, the distribution of authority and spending became diluted, diffuse and intertwined between the central and sub-national governments, which made it hard for either level of government to achieve results without negotiating and agreeing on a course of action.[552]

German States are, nevertheless, constrained in their revenue competences, as the Constitution specifies that the distribution should be implemented between the centre and subnational units in detail. There are essentially two systems. First, a tax sharing system, which aims to distribute the proceeds of major shared taxes in accordance with certain principles. Income tax revenue is distributed based on the derivation principle, meaning that they follow the revenue's regional origin; corporate tax revenue is divided according to a formula based on plant location; and part of the VAT is shared on a per capita basis. Secondly, a revenue equalisation system is in place, which operates in three stages. Two of those stages are horizontal in nature, in the sense that they unevenly distribute the proceeds between the *Länder*, while the last stage has a vertical nature, encompassing transfers from the centre.[553] Regarding borrowing, the *Länder* have their own constitutional restrictions in place and the *Bund* lacks the power to establish quantitative limits. Although constrained in their tax competences, German States enjoy decision-

[552] Rodden, 'Soft Budget Constraints and German Federalism' (n 554) 166.

[553] Hepp and Hagen (n 551) 238; Jan Werner, 'Equalisation among the States in Germany: The Junction between Solidarity and Subsidiarity' (2018) 92 Presupuesto y Gasto Público 155, 167; Joachim Englisch and Henning Tappe, 'The Federal Republic of Germany' in Gianluigi Bizioli and Claudio Sacchetto (eds), *Tax Aspects of Fiscal Federalism: A Comparative Analysis* (International Bureau of Fiscal Documentation 2011) 273. The two horizontal stages can be divided into three moments: (i) most VAT revenue is distributed by population and a part of it goes to the States with lowest revenue after the tax sharing system has finished; (ii) afterwards, tax capacity and resource needs are calculated for all States (the so-called financial endowment). States with an endowment that exceeds their needs pay an additional amount to be horizontally transferred to financially weak States; (iii) the last stage of the equalisation scheme involves federal grant supplementary payment to some States, in order to further reduce the difference in per-capital tax revenues. The equalisation scheme is a highly contentious issue, having originated several legal proceedings filed by Baden-Württemberg, Bavaria and Hesse, the traditional net payers in the German system.

autonomy over their respective budgetary processes (thus, over their expenditure and borrowing) in what is designated fiscal semi-sovereignty.[554]

Importantly, this fiscal competence distribution creates a set of incentives that have the potential to hinder public finance restrictions. Indeed, the equalisation system provides no reason for creditors and voters to establish a meaningful distinction between the *Länder* and *Bund*.[555] The *Länder* the largest subnational debtors in the EU, and, between 1970 and 2019, two of the smallest German States – Bremen and Saarland – accumulated among the highest per capita debt burdens. Indeed, debt constitutional restrictions proved ineffective not only due to the exceptions created but also because some States frequently breached them.[556]

This pressures the federal government and creates potential moral hazard concerns: not only are smaller States prone to being bailed out, but also larger, wealthier States (ie Bavaria or Baden-Würtemberg) may exert their too-big-to-fail economic influence on the centre. This seems to be well understood by the *Bundesbank*. At the end of 2018, the *Bundestag* created a constitutional amendment to extend Federal Government financial assistance to increase sub-national investments in education. The *Bundesrat* referred the bill to the parliamentary mediation committee, contesting not the growing vertical assistance but the enlargement of States' financial contributions. Crucially, States' view of the *Bundesbank* is that the growing financial intertwinement blurs the responsibilities of the various government levels and weakens States' individual responsibilities.[557] [558]

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[554] Peter Katzenstein, *Policy and Politics in West Germany: The Growth of a Semisovereign State* (Temple University Press 1987); Gregor Kirchhof, 'Debt Limits in Constitutional Law: The "Debt Brake"' in Wolf-Georg Ringe and Peter Huber (eds), *Legal Challenges in the Global Financial Crisis: Bail-outs, the Euro and Regulation* (Hart Publishing 2014) 53.

[555] For instance, in 2020, during the COVID-19 pandemic, sixteen federal states economic activity dropped by 4-10% in the first half of the year. However, the 'well-established fiscal equalisation system spreads revenue shortfalls across all Länder, weakening the link between tax revenues and individual economic performance. This ensures burden-sharing in the crisis and that Länder creditworthiness remains in lockstep with the sovereign rating'. See Julian Zimmermann, 'Strong Fiscal Framework Ensures Burden Sharing and Anchors German Länder Credit Profiles' (Scope Ratings GmbH, 17 February 2021) <https://www.scoperatings.com/index.html#!search/research/detail/166567EN> accessed 17 February 2022.

[556] This is the case of Bremen and Saarland and, less frequently, of Hamburg and Niedersachsen. See Rodden, *Hamilton's Paradox: The Promise and Peril of Fiscal Federalism* (n 426) 161.

[557] Deutsche Bundesbank, 'Public Finances' (February 2019) <https://www.bundesbank.de/resource/blob/778722/e8b53607fc939a19575bd94a0efeacf4/mL/2019-02-oeffentliche-finanzen-data.pdf> accessed 18 February 2022, 66.

[558] Although, in Germany, this possibility remains theoretical, in Brazil it has indeed taken place. In fact, the high level of central Government involvement in financing, lending and attempting to regulate States, created expectations among voters and creditors that States' debt is implicitly backed by the central Government. In Brazil, sub-national governments were allowed to borrow directly from large state-owned banks, some of them among the largest and most important financial institutions in the country. At a certain

7.2.2. Constitutionally-mandated financial support: the cases of Saarland and Bremen

Saarland and Bremen are small German States with low economic diversification, which makes them vulnerable to economic downturns and hinders their capacity to cope with the consequences. Both States are, therefore, extremely dependent on federal transfers. According to Rodden, *Saarland* has always been a net receiver and *Bremen* has, for the most part, been a net receiver since the 1970s. Despite constant and increasing dependence on equalisation payments and supplementary transfers, both *Länder* continued to increase spending, run relatively large deficits and rely on debt to fund current expenditures since the 1980s.[559]

Thus, fiscal dependence allowed these State governments to continue to borrow and spend, particularly through *Länder*-controlled banks, regardless of potential voter discontent and constitutional restrictions. Regarding the former, their idea was to place the responsibility of their economic and financial woes on the rest of the federation's lack of solidarity. Regarding constitutional restrictions, let us take the example of the Constitution of the State of *Saarland*, according to which public debt should not exceed investment spending. However, the State's Government disregarded this obligation, despite the State's Constitutional Court decision that the budget did not conform with State constitutional provisions.[560]

Furthermore, in 1988, both States pleaded to the *BVerfG* to sustain the claim that their high public debt levels were caused by negative economic developments beyond their control and, consequently, federal support was needed. They also claimed that if they were forced to manage the fiscal burden alone, expenditure cuts would be so dire that public service output would be severely affected, thereby breaching the federal Constitution (namely the principle of equalisation of living conditions throughout

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point, some of their largest assets were the low-quality debts of their State's Government. The Senate was responsible for approving and regulating States' borrowing and representatives of insolvent States found that approval for unsustainable borrowing was relatively easy to obtain as part of the game of legislative trading. These efforts of hierarchical regulation undermined market discipline signalling the credibility of the central Government's commitment to no-bailout. Eventually, it became clear that a bailout of States, particularly that of São Paulo, would be necessary to save the banking system from collapse. Rodden, 'Market Discipline and U.S. Federalism' (n 428) 130.

[559] Rodden, *Hamilton's Paradox: The Promise and Peril of Fiscal Federalism* (n 426) 163.

[560] Helmut Seitz, 'Subnational Government Bailouts in Germany' (1999) Zentrum für Europäische Integrationsforschung Working Paper B 20 <.https://econpapers.repec.org/paper/zbwzeiwps/b201999.htm> accessed 18 February 2022, 11.

Germany) and federal law (since a large portion of expenditures were centrally mandated).[561]

In a 1992 ruling, the *BVerfG* concluded that, given their high debt levels, Bremen and Saarland were facing a situation of extreme fiscal hardship. As a result, the federal Government had an obligation to provide additional special-need financial assistance, which was made available from 1994 to 2004.[562] This was a consequence of German unification, which added six new, fiscally-weak *Länder*. In fact, the 1995 Solidarity Pact established onerous obligations for the few south-western, wealthier *Länder*. Eventually, this led to a successful complaint of confiscatory fiscal equalisation before the federal Constitutional Court and a subsequent revision of the Pact. Despite the shift in judicial rulings and so-called debt brake reform of 2009 (which amended articles 109 and 115 of the federal Constitution to establish that the budgets of the federation and those of the *Länder* must, in principle, be balanced without income from credits) subnational units retained and exercised exceptions permitting additional borrowing and exerting their leverage on the Federal Government (which the concession of the 2012 joint Federal-*Land* bond issuance is an example of) for the sub-national ratification of the fiscal compact, is an example of).[563]

Significantly, the judicial decision confirmed the beliefs of sub-national executives in Bremen and Saarland regarding bailout from the centre, further weakening their incentives to carry out the adjustments themselves. These weak incentives are apparent in recent data, placing Bremen, Hamburg and Saarland as the three largest per capita debtors of 2019 (prior to COVID-19).[564] Crucially, as the *Bundesbank* puts it:

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[561] Helmut Seitz, 'Subnational Government Bailouts in Germany' (1999) Zentrum für Europäische Integrationsforschung Working Paper B 20 <.https://econpapers.repec.org/paper/zbwzeiwps/b201999.htm> accessed 18 February 2022, 11.

[562] Following the costly rescue of *Bankgesellschaft Berlin*, the Constitutional Court ruled that the State was in a different situation because it had not yet exhausted all of its fiscal options. This ruling argued that, before being considered as a fiscal emergency to receive extraordinary federal financial support, a Land should exhaust its budgetary options. An 'emergency' was understood a threat so serious as to prevent the Land from carrying out its constitutional duties. Kenneth Dyson, *States, Debt and Power: 'Saints' and 'Sinners' in European History and Integration* (Oxford University Press 2014) 538.

[563] ibid. 540; Kirchhof (n 554) 59. On the role of the *BVerfG* see Arthur Benz, 'The Federal Constitutional Court of Germany: Guardian of Unitarism and Federalism' in Nicholas Aroney and Russell Kincaid (eds), *Courts in federal countries: federalists or unitarists?* (University of Toronto Press 2017) 193.

[564] Deutsche Bundesbank, 'State Government Finances in 2020: Deficit Due to Temporary Effects of Pandemic, Escape Clauses Also Used to Build Reserves' (October 2021) <https://www.bundesbank.de/resource/blob/879318/d3cc1b83ff01cf605e13737723ea762b/mL/2021-10-laenderfinanzen-2020-data.pdf> accessed 18 February 2022, 25, and Federal Statistical Office of Germany at https://www.destatis.de/EN/Home/_node.html.

> With the debt brake, consolidation assistance was introduced for particularly highly indebted federal states. The costs are split between central government and state governments. An annual volume of €800 million has been earmarked for this purpose for the 2011 to 2019 fiscal years. The lion's share of this sum goes to two small states: Saarland (€260 million, or €260 per capita) and Bremen (€300 million, or €440 per capita). The disbursement of assistance is conditional on progress in consolidation. It has taken place every year thus far.[565]

7.3. Dependence of small and large States: brief note on Brazil

Although, in Germany, the possibility of a too-big-to-fail scenario remains theoretical, in Brazil it has indeed taken place.[566] In Brazil, like Germany, sub-national governments were allowed to borrow directly from large State-owned banks, some of them among the largest and most important in the country. At a certain point, some of their largest assets were low quality debts in their own State governments.

The Senate was responsible for approving and regulating States' borrowing. Representatives of insolvent States found that approval for unsustainable borrowing was not hard to obtain. Importantly, however, hierarchical intervention inadvertently undermined market discipline by weakening the central Government's no-bailout commitment credibility. As described by Rodden, the situation in the 1980s demonstrates this assertion as interest rates on States' debt began to rise and sub-national public finances began to deteriorate. Like the US, Germany and the eurozone, in Brazil, the political sphere was not protected from market pressure, which ultimately led to the

[565] Deutsche Bundesbank, 'State Government Finances: Comparison of Developments, Debt Brakes and Fiscal Surveillance' (October 2018) <https://www.bundesbank.de/resource/blob/778722/e8b53607fc939a19575bd94a0efeacf4/mL/2019-02-oeffentliche-finanzen-data.pdf> accessed 18 February 2022, 23.

[566] Rodden, 'Market Discipline and U.S. Federalism' (n 428) 130. In Brazil, sub-national governments were allowed to borrow directly from large state-owned banks, some of them among the largest and most important in the country. At certain point, some of their largest assets were low quality debts to their own state governments. The Senate was responsible for approving and regulating States' borrowing and representatives of insolvent states found that approval for unsustainable borrowing was relatively easy to obtain as part of the game of legislative trading. These efforts of hierarchical regulation inadvertently undermined market discipline by sending signals about the central Government's no-bailout commitment's credibility. Eventually, it became clear that a bailout of states, in particular São Paulo, would be necessary to save the banking system from collapse.

federal transformation of States' outstanding debt stocks (the portion which they could not (re)finance) into long-term federal debt. Notably, in Brazil, most States were financially guaranteed by the centre, particularly São Paulo, which was the largest economically.[567]

As such, the Brazilian central Government is very involved in States' financing, while responsibility for expenditure is distributed between every layer of government. This caused voters and creditors to expect that sub-national debt was implicitly guaranteed at a federal level. Moreover, Brazil and the US have similar pasts. In Brazil, States issued significant loans on behalf of the central Government prior to the enactment of the Constitution, leading to a rebuttal of responsibility for financial troubles, like the US prior to the Revolutionary War. As a result, Brazilian States are largely indebted to the central Government rather than private creditors.

7.4. Critical assessment

This chapter aims to understand how the market process can impact bailout expectations and moral hazard. The US States set their fiscal rules independently and enforced them autonomously (sometimes by the market process), rather than having them stipulated and enforced vertically (top-down). In fact, decentralised BBRs might isolate deviant behaviour and prevent a contagion effect, whereas a rule centrally defined and enforced could lose credibility once breached. Although some differences exist vis-à-vis the EU, namely regarding the integration of financial markets, we are more likely to observe a contagion effect among US States, which are intertwined to a higher degree than EU Member States.[568]

Due to distrust in the market process, the EU established a top-down economic framework. Ultimately, this increased bailout expectations – a course that is, in many ways, similar to the German *Länder* and Brazilian States. This achieves the opposite effect of the teleology underlying article 125 (1) TFEU, especially if read in tandem with

[567] Rodden, *Hamilton's Paradox: The Promise and Peril of Fiscal Federalism* (n 426) 200.
[568] Randall Henning and Martin Kessler, 'Fiscal Federalism: US History for Architects of Europe's Fiscal Union' (2012) <https://www.bruegel.org/2012/01/fiscal-federalism-us-history-for-architects-of-europes-fiscal-union/> accessed 1 February 2022, 27. For a different opinion, stating that, after the financial crisis, it was clear that EU fiscal stability rules had to be strengthened, see Ruffert (n 333) 37.

article 126 TFEU. In fact, these articles reinforce one another as both provide incentives for fiscal responsibility.

Apart from the teleological element, a literal reading of article 125 (1) TFEU can provide some clarity. Its wording stresses the element of no liability ('liable') and no ownership ('assume') of other Member States' commitments either by other States or the Union. However, the risk that some of the most indebted countries needing a debt waver has increased since the financial crisis. Naturally, this risk would be proportional to the interest rate of their bonds in the market: the higher the interest, the higher the risk of insolvency and, therefore, the necessity of a reduction in the total principal. From my perspective, this increases pressure on the ECB to act on secondary markets, which it did, notably with the PSPP and PEPP. Crucially, however, the more intervention from public institutions or bodies (such as the ECB or the ESM) the more likely it is that, at some point, they must bear some of the costs, which breaches the no-bailout clause in its current wording.

Furthermore, the change from a (degree of) market paradigm to top-down management of fiscal indicators has demonstrated the limits of the constitutionalisation of economic policies, especially fiscal policy. While it is true that establishing provisions on fiscal policy in the Treaty reflects 'a certain mistrust in the capacity of democratic decision-makers to take the necessary decisions for sustainable economic growth and development',[569] it does not seem to have achieved a successful behavioural impact in Member States.[570]

Moreover, and crucially, public finance restrictions at Member State level were not adopted under regular circumstances, as political pressure was acute during the financial crisis. As the main contributor, Germany pressed for the inclusion of these provisions in the Lisbon Treaty. However, due to the UK veto, Member States signed an international Treaty.[571]

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[569] Matthias Goldmann, 'Article 126 (Ex Article 104 TEC) [Avoidance of Excessive Deficits; Budgetary Discipline]' in Helmut Siekmann (ed), *The European Monetary Union* (Hart Publishing 2022) 193, 210. See also James Buchanan, 'Constitutional Economics' in John Eatwell, Murray Milgate and Peter Newman (eds), *The World of Economics* (Palgrave Macmillan 1991) 134.

[570] For instance, Bruno Le Maire considered SGP debt rules to be obsolete. See Victor Mallet and Leila Abboud, 'French Finance Minister Says EU Debt Rules Are 'Obsolete' *Financial Times* (7 July 2022) <https://www.ft.com/content/dde19dbd-80fe-4bda-95a8-55cf38ebfa82> accessed 18 July 2022.

[571] Craig, 'The Stability, Coordination and Governance Treaty: Principle, Politics and Pragmatism' (n 511).

Importantly, if EU Member States had enshrined the balanced budget restrictions or other provisions of binding force and permanent character in their Constitutions, why was it necessary to continue the development of a complex supranational surveillance mechanism? In this regard, Laffan explains that, despite the political saliency of the TSCG, its value was questioned from the beginning, as it remained largely unenforced. As the EP and Council members stated, 'you do something with the rules but then it is not followed; (…) the Fiscal Compact is dead; (…) no one cares about it'.[572] Thus, it seems that the issue identified between the no-bailout clause and EDP was replicated in the new EU economic governance framework, as Eichengreen argued.

However, according to Merino, the TSCG 'permitted national democratic debates' that probably would not have taken place had there been an option to approve it according to secondary legislation. This author stresses that it was an important part of the French presidential campaign of 2012. Be that as it may, the eventual winner and future president promised to renegotiate the terms of the agreements,[573] which can be interpreted as a consequence of the imposition of terms through a 'hasty and non-democratic negotiation process' that unduly constrained national parliaments' sovereign right to decide on budgetary matters.[574]

The point here is that it is challenging to absorb the process of ownership of a given set of rules on a national level when it is derived from a process of legal internalisation.[575] Especially when the context on which such rules were designed was one of imbalance between the relationship of Member States, given the financial hardship experienced by some (the asymmetric effect) and lack of national direct responsibility (by virtue of the contagion effect or mistakes in experts recommendations).[576] This is clear from the fact

[572] Laffan and Schlosser (n 286) 245.
[573] Merino, 'The Intergovernmental Method as Source of Democratic Legitimacy of the Economic and Monetary Union: A Critical View' (n 265) 71.
[574] Keppenne, 'Democracy and the Role of the Commission in the European Fiscal Union: Some Considerations on the Recent Evolutions' (n 331) 89.
[575] This is the term used by Amtenbrink and Repasi in the EU law sphere. In other words, by enacting national laws, countries only guarantee formal abidance. Importantly, the authors explain that Spain and Italy are examples of an internalisation process conducted with scarce debate. As a result, substantive abidance, in the sense of the development of a wide public understanding and acceptance of fiscal prudence, is not as robust. See Amtenbrink and Repasi (n 489) 168. In the same line of reasoning, see Ines Ciolli, 'The Balanced Budget Rule in the Italian Constitution: It Ain't Necessarily So...Useful?' (2014) 4 Rivista AIC 1; Cristina Fasone, 'Do Constitutional Courts Care about Parliaments in the Euro-Crisis? On the Precedence of the "Constitutional Identity Review"' (2018) 2 Italian Journal of Public Law 351, 376.
[576] This point is stressed by Lastra, regarding IMF interventions in general. See Rosa Maria Lastra, 'The Role of the International Monetary Fund' in Rosa Maria Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford University Press 2014) 49, 54. See also Varela (n 313) 72. The author states that external mistakes deepen, instead of softening, the crisis, '[p]or ejemplo, los cometidos por el FMI durante

that, as the financial crisis began to subside, EU citizens have become increasingly less tolerant of supranational interference with domestic policies.[577]

Differently, in the 1840s in the US, future bailout expectations were almost non-existent. That is increasingly changing given the federal financial aid that was approved to address the financial crisis. In fact, it is crucial to assess whether the perceived probability is sufficiently low enough to provide incentives for States to adjust. In other words: when faced with budgetary difficulties, would State governments change course or continue upon the same fiscal path, hoping for federal aid? If so, is the market willing to fund it?[578]

To answer this question, one must assess the level of dependency between sub-national units and the federal level, namely regarding the autonomy to levy taxes, decide expenditure and decide which share of expenditure should be funded by the centre. In this regard, EU Member States are the most autonomous among the above-mentioned federations. Not only is there a broad capacity to make decisions regarding taxes and expenditure but there is very little reliance on supranational grants: as seen above (Part II, Point 3) the EU budget accounts for 1% of EU GNI and two-thirds are related to redistributive programmes, such as regional policy and the CAP. This has no parallel among other multi-level jurisdictions. For instance, US States' budgets, which are considered to hold significant autonomy, average 22% of yearly expenditures from federal grants,[579] meaning most expenditures are funded by taxes levied and collected by individual States.[580]

In contrast, German and Brazilian States hold a vast array of expenditure responsibilities with reduced revenue autonomy, having designed a system based on intergovernmental grants. Coupled with a legislative system similar to that of the US and EU (ie an overrepresentation of small States in the upper-chamber), it has sparked the

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las crisis latinoamericanas y asiáticas en la década de 1990, o incluso la de la propria troika en los inicios de la crisis griega'.

[577] Alberto Alesina, Guido Tabellini and Francesco Trebbi, 'Is Europe and Optimal Political Area?' (2017) Brookings Paper on Economic Activity < https://www.brookings.edu/bpea-articles/is-europe-an-optimal-political-area/> accessed 1 March 2023.

[578] Rodden, 'Market Discipline and U.S. Federalism' (n 428) 136.

[579] The Federal Government funds a wide range of public policies, such as health care, transportation, income security, education, job training, social services, community development, and environmental protection. See https://www.census.gov/data/tables/2020/econ/state/historical-tables.html

[580] Keleman points out that the only reason that US States can comply with their BBRs is because of the federal grants they receive every year. Kelemen (n 490) 155. However, many of those grants may be insufficient to cover the expense associated with the obligations. See Silvers (n 528).

necessary incentives for fiscal dependence and political bargaining. This is especially true in Brazil, where most States' debt is owed to the central Government.

There is a certain resemblance with the EU. Importantly, pursuant to the financial and sovereign debt crisis, Member States' debt obligations are mostly held either by other Member States (those who had a financial assistance plan),[581] or EU institutions, notably the ECB. Regarding the latter, PSPP and PEPP have furthered the acquisition of Member State's debt and increased their dependence on the central bank. Since the PSPP was established in March 2015, until 2022, central banks significantly expanded their portfolio of Member States' public debt. As an example, such exposure evolved from: 19% to 36 % of Portuguese debt;[582] 4% to 28% of Spanish debt;[583] 3% to 16% of Italian debt,[584] 5% to 20% of French debt;[585] and 4% to 26% of German debt.[586] Concurrently, these State, including Greece, increased their debt-to-GDP ratio between 2003 and 2020. In fact, in the latter year, only 14 EU countries complied with the SGP's debt limit.[587]

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[581] More than 20% of Portuguese debt was owed to the IMF and EU funds for the period of 2011-2018, having peaked at 36% in 2014. See Agência de Gestão da Tesouraria e da Dívida Pública, 'Gestão Da Tesouraria Do Estado e Da Dívida Pública' (2018) <https://www.igcp.pt/fotos/editor2/2019/Relatotio_Anual/RA2018_20190723_V_internet.pdf> accessed 2 March 2022. Most prominently, more than 80% of Greek debt was held by the 'official sector' from 2012-2020. See Public Debt Management Agency, 'Central Government Debt by Type of Creditor' (2021) <https://www.pdma.gr/en/public-debt-strategy/public-debt/composition-of-debt/maturity-profile-en> accessed 2 March 2022.

[582] Agência de Gestão da Tesouraria e da Dívida Pública, 'Gestão Da Tesouraria Do Estado e Da Dívida Pública' (2021) <https://www.igcp.pt/fotos/editor2/2021/Relatorio_Anual_Divida_e_Tesouraria/RA2020.pdf> accessed 2 March 2022, 10.

[583] Tesoro Público, 'Distribución Por Tenedores' (2021) <https://www.tesoro.es/en/deuda-publica/historico-de-estadisticas/Government-Debt-by-holders-2002-2017> accessed 2 March 2022.

[584] See Dipartimento del Tesoro, 'Public Debt Report 2015' (2016) <https://www.dt.mef.gov.it/export/sites/sitodt/modules/documenti_en/debito_pubblico/presentazioni_studi_relazioni/Public_Debt_Report_2015.pdf> accessed 2 March 2022; Dipartimento del Tesoro, 'Public Debt Report 2020' (2021) <https://www.dt.mef.gov.it/export/sites/sitodt/modules/documenti_en/debito_pubblico/presentazioni_studi_relazioni/Public_Debt_Report_2020.pdf> accessed 2 March 2022. This figure has, of course, to be placed into proper context, as total Italian debt at the end of 2020 was €2.5 trillion, of which the Central Bank of Italy held €411 billion, up from €71 billion at the end of 2015.

[585] See European Central Bank, Statistical Data Warehouse at https://sdw.ecb.europa.eu/browse.do?node=9693774.

[586] Deutsche Bundesbank, 'Monthly Report December 2021' (2021) <https://www.bundesbank.de/resource/blob/836424/e0dd8f13c901da0cda3a27db9050c458/mL/2021-12-monatsbericht-data.pdf> accessed 2 March 2022, Statistical Section, 63.

[587] See European Central Bank, Statistical Data Warehouse, at https://sdw.ecb.europa.eu/browse.do?node=9691260. In 2020, thirteen Member States had government debt ratios higher than 60% of GDP, with the highest registered in Greece (206.3%), Italy (155.6%), Portugal (135.2%), Spain (120.0%), Cyprus (115.3%), France (115.0%) and Belgium (112.8%). The lowest ratios of government debt-to-GDP were recorded in Estonia (19.0%), Bulgaria (24.7%), Luxembourg (24.8%), Czechia (37.7%) and Sweden (39.7%).

There is also path dependency regarding EU regional policy funds, considering their share of public investment in the period between 2015-2017. According to the European Commission, cohesion is the EU's main investment policy, for which they provide funding equivalent to 8.5% of government capital investment. However, this figure averages-out important discrepancies, given that, for several Member States, it surpasses 50%.[588] Similarly, NGEU's disbursement of grants represents a diverse percentage of GDP (according to 2020 levels) across Member States. Be that as it may, it exceeds 4% of GDP in fourteen of them (and, notably, more than 10% in three).[589]

Crucially, this context changes incentives, as negotiations with less financially-healthy States gradually exit the market realm and enter the political process. Just as in Brazil, where the political process has retained the intergovernmental grant system in the Senate (the upper-chamber, where States are represented) the EU has retained economic policy as a competence of Member States, either in the framework of the European Council or outside of the venue of EU law.

At this point, one may question whether this practice does not hinder institutional independence concerning EU monetary and fiscal integration.[590] This dependency was induced by the ECB and ESM to counter not only the financial crisis but also the incomplete financial architecture of the EU. Resembling Brazil and Germany where, for diverse reasons, voters expect the centre to financially assist sub-national governments, a survey conducted by the ECB in May 2021 showed that 39% of respondents believed its main task was financing governments.[591] Given the foregoing, one could reasonably conclude that at least some bailout assumption had already developed.[592]

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[588] European Commission, 'Share of Cohesion Policy per Member State to Public Investment 2015-2017' (2020) <https://cohesiondata.ec.europa.eu/Other-Eurostat/Share-of-Cohesion-Policy-per-Member-State-to-publi/drqq-sbh7> accessed 2 March 2022. Portugal led with 84%, followed by Croatia (80%), Lithuania (74%), Poland (61%), Latvia (60%), Hungary (55%) and Slovakia (55%). Only 11 Member States are below the 20% mark.

[589] Thu Nguyen, 'EU Economic Policy Coordination After the Recovery and Resilience Facility' (Follow the Money? European Integration in Light of EU Budgetary Law Conference, 9 June 2022).

[590] In a similar vein, see Siekmann Siekmann (n 195) 85.

[591] European Central Bank, 'Economic Bulletin' (8/2021) <https://www.ecb.europa.eu/pub/pdf/ecbu/eb202108.en.pdf> accessed 1 March 2022, 129. Respondents were asked the following question: "To your knowledge, which of the following are tasks or objectives of the ECB?". Possible answers and the relative weight of responses were the following: (i) to ensure financial stability (72%); (ii) to help euro area countries in financial difficulties (67%); (iii) to stabilise the foreign exchange rate of the euro (66%); (iv) to keep inflation at bay (64%) (v) to supervise banks (64%); (vi) to support growth and employment (50%) and (vii) to finance governments (39%).

[592] This tendency is seen all over the world. In this sense, see The Economist, 'The World Enters a New Era: Bail-Outs for Everyone!' (25 September 2022) <https://www.economist.com/finance-and-economics/2022/09/25/the-world-enters-a-new-era-bail-outs-for-everyone?utm_medium=social-

On balance, while technically not assuming debts since the financial crisis, the EU provided Member States with a safety net in the form of successive financial bodies. While balanced budget requirements were enacted, their effectiveness was under the veil of ECB unconventional monetary policy, providing historically low interest rates in bond markets and, consequently, an opportunity to not only reduce the average interest rate on their public debt stock but also dispel concerns of public debt unsustainability.

NGEU was adopted in this context, in which mounting supranational restrictions were unmatched by a concomitant increase of EU economic intervention. This model[593] seems to contradict logical reasoning, since Member States are obliged to establish a restrictive BBR and, simultaneously, be responsible for macroeconomic stabilisation.[594] As such, the adoption of NGEU was heralded as a watershed moment in the EU, even being considered as Hamiltonian. Even though both programmes (NGEU and Alexander Hamilton's plan to recover the US) have distinct features and contexts, their objectives and effects hold particular similarities. As in Hamilton's plan, the objective of NGEU is to increase federal power, by enhancing the EU's fiscal capacity. Admittedly, the EU budget is small and holds redistributive priorities based on nationalistic concerns that severely limit its ability to produce significant results in the EU economy.

While increasing the centre's budget could be seen as a necessity, it is important to ask how funds are spent. In the US, there are three general types of grants to state and

media.content.np&utm_source=linkedin&utm_campaign=editorial-social&utm_content=discovery.content>, accessed 27 September 2022.

[593] In this vein, the EU has chosen a model that does not fit with either of the broad segments of fiscal federalism theory. The first model combines strong fiscal centralisation with the adoption of BBRs at State level, such as the US. The second model combines weak fiscal centralisation with the absence of BBRs, such as the EU prior to the financial crisis. See Malleghem (n 514) 151, 176.

[594] In practice, this would create an obligation without a proper power to fund it. In fact, even if States hold the competence to conduct counter-cyclical policies (and need to dispose of financial means at a certain point) they are constrained by public finance provisions, effectively limiting their ability to fully pursue such a policy. Not only would this hinder the competence in practice, but it would also create a stronger dependency on the centre. In this vein, see Silvers (n 528).

local governments: categorical grants,[595] block grants[596] and general revenue sharing.[597] The difference between each is the degree of discretion held by the federal level. Categorical grants can only be used for a specifically aided program and are usually limited to narrowly-defined activities. Block grants can only be used for a specifically aided set of programs and are not usually limited to narrowly-defined activities. General revenue sharing can be used for any purpose that is not expressly prohibited by federal or state law and it is not limited to narrowly-defined activities. Overall, federal grants relative to State expenditure have increased since the 1950s, representing close to 25% in 2021. However, the issue of unfunded mandates (legally binding obligations on States, created but inadequately funded by Congress) is pressing and increases dependency on the federal level. This contrasts with the EU, which, at 1% of the EU budget, does not display the same degree of interdependence.[598]

[595] There are four types of categorical grants: project categorical grants, formula categorical grants, formula-project categorical grants and open-end reimbursement categorical grants. Project categorical grants are awarded on a competitive basis through an application process. Formula categorical grants are allocated among recipients according to factors specified in legislation or administrative regulations (ie population, household income, per capita income). Formula-project categorical grants use a mixture of fund allocation means followed by an application process, which is specified by each recipient State to allocate on a competitive basis. Open-end reimbursement categorical grants provide a reimbursement of a specified proportion of recipient program costs, eliminating competition among recipients as well as the need for an allocation formula. See Congressional Research Service, 'Federal Grants to State and Local Governments: A Historical Perspective on Contemporary Issues' (2019) <https://sgp.fas.org/crs/misc/R40638.pdf> accessed 2 February 2022; United States Advisory Commission on Intergovernmental Relations, 'Categorical Grants, Their Role and Design' <https://digital.library.unt.edu/ark:/67531/metadc1371/> accessed 8 February 2024.

[596] A block grant authorises federal aid for a range of activities within a functional area. It gives recipient jurisdictions substantial administrative discretion, tailored towards keeping federal administrative intrusiveness to a minimum, while recognising the need to ensure adequate oversight and that national goals are accomplished. Its formula-based distribution provision narrows grantor administrative discretion and provides some sense of fiscal certainty for grantees. Moreover, its eligibility provision is specific, relatively restrictive and tends to favour units of general local government. On block grants, see Congressional Research Service, 'Community Development Block Grants: Funding and Allocation Processes' (2021) <https://sgp.fas.org/crs/misc/R46733.pdf> accessed 2 February 2022; Congressional Research Service, 'Block Grants: Perspectives and Controversies' (2020) <https://sgp.fas.org/crs/misc/R40486.pdf> accessed 2 February 2022.

[597] Congressional Research Service, 'General Revenue Sharing: Background and Analysis' (2009) <https://www.everycrsreport.com/files/20090109_RL31936_074c11bf615bf37fba65657933ac3be351a5c16e.pdf> accessed 2 February 2022. General revenue sharing grants were only in place between 1972 and 1986. Although they had several economic rationales, such as fiscal reallocation, improvement of State and local government liquidity problems and increase federal and State fiscal policy synchronisation, these grants are far from consensual and their use, eventually, ceased.

[598] Cheryl Saunders, 'Financial Autonomy vs Solidarity: A Dialogue between Two Complementary Opposites' in Alice Valdesalici and Francesco Palermo (eds), *Comparing Fiscal Federalism* (Brill | Nijhoff 2018) 40, 45.

Mature federations, like the US, define economic objectives nationwide, with transnational focus and implementation.[599] While in the EU there are equivalent grants (ie NGEU or regional policy), their focus is not transnational, but divided among Member States in accordance with their national needs and preferences. This is reinforced by the fact that national plans were priorly approved by national parliaments and, then, by the Council. This is a paradoxical situation, given that NGEU is financed by new EU own resources, which could prompt more EP involvement. However, this involvement is limited to engaging in inter-institutional dialogue with the European Commission and being recipient of information for transparency purposes. Be that as it may, it would be difficult to understand how the EP could intervene in reforms decided by Member States.

NGEU has, however, a slightly different nature to other EU funding policies, not only because it represents an important signal of solidarity between States and citizens in times of crisis, but also because it sets broad objectives for funding eligibility. This means that States are, in fact, adapting their investment in line with EU-wide defined boundaries.[600] Notwithstanding, it is not the Union that determines the common goods to be attained or the modalities and timing of their attainment. These elements are determined by individual Member States in their national recovery plans, prepared and implemented by national authorities.[601] In fact, article 17 (3) of the RRF Regulation reinforces the national nature by establishing that the recovery and resilience plans must be consistent with the country-specific challenges and priorities identified in the European Semester, as well as those identified by the Council's recommendations on the economic policy of Member States in the euro area.

[599] Just as an illustrative example, the Bridge investment program of the US Infrastructure Investment and Jobs Act defines eligible entities as (i) a State or a group of States; (ii) a metropolitan planning organisation with a population of over 200.000; (iii) a unit of local government or a group of local governments; (iv) a political subdivision of a State or local government; (v) a special purpose district or public authority with a transportation function; (vi) the Federal land management agency; (vii) a multistate or multijurisdictional group of entities, among others. Moreover, goals are clearly defined by Congress: (i) to improve the safety, efficiency, and reliability of the movement of people and freight over bridges; (ii) to improve the condition of bridges in the United States; (iii) to provide financial assistance that leverages and encourages non-Federal contributions from sponsors and stakeholders involved in the planning, design, and construction of eligible projects. These are chosen on a competitive basis, taking into account several quality indicators and geographic diversity. Accountability to Congress is ensured through the publication of an annual report to be assessed by US Comptroller General.

[600] Bruno De Witte, 'Integration Through Funding' in Ruth Weber (ed), *The Financial Constitution of European Integration* (Bloomsbury Publishing 2023) 221.

[601] Emanuele Cannizzaro, 'Neither Representation nor Taxation? Or, "Europe's Moment" – Part I' (2020) 5 European Papers 703.

Lastly and crucially, it should be highlighted that the US fiscal framework still works on the belief that States will not be bailed out, which is still generally considered a reasonable assumption. In any case, modern economies face different business cycles compared to the past and face a much more severe crisis caused by systemic risk, which is seen as unavoidable and must be dealt with supranationally.[602]

In the EU, however, the political reluctance to move towards a so-called transfer union[603] had the unfortunate consequence of increasing dependence on supranational institutions or bodies, such as the ECB or ESM. As seen previously, in order to safeguard the financial stability of the eurozone as a whole, both purchased large amounts of sovereign debt on secondary markets. Despite being dependent on strict conditionality to comply with the CJEU's case law, one should not underestimate the economic incentives that this approach provides Member States or their potentially detrimental effect, notably on moral hazard and complying with the *ratio legis* of the no-bailout clause.

Despite the need for unconventional actions in the midst of financial panic, as no realistic alternative existed, such interventions convey, as argued in this chapter, a perilous idea that, at a certain point in time, action will be taken by EU institutions or financial assistance will be granted to rescue Member States. In my view, this course of action is misaligned with the teleology enshrined in EU law, for which compliance with article 125 (1) TFEU requires a two-fold condition. First, Member States must continue to be liable for their financial commitments. This implies that restructuring debt held either by EU institutions or Member States would breach the referred Treaty provision.[604] Second, Member States must know they are on their own when meeting their respective financial obligations. As explained in this chapter, the credibility of a no-bailout clause, albeit a challenge not exclusive to the EU, is extremely important: certainty or uncertainty on supranational bailout impacts lower-level government decision-making on fiscal prudence, making it less or more likely, respectively.

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[602] Adam Levitin, 'In Defense of Bailouts' (2011) 99 The Georgetown Law Journal 435.

[603] This political reluctance is considered by Goldmann as 'deplorable' given that, on aggregate terms, the Union exhibits a balanced current account and overall low level of fiscal deficits. See Goldmann, 'Article 126 (Ex Article 104 TEC) [Avoidance of Excessive Deficits; Budgetary Discipline]' (n 569) 211.

[604] This would be the case regardless of the motivation of the creditor. In fact, the Treaty does not give the flexibility to encompass restructuring with the purpose of protecting the creditor's investment (as opposed to granting alternative means of funding), as suggested by Ioannidis. See Michael Ioannidis, 'Debt Restructuring in the Light of Pringle and Gauweiler - Flexibility and Conditionality', *ESCB Legal Conference 2016* (European Central Bank 2017) 78, 81.

The need for uncertainty has been acknowledged by the CJEU in *Gauweiler* and *Weiss* in the context of article 123 (1) TFEU: in order to comply with the prohibition of the monetary financing principle, a degree of lack of transparency from the ECB would be necessary to ensure that markets could not anticipate its action. However, if the various programmes were designed to keep interest rates on sovereign bonds at a reasonable level, then action would not be a matter of *if*, but *when*, therefore hindering the core reasoning on economic incentives that underlies the Treaties. In my view, the EMU's entire legal architecture was built upon the former perspective, not the latter.

Therefore, while in the EU there is no higher-level government with fiscal capacity to assist financially troubled States, the ESM and ECB[605] are, in practice, behaving as proxies. Consequently, in the referred case law, the Court has accommodated monetary policy flexibility and public assistance in the spirit of the Treaties, thus greenlighting a form of fiscal redistribution and, thus, eroding the credibility of the no-bailout principle.

To conclude, this chapter has highlighted the virtues and perils of the market process regarding States fiscal compliance and their interaction with higher level governments in the context of complex, high-stakes situations. The market process is not a perfect alternative to the political process. Arguably, in the EU, the market did not correctly pressure Member States to be fiscally prudent. Likewise, in the US, there are indications that the Federal Government's pledge to not bailout States is, sometimes, insufficient. Moreover, the higher States' debt, the higher the stakes and complexity for market participants. However, this should not allow us to promptly disregard the virtues of the market process and, especially, compare it with the costs and benefits of a solution based on the political process. Moreover, if correctly structured, one should also acknowledge that the market can provide powerful incentives for Member State fiscal compliance and pave the way for compromises in the political process, while boasting the democratic credentials of the EU and its Member States.

[605] These institutions may ascribe less incentive to be repaid (the so-called creditor moral hazard), as indicated by Ioannidis. ibid. 87.

CHAPTER 3

JUDICIAL SYNDICATION AND ITS LIMITS

8. Judicial control in the European Union

8.1. General remarks

The EU judiciary has had an impactful role in the development of integration in the European political space. As referred to above (Part II, Point 1), competence creep in the context of internal market integration has been promoted by the Court.

Therefore, the definition of discretion and the way in which the CJEU has put it in practice is an important topic. The Supreme Court of Canada provided a definition of discretion in *Dunsmuir v New Brunswick*, whereby:

> Deference is both an attitude of the court and a requirement of the law of judicial review. It does not mean that courts are subservient to the determinations of decision makers, or that courts must show blind reverence to their interpretations, or that they may be content to pay lip service to the concept of reasonableness review while in fact imposing their own view. Rather, deference imports respect for the decision-making process of adjudicative bodies with regard to both the facts and the law. The notion of deference 'is rooted in part in a respect for governmental decisions to create administrative bodies with delegated powers' (…) the concept of 'deference as respect' requires of the courts 'not submission but a respectful attention to the reasons offered or which could be offered in support of a decision'.[606]

Conversely, while there is no fixed definition for judicial activism,[607] some features pointedly identify it, namely the invalidation of constitutional actions of other branches, failure to adhere to precedent, the making of judicial 'legislation' or result-oriented

[606] *Dunsmuir v New Brunswick* [2008] 1 SCR 190, 2008 SCC 9, 48.
[607] On this notion, see Catarina Santos Botelho, 'Aspirational Constitutionalism, Social Rights Prolixity and Judicial Activism: Trilogy or Trinity?' (2017) 3.4 Comparative Constitutional Law and Administrative Law Quarterly 62.

judging.[608] In essence, it is a democracy-adverse conduct based on judges' personal preferences, ideological orientations or political interests. Instead of leaving the parliament or people to choose between differing but legitimate interpretations of vaguely formulated constitutional matters, activist decisions enforce one possible interpretation.[609]

In the EU, there is no clear conceptual distinction between 'discretionary choices' and 'technical choices' of EU administrative authorities.[610] In fact, an appropriate standard of review in administrative decisions of a technical nature has come to the forefront of European courts, most often in competition cases. While, at the outset, the Court embraced a deferent approach of administrative choices,[611] it did so with scarce review of the sufficiency of the evidence supporting a given measure. In this sense, Azoulai argues that this approach reflects a particular interpretation; that discretion is 'the principle of all the Commission's interventions in […] competition policy' and that, on this matter, the European Commission holds an executive competence that is close to a reserved area. Doing otherwise would, naturally, have been time-consuming and incompatible with the need to proceed with internal market integration.[612]

However, this course of action has changed to permit more intensive scrutiny. In fact, the CJEU started reviewing the interpretation of information of an economic nature, notably in the area of competition law.[613] Moreover, the Court began to require the European Commission to establish whether the evidence was factually correct, reliable and consistent, but also whether it contained all of the information necessary to assess a complex situation and substantiate the conclusions reached. Importantly, according to AG Kokott, 'it would be an error to assume that the Commission's margin of discretion

[608] Keenan Kmiec, 'The Origin and Current Meanings of Judicial Activism' (2004) 92 California Law Review 1441.
[609] Michael Hein, 'The Least Dangerous Branch? Constitutional Review of Constitutional Amendments in Europe' in Martin Belov (ed), *Courts, Politics and Constitutional Law: Judicialization of Politics and Politicization of the Judiciary* (Routledge 2020) 187, 191.
[610] Discretion stricto sensu is considered to mean the process through which the EU administration assesses and weighs competing public interests. Technical discretion refers to the assessment, within the framework of a set of legislative criteria, of the aspects of the decision-making process that require expert knowledge – and, ultimately, may leave no actual discretion stricto sensu to the authority. See Mariolina Eliantonio, 'Deference to the Administration in Judicial Review: The European Union' in Guobin Zhu (ed), *Deference to the Administration in Judicial Review: Comparative Perspectives* (Springer 2019) 165.
[611] Case 42/84, *Remia BV and others v Commission of the European Communities* [1985] ECR 2545, in which the Court stated that judicial review should be limited to verifying 'whether the rules on procedure and on the statement of reasons have been complied with, whether the facts have been accurately stated, and whether there has been any manifest error of assessment or misuse of powers'.
[612] Paul Craig, EU Administrative Law (Oxford University Press 2019) 451.
[613] Case 12/03 P, *Commission of the European Communities v Tetra Laval BV* [2005] ECR I-987.

precludes the Community Courts in any event from giving their own analysis of the facts and the evidence'.[614] Therefore, while not requiring a full-scale assessment, there seems to be a strong consensus that this test allows for a relatively strict review of the European Commission's decisions. Be that as it may, when it comes to weighing conflicting interests, the courts' control is relatively limited and will only lead to finding unlawfulness if serious flaws are detected in the exercise of discretionary powers.[615]

Beyond the area of competition law, stricter judicial scrutiny has been applied regarding public health,[616] the environment[617] and fundamental rights.[618] These cases dealt with situations in which the EU administrative authorities had to conduct complex factual assessments. However, Mendes argued that this case law seems to dismiss public interest, as it enables the courts to scrutinise choices that stem logically from factual assessments (cognition), not the choices that derive from balancing the public interests that ought to be pursued against those that may be forfeited in given circumstances (volition).[619]

In contrast, the Court took a different approach regarding the assessment of the EU's response to the crisis, allowing conditional financial assistance and being deferent regarding the actions undertaken by the ECB.[620]

8.2. Scrutiny of financial assistance

The Court has scrutinised the ESM in *Pringle*[621] This case was initiated by a member of the lower house of the Irish Parliament and referred to the CJEU by the Irish Supreme Court. The most important question under consideration was whether Member States breached EU law by establishing the ESM Treaty.

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[614] Case *C-413/06 P, Bertelsmann AG and Sony Corporation of America v Independent Music Publishers and Labels Association (Impala)* ECLI:EU:C:2007:790, 240.
[615] Eliantonio (n 610).
[616] Case T-13/99, *Pfizer Animal Health SA v Council of the European Union* [2002] ECR II-3305.
[617] Case T-187/06, *Ralf Schräder v Community Plant Variety Office (CPVO)* [2008] ECR II-3151.
[618] Case T-85/09, *Yassin Abdullah Kadi v European Commission* [2010] ECR II-5177.
[619] Joana Mendes, 'Discretion, Care and Public Interests in the EU Administration: Probing the Limits of Law' (2016) 53 Common Market Law Review 419, 436.
[620] Takis Tridimas and Napoleon Xanthoulis, 'A Legal Analysis of the Gauweiler Case: Between Monetary Policy and Constitutional Conflict' (2016) 23 Maastricht Journal of European and Comparative Law 17; Dawson, Akbik and Bobić (n 341).
[621] The ESM was also scrutinised by three national courts, namely Estonia, Finland and Germany, which will be referred to below (Part III, Chapter 3, Point 9). For a complete overview, see Federico Fabbrini, 'The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective' (2014) 32 Berkeley Journal of International Law 64.

Among other arguments,[622] the claimant considered that the ESM effectively introduced changes in the competences of EU institutions, namely because it should be considered a monetary policy instrument and, therefore, an exclusive EU competence. Moreover, it was argued that the ESM should be seen as an autonomous and permanent international institution, which enabled the circumvention of prohibitions and restrictions established by TFEU for EMU, namely the no-bailout principle.[623]

8.2.1. ESM as economic policy

The Court starts by assessing the objectives pursued by the ECB and ESM and stated that the purpose of the former was to safeguard price stability, whilst the latter was thought to provide financial stability.

The instruments used were also mentioned. The Court stated that the ESM was not competent to make decisions regarding monetary policy issues, such as setting interest rates for the euro area or issuing the euro currency. Rather, it aims to guarantee the financing requirements of its members by providing financial assistance to those experiencing or threatened by severe financing problems. Moreover, such assistance must be entirely funded by paid-in capital or issuing financial instruments.[624]

The Court further argued that, even if the activities conducted by the ESM might influence inflation and, therefore, monetary policy decisions, that would be an indirect consequence of the economic policy measures adopted.[625]

Lastly, AG Kokott provides an argument focused on the differences between the tasks entrusted to the ECB and ESM. In particular, the AG mentioned that conducting foreign-exchange operations consistent with the exchange-rate policy, management of foreign reserves of the Member States and promotion of the smooth operation of payment systems are tasks that describe the scope of monetary policy according to Article 3 (1) (c)

[622] Other arguments were related to the amendment of article 136 TFEU or to effective judicial protection. On this, see 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.
[623] See *Pringle* (n 118), para 25.
[624] ibid. para 96.
[625] ibid. para 97.

TFEU. Importantly, the provision of credit facilities to Member States (as an ESM task) does not figure among them. As such, it does not fall under the ECB's remit.[626]

8.2.2. Interplay with Union and Member States economic policy competences

The ESM is, thus, considered to be a mechanism pertaining to the sphere of economic policy. As such, the Court addressed its relationship with the Union's competences and the provisions in this policy area. First, the claimants argued that articles 2 (3), 119 to 121 and 126 TFEU confer competence to the Union regarding the coordination of economic policy. The Court argued that the ESM was not concerned with the coordination of Member States' economic policies. Rather, it constituted a financing mechanism, the purpose of which was to mobilise funding and provide financial stability support for members who were experiencing, or threatened by, severe financing problems.[627]

Moreover, the CJEU acknowledged that this assistance could take the form of a macro-economic adjustment programme. However, it ultimately decided that the conditionality prescribed did not constitute an instrument for the coordination of Member States' economic policies. In fact, it was intended to ensure that the activities of the ESM were compatible with article 125 TFEU and the coordinating measures adopted by the Union. In fact, article 13 (3) (4) ESM Treaty states that the conditions attached to any form of support must be consistent with the measures of economic policy coordination provided in the Treaties, tasking the European Commission to ensure consistency before signing every MoU.[628]

Furthermore, the Court addressed the question of whether the ESM encroaches on the Council's power to issue recommendations under article 126, particularly if the conditionalism of financial assistance should be considered equivalent to the recommendations provided by this provision. Importantly, the Court clarified that, by virtue of the mentioned consistency, the ESM macro-economic programmes are subject

[626] Case C-370/12, *Thomas Pringle v Government of Ireland and Others*, EU:C:2012:756, Opinion of AG Kokott, paras 79-82.
[627] *Pringle* (n 118), para 110.
[628] ibid. paras 111-112.

to past recommendations and cannot prevent future ones, as the ESM is not competent to issue them.[629]

Lastly, I will discuss article 122 TFEU. The Court recalls that this provision only encompasses financial assistance granted by the Union, not assistance granted by Member States. In fact, article 122 (1) TFEU is not appropriate for any financial assistance from the Union to Member States who are experiencing, or threatened by, severe financial problems. Rather, its scope is to adopt measures appropriate to the economic situation of each Member State, particularly regarding difficulties in the supply of certain products, notably in the area of energy. Consequently, the establishment of the ESM does not hinder the powers conferred on the Council by this provision.

Regarding article 122 (2) TFEU, the Court assessed whether the ESM encroaches on the competence attributed to the Union, particularly if it exhaustively defines the exceptional circumstances enabling Member States to receive financial assistance and whether the institutions of the Union hold exclusive competence. The CJEU argued that, under certain conditions, article 122 (2) TFEU enables the Council to grant financial assistance to any Member State with difficulties, or the serious threat thereof, that derive from natural disasters or exceptional occurrences beyond its control. Hence, the establishment of the ESM does not hinder the exercise of the Union's competences.[630]

8.2.3. Preserving incentives for fiscal rectitude

Article 123 TFEU stipulates the prohibition of monetary financing. In essence, it aims to retain market-induced incentives for (Union and) Member States' fiscal rectitude. To do this, the Treaty forbids the ECB and national central banks from holding overdraft facilities or any other type of credit facility from their respective public authorities and bodies, as well as the direct purchase of debt instruments.

In this regard, the CJEU assessed whether the ESM Treaty was intended to circumvent such prohibition. In doing so, the Court argued that the scope of Article 123 TFEU covered the ECB and the central banks of the Member States, not the financial assistance granted by one or more Member States to another Member State. Accordingly, even acting through the ESM, Member States are not derogating from the referred

[629] ibid. para 113.
[630] ibid. paras 115-122.

prohibition. Lastly, it stated that there is no basis to consider that the funds provided by ESM Members to the ESM might derive from financial instruments prohibited by Article 123 (1) TFEU. Hence, Article 123 TFEU does not preclude the conclusion of a Treaty, such as the ESM Treaty, by eurozone Member States.

The Court was also asked to deliberate on the question of whether the ESM Treaty breached article 125 TFEU, which foresees the no-bailout clause. At the outset, it argues that the wording of the provision reveals that it is not intended to prohibit either the Union or Member States from granting any form of financial assistance.

From a systematic viewpoint, the Court held that there are other provisions that allow financial assistance, such as article 122 (2) TFEU, without derogating from article 125 TFEU. This means that there is no such prohibition. In addition, the wording used in article 123 TFEU is stronger than that used in the no-bailout clause. If this prohibition was not found regarding the former, *a fortiori*, it should not be found regarding the latter.[631]

Given the foregoing, the CJEU considered that the assessment of compatibility with article 125 TFEU was justified to focus on its objectives. Since the preparatory work of the Treaty of Maastricht, the aim has been to ensure that Member States follow a sound budgetary policy by exposing them to market discipline. In turn, fiscal discipline contributed to the overall Union goal of maintaining the financial stability of the monetary union.

It follows that diminishing such an incentive as a result of being granted financial assistance would be incompatible with article 125 TFEU. Conversely, this provision does not prohibit the granting of financial assistance if the recipient Member State remains responsible for its commitments, provided that the associated conditions ensure the implementation of sound budgetary policy.

Given this theoretical framework, the Court concludes that the ESM's instruments demonstrate it will not act as guarantor of the debts of recipient Member States. On the contrary, the latter remains responsible to its creditors for its financial commitments, as any financial assistance must be repaid to the ESM, including an appropriate margin.[632]

[631] ibid. paras 130-131.
[632] ibid. paras 133-136.

Regarding stability support, the Court considered the purchase of bonds in the primary market of an ESM member as comparable to other instruments, given that the mechanism does not assume the debts of recipient members. Similarly, on secondary market acquisitions, it concluded that the issuing Member State remains solely accountable for repaying debts. This conclusion is unaffected by the fact that the ESM pays a price to the holder of those bonds – a creditor of the issuing ESM Member. It is also worth mentioning that this kind of support is of a last resort nature, as it may only be granted if the member experiences or is threatened by severe financial problems capable of hindering the financial stability of the euro area as a whole.

Importantly, all types of assistance entail strict conditionality appropriate to the financial assistance instrument chosen. According to the Court, the purpose of this feature is to ensure that the ESM and recipient Member States comply with the EU economic governance legal framework and pursue a sound budgetary policy.[633]

Lastly, while an increased capital call will be made to ESM Members if a recipient ESM member fails to pay the amounts due, the latter remains bound to contribute with its part of the capital, consistent with market discipline teleology.[634]

Consequently, the Court concludes that 'a mechanism such as the ESM and the Member States who participate in it are not liable for the commitments of a Member State which receives stability support and nor do they assume those commitments, [is] within the meaning of Article 125 TFEU'.[635]

8.3. Scrutiny of monetary policy

The CJEU considered cases regarding OMT and PSPP in *Gauweiler*[636] and *Weiss*[637] respectively.

The *Gauweiler* case[638] originated with the first ever preliminary ruling referenced to the CJEU by the *BVerfG*. Crucially, it formally triggered a substantive constitutional

[633] ibid. paras 140-143.
[634] ibid. paras 144-147.
[635] ibid. para 146.
[636] Case C-62/14, *Peter Gauweiler and Others* v *Deutscher Bundestag*, EU:C:2015:400.
[637] Case C-493/17, *Heinrich Weiss and Others*, EU:C:2018:1000.
[638] On this case, in the literature, see Kumm, 'Rebel Without a Good Cause: Karlsruhe's Misguided Attempt to Draw the CJEU into a Game of "Chicken" and What the CJEU Might to About It' (n 48); Goldmann, 'Adjudicating Economics? Central Bank Independence and the Appropriate Standard of Judicial Review' (n 48); Federico Fabbrini, 'After the OMT Case: The Supremacy of EU Law as the Guarantee of the

interaction between these two high courts on a set of issues related to EU integration and distribution of competences with Member States regarding the interpretation and implementation of EU Treaties by the ECB.[639]

In essence, the applicants submitted two issues to the national proceedings before the *BVerfG*.[640] First, that OMT's decisions were *ultra vires* because they were not covered by the mandate of the ECB, breaching Article 123 TFEU. Second, that these decisions breached the principle of democracy protected by the German Constitution and, thereby, impaired German constitutional identity.[641]

The national court decided to stay the proceedings and asked the Court whether OMT exceeded the powers conferred to the ECB on monetary policy and whether this Decision violated the (primary law) principle of monetary financing prohibition. At the outset, the *BVerfG* clearly stated that the ECB's mandate should be strictly interpreted, in order to meet democratic requirements. Moreover, it argued that compliance must be subject to comprehensive and substantive judicial review.[642]

Similar issues arose in the *Weiss* case.[643] Therefore, the questions posed by the national court in its preliminary ruling resembled those in *Gauweiler*. Thus, the Court ruled on several questions, such as the limits of monetary policy, proportionality review or prohibition of monetary financing. Once again, the CJEU upheld the measures adopted by the ECB, broadly relying on past case law. This case is pivotal, namely due to the ultra vires decision reached by the *BVerfG* regarding PSPP.[644] In taking this decision, it diverged from the determinations of the Court in the preliminary ruling response.

Equality of the Member States' (2015) 16 German Law Journal 1003; Adamski (n 177); Vestert Borger, 'Outright Monetary Transactions and the Stability Mandate of the ECB: Gauweiler' (2016) 53 Common Market Law Review 139.

[639] While the Court had already delivered an important ruling in *Pringle*, its main issue was substantively different as it related to the compatibility of the ESM with EU law.

[640] *Gauweiler* (n 636), para. 6.

[641] For other national and supranational courts using the same argument, see Federico Fabbrini and András Sajó, 'The Dangers of Constitutional Identity' (2019) 25 European Law Journal 457. See also Sadurski, ''Solange, Chapter 3′: Constitutional Courts in Central Europe – Democracy – European Union' (n 49); Claes and Reestman (n 49).

[642] *Gauweiler* (n 636) paras 8-10.

[643] On this case, see Andrej Lang, 'Ultra Vires Review of the ECB's Policy of Quantitative Easing:An Analysis of the German Constitutional Court's Preliminary Reference Order in the PSPP Case' (2018) 55 Common Market Law Review 923; Sluis, 'Similar, Therefore Different: Judicial Review of Another Unconventional Monetary Policy in Weiss (C-493/17)' (n 48); Dawson and Bobić (n 348) 1005.

[644] BVerfG, Judgment of the Second Senate (n 47).

8.3.1. Limits of monetary policy competence

8.3.1.1. Gauweiler

The Court recalled that the Union has exclusive competence on monetary policy regarding Member States with the euro as their official currency, pursuant to article 3 (1) (c) TFEU. While there is no primary law definition of monetary policy, the Treaties establish that their primary objective is to maintain price stability and, second to that, support the Union's general economic policies with a view to contribute to the achievement of the objectives established in Article 3 TEU.[645] This task should be conducted by the ECB and national central banks (article 282 TFEU) with independence (article 130 TFEU).

Building upon *Pringle*, the Court considered that the objectives of that measure, as well as the instruments used to implement it, are pivotal to establish the nature of a measure and determine whether it falls under monetary or economic policy.[646] Accordingly, the Court considered that OMT falls within the remit of monetary policy for several reasons. First, the objective of safeguarding the singleness of monetary policy does not exceed the mandate, given that it must be single.

Second, the objective of preserving the appropriate transmission of monetary policy is not only likely to achieve this singleness but also to maintain price stability. According to the Court, this is because the mechanisms used for effective transmission are essential in price developments. Therefore, disrupting these mechanisms affects the ability to guarantee price stability. And while monetary policy decisions might spillover to economic policy matters (such as to contribute to the stability of the euro area), this circumstance does not change its inherent nature.[647]

Regarding the means of implementation, the ESCB and ECB Statute permits the buying and selling of outright marketable instruments. The fact that the transactions would be selective was not considered problematic, given that the fragmentation of monetary policy transmission was not homogeneous. Accordingly, a targeted bond-buying programme would be adequate to address the identified shortcomings.[648]

[645] ibid. paras 34-45.
[646] ibid. para 46.
[647] ibid. paras 48-52.
[648] ibid. paras 53-56.

The Court also rejected the claim that abiding by the conditionality principle would place the decision in the sphere of economic policy. While it is true that compliance with an EFSF or ESM macroeconomic adjustment programme might entail economic effects, these effects should be considered indirect and not treated as equivalent. Moreover, the CJEU stressed that the conditionality principle plays an essential role in respecting the subsidiarity principle on economic policy decisions. This is because monetary policy intervention might have relaxed economic conditions and indicators, which could have justified adjustment efforts had that involvement not taken place.[649]

Finally, OMT passed the proportionality test. At the outset, the CJEU argued that the ECB is entrusted with broad discretion, given the 'choices of a technical nature and to undertake forecasts and complex assessments', which it must conduct with care and accuracy. That does not mean, however, that it is exempt from judicial review. In fact, the more discretion entrusted, the more fundamental it is to comply with procedural guarantees and conduct compliance reviews, which include, at least, a two-fold obligation: on the one hand, examining all relevant elements carefully and impartially; on the other hand, providing an adequate statement of reasons.

On appropriateness, the Court extensively relied on economic assessments made by the ECB. These pointed towards severe volatility on risk premiums in several Member States, which consequently fragmented monetary policy transmission, namely bank refinancing and credit costs. As such, no manifest error of assessment was identified.[650]

The programme was also deemed necessary. The Court, once again, extensively relied on the ECB's assertion that the mere announcement of OMT was sufficient to restore monetary policy transmission. Moreover, a series of safeguards were implemented, such as the conditionality principle and limitations in scope to bonds maturing up to three years. These allowed the Court to conclude that OMT had not done more than was needed.[651]

8.3.1.2. Weiss

[649] ibid. paras 57-65.
[650] ibid. paras 66-74.
[651] ibid. paras 75-92.

On whether PSPP should be considered as a measure of monetary policy nature, the Court focused firstly on its objectives. It found that the objective was to return to inflation rates below, but close to, 2% over the medium term, in line with the EU's monetary policy's primary objective. This conclusion was not hindered by the considerable economic policy effects instigated by PSPP. In fact, the Court argued, the Treaties did not draw an inflexible line between economic and monetary policies, as expressed by the fact that support for general economic policies in the Union was a secondary monetary policy objective. As noted in *Gauweiler*, a monetary policy measure is not equivalent to an economic measure just because of its indirect economic effects.

The Court also rejected the *BVerfG*'s view that knowingly accepted and foreseeable effects of a measure should be considered indirect effects (and, thus, precluded from adoption). Should that be the case, the ESCB would be prevented from using the means outlined in the Treaties to pursue its primary objective, which might represent an 'insurmountable obstacle'. As the instruments are foreseen in the ESCB and ECB Statute, the Court declared that both the objectives and the means were covered under Treaty provisions.[652]

8.3.2. Monetary financing of Member States

8.3.2.1. Gauweiler

Article 123 (1) TFEU prohibits overdraft facilities and any type of credit facility with ESCB in favour of the Union (ie institutions or agencies) or Member States (ie central governments, regional, local or public undertakings), as well as the ESCB's direct purchase of their respective debt instruments.

From the provision, stated above, derives the prohibition of purchasing bonds on the primary market. Acquisitions on the secondary market are not precluded (from creditors of Member States). However, such a possibility is not without its limitations, as the Court considered that it should not have an equivalent effect to direct purchases. This means that acquisitions must not discourage countries from pursuing sound budgetary policies by artificially lowering market pressure. This discouragement would take place in practice, according to the Court, if potential purchasers on the primary market were certain that the ECB would take their securities within a certain period. In this respect, it noted that the

[652] ibid. paras 53-70.

operations (scope, start, continuation and suspension) were neither pre-determined nor pre-announced. Several safeguards were considered important in order to mitigate the risk of reducing impetus of sound budgetary policy: bond maturity limitation; the possibility of selling bonds at any time; Member States' need to resume access to the market, and compliance with structural adjustment programmes.[653]

8.3.2.2. Weiss

The two-step test developed in *Gauweiler* was applied to determine the compatibility of PSPP with article 123 (1) TFEU. First, the *BVerfG* claimed that it creates a *de facto* certainty that private acquisitions will be subsequently purchased by the ECB, hence having an equivalent effect on purchases on the primary market. Whilst acknowledging that a certain degree of certainty is deliberately provided, the Court stressed that the amount and type of safeguards were sufficient to counter that effect (ie blackout periods; discretion of the Governing Council in the execution, the acquisition of different types of bonds; and the limitations per issue and issuer).[654]

Second, on the question of Member States' reduced impetus to conduct sound budgetary policy, the Court adopted a similar approach in listing the aforementioned restrictions as sufficient safeguards to prevent Member States' lack of incentives to pursue sound economic policies.[655]

The national court also argued that holding bonds until maturity and purchasing them at a negative yield to maturity could breach Treaty provisions. The Court did not agree. In fact, it not only insisted that there was nothing in the ESCB and ECB Statute to preclude it, but also that it remained for the ECB to assess whether and when it was appropriate to sell securities. Additionally, it was not implied that payment was not demanded if those assets were held until the payment was due. Although holding until maturity takes pressure off Member States' debt markets, because it does not increase the amount of securities in the market, these economic effects are indirect and, therefore, within the scope of the Treaties.[656] Acquisitions of bonds at negative yields to maturity were considered in line with the Treaties as they were acquired through secondary

[653] ibid. paras 93-127.
[654] ibid. paras 109-128.
[655] ibid. paras 129-144.
[656] ibid. paras 145-152.

markets, did not hinder sound budgetary policies (since negative rate emissions imply a good fiscal position) and would make it more difficult for private operators to identify which bonds would be purchased in the future.[657]

8.3.3. Proportionality

8.3.3.1. Gauweiler

Regarding the principle of proportionality, it stated that OMT was based on an analysis of the economic situation of the euro area, which was characterised by significant volatility in the interest rate of government bonds. The Court highlighted that, according to the ECB, these spreads were due to the risk of a dissolution of the euro area and not to the differences in the economies of each Member State. This, the ECB argued, hindered the transmission of monetary policy in a significant part of the eurozone. As a result, the Court considered that there was no manifest error of assessment.[658]

The programme also passed the necessity test. Indeed, the Court considered that the 'mere announcement of the programme at issue in the main proceedings was sufficient to achieve the effect sought — namely to restore the monetary policy transmission mechanism and the singleness of monetary policy'.[659] Accordingly, it was legitimate to conclude that OMT was appropriate for the purpose of contributing to the ESCB's objectives, namely to maintain price stability.[660]

Finally, the Court takes the view that the ESCB took into consideration 'the various interests in play so as to actually prevent disadvantages from arising, when the programme in question is implemented, which are manifestly disproportionate to the programme's objectives'.[661]

8.3.3.2. Weiss

After *Gauweiler* granted the ECB broad discretion, the Court justified the necessity of PSPP with reference to possible deflation over the medium term. In fact, despite the monetary policies adopted, the ECB provided internal documentation arguing in favour

[657] ibid. paras 153-157.
[658] *Gauweiler* (n 636), paras 72-74.
[659] ibid. para 79.
[660] ibid. para 80.
[661] ibid. para 91.

of a high level of risk of price decreases in December 2014, with grim forecasts. Against this backdrop, the practices of other central banks and various studies on the efficacy of large-scale purchases of government bonds to meet the inflation target, the Court found no manifest error of assessment.[662]

The Court, then, moved to the adequacy test. It stated that the measure was taken in the context of the risk of triggering a deflationary cycle and that it was not foreseeable that different, less intensive programmes could have achieved the primary objective of monetary policy. Other features were considered, such as the non-selective and temporary nature, stringent eligibility criteria and purchase limits per issue and per issuer. The successive extensions of the programme and substantial size of its purchases were considered adequate given the insufficient changes in inflation rates. Finally, the loss-sharing framework was considered acceptable to prevent spillovers from other Member States' potential economic deterioration.[663]

8.4. *Bundesverfassungsgericht* decision pursuant to Weiss

The *BVerfG* did not follow the determinations in the response to the preliminary ruling by the CJEU.[664] On the standard of review, it considered that the CJEU granted the ECB an unreasonably large margin of appreciation. In fact, the German court argued that, when the fundamental interests of Member States were affected, a judicial review must go further than accepting the ECB's positions at face value. Crucially, in the absence of closer scrutiny, the integrity of EU distribution of competences may be at risk, with tantamount consequences to the principles of conferral and democracy.[665]

The application of the principle of proportionality might also hinder the principle of conferral. On this matter, the *BVerfG* argued that the suitability and necessity of the measure needed to be assessed in connection with the economic effects it entails. In the absence of such an assessment, ie where monetary policy objectives are pursued unconditionally and its economic policy effects are ignored, the principle of proportionality is disregarded.[666]

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[662] ibid. paras 71-78.
[663] ibid. paras 79-100.
[664] BVerfG, Judgment of the Second Senate (n 47).
[665] ibid. para 142.
[666] ibid. paras 138-145.

The prohibition of monetary financing should be conducted by resorting to an overall assessment of the circumstances. In particular, we should assess the purchase limit of 33% and distribution of these purchases, which, according to the ECB's capital key, prevent the existence of selective measures under PSPP. Nor does it allow the Eurosystem to become the creditor with the most claims regarding a given Member State.[667] However, changes to the risk-sharing regime would affect the limits set by the overall budgetary responsibility of the *Bundestag* and constitute an assumption of liability for decisions made by third parties with unforeseeable consequences. This is inadmissible under the Constitution.[668]

Based on the foregoing, the *BVerfG* declared the ECB's decision to be ultra vires, requiring the German Government and the *Bundestag* to take steps to ensure that the ECB conducted a proper proportionality assessment.[669] [670]

8.5. Bifurcation of judicial control in economic and monetary union

The paradigm of integration through law made the Court strong for decades. Notwithstanding, such a paradigm has been increasingly replaced with technocratic rule-based governance, the most immediate consequence being a reduction in the Court's scope of engagement. Therefore, judicial activism has changed to what some literature designates as extreme deference regarding economic and monetary measures.[671]

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[667] ibid. paras 197-212.
[668] ibid. paras 222-228.
[669] ibid. paras 229-232.
[670] After diligences promoted by German institutions, the *Bundestag* passed a resolution supporting the asset purchase programme. This was later acknowledged by the *BVerfG*, by dismissing claims that the requirements set out in its prior judgement had not been satisfied. In fact, it considered that the German Government and *Bundestag* substantially addressed and appraised the monetary policy decisions taken by the ECB Governing Council following previous case-law. See BVerfG, Order of the Second Senate (2021) 2 BvR 1651/15, para 108-111. The same thing took place regarding a preliminary injunction against the ratification of Next Generation EU in Germany. Mindful of the impact a delay would cause, had the injunction been accepted, the *BVerfG* dismissed the claim arguing that the *Bundestag* had not breached its budgetary responsibility and should be granted a wide margin of appreciation on the budgetary autonomy of Germany. See BVerfG, Order of the Second Senate (2021) 2 BvR 547/21. However, it is unclear whether NGEU should be a basis for future similar programmes, as argued by Paul Dermine and Ana Bobić, 'Of Winners and Losers: A Commentary of the Bundesverfassungsgericht ORD Judgment of 6 December 2022' (2024) European Constitutional Law Review, First View, 1.
[671] Carlos Aymerich, 'Challenging Austerity before European Courts' in Anuscheh Farahat and Xabier Arzoz (eds), *Contesting Austerity: A Socio-Legal Inquiry* (Hart Publishing 2021) 99, 101; Merijn Chamon, *EU Agencies: Legal and Political Limits to the Transformation of the EU Administration* (Oxford University Press 2016) 206 and 367.

Before the crisis, the CJEU was not as deferential, as shown by the well-known 2003 *OLAF* case.[672] In this case, the European Commission sought to annul an ECB Decision on fraud prevention, which had established an internal anti-fraud investigation framework without reference to the powers of OLAF. The Court annulled this decision. Among other issues at stake, there was the matter of the preservation of the central bank's independence and duty to consult the ECB regarding legislation within its field of competence prior to taking action. On the former, the ECB submitted that conferring on OLAF power to conduct internal investigations within the ECB would undermine its independence, since the mere threat of its exercise could pressure the members of the Governing Council or the Executive Board of the ECB and jeopardise their independence when making decisions. The Court considered that 'recognition that the ECB has such independence does not have the consequence of separating it entirely from the European Community and exempting it from every rule of Community law'.[673] With this statement, the Court takes the view that independence is not equivalent to exemption from the EU legal framework.[674]

Regarding the consultation duty, the ECB opposed the annulment application arguing that its decision could not infringe Regulation (EC) No 1073/1999, concerning investigations by OLAF, as that Regulation was itself invalid because the ECB was not consulted prior to its adoption. In response, the Court noted that the ECB had not been assigned any specific tasks regarding the prevention of fraud detrimental to the interests of the Community.

Importantly, after the crisis, the CJEU shied away from a robust intervention, particularly in the realm of EU economic policy. As Barrett noted, this is too essential and politically sensitive for the judiciary to assume an expansive role. Significantly, judicial mishandling could 'risk entirely derailing the still-evolving Eurozone'.[675]

However, in the Economic and Financial Affairs Council meeting of 25 November 2003, the Council rejected the adoption of decisions against Germany and France because

[672] Case C-11/00, *Commission of the European Communities v European Central Bank* [2003] ECR I-7147. On this case see Simona Elena Lambrinoc, 'The Legal Duty to Consult the European Central Bank: National and EU Consultations' (2009) European Central Bank Legal Working Paper Series 9/2009, accessed 21 September 2022; Okeoghene Odudu, 'Annotation of Case C-11/00 Commission of the European Communities v European Central Bank, Judgment of 10 July 2003, Full Court' (2004) 41 Common Market Law Review 1073.
[673] *OLAF* (n 672), para 135.
[674] In this vein, see Barrett, 'The Role of Courts in the Eurozone' (n 490) 130.
[675] ibid, 127.

there was no qualified majority to this effect. Fearing the potential erosion of SGP credibility, the European Commission brought this decision before the Court, arguing that the Council should have followed the procedure established in Regulation 1467/1997 and not declared the SGP in abeyance by way of Council conclusion. From the Council's perspective, silence did not undermine the credibility of the SGP.[676] The CJEU eventually ruled that the correct legal framework could be found in article 9 of Regulation 1467/1997 and not in the Council's conclusion, as the European Commission argued. Nevertheless, it did not address the substantive issue of whether an exception could be granted to both countries.

Crucially, both the Council's decision and the Court's judgement show that the effectiveness of budgetary constraints is not guaranteed, per se, by constitutionalisation[677] and that breaching Treaty-rules no longer equates to strong judicial intervention, as was usually the case.

This situation generates problems of institutional incoherence, erosion of credibility and intergovernmental strain. First, institutions need to act within certain principles and according to a compass in order to foster legal certainty and inspire confidence in their activities. This means acting in a coherent manner. Although many consider that the SGP was originally meant to constrain Member States' finances, lack of adherence and laxity of enforcement makes uniformity in application difficult. At the same time, despite the questionable effectiveness of the supranational rules on Member States' finances, they are difficult to change, given the procedure for Treaty change. Given the mismatch of place of decision and place of responsibility, they are a potential source of strain between Member States.

Although the matter was procedural in nature, the fact remains that the European Commission was barred from enforcing the SGP if no political will existed. It was, arguably, the first time that integration through law and technocratic rule-based governance met their limits, precisely regarding areas of significant political sensitivity.[678]

[676] Case C-27/04, *Commission of the European Communities v Council of the European Union* (n 491) paras 53-64.
[677] Alessandro Busca, 'A Legal and Economic Assessment of the EMU's Common Principles and Alternative Routes of Budget Constraints' (Doctoral thesis, European University Institute 2018), 153.
[678] Barrett, 'The Role of Courts in the Eurozone' (n 490) 130.

Unsurprisingly, therefore, the Court showed a notable degree of deference to the political process in *Pringle*, in which the ESM was upheld by way of a teleological interpretation of the Treaty provisions. Similarly to what it had done in Costa and Van Gend en Loos (regarding supremacy and direct effect of EU Law), such an interpretation allowed the Court to set the *financial stability of the eurozone* as the ultimate objective of the EMU, which was not inscribed in the Treaties, hence displacing the principle of fiscal responsibility.[679] Consequently, political institutions were awarded a significant degree of deference, with some literature arguing that the Court took the back seat vis-a-vis the political process.[680]

In my view, this judicial circumspection was deliberate, as it was not always the legally obvious interpretation for the Court. In this regard, Joerges questions what would have happened to the EU, had the CJEU found that:

> Thomas Pringle's concerns about Europe's crisis management were well-founded; that the support mechanisms which the EFSF and the ESM have established interfere with the exclusive European competence for monetary policy; that the amendment of Article 136 TFEU was not possible under the simplified revision procedure enshrined in Article 48(6) TEU; that new policies being adopted and pursued by the Member States jeopardized the primacy of price stability; that the bail-out provision of Article 125 TFEU prohibited the granting of financial assistance to Member States whose currency is the Euro; that the functions assumed by the Commission, the ECB, and the IWF were irreconcilable with the principles on the conferral of powers laid down in Article 13 TFEU; or that the mandate allocated to the CJEU in the ESM Treaty exceeded judicial powers? It is simply impossible to predict the dire consequences.[681]

At a moment of high financial volatility, uncertainty and structural weaknesses in the eurozone, the several provisional financial funds were arguably key to its survival.

[679] ibid. 131; Hinarejos, *The Euro Crisis in Constitutional Perspective* (n 252) 125.
[680] Hinarejos, *The Euro Crisis in Constitutional Perspective* (n 252) 121.
[681] Christian Joerges, 'Europe's Economic Constitution in Crisis and the Emergence of a New Constitutional Constellation' (2014) 15 German Law Journal 985, 1013.

Contrary to the Court's earlier case law, which was decided when judicial activism was necessary to further European integration, Barrett considers that, in contrast, the major euro-crisis cases were decided when the safeguarding of European integration needed something different, namely, when the law was not an obstacle.[682]

The deference and restraint shown in *Pringle* proved to be enduring. Indeed, in *Gauweiler* and *Weiss*, the legality of the ECB's asset purchase programmes was confirmed by the Court, continuing a line of extensive teleological reasoning.[683] This reasoning not only provided the Treaties with more flexibility and wider scope, but also awarded increasing discretion to institutions, such as the ESM and, particularly, the ECB. As Harvey suggests, OMT and PSPP conditionality were not devised by the Court. Rather, the CJEU assessed the ECB-designed constraints and accepted them one by one.[684]

Furthermore, in the ESMA case, the CJEU invoked the maintenance of the eurozone's stability as rationale to reject actions filed against austerity measures. In fact, the Court justified the ESMA's power of intervention with the need to manage adverse developments, which threatened the financial stability of the EU and market confidence, even if that endowment did not comply with Treaty provisions (ie articles 290 and 291) or the Court-developed Meroni doctrine.[685]

In these cases, the Court would not allow a strict application of the constitutional framework to hinder EMU's evolution from a rule-based to policy-based political area.[686] This new approach introduced significant challenges. First, in *Pringle*, the Court adopted a restrictive interpretation regarding the Union's exclusive competences on monetary policy, in order to pave the way to ESM's approval. On the contrary, in *Gauweiler* and *Weiss*, the Court applied an extensive interpretation of the OMT and PSPP assessment by adopting a procedural review. While this type of judicial syndication may have merit,[687]

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[682] Barrett, 'The Role of Courts in the Eurozone' (n 490) 131.
[683] Alicia Hinarejos, 'Gauweiler and the Outright Monetary Transactions Programme: The Mandate of the European Central Bank and the Changing Nature of Economic and Monetary Union' (2015) 11 European Constitutional Law Review 563.
[684] Darren Harvey, 'Towards Process-Oriented Proportionality Review In The European Union' (2017) 23 European Public Law 93.
[685] Case C-270/12, *United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union* [2014] ECLI:EU:C:2014:18, paras 85-86.
[686] ibid. paras 135-138; In the same vein, see Hinarejos, *The Euro Crisis in Constitutional Perspective* (n 252) 143.
[687] See Koen Lenaerts, 'The European Court of Justice and Process-Oriented Review' (2012) 31 Yearbook of European Law 3.

some literature considers that it almost caused unconventional monetary policy programmes to be exempt from meaningful review and could establish an environment in which the ECB's discretion goes unchecked in a way that could hinder the Treaty's delimitation of competences.[688] The distribution of competence is a paramount legal issue, given that it expresses a substantive agreement by Member States. According to Siekmann, compliance with this agreement should be prioritised by the judicial branch, thereby justifying robust judicial review to protect legal certainty and citizens' democratic voice, as expressed by their respective Heads of State or Government and national parliaments, as well as the system's and ECB's current institutional balance.[689] In the same vein, Hinarejos considers that, while deference was understandable, the right level of judicial scrutiny is pivotal.[690]

In contrast, Goldmann proposes the concept of 'mutually assured discretion' in vertical and horizontal institutional relations.[691] The author argues that this would be a better way to achieve a more balanced EMU, in the sense that all parties expect a certain degree of discretion from one another, with the Court granting discretion to the ECB and other EU institutions. This is especially the case within the EMU because the legal provisions that underpin it are vague and purpose-oriented, so it is difficult to be strict and rule-based.

With a different line of reasoning, Dawson rightly argues that indeterminate concepts subject to judicial interpretation are frequent in law. This observation was the starting point for the author's proposal of a four-pronged strategy on how to control discretion based on deference, prescription and soft law, proceduralism and political accountability, as well as interdisciplinary justification.[692] While deference may be important, particularly on highly specialised matters, it must be complemented by other actions, namely by the use of soft-law (ie by issuing communications). Given the

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[688] Siekmann (n 195) 75; Cesare Pinelli, 'Are Courts Engaged in a "Dialogue" on Financial Matters?' in Martin Belov (ed), *Judicial Dialogue* (Eleven International Publishing 2019) 111, 122.
[689] Siekmann (n 195) 75-84. The author goes further in the terms used to describe the situation, stating that by applying such an extensive and low-intensity review, the Court may have reduced the constitutional distribution of competences to a mere guideline with little normative value. This is why the *BVerfG*'s reasoning is also criticised by the author, as the national court should have targeted the violation of the principle of attribution (a conscious and deliberative legislative decision) and not the principle of proportionality.
[690] Hinarejos, *The Euro Crisis in Constitutional Perspective* (n 252) 152.
[691] Goldmann, 'Discretion, Not Rules: Postunitary Constitutional Pluralism in the Economic and Monetary Union' (n 217).
[692] Mark Dawson, 'How Can EU Law Contain Executive Discretion?' in Joana Mendes (ed), EU Executive Discretion and the Limits of Law (Oxford University Press 2019) 64, 67.

possibility of judicial review of these mechanisms,[693] such an approach may hinder administrative transparency if it leads to reducing their use. Regarding the procedure, a lighter reading may simply demand the authority to explain its reasoning. However, a harsher one could mandate decisions to incorporate a wide spectrum of consequences, such as potential effects on stakeholders, which would decrease the degree of discretion because further situations would need to be duly considered. This reasoning applies to judicial decision-making, ie by allowing briefings from high-level economists and think tanks or creating specialised sections within the Court. Lastly, on interdisciplinary justification, one needs to consider whether the Court should have substituted the ECB's opinion for its own in such a specific matter. In this vein, Dawson considers that judges deal with economic matters frequently and that those serving on EU courts are not an exception. For instance, regarding free movement and competition law, the Court has always demanded the European Commission to justify its decisions. This judicial practice has, over time, led to the European Commission publishing economic-heavy guidelines, in order to provide more legal certainty and transparency for its decision-making process. Therefore, the Court should have considered the impact on the euro area and the ability to effectively set interest rates, had an OMT scheme been absent.

These court decisions reveal an intrinsic contradiction[694] of two systems within the EU economic governance framework. On the one hand, a system based on automatisms (through the TSCG, six-pack and two-pack) and, on the other hand, the quasi-discretionary powers acquired by the ECB beyond the maintenance of price stability, due to political branch malfunction.

Crucially, the vertical nature of EU economic integration is, again, salient as *Gauweiler* legitimised the ECB as a powerful actor. As the phasing-out of monetary easing has shown, the improvement of Member States' economic and financial indicators was arguably more due to ECB's support rather than an economic governance framework based on tight, supranational surveillance.[695] In this vein, it seems that 'Europe's

[693] Case T-496/11, *United Kingdom of Great Britain and Northern Ireland v European Central Bank (ECB)* [2015] ECLI:EU:T:2015:133.

[694] See also Amtenbrink, 'Economic and Monetary Union' (n 227) 944-945, who states that a combined reading of the case-law results in the Court's acquaintance of economic and monetary policies' interconnectedness. Whereas the former is geared towards the stability of the euro area, monetary policy in the euro area is geared towards the stability of the single currency. However, the author is of the view that a common constitutional culture, at least regarding economic aspects, is still very distant in the EU even (more perplexingly) for the closer circle of the euro area countries.

[695] Nuno Albuquerque Matos, 'The (Dual) Primary Mandate of the European Central Bank: Between Inflation and Eurozone Survival' (*European Law Blog*, 2022) <https://europeanlawblog.eu/2022/06/23/the-

economic constitution and its entire constitutional configuration has been replaced by the discretionary decision-making powers of an unaccountable technocracy'.[696]

The Court's deference towards Member States and the ECB simply adhered to the referred contradiction.[697] In fact, the effects of a potential EMU collapse brought about a sense of urgency in legitimating actions, regardless of the institutional forum able to deliver it, even if it meant using EU institutions outside of the EU legal order. This ample deference shows that the Court took a pragmatic approach based on its awareness of financial emergency, despite the justifications to authorise the ESM's setup and the ECB's unconventional monetary policies.[698]

This contradiction is also clear in the different procedural paths taken to approach the Court. Indeed, the main avenue for judicial review of actions of Union institutions shifted from action for annulment to a preliminary ruling. While the former is a procedure with little national involvement (given that EU institutions are usually the leading actors due to high procedural burden on individuals), the latter emboldens citizens and national discussions. In fact, there are distinct differences between 'regular' EU agencies and the ECB. Not only are the former established by secondary law, as opposed to the primary law status of the central bank, but, also, the powers held by both are starkly distinct. Therefore, it is understandable that the EU agencification process, as well as the questions over the role and boundaries of judicial review, had largely remained an internal affair of EU institutions with minimal involvement of national organs. In contrast, the ECB attracted a lot of attention at the national level. Significantly, the broad margin of discretion granted it visibility during its management of the crisis and the consequentiality of its actions prompted a review of the legitimacy of European integration.[699]

Indeed, the referred EU monetary policy cases assessed by the Court originated from a preliminary ruling procedure initiated by the *BVerfG*.[700] In short, the main issue

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dual-primary-mandate-of-the-european-central-bank-between-inflation-and-eurozone-survival/> accessed 13 September 2022.

[696] Christian Joerges, 'Comments on the Draft Treaty on the Democratisation of the Governance of the Euro Area' (2018) 3 European Papers 75, 78.

[697] Pinelli (n 688) 123.

[698] Paul Craig, 'Pringle and Use of EU Institutions Outside the EU Legal Framework: Foundations, Procedure and Substance' (2013) 9 European Constitutional Law Review 263; Pinelli (n 688) 124; Aymerich (n 671) 102.

[699] Joan Solanes Mullor, 'What Goes Up Must Go Up: Raising Judicial Scrutiny over the European Central Bank through Judicial Dialogue' in Martin Belov (ed), *Judicial Dialogue* (Eleven International Publishing 2019) 155, 168-169.

[700] The literature on both preliminary references is robust. See, among many others, Alicia Hinarejos, 'The Euro Area Crisis and Constitutional Limits to Fiscal Integration' (2012) 14 Cambridge Yearbook of

in both cases was a potential breach of the principle of democracy established in the German Constitution, which, thereby impairing German constitutional identity. The *BVerfG* accepted the argumentation of the CJEU regarding OMT since such a programme had not been used and no funds had been disbursed under it. Conversely, PSPP was considered ultra vires essentially because the magnitude of its purchases entailed economic and fiscal consequences and because the proportionality test was considered too light.

Consistent with the analysis on the erosion of monetary policy principles (above, Part III, Chapter 3, Point 1.1), the *BVerfG* adopted an interdisciplinary analysis of a legal and economic nature. Arguably, this initiative intended to protect the existence of EMU, as opposed to the alternative of not having a monetary union at all. Indeed, in the eyes of Karlsruhe justices, they attempted to contain the delimitation of competences within the boundaries defined by the Treaties, which is the common ground upon which all EU Member States agreed.

As Amtenbrink and Repasi argue, 'whilst the ECJ rather confirms the intention of the drafters of the Treaties to shield the ECB from influence from (democratically) elected politicians, the german court seeks to keep the impact of independent monetary policy decision on national democracy as limited as possible by narrowing its monetary policy mandate'.[701]

The *BVerfG*, however, did propose another way to address the ultra vires problem. In order to remain binding on Germany and its national institutions, the German Government and Parliament would have to assess the proportionality of PSPP. Therefore, it is clear that when monetary policy entails increasing economic consequences, there are two ways for the *BVerfG* to address the problem: either by demanding judicial review in order to safeguard the defined Treaty competence perimeter, notably by applying a stricter

European Legal Studies 243; Annamaria Viterbo, 'The PSPP Judgment of the German Federal Constitutional Court: Throwing Sand in the Wheels of the European Central Bank' (2020) 5 European Papers 671; Asteris Pliakos and Georgios Anagnostaras, 'Adjudicating Economics II: The Quantitative Easing Programme Declared Valid' (2020) 45 European Law Review 128; Claude Blumann, 'Quelques Enseignements de l'arrêt Du Bundesverfassungsgericht Du 5 Mai 2020 Sur Les Fondamentaux Du Droit de l'Union Européenne' (2020) 4 Revue Trimestrielle de Droit Européen 889; Robert Kovar, 'L'affaire OMT. L'extension Des Moyens d'intervention de La Banque Centrale Européenne' (2015) 3 Revue Trimestrielle de Droit Européen 579; Diana-Urania Galetta and Jacques Ziller, 'The Bundesverfassungsgericht's Glaring and Deliberate Breaches of EU Law Based on "Unintelligible" and "Arbitrary" Grounds' (2021) 27 European Public Law 63.

[701] Fabian Amtenbrink and René Repasi, 'The German Federal Constitutional Court's Decision in Weiss: A Contextual Analysis' (2020) 45 European Law Review 757, 776.

proportionality test; or by enhancing democratic legitimacy, so that the 'redefined' competence perimeter would be properly authorised by political institutions.[702]

In a nutshell, from my point of view, although it seems that the *BVerfG* engaged in an institutional challenge with the CJEU, in actuality, it drew up a policy roadmap with options it deemed sufficient (but necessary) to bring the ECB's actions to legality. Given that the CJEU did not endorse the first option, its answer was to defer to the political process: ultimately, it would be up to the German Government and Parliament to decide the bindingness of the ECB's actions'.

9. Judicial control in Member States

A judicial debate also occurred in the judicial institutions of Member States. This was due to policy-makers considerable reliance on international law instruments rather than on EU law measures when developing the eurozone. This prompted policy-makers to call on national courts to deal with general challenges to austerity measures in a memoranda of understanding.[703]

Mindful that this solution was born out of the difficulties related to the Treaty amendment procedure, it is questionable why national courts were so involved, given that the issues had a broad, European-wide nature.[704] Most national constitutional courts deferred to their respective governments,[705] albeit relying on an interpretation of their national constitutions and showing a degree of disconnect with EU law.[706]

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[702] ibid. See also Adamski (n 177) 1478.

[703] Federico Fabbrini, *Economic Governance in Europe: Comparative Paradoxes and Constitutional Challenges* (Oxford University Press 2016); Fabbrini, 'The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective' (n 621). This would not have been possible had the option been to adopt EU secondary law, as the validity control of EU legislation is a competence of the CJEU, as stated in Case C-314/85, *Foto-Frost v Hauptzollamt Lübeck-Ost* [1987] ECR 4199, paras 15-18.

[704] Barrett, 'The Role of Courts in the Eurozone' (n 490) 127.

[705] Ana Bobić, '(Re)Turning to Solidarity EU Economic Governance: A Normative Proposal' in Anuscheh Farahat and Xabier Arzoz (eds), *Contesting Austerity: A Socio-Legal Inquiry* (Hart Publishing 2021) 115, 124; Juli Ponce, 'Taking Social Rights Seriously? The Spanish Case' in Anuscheh Farahat and Xabier Arzoz (eds), *Contesting Austerity: A Socio-Legal Inquiry* (Hart Publishing 2021) 153.

[706] Maduro, Frada and Pierdominici (n 235). In this vein see Claire Kilpatrick, 'On the Rule of Law and Economic Emergency: The Degradation of Basic Legal Values in Europe's Bailouts' (2015) 35 Oxford Journal of Legal Studies 325; Giacomo Rugge, 'Bundesverfassungsgericht e Corte Di Giustizia Dell'UE: Quale Futuro per Il Dialogo Sul Rispetto Dell'identità Nazionale?' (2016) 4 Il Diritto Dell'Unione Europea 789. Rugge argues that before setting aside EU law, constitutional courts should first provide the ECJ with the opportunity to address the conflict between supranational and national provisions.

A lot of literature relies, rightfully so, on the distinction between creditor and debtor countries. However, I will look at the current issue from the perspective of judicial supply and demand of rights. From this perspective, debtor countries' courts are positioned on the 'demand' side of the spectrum, given that they essentially deal with actions related to the protection of public employees and pensioners' incomes. In contrast, creditor countries' courts are positioned on the 'supply' side of the spectrum, in that they deal with actions related to the assessment of instruments that permit the continuity of the commitments of other EU Member States.

9.1. Demand of rights

I begin my approach to the demand side of rights with Greece as an example.[707] In Greece, between 2012-2014, the CoS deferred to the executive branch in two ways: perception and means deference. The degree was varied. In some cases, the CoS exercised a lower degree of means deference, by finding some measures (or parts of measures) of lesser importance unconstitutional. However, in these cases, it did not examine whether the emergency caused by the financial crisis existed or was as existential as portrayed by the executive and legislative branches, thus exercising perception deference to a significant extent. Therefore, several austerity measures were found to be constitutional.

This changed in 2014, as a more activist form of judicial review prompted many measures to be considered unconstitutional, even though both branches continued to consider the second and third assistance programmes as emergency measures. In some cases, there were contentious and controversial decisions that countered the precedent on the same facts, regarding the same legal framework. However, overall, between 2014-2019, the outcomes of CoS's judgements were mixed and some deference was, nevertheless, awarded.

Regarding this shift, the immediate difference to highlight is the context. In fact, the economic and financial conditions of 2014 were unlike those of 2010 when the first financial assistance package was approved, notably because several reforms had already

[707] See Elisavet Lampropoulou, 'The Political Role of the Greek Council of State under Circumstances of Economic Emergency' in Anuscheh Farahat and Xabier Arzoz (eds), *Contesting Austerity: A Socio-Legal Inquiry* (Hart Publishing 2021) 135; Akritas Kaidatzis, 'Socioeconomic Rights Enforcement and Resource Allocation in Times of Austerity: The Case of Greece 2015 – 2018' in Anuscheh Farahat and Xabier Arzoz (eds), *Contesting Austerity: A Socio-Legal Inquiry* (Hart Publishing 2021) 275.

been implemented during that time frame at the EU level (ie. the six-pack, two-pack, SSM and the OMT mechanism, coupled with PSPP since early 2015). In short, in Greece, the stakes were lower, the reality less complex and the impact of judicial intervention less severe.

In a significant statement, Judge Pikrammenos argues that '[d]uring the first period, [CoS] guided society and educated the political authority. Now, it has taken up the role of expressing social reaction, trying to solve the conundrums that have been created alone'. However, 'the idea that during periods of crisis illuminated judges will guide Greek society is impossible and would be terrifying if it were to be possible'.[708]

Lampropoulou notes that the CoS managed to protect certain groups of society, but in an inconsistent and ineffective way. In the meantime, it has transgressed the limits of judicial review, either by assessing the austerity policies' feasibility or by trying to control the damage that arose from its own rulings. As a result, the author argues that effective judicial review is a condition to preserving an institutional balance, in the sense that the executive needs to be held accountable for its actions, particularly in times of crisis. Hence, judicial review is a crucial institutional guarantee of fundamental rights protection and a powerful tool to contest austerity measures: in a word, to demand rights. However, the author states that '[s]ince the onset of the crisis, this balance seems to have changed *de facto*, without resulting in an increased protection of fundamental rights'.[709]

Many factors may have contributed to this outcome, as referred to by the author. I would highlight two: the pronounced political and financial character of the crisis and the complexity of the legal nature of the bailouts. As complexity and a demand for rights increase, so does the strain of all processes (including the judicial process) with a concomitant decrease in their capacity to supply rights. In a less complex situation, the political process in Greece probably did not have to result in cutting public expenditure and, even if it did, a negotiation between government and labour unions could have been possible to achieve.

Likewise, as institutions of limited capacity and expertise, courts are effective in the context of simpler or less complex situations – precisely situations in which they are less useful, albeit more willing, to supply rights. Conversely, it is in complex situations

[708] Panagiotis Pikrammenos, 'The Role of Justice in the Modern Greek Society' (2016) 1 Dioikitiki Diki 1 apud Lampropoulou (n 707) 146.
[709] Lampropoulou (n 707) 146-147.

that courts are more needed and less able or willing to supply rights. This mismatch between the supply and demand of rights is caused by complexity. In this vein, it is useless to extrapolate the way in which courts handle cases in simple(r) contexts. In some cases, as Komesar shows, the best way to protect citizens' rights, counterintuitive as it may seem, is not to rely on courts in complex situations. For example, activist courts during a financial crisis might increase uncertainty in the markets, as well as increase uncertainty in legislative and executive branches regarding the way public policy might be handled in the future (if forward guidance is not given or clear enough). These factors may indeed exacerbate and prolong the resolution of emergency situations, further hindering citizens' rights.

Moreover, in my view, courts may aggravate matters further if they wrongly identify political malfunction. Indeed, if majoritarian or minoritarian biases are improperly identified, it is possible that these malfunctions will be emboldened, thereby causing further restrictions of judicial protection.

Portugal is also a good case study in this regard, as the Constitutional Court, in Barret's words, 'showed willingness to inflict a bloody nose on its national administration, thereby triggering in effect a process of dialogue with government and troika alike'[710] in a highly adverse context and complex issue.[711] Therefore, it is reasonable to consider Portugal an outlier regarding judicial conduct during the euro-crisis. As such, should the Portuguese Constitutional Court be considered an exception in Komesar's comparative institutional analysis theory, according to which institutions are increasingly efficient and respond satisfactorily in simple situations, and the other way around in difficult ones?

Let us take a closer look at the crisis case law decisions and their legal effects, particularly on the assessment of the reduction of public sector wages and pensions. In 2011, austerity measures were not considered to breach the Constitution.[712] In this case,

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[710] Barrett, 'The Role of Courts in the Eurozone' (n 490) 128; Teresa Violante, 'Constitutional Adjudication as a Forum for Contesting Austerity: The Case of Portugal' in Anuscheh Farahat and Xabier Arzoz (eds), *Contesting Austerity: A Socio-Legal Inquiry* (Hart Publishing 2021) 173; Miguel Nogueira de Brito, 'Putting Social Rights in Brackets? The Portuguese Experience with Welfare Rights Challenges in Times of Crisis' (2014) 1–2 European Journal of Social Law 87; Maduro, Frada and Pierdominici (n 235).

[711] In fact, economic and social redistributive issues are among those that are most difficult for constitutional courts to get into, as mentioned by Maduro, Frada and Pierdominici (n 235) 12. See also Botelho (n 607) 78.

[712] Tribunal Constitucional, decision 396/2011 [2011] < https://www.tribunalconstitucional.pt/tc/acordaos/20110396.html> accessed 27 September 2021.

the Constitutional Court stated that it should not meddle in the debate regarding which public policy measures should be enacted. Crucially, one of the arguments was based on the country's emergency financial situation. The Constitutional Court argued that the public expenditure reduction plan was based on coherent rationality and within the margin of appreciation of the legislator, especially given the 'commitments with European and international bodies, to achieve results in the short term, it was understood that, on the expenditure side, only the reduction in salaries would guarantee certain and immediate effectiveness, being, to that extent, indispensable'.[713]

Differently, in 2012, unconstitutionality was declared, but the effect was suspended. The Constitutional Court's reasoning was that 'as the 2012 budget execution is already well under way, it is recognized that the consequences of the declaration of unconstitutionality announced above […] could inevitably determine [the deficit target's] non-compliance, jeopardizing the maintenance of the agreed financing and the consequent solvency of the state'.[714]

In 2013, unconstitutionality was found, again. The Constitutional Court produced immediate legal effects and did not introduce a caveat, leaving the executive with the task of looking for other measures to fill the financial gap. In this case, the Constitutional Court took note of the time it had taken the legislature to devise new austerity measures that would not unduly overburden certain categories of individuals. In addition, it considered that other measures were still available to the legislature.[715]

Similarly, in 2014, unconstitutionality was found, again, but public sector cuts only produced *ex nunc* legal effects from June onwards, due to an already advanced stage of budgetary execution.[716]

Taking the above into account, it is still possible that Komesar's theory holds. Indeed, the Constitutional Court was broadly deferent until the end of 2012 – the most critical period – while becoming more activist in the ensuing years. In fact, the difference

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[713] ibid, para 9 (my translation). For a critical view see Catarina Santos Botelho, 'Os Direitos Sociais Num Contexto de Austeridade: Um Elogio Fúnebre Ao Princípio Da Proibição Do Retrocesso Social?' (2015) I Revista da Ordem dos Advogados 259.

[714] Tribunal Constitucional, decision 353/2012 [2012] < https://www.tribunalconstitucional.pt/tc/acordaos/20120353.html> accessed 27 September 2021, para 6 (my translation).

[715] Tribunal Constitucional, decision 187/2013 [2013] https://www.tribunalconstitucional.pt/tc/acordaos/20130187.html> accessed 27 September 2021.

[716] Tribunal Constitucional, decision 413/2014 [2014]. < http://www.tribunalconstitucional.pt/tc/acordaos/20140413.html> accessed 27 September 2021.

in the 10-year bond yield – a yardstick for long-term sustainability – is significant. In fact, on the date of each judicial decision, the yields were 11.3%, 10.5%, 6.2% and 3.6% respectively.[717] The difference in stakes is noteworthy, which is coincident with the court's looser or harsher rulings, respectively.

9.2. Supply of rights

Turning now to the supply side of the spectrum, I will briefly focus on Estonia, Finland and Germany.[718] The Supreme Court of Estonia assessed the compatibility of the ESM Treaty with the Estonian Constitution. The main issues, this court determined, were the principle of democracy, parliamentary prerogatives and the budgetary powers of the Estonian Parliament. It noted that the emergency procedure constituted an interference in parliamentary competence, not only in the current but also the future composition of the chamber. However, the Estonian Supreme Court held that Estonia, as an integral part of the euro area, is economically and financially integrated with other Member States, which means that any problems arising in the EU would inevitably have repercussions in their country. Therefore, by approving the ESM, Estonia would be providing itself with indirect relief.[719]

However, in a composition of nineteen justices, five issued dissenting opinions, while six issued a joint opinion rejecting the use of proportionality to support the constitutionality of Article 4 (4) ESM Treaty. In their dissent, the justices emphasised that the Court should have assessed whether the 'contested emergency procedure which leaves the state of Estonia out of the decision-making outweighs the sovereignty of the state of Estonia, including the financial competence of the [Parliament] and the principle of a state subject to the rule of law which are one of the most substantial principles' and argued that, in their view, the answer should be negative.[720] Moreover, while international cooperation is considered valid by dissenting justices, the benefits of entering into such a

[717] Available at https://data.oecd.org/interest/long-term-interest-rates.htm.
[718] These are small, medium and large countries that were not direct beneficiaries of the intergovernmental financial funds. As Tuori and Tuori (n 231) 195 describe, in Finland the review was made in Parliament by the constitutional law committee, which is the main constitutional review body tasked to exercise a quasi-judicial function in interpreting the Finnish Constitution. In Ireland, the Supreme Court also assessed the legality of the ESM which led to the preliminary ruling originating the *Pringle* case. However, Ireland was already an EFSF beneficiary at the time.
[719] Judgment No 3-4-1-6-12 of the Estonian Supreme Court en banc (2012) < https://www.riigikohus.ee/en/constitutional-judgment-3-4-1-6-12> accessed 28 September 2022.
[720] ibid. (Justices Jõks, Järvesaar, Kergandberg, Kivi, Kull and Laarmaa, dissenting) para 8.

framework would possibly be asymmetric given that, from their perspective, 'if Estonia's economy should encounter difficulties in the future' the size of 'Estonia's economy alone does not constitute a threat to the euro area',[721] hence, the ESM would not be an option for the country.

In the end, only a slight majority of ten justices emphasised the social and political advantage brought about by Estonian involvement in the ESM and concluded that ratification of the ESM pursued a purpose of constitutional value. In contrast, nine justices emphasised the limitation to national sovereignty, as well as the potential financial burden. This goes to show that, despite the openness shown by the Estonian Constitutional Court,[722] the supply of rights in a small EU Member State was very difficult to obtain, as deference to the political branches was not as forthright regarding the judicial review of austerity measures.

In Finland, both the EFSF and ESM legal frameworks were reviewed by a parliamentary committee (constitutional law committee). Like Estonia, its main concerns were Parliament's budgetary power, Finland's national sovereignty and the state's fiscal ability to meet its constitutional obligations. In assessing possible infringements of these criteria, 'the Committee has examined the amount of potential liabilities, the risk of their realisation and Parliament's power to influence their future specification'.[723] For instance, the first draft of the ESM's emergency procedure not only comprised of decisions on granting assistance, but also decisions directly affecting the liability of Member States, such as calls for authorised unpaid capital, which would be made by a qualified majority of 85%. To this provision, the constitutional law committee concluded that it would require the acceptance of a qualified majority of Finnish members of Parliament. These concerns eventually contributed to an amendment of the proposal.

Regarding Germany, the *BVerfG* assessed temporary (Greek Loan Facility – GLF – and EFSF) and permanent financial mechanisms of intergovernmental nature (ESM). Regarding the former, relevant domestic legal acts empowered the Federal Ministry of Finance to grant Greece assistance in the form of guarantees (GLF) or to support EFSF's borrowing activity. Like in Estonia and Finland, the most pressing argument that applicants made was one of alleged erosion of the German Parliament's budgetary

[721] ibid. (Justices Jõks, Järvesaar, Kergandberg, Kivi, Kull and Laarmaa, dissenting) para 12.
[722] Fabbrini, 'The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective' (n 621) 82.
[723] Tuori and Tuori (n 231) 196.

autonomy, their right to vote and the principle of democracy. According to the Maastricht judgement, this argumentation may be admissible if and when German Parliament transfers powers to EU institutions to such an extent that substantially curtails them, which may be the case if it authorises guarantees that adversely affect budgetary autonomy.[724]

The *BVerfG* argued that openness to European integration means recognising shared fiscal sovereignty. However, Parliament must keep its autonomy regarding decisions on revenue and expenditure, notably on potentially sizable commitments. For this reason, the German court states, 'no permanent mechanisms may be created under international treaties which are tantamount to accepting liability for decisions by free will of other states, above all if they entail consequences which are hard to calculate'.[725] In the end, the *BVerfG* deferred to the political process by considering that Parliament had a margin of appreciation which should be respected. Consequently, only a manifest violation of its autonomy would infringe upon the Constitution, which had not occurred in the case at hand.[726]

The same constitutional values were at stake concerning the ESM, with similar arguments being put forward by applicants: that Parliament was taking incalculable risks and that, as such, the democratic decision process had shifted beyond national control.[727]

The issues were: acquiring the provisions intended to restore paid-in capital, preventing ESM from defaulting on payment obligations and revising increased capital calls whenever another member failed to meet their respective payment. These issues were considered compatible with the Constitution if Germany's foreseen payment obligations were respected. Moreover, in order to make informed decisions, Parliament should have access to information and it should not be hindered, for instance, by professional secrecy or other provisions. Lastly, on the subject of suspending voting rights if a member failed to comply with its fiscal obligations, the Court held that given the stringent provisions of German fiscal law, a suspension of Germany's voting rights could be largely ruled out.

[724] BVerfG, Judgment of the Second Senate (2011) 2 BvR 987/10, paras 98-103.
[725] ibid. para 128.
[726] ibid. paras 130 and 141.
[727] BVerfG, Judgment of the Second Senate (2012) 2 BvR 1390/12.

All in all, it is possible to assert that, with the exception of Estonia, the financial funds assessment was relatively mild in comparison with constitutional courts or bodies. The courts deferred to the political process, albeit voicing their concerns about the need to establish safeguards and respect the democratic process, as was the case in Finland and Germany.

10. Deference in the United States: a brief comparative overview

In the United States, judicial deference is essentially divided over *de iure* and *de facto* deference. Regarding the former, judicial deference to agency decisions is required, for example, by 'substantial evidence',[728] 'arbitrary and capricious' and 'hard look' reviews, as established by the American Administrative Procedure Act, as well as what is known as Chevron deference.

Substantial evidence standard requires the court to examine not only evidence that supports the agency action, but also evidence that detracts. In addition, the agency's reasoning needs to be assessed.[729]

On the contrary, a capricious review today is certainly interpreted as encompassing a hard look review. Indeed, the Supreme Court has argued that an arbitrary and capricious review requires, 'a thorough, probing in-depth review' that is 'searching and careful'.[730] Arbitrary and capricious actions would be considered if the agency relied on factors that Congress did not intended them to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that countered the evidence set

[728] As a result, the US Court of Appeals of the 8th Circuit noted that an agency making a credibility determination must give specific enough reasons that a reviewing court can appreciate the reasoning behind the decision and be sufficiently cogent that a reasonable adjudicator would not be compelled to reach the contrary conclusion. See *Singh v Gonzales* [8th Cir.2007] 495 F.3d 553, 5-6.

[729] John Reitz, 'Judicial Deference to the Administration in the United States' in Guobin Zhu (ed), *Deference to the Administration in Judicial Review: Comparative Perspectives* (Springer 2019) 416.

[730] In *Motor Vehicle Manufacturers Association of the United States v State Farm Mutual Automobile Insurance Co* [1983] 463 US 29, 463, a leading case for a hard-look review, the Supreme Court stated that the arbitrary and capricious standard is narrow and a court should not substitute its judgment for that of the agency. However, the latter must examine the relevant data and articulate a satisfactory explanation for its action, which includes rational connection between the facts found and the choice made. This case originated in a challenge to a rule promulgated by the motor vehicle safety requiring new vehicles to be equipped with 'passive restraints' (ie restraints that did not depend on action by the occupants of the vehicles to turn them on or attach them), such as detachable automatic seatbelts. The Supreme Court stated that these belts had been tested in limited studies, therefore providing no reliable direct evidence showing whether usage rates would increase if automatic belts were required. Specifically, the Supreme Court considered that the agency failed to take into account the factor of inertia: the fact that it requires effort to detach the detachable belts, just as the agency's studies had determined that low usage rates of manual belts stemmed in part from a similar problem of inertia.

before the agency, or were so implausible that it could not be ascribed to a difference in view.

Lastly, in *Chevron U.S.A., Inc. v Natural Resources Defense Council, Inc*, the Supreme Court laid down a two-step test. First, ascertain whether the question was directly and precisely addressed by Congress. If its intent is clear, that is the end of the matter: courts and agencies must enforce it. Alternatively, a court might determine that Congress has not directly addressed the precise issue in question. In this case, judicial constructions should not be imposed outright, as there is a presumption of deference to the administration, irrespective of Congress having intended to defer (because it consciously decided to delegate) or not (because it was not aware of the ambiguity). Rather, the court must answer whether the agency's answer was based on a permissible construction of the statute, which entails a rationality test, ie a reasonable interpretation made by the administration.

As Reitz notes, *State Farm* and *Chevron* are on opposite ends of the spectrum. While the former constitutes an 'exhortation to the lower courts to make arbitrary-and-capricious review meaningful by taking a hard look at how the agency has exercised its de jure discretion', the latter 'is an exhortation not to substitute the courts' judgment for that of the agency on matters related to the agency's de jure discretion'.[731] In any case, if the executive branch makes a good case rationalising the use of administrative powers, it has a good chance of being awarded a substantial degree of judicial deference, regardless of the kind of review, to which there is some empirical evidence.[732]

However, the *Chevron* presumption is under question, notably by several Supreme Court Justices,[733] particularly by two of the newest members on the bench,[734] but also by lawmakers. In fact, in 2016 and 2017, the House of Representatives passed bills to abolish *Chevron* deference. Furthermore, in 2022, the Supreme Court ruled that no agency may adopt rules that are transformational to the economy, unless Congress has specifically

[731] Reitz (n 729) 432.
[732] Peter Schuck and E Donald Elliot, 'To the Chevron Station: An Empirical Study of Federal Administrative Law' (1990) 39 Duke Law Journal 984, 1058.
[733] See *City of Arlington v Federal Communications Commission* [2013] 569 US 290.
[734] Neil Gorsuch and Brett Kavanaugh were critics of the Chevron doctrine. They argue that it constitutes an abdication of the court's duty to independently interpret the law, while overly empowering the executive branch at the expense of the legislative and judicial branches. See Michael W McConnell, 'Kavanaugh And The "Chevron Doctrine"' (*Stanford Law School Blogs: Legal Aggregate*, 2 August 2018) <https://law.stanford.edu/2018/08/02/kavanaugh-and-the-chevron-doctrine/> accessed 14 September 2022.

authorised a rule to address a specific problem, like climate change.[735] Notwithstanding, eliminating Chevron would not necessarily mean that judicial deference would cease. It would mean, however, that there would be a rebalancing of power between the executive and judicial branches, tilting towards the latter, in order to determine whether Congress had given the agencies such power.

11. Judicial process to address issues of economic and monetary policies?

11.1. Courts and democracy

Courts hold an important role in societies and constitutional orders. As Zhu argues, 'courts by default are the link between democracy and the rule of law'.[736] While the political process expresses the same majoritarian view as societies, channelling those views in policy and law making, courts serve a different purpose, as they do not express the views of the majority: they are counter majoritarian institutions.

By exercising their constitutional role, courts have navigated between the power to strike down laws, law-making and a practice of deference to the political branches of government, which is a silent feature in the constitutional order. This evolution is well described by Van Hoecke, who states that courts have been in a weak position in relation to political power for a long time as far as law creation is concerned. Importantly, judges' fear of governance led to them finding themselves in a subordinate position under legislature in the last two centuries, which did not foster the political and social conditions for constitutional review (and potential annulment) of legislation. Classical theory justifies this position as a matter of democratic legitimacy, as legislatures are elected, whereas judges are not. Consequently, the definition of the law should be reserved for the legislative branch. However, this theory has 'overestimated the possibility of organising society entirely through general rules, and underestimated the necessity of a division of labour between the legislature and judges, including the creation of law'.[737] In fact, law is not set in stone and applied by officials or judges thereafter. On the contrary, judges hold the important task of making, adapting and developing the law in their daily practice.

[735] *West Virginia v Environmental Protection Agency* [2022] 597 US 697
[736] Guobin Zhu, 'Deference to the Administration in Judicial Review: Comparative Perspectives' in Guobin Zhu (ed), *Deference to the Administration in Judicial Review: Comparative Perspectives* (Springer 2019) 1, 3.
[737] Mark van Hoecke, 'Constitutional Courts and Deliberative Democracy' in Patricia Popelier, Armen Mazmanyan and Werner Vandenbruwaene (eds), *The role of constitutional courts in multilevel governance* (Intersentia 2013) 183.

Consequently, if a court adapts, and even changes, the content of a legislative rule does not usurp its role but, rather, fully discharges its tasks and duties.[738]

Indeed, twentieth century European political history has challenged the conception of democracy, as the emergence of minorities and fundamental rights protection questioned the majority rule. In fact, the courts' increased role has 'turned the traditional continental model of the monopolistic centralised nation state with an absolute priority for the legislature on its head'.[739] Consequently, in most countries, constitutional courts have been introduced[740] and attributed competences to check legislation, which is seen as a step towards the implementation of the rule of law. In this vein, courts' legitimacy is intrinsically connected to the correction of abuses or mistakes of political majorities.[741] This view is shared by US Supreme Court Chief Justice Roberts. In the aftermath of the Dobbs decision, which generated significant public opposition, he argued that it should be neither for the political branch to determine nor the public to be the guide of the law. That role is reserved for the judicial branch. Therefore, disagreements, even if broad-based, are not a basis for questioning the court's legitimacy.[742]

In addition, courts lack the power of the purse and the sword, holding merely judgement, which makes them the least dangerous branch of government.[743] In this sense, quality of argumentation and impartiality are a decisive source of legitimacy,[744] while

[738] ibid. 190.
[739] ibid. 184.
[740] For instance, in the US, the Supreme Court established this competence in *Marbury v Madison* [1803] 5 US 137.
[741] Hoecke (n 737) 185. However, political developments in some EU Member States have affected the rule of law and hindered courts' ability to pursue their counter majoritarian purpose. See, for instance, Konrad Lachmayer, 'Disempowering Courts: The Interrelationship between Courts and Politics in Contemporary Legal Orders or the Manifold Ways of Attacking Judicial Independence' in Martin Belov (ed), *Courts, Politics and Constitutional Law: Judicialization of Politics and Politicization of the Judiciary* (Routledge 2020) 31.
[742] Robert Barnes and Michael Karlik, 'Roberts Says Supreme Court Will Reopen to Public and Defends Legitimacy' *The Washington Post* (10 September 2022) <https://www.washingtonpost.com/politics/2022/09/10/supreme-court-roberts-legitimacy/> accessed 15 September 2022.
[743] Alexander Hamilton, 'No 78: A View of the Constitution of the Judicial Department in Relation to the Tenure of Good Behaviour' in George Carey and James McClellan (eds), The Federalist (Liberty Fund 2001) 401.
[744] Arguing that courts' legitimacy should not necessarily follow the same frame of analysis as directly elected branches of government, Lord Manson considers that courts hold their own kind of legitimacy. See Lord Mance, 'The Role of Judges in a Representative Democracy' in Giuliano Amato, Benedetta Barbisan and Cesare Pinelli (eds), Rule of Law vs Majoritarian Democracy (Hart Publishing 2021) 335, 344. For a view that courts lack democratic legitimacy see Barrett, 'The Role of Courts in the Eurozone' (n 490) 143.

others add the deliberative process that precedes a judicial decision as a feature that emboldens courts.[745]

However, the conception that courts may fulfil the role of prime arbiter and corrector of majoritarian abuses and biases, which I follow, is not consensual. For instance, Mazmanyan is of the view that constitutional courts tend to follow public opinion, a feature that the author describes as majoritarian counter majoritarianism. The argument is that courts need social acceptance not only to counter their non-elected nature, but also because societal compliance is enhanced if people are generally in agreement with judicial determinations. The author establishes an intrinsic connection between the public and the constitutional courts that enhances democratic governance. Conversely, the lack of a connection 'between supranational European courts and the rather abstract European public is obviously a factor amounting to a competitive disadvantage of the supranational jurisdiction as opposed to the national one'.[746]

Van Hoecke takes a more nuanced approach, arguing that, in the absence of a formal mechanism, legitimation of judicial decisions stems from a process described as 'deliberative communication'. Indeed, the existence of various communication cycles (judges and parties; appeals; professional/scholar community involvement; high profile cases involving public attention) creates different circles of deliberative politics as they establish various forms of public forums. For example, technical and individual matters foster more limited deliberative circles, as there is only a small interest for the community at large.

On the contrary, ethical and political matters generate greater interest, so it is appropriate to discuss them within a larger audience. The same goes for technical matters, which are of a general importance, because the decision may, as a precedent, affect several others. Here, too, a broader debate is desirable.[747] As described above (Part II, Point 1), the system of delimitation of competences in the Treaties and the functional

[745] Armen Mazmanyan, 'Majoritarianism, Deliberation and Accountability as Institutional Instincts of Constitutional Courts' in Patricia Popelier, Armen Mazmanyan and Werner Vandenbruwaene (eds), *The role of constitutional courts in multilevel governance* (Intersentia 2013) 165, 179.
[746] ibid.
[747] Hoecke (n 737) 191-193. The author exemplifies with a 2009 case decided by the European Court of Human Rights, in which it unanimously held that hanging a crucifix in (Italian) public schools infringed freedom of religion. Pursuant to the shock felt and expressed by Italians, the decision was referred to the grand chamber which, having felt that the Court had gone too far into the legislative realm decided, almost unanimously, that it was up to Member States to choose, within their margin of appreciation, given the diversity of practices in Europe.

approach underpinning the way institutions conduct their activities has not achieved an acceptable balance between the EU and Member States. Arguably, it has promoted EU integration with an insufficient degree of transparency and accountability.[748] It neither effectively contained negative integration through case law of the Court nor positive integration through EU legislation in areas reserved for Member States. In fact, the CJEU established new general rules with broader scopes and sometimes different content, compared to the original Treaties. However, in doing so, the system failed to fully protect the values it was supposed to uphold, such as democracy, subsidiarity and national diversity.[749]

Importantly, Member States limited the functionality nature of the Union by changing their perspective on the conferral principle. While the scope of Union action was initially largely driven by the pursuit of its objectives, under article 5 (2) TFEU, these are, currently, dependent on the attributed competences. This means that the Union must pursue its objectives to the extent its competences permit, but not more. Interestingly, Garben argues that the demarcation method is expected to contain EU integration and protect Member State autonomy,[750] as demonstrated by the migration towards more flexible methods, such as minimum harmonisation, non-binding technical standards and mutual recognition.[751] However, the Court's case law reveals the ineffectiveness of this method.

Within this context, the executive branch has largely expanded to bodies influenced by the political leadership in a process known as agencification,[752] providing a substantial degree of autonomy based on technical grounds. As courts are, generally, entrusted with the important task of reviewing administrative actions, judicial deference to the administration has become a significant issue.

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[748] This path is similar to the one experienced by the United States by means of surrogacy, as explained by Gerstle (n 528) 100.
[749] Garben (n 27) 57.
[750] ibid. 72.
[751] Majone, 'The European Commission: The Limits of Centralization and the Perils of Parliamentarization' (n 241) 375. The CJEU is more demanding than the US Supreme Court, which allows for a certain level of discrimination (notably on tax matters) in order to safeguard State sovereignty. In this regard, see Reuven Avi-Yonah, 'What Can the US Supreme Court and the European Court of Justice Learn from Each Other's Tax Jurisprudence?' in Reuven Avi-Yonah and Michael Lang (eds), *Comparative Fiscal Federalism* (2nd edn, Wolter Kluwer 2016) 321.
[752] Silva (n 16); MJC Vile, *Constitutionalism and the Separation of Powers* (2nd edn, Liberty Fund 1998).

11.2. Suitability of the adjudicative process

The main issue is that constitutional courts hold irreconcilable points of view. On the one hand, the CJEU held a deferential approach regarding the ECB, which the *BVerfG* disagreed with because it wanted strong judicial action as a first-best response. However, in general terms, courts have limited expertise in matters related to economic and monetary policies. Second, courts lack the necessary legitimacy that accompanies the electoral process in order to address matters related to taxation and the spending of public funds.[753] Moreover, it is questionable whether courts' intervention brings about economic benefits, as it may increase uncertainty and market turmoil.[754] Lastly, as I have endeavoured to explain, they may be deferent in turbulent times and more demanding in lighter ones, which hinders their suitability in this area. Even some of the authors insisting upon more judicial intervention in complex periods[755] or more significant judicial control, when requested,[756] seem to acknowledge it.

On the other hand, while courts in creditor countries want to safeguard their financial interests and parliamentary power to ensure it approves financial aid on a case-by-case basis, courts in debtor countries want to preserve autonomy regarding their means to achieve a pre-established goal or result. This judicial connection mirrors, in my view, the underlying logic of the intergovernmental method chosen by EU economic governance, which paved the way for a divide between Member States during the most acute period of the financial and sovereign debt crises.

With the aim of increasing EU citizens' opportunities to contest EMU decisions, beyond the priority on the principle of equality of Member States,[757] Bobić argues for a reinterpretation of the principles of equality and solidarity in order to reach an equilibrium. A multilevel polity would be a way to ensure political equality among its

[753] See Fabbrini, 'The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective' (n 621) 116. See also Mance (n 744), who argues that judges do not lack, rather hold a different kind of legitimacy.
[754] Barrett, 'The Role of Courts in the Eurozone' (n 490) 127; Daniel Sarmiento, 'The OMT Case and the Demise of the Pluralist Movement' (*Despite our Differences*, 21 September 2015) <https://despiteourdifferencesblog.wordpress.com/2015/09/21/the-omt-case-and-the-demise-of-the-pluralist-movement/> accessed 10 October 2022.
[755] Barrett, 'The Role of Courts in the Eurozone' (n 490) 149.
[756] Joana Mendes, 'Law and Discretion in Monetary Policy and in the Banking Union: Complexity Between High Politics and Administration' (2023) 60 Common Market Law Review 1579, 1610-1619.
[757] A principle developed by Fabbrini, 'States' Equality v States' Power: The Euro-Crisis, Inter-State Relations and the Paradox of Domination' (n 407).

citizens, which would translate in their ability to determine their destinies.[758] By connecting equality and solidarity, the author seeks to overcome nationality as a key concept, binding citizens to commitments of justice. Citizens would, therefore, be bound by solidarity, which represents the act of pursuing a shared goal, while equality would ensure mutual respect among partners on the path to such an objective.

This theory would impact the courts, first and foremost because equality between States would be seen not as an end in and of itself but as a means to achieve justice. Therefore, conditionality and State equality would need to be tempered by accounting for the distributive effects of EMU decisions across the entire euro area. In particular, the justification of the *BVerfG* would have to do more than merely demonstrate that Member States are not required to financially contribute more than is due. In essence, establishing solidarity and equality as equals would require the need 'to ensure that a plurality of interests and risks are taken into account, beyond the budgetary concerns of each Member State'.[759]

It seems that the author considers that courts (particularly national courts) are the relevant institutional avenue to pursue the objectives of contestation, political equality and internalisation of EMU's distributive effect, just as others consider that the EU's adjudicative process should demand the enforcement of ECB's mandate.

According to Bobić, they could go about this in three ways. First, courts could enlarge access to private parties by expanding their interpretation of 'direct concern', as seen in article 263 TFEU: understanding EMU as a solidarity area would entail a more immediate effect on citizens. Second, judicial remedies are not static legal instruments. As the decision made by Rimsevics shows, it was through teleological interpretation of the Treaties that the CJEU invalidated a national measure.[760] Finally, courts are institutions created and designed with the purpose of safeguarding the rights and interests of all citizens equally. Therefore, to ensure democratic contestation, courts are able to enforce the obligation of decision-makers to act in the interest of the entire interdependent

[758] Bobić (n 705) 128-129. See also Ana Bobić, *The Individual in the Economic and Monetary Union: A Study of Legal Accountability* (Cambridge University Press 2024); Anastasia Poulou, 'Austerity and European Social Rights: How Can Courts Protect Europe's Lost Generation?' (2014) 15 German Law Journal 1145; Christoph Grabenwarter and others, 'The Role of the Constitutional Courts in the European Judicial Network' (2021) 27 Europen Public Law 43.
[759] Bobić (n 705) 129.
[760] Joined cases C-202/18 and C-238/18, *Ilmārs Rimšēvičs and European Central Bank v Republic of Latvia* [2019] ECLI:EU:C:2019:139 (n 91), in which a national measure applying the ESCB and ECB Statute was invalidated, on the grounds of ECB independence.

euro area by reviewing administrative action, notably regarding the duty to state reasons or legality.

While this is an interesting theory, it is, however, assumed that a demand of rights through the judicial system would be the best option, despite the absence of weighing its benefits and costs or comparing them with existing alternatives. Therefore, we must consider whether the adjudicative process is better than the alternatives, in order to address the EU's economic and monetary policy issues.

There are several reasons that justify a negative answer. Regarding national courts' intervention, at the outset, it is not possible to accommodate 19 (or 27) constitutional orders, as these indirectly derive from the *BVerfG's* judgement pursuant to *Weiss*. As occurred with some national constitutional courts, this might result in applying their national constitutions, sometimes disregarding their connection with EU law, or holding varying interpretations of similar legal concepts (ie equality, sovereignty and proportionality), thus promoting inconsistent application. Such an approach would serve to protect national policy choices and would not contribute to strengthening EU institutions democratic legitimacy.[761]

Secondly, national courts (as national parliaments or any other national institution) are unable to strike the necessary balance between the Member States' conflicting interests. On the one hand, since they lack the perspectives and sensitivities of other countries' citizens, groups and institutions, national courts may favour their own national interests, therefore, hindering those of others. On the other hand, it would create significant legitimacy concerns, both outward (by weighing other peoples' interests with no mandate to do so) and inward (by mixing these interests with those of their national people).

Lastly, judicial overreach may transpire. In fact, by declaring PSPP ultra vires, the *BVerfG* leveraged Germany's role and relative position within EMU, given that its economic size ensures that any withdrawal from any eurozone initiative would be fatal.[762]

[761] Amtenbrink and Repasi, 'The German Federal Constitutional Court's Decision in Weiss: A Contextual Analysis' (n 701) 776.
[762] Barrett, 'The Role of Courts in the Eurozone' (n 490) 143.

Nevertheless, some arguments are presented to justify robust judicial intervention in EMU as a solution going forward.[763] In the absence of a larger EU budget and political union, as well as an EU economic policy based on an intergovernmental method with reduced parliamentary control, courts (at EU and national levels) may be in the best position to legitimate unconventional monetary policies with significant economic effects.

Another argument is that national courts' intervention may facilitate the acceptance of measures that could otherwise meet political opposition. Although national courts could interfere with policies decided at the European level, they could also add necessary legitimacy, particularly regarding austerity measures applied pursuant to bailout programmes. In this vein, Reestman argues that national courts 'legitimized and furthered the public and political acceptance of the treaties and thereby also a fundamental change in the functioning of the EMU: they provided a legitimacy that the political process was unable to provide on its own'. The author further states that 'the judgements all indicate that there is a point at which further EMU integration requires recourse to, and legitimation by, the constitutional authorities of the Member States. That is the expression of the basic principles upon which also the European Union is built: democracy and the rule of law'.[764]

However, a switch of actors would hardly solve democratic issues, such as if one non-majoritarian body (a court) replaces a decision made by another non-majoritarian body (a central bank).[765] Moreover, one should not equate democratic legitimacy with rule of law: if the political process is unable to deliver the necessary legitimation, *a fortiori* it cannot be made possible via the adjudicative process. In addition, in complex economic and financial situations, it was shown that it is common for courts to defer to

[763] ibid. 144-145. An opposite view is presented by Mitu Gulati and Georg Vanberg, 'Paper Tigers (or How Much Will Courts Protect Rights in a Financial Crisis?)' in Franklin Allen, Elena Carletti and Mitu Gulati (eds), *Institutions and the Crisis* (European University Institute 2018) 111.

[764] Jan-Herman Reestman, 'Legitimacy through Adjudication: The ESM Treaty and the Fiscal Compact before the National Courts' in Thomas Beukers, Bruno De Witte and Claire Kilpatrick (eds), *Constitutional Change through Euro-Crisis Law* (Cambridge University Press 2017) 243. In the same vein see Mark Tushnet, *Taking the Constitution Away from the Courts* (Princeton University Press 1999) 149, in which the author explains that there are many explanations for courts' intervention. One of them is deference by the political to the judicial branch. Unable to pass certain legislation (and knowledgeable of the fact that support for one of a multitude of options would be politically damaging) the political process may be hopeful that courts will settle the matter in a way that citizens find more acceptable, as the judicial branch is seen as holding a higher degree of neutrality.

[765] Amtenbrink and Repasi, 'The German Federal Constitutional Court's Decision in Weiss: A Contextual Analysis' (n 701) 776.

the political process and for good reason: legitimacy lies, primarily, in directly elected power, not with institutions whose legitimacy is indirectly acquired and depends on the force of arguments.[766]

Lastly, there is the argument that national courts are better placed than EU courts to protect social rights in the case of social unrest,[767] as well as the fact that the CJEU refused to address Romanian and Portuguese requests for preliminary rulings. Be that as it may, on the one hand, national courts demonstrated a great deal of deference to the executive branch during the execution of austerity programmes in EU Member States. As Barrett affirms, '[g]iven the economic context, it is perhaps unsurprising that considerable national judicial deference to the political process tends to be displayed in both "architecture" and "bailout" cases. Such deference has nonetheless been observed to be generally higher in the former variety of case'.[768] On the other hand, the CJEU's refusal was due to procedural (jurisdiction) issues, not a result of the merits of the case. Therefore, any national measure deriving from EU legislation will be under the remit of the Court to assess.

It is hard to understand how judicial deference may equate to a lack of protection for the most vulnerable segments of society, as these do not normally figure as claimants in the judicial procedure. In fact, during the financial crisis, the claims mostly concerned the rights of public sector employees and pensioners – in some cases, above a certain level of remuneration that hardly qualified them as the most vulnerable members of society.

11.3. Problem of alternatives, costs and resources

In order to fully understand the Court's judicial deference, we must first acknowledge the evolving context of the CJEU.

[766] In the same vein, see Aharon Barak, *The Judge in a Democracy* (Princeton University Press 2006) 88.
[767] Case T-786/14, *Eleni Pavlikka Bourdouvali and Others v Council of the European Union and Others* [2018] ECLI:EU:T:2018:487.
[768] Barrett, 'The Role of Courts in the Eurozone' (n 490) 146.

First, it is useful to briefly compare the free movement of goods and monetary union case law. Interestingly, in *Geddo*,[769] *Dassonville*[770] and *Cassis de Dijon*,[771] the Court purposefully decided to adopt a large criterion that would encompass a significant number of quantitative restrictions or measures that had an equivalent effect. This approach was tempered in subsequent case law,[772] essentially due to a mismatch between the influx of cases and Court's capacity to deliver rulings. Be that as it may, the CJEU was very willing to employ a stricter standard of judicial review. It did so by looking past the appearance of legal provisions and taking an effects-based approach, thus enlarging the scope of the measures under its purview. Moreover, it employed a strict standard while assessing the measures' proportionality.[773]

In contrast, in *Gauweiler* and *Weiss*, the Court detracted from an analysis on the economic effects of monetary policy[774] and chose to apply a formalistic review of the ECB's competences to define monetary policy and the stated objectives of the unconventional measures underlying the policy. Had the CJEU chosen to pursue an effects-based approach, more judicialisation could have taken place: like the

[769] Case 2/73, *Riseria Luigi Geddo v Ente Nazionale Risi* [1973] ECR 865. In paragraph 7 of the judgement, the Court states that '[t]he prohibition on quantitative restrictions covers measures which amount to a total or partial restraint of, according to the circumstances, imports, exports or goods in transit'.

[770] Case 8/74, *Procureur du Roi v Benoît and Gustave Dassonville* [1974] ECR 837. In paragraph 5, the Court states that '[a]ll trading rules enacted by member states which are capable of hindering, directly or indirectly, actually or potentially, intra-community trade are to be considered as measures having an effect equivalent to quantitative restrictions'. By adopting such a broad understanding, the Court aims to encompass provisions capable of potentially affecting trade indirectly. Similarly, it later disregarded economic/statistical analysis (case 249/81, *Commission of the European Communities v Ireland* [1982] ECR 4005), dismissed a de minimis rule (case C-67/97, *Criminal proceedings against Ditlev Bluhme* [1998] ECR I-8033) and considered article 34 TFEU to hold a horizontal reach regarding trade barriers to imports not specifically covered by other Treaty provisions (case 252/86, *Gabriel Bergandi v Directeur général des impôts* [1988] ECR 1343).

[771] Case 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649. In paragraph 14, the Court states that '[i]n practice, the principal effect of requirements of this nature is to promote alcoholic beverages having a high alcohol content by excluding from the national market products of other Member States which do not answer that description. It therefore appears that the unilateral requirement imposed by the rule of Member State of a minimum alcohol content for the purposes of the sale of alcoholic beverages constitutes an obstacle to trade which is incompatible with the provisions of Article [34] of the Treaty (…). There is therefore no valid reason why, provided that they have been lawfully produced and marketed in one of the member states, alcoholic beverages should not be introduced into any other member state; the sale of such products may not be subject to a legal prohibition on the marketing of beverages with an alcohol content lower than the limit set by the national rules'.

[772] See Joined Cases C-267/91 and 268/91, *Criminal proceedings against Bernard Keck and Daniel Mithouard* [1993] ECR 1-6097; Case C-110/05, *Commission of the European Communities v Italian Republic* [2009] ECR I-519.

[773] For a detailed overview of the four freedoms, see Barnard (n 39).

[774] Dawson and Bobić (n 348). In a different vein, arguing that it makes little sense to define monetary policy by juxtaposing it to economic policy see Borger, 'Outright Monetary Transactions and the Stability Mandate of the ECB: Gauweiler' (n 638) 181; Alexander Thiele, 'Friendly or Unfriendly Act? The "Historic" Referral of the Constitutional Court to the ECJ Regarding the ECB's OMT Program' (2014) 15 German Law Journal 241, 258.

consequences of case law on free movement of goods, an analysis of economic effects could lead to the review of every unconventional measure decided by the ECB.

However, the Court is well aware of its resource limitations, both qualitatively (expertise) and quantitatively (output capacity), as well as the costs of judicial activity. Therefore, regarding free movement of goods, in Keck, the Court tried to streamline a solution to reduce public access to the judicial process (a method known as dispatch and resolution).[775] However, this practice introduced elements of arbitrariness in the system, given that one-size-fits-all solutions to multifaceted, complex issues seldom work.[776] Concerning monetary policy, while the Court successfully avoided providing a similar, streamlined solution, it had to choose between an expensive case-by-case review and a soft approach. On the topic of the high costs of singular measure review, with its political saliency and, arguably, eurozone survival at stake, the Court took a path with features consistent with the latter.

The economic context has evolved as well. Free movement case law was made under a nascent stage of integration. As a matter of fact, primary law provisions on the free movement of capital were very restrictive until the enactment of the Maastricht Treaty in 1992, which ensured relatively controlled cross-border financial spillovers. At least, one can argue that a Court decision in the 1960s or 1970s would be unlikely to cause an immediate negative impact in Member States' economic and financial indicators. In contrast, the establishment of EMU was a pivotal moment for participating Member

[775] The US Supreme Court pursued a similar path regarding the commerce clause and the economic due process. See Komesar, 'A Job for the Judges: The Judiciary and the Constitution in a Massive and Complex Society' (n 398) 693; Julian Eule, 'Laying the Dormant Commerce Clause to Rest' (1982) 91 The Yale Law Journal 425. See also Neil Komesar, *Law's Limits: The Rule of Law and the Supply and Demand of Rights* (Cambridge University Press 2001).

[776] This method was also used by the US Supreme Court, for instance in *Roe v Wade* [1973] 410 US 113. Faced with a wide variety of abortion regulations and prohibitions, the Supreme Court concluded that the invalidating all regulations and prohibitions was not feasible. Nevertheless, instead of invalidating the particular State anti-abortion law or acknowledging that there might be instances in which the State's interests could justify regulation, it set out in detail the circumstances in which the State might regulate or prohibit abortion. See Komesar, 'A Job for the Judges: The Judiciary and the Constitution in a Massive and Complex Society' (n 398) 693-694.

States, as they very much reinforced their interconnection, not just by way of intra-Union trades in goods[777] and services,[778] but also financial links.[779]

Given these differences, judicial decisions related to EMU may have a considerable economic and financial impact on Member States and, consequently, the Union as a whole. As such, there is a sense that a court decision negatively influencing monetary policy, particularly through unconventional measures, could entail a significant risk of regression in the integration process.

Lastly, the institutional context surrounding a judicial decision is of the utmost importance. As Komesar notes, in order to introduce corrections, courts must resolve complex and difficult societal issues, which have been addressed by the political process. Moreover, potential for judicial correction is a necessary, although insufficient, condition for its intervention. For the author:

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[777] Intra-EU trade in goods has increased immensely in absolute figures between January 2002 and December 2022. According to the Eurostat, monthly figures more than doubled, from €120 billion to €363 billion respectively. As a result, in almost two decades, intra-EU trade went from totaling €1.5 trillion in 2002 to over €2.8 trillion in 2020. Moreover, there is a wide variation of intra-EU trade in goods. On the one hand, the value of trade in goods within the EU in 2020 ranged from €638 billion for Germany to €0.9 billion for Cyprus. On the other hand, exports over the value of €100 billion were concentrated in nine Member States, accounting for 80% of the total value, namely Germany, Netherlands, Belgium, France, Italy, Poland, Spain, Czech Republic and Austria. Thus, there is geographical proximity in the circulation of goods. Lastly, the vast majority of Member States have at least one feature in common regarding trade in goods: to varying degrees, they are dependent on the internal market for their exporting activity, which highlights the degree of interconnectedness of the European economy regarding trade in goods.
See Eurostat, 'Intra-EU Trade in Goods - Main Features. Statistics Explained' (2022) < https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Intra-EU_trade_in_goods_-_main_features#Evolution_of_intra-EU_trade_in_goods > accessed 7 March 2024.

[778] In 2019, 19 Member States reported that a majority of their total trade in services took place within the EU and that the EU average shows that about half of all international services transactions took place within the EU, whereas the other half were with non-member countries. Looking at the broader period of 2011-2020, like the trade of goods, there is a distinctive increase in intra-EU services trade by certain Member States, notably Belgium, Denmark, Germany, Ireland, Spain, France, Italy, Luxembourg, Netherlands, Sweden and the UK. There is, however, a wide gap in favour of Ireland, the UK, Germany, France and the Netherlands (countries that experience wide prominence of the financial services sector in their economies).
See Eurostat, 'International Trade in Services. Statistics Explained' (2021) <https://ec.europa.eu/eurostat/statistics-explained/index.php?title=International_trade_in_services>, accessed 17 May 2021.

[779] The importance of the development of the internal market for capital is visible in four financial integration indicators presented by the European Commission: the composition of cross-border capital flows; foreign direct investment (FDI) versus portfolio investment (PI); debt versus equity instruments and home bias in PIs. European Commission, 'Commission Staff Working Document on the Movement of Capital and the Freedom of Payments' SWD (2021) 68 final < https://data.consilium.europa.eu/doc/document/ST-7578-2021-INIT/en/pdf> accessed 27 December 2023, 16. See also European Central Bank, 'Financial Integration and Structure in the Euro Area' (2022) <https://www.ecb.europa.eu/pub/pdf/fie/ecb.fie202204~4c4f5f572f.en.pdf> accessed 27 December 2023.

> It is still necessary to balance the relative abilities of the political and judicial processes to resolve the basic substantive issues involved. The existence of the corrective potential may tip the balance where political malfunction does not otherwise seem severe or the limitations on the judiciary would otherwise appear daunting. But it is still the balance of all of these factors considered together which is determinative.[780]

The EU's political process malfunction since its inception is well known, with the unanimity rule in the Council routinely blocking the decision-making process by effectively granting every Member State a veto right. Mindful of the equilibrium established during the EU's foundational period, as described by Weiler, which was the only way Member States could accept the CJEU's activism and, therefore, guarantee significant levels of compliance with EU law in each Member State,[781] the fact is that this malfunction effectively left the Court with no institutional actor to enhance European integration. Although the Single European Act foresaw qualified majority voting in many policy areas, thereby improving the decision-making speed, notable challenges persist regarding economic policy.

On the contrary, there is a Court-like institution regarding EU monetary policy. In other words, while the CJEU holds the final word on the application and interpretation of Union law when in litigation, the ECB is entrusted with the exclusive competence to define and implement EU-wide monetary policy, in collaboration with eurozone and non-eurozone central banks. Although significant issues loom over the scope of mandate, the ECB formally displays executive action with an EU-wide focus and a decision-making process based on simple majority voting, with only minor requirements for a qualified

[780] Komesar, 'A Job for the Judges: The Judiciary and the Constitution in a Massive and Complex Society' (n 398) 700. As the author exemplifies, if courts want to ensure public access to information about government activity, they must often consider the implications of that access on such sensitive subjects as national security and foreign affairs. Another example is the protection of political speech and free press. Although protection of these rights would help correct political malfunction it does not necessarily justify judicial protection, as opposed to political protection. Hence, if the political process can adequately protect speech and press, judicial protection is not needed. The importance of judicial intervention is also patent in the US Supreme Court's intervention to counter school racial segregation or the right to abortion.

[781] James Buchanan and Gordon Tullock, *The Calculus of Consent* (Liberty Fund 1962) 162, 196, argue that the rule of unanimity is equal to the rule of one. However, they also mention that, while it is correct to argue that more inclusive voting rules tend to produce more stable outcomes (ie unanimity), the reward for every individual member will be lower the larger the inclusiveness and, consequently, so will the price to abandon the agreement.

majority.[782] In this sense, the Court might feel a lesser need to intervene in monetary policy issues, as executive power is less dysfunctional in this policy area than previously regarding free movement law.

11.4. Judicial bias in European economic and monetary union?

Courts may also exhibit bias. Unlike the political process, the judiciary process embodies different features, namely greater job stability, independence requirements, honesty and ethos on the part of judges in general,[783] as factors to counter malfunction and enable them to pursue their role as an effective countervailing force.

However, courts need social acceptance in order to counter their non-elected nature and because they care about societal compliance following their determinations. This is referred to as majoritarian counter-majoritarianism: a general tendency for constitutional courts to adhere to what the majority of the public wants.[784]

In fact, in the EU as a whole, at the height of the crisis, it seems there was broad support for the creation of a financing mechanism and, subsequently, the ECB's intervention in the market. If the positioning of each central bank Governor in the ECB Governing Council may serve as a rough indication of societal concerns, then it is clear that monetary conservatism was retreating. Therefore, the Court may have chosen to side with the ECB for societal purposes (high-stakes) but also for the complexity of the situation (lack of capacity). Returning to the creation of the EMU and governance framework of the ESM, it is conceivable that the Court was aware that the minoritarian bias enshrined in both Treaties (Maastricht and ESM Treaty) resembled the interests of only a few Member States. From this perspective, while the ESM mostly escapes its

[782] See article 10.2 of the ESCB and ECB Statute.

[783] Nevertheless, the judiciary portrays different features from the political realm, namely greater job stability, independence requirements, honesty and ethos on the part of judges in general. There are, however, notable differences between the justices of the US Supreme Court and the CJEU, most importantly regarding the length of mandate and the nomination process. While in the US, Supreme Court justices are nominated by the President for life and have a process with intense public scrutiny in the Senate, in the EU justices are appointed by Member States for a period of six years with the possibility of reappointment (article 253 TFEU). No scrutiny is foreseen, except for one evaluation panel, according to article 255 TFEU. On judicial appointments and independence see Mitchel De SO L'E Lasser, 'Judicial Appointments, Judicial Independence and the European High Courts' in Tamara Perišin and Siniša Rodin (eds), *The Transformation or Reconstitution of Europe: The Critical Legal Studies Perspective on the Role of the Courts in the European Union* (Hart Publishing 2018) 121.

[784] Mazmanyan (n 745) 179.

jurisdiction, as confirmed in *Pringle*, it did allow robust quantitative easing by the ECB, which, in my view, nurtured a majoritarian bias within the central bank.

Courts may also choose to anticipate a potential, future majoritarian tendency that is not yet represented in the political process.[785] Sometimes it works, as shown with the US Supreme Court's case law in *Romer v Evans*.[786] Briefly put, the people of Colorado approved a State constitutional provision barring the State or any city from adopting policies banning discrimination on the basis of sexual orientation, which the Supreme Court found to be unconstitutional. Interestingly, public opinion surveys showed high levels of support across the US for the proposition that employers should not discriminate on these grounds. Within a few months after the Court's decision, the Senate came within one vote of adopting the Employment Nondiscrimination Act to bar discrimination (1996), which passed the House of Representatives (2007) and the Senate (2013).[787]

In this context, it is possible to theorise on the CJEU case law on EMU. Sensing that minoritarian bias is present in economic policies, regarding financing and fiscal rules, it may have tried to anticipate the future in a way that would make the political process discuss and, eventually, decide whether the stability of the eurozone, in the sense of avoiding fragmentation, should be a task for the ECB or EU political branches.

Courts may be affected by the minoritarian bias, primarily in the way in which the adjudication process works, presenting itself as a more or less important source of information for judges. One situation in which there is a risk of this distortion occurring is if the court uses a relatively small number of opinions to form its own and if it gathers an inadequate amount of information on the issues at hand. Regarding this matter, the political process has an advantage, as it specialises in the most areas and employs more dedicated people. In other words, the greater the complexity of any given situation and the less acquainted judges are with it, the higher the probability of being significantly influenced by, or relying on the information that parties submit to the proceedings.

This hypothesis for minoritarian bias may have occurred in the EU monetary union case law through the way the procedure was conducted, as the Court heavily relied on information submitted by the ECB. While representatives of the *Bundesbank* were heard

[785] Alexander Bickel, *The Supreme Court and the Idea of Progress* (Yale University Press 1978) 100.
[786] *Romer v Evans* (1996) 517 US 620.
[787] Data available in www.congress.gov.

in the proceedings, the evidence relied upon by the Court, for instance in assessing the proportionality of PSPP, was exclusively provided by the ECB.

Problematically, according to Dawson and Bobić, it is difficult to assess the rigour and pluralism of the ECB's decision-making practice. In fact, while the Court heavily relied on the minutes of the Governing Council, 'these minutes are redacted anonymized, making it *de facto* difficult to assess the extent to which a meaningful and pluralistic discussion on particular questions has taken place'.[788] Moreover, the economic assessments of the ECB do not resemble an impact assessment (an *ex ante* exercise intended to address a number of public policy variables and their potential consequences). These authors consider that, while an impact assessment is not a holy grail, the tools supporting the ECB's decision do not compare with the lowest level impact assessments.

Minoritarian bias in EMU case law may have been fuelled by the legal architecture of access to justice, in general, and the specific features of monetary policy, in particular. The former increases costs to instigate a procedure, the result of which is less input of cases. For instance, while it is theoretically possible to take action against the ECB, it is very difficult to show a direct and individual concern for monetary policy and meet the admissibility threshold. Moreover, the action for annulment has a two-month deadline, which is a short period of time relative to the complex context determining the dynamic of inflation.[789] Given these procedural hurdles, it is no surprise that German citizens elected the national identity clause to bring a case before the *BVerfG*.

On the other hand, the features of monetary policy hold a high degree of technicality and complexity, which make it very difficult to understand. The costs and benefits of monetary policy are dispersed across the EU population, making it challenging to make a solid acquaintance of them, therefore, reducing litigation to smaller groups with higher stakes.

Minoritarian bias in the judicial context may not, however, always be as negative as majoritarian bias in the political process – its most common malfunction. In contrast, courts tend to display the former bias frequently, which places them in a relatively

[788] Dawson and Bobić (n 348) 1033.
[789] In the same vein, see Waldhoff, 'Article 127 (Ex Article 105 TEC) [Objectives, Tasks and Competences of the ESCB]' (n 207) 268.

advantageous position to tackle the latter.[790] This is well articulated by the Supreme *Court of Canada in Vriend v Alberta*, whereby:

> Although a court's invalidation of legislation usually involves negating the will of the majority, we must remember that the concept of democracy is broader than the notion of majority rule, fundamental as that may be. In this respect, we would do well to heed the words of Dickson C.J. […]:
>
> The Court must be guided by the values and principles essential to a free and democratic society which I believe to embody, to name but a few, respect for the inherent dignity of the human person, commitment to social justice and equality, accommodation of a wide variety of beliefs, respect for cultural and group identity, and faith in social and political institutions which enhance the participation of individuals and groups in society.[791]

Therefore, one may argue that the law is more useful and matters more when it protects the legitimate interests of unpopular minorities, including those strongly suspected of committing or intending serious misdeeds.[792]

Be that as it may, the problem with EU economic and monetary issues, on the one hand, and judicial intervention, on the other, is the mismatch of political boundaries. In contrast with a fragmented economic policy, monetary and judicial matters have a federal structure and principles, which creates a problem of disconnect. In fact, if the quality of democratic governance is an expression of an organic connection established between public and constitutional courts, 'then the lack of such a connection between supranational European courts and the rather abstract European public is obviously a factor amounting to a competitive disadvantage of the supranational jurisdiction as opposed to the national one'.[793] Ultimately, this may be a specific feature of EU integration, which we can add to the general shortcomings that courts display: European courts, most importantly the CJEU, do not appear to be in a position to properly conduct

[790] Komesar, 'A Job for the Judges: The Judiciary and the Constitution in a Massive and Complex Society' (n 398) 699.
[791] *Vriend v Alberta* [1998] 1 SCR 493, 140.
[792] Mance (n 744).
[793] Mazmanyan (n 745) 179.

a substantive role in economic and monetary issues given that, in doing so, it could risk the dissolution of EMU.

INTERIM CONCLUSIONS

VERTICALISATION OF THE EUROPEAN UNION

As referred to in Part II, the autonomy of Member States has decreased since the early stages of EU integration, due to the intervention of the CJEU.[794] It seemed the Court would decide upon an outcome and, then, find a way to achieve it legally. It is rare for the Court to state it does not wish for a certain result to occur due to the Treaty framework in place: it is against this situation that national constitutional courts rebel,[795] arguably abusing the constitutional identity clause.[796] In fact, there seemed to be a principal-agent inversion, whereby the Court took on the role of principal in interpreting internal market provisions, often in a maximalist way. In practice, this approach resulted in the imposition of substantive policy choices, as seen by the case law codification exercise that is often pursued by the EU legislative process.[797]

While this view might miss the fact that the CJEU and national courts have different functions (which, in a way, balance EU and national interests),[798] it seemed the CJEU had force and will, not merely judgement, which Hamilton advised against.[799] The paradox is that, contrary to Hamilton's opinion that courts were designed to be an intermediate body between the people and the legislature (ie to keep the latter within the limits of its

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[794] Giuseppe Martinico, *The Tangled Complexity of the EU Constitutional Process: The Frustrating Knot of Europe* (Routledge 2013) 76.

[795] EU Law Live, 'A Conversation with Joseph Weiler (Part 1), on the Past, Present and Future of European Integration' (n 45). In the same vein, see Yonah (n 751) 321.

[796] Julian Scholtes, 'The Abuse of Constitutional Identity: Illiberal Constitutional Discourse and European Constitutional Pluralism' (PhD Thesis, European University Institute 2022).

[797] Peter Lindseth, 'The Perils of "As If" European Constitutionalism' (2016) 22 European Law Journal 696. See also Gareth Davies, 'The European Union Legislature as an Agent of the European Court of Justice' (2016) 54 Journal of Common Market Studies 846.

[798] For the CJEU, it is important to uphold the integrity of a federal structure by applying common rules and promoting the European common good. Differently, national courts actions may be a vehicle for national interests and, as a result, the rulings of the CJEU are often directed against Member States rather than against EU institutions. See Christoph Möllers, *The Three Branches: A Comparative Model of Separation of Powers* (Oxford University Press 2013). 173.

[799] Hamilton, 'No 78: A View of the Constitution of the Judicial Department in Relation to the Tenure of Good Behaviour' (n 743) 402. On a different note, regarding judicial power, see Alexander Latham-Gambi, '"Judicial Power" and Political Power: Reflections in Light of the Quartet' in TT Arving and others (eds), *Executive Decision-Making and the Courts: Revisiting the Origins of Modern Judicial Review* (Hart Publishing 2021) 373. The author argues that judicial power is the product of a mix of different features, namely capacity to decide (as opposite to the propensity of decisions); capacity to achieve ends (particularly, wide-ranging ends, which impact the way society is governed); the reasons leading the judicial power to successfully challenge executive action, to which *de facto* legitimacy and independence play an important role; and judicial capacity to influence the outcomes of disputes that do not proceed to final judicial resolution (ie because they are settled by the parties, the claimant decides to discontinue or simply not bring proceedings). A strong judiciary, the author notes, does not necessarily correspond to a decrease of power of the executive as legislative branches. On the contrary, as power is not a zero-sum game, the drawing of constraints can serve to shape the field of possible action and embolden those subject to them.

authority), in the EU, the judicial body has not acted as a container but as a promoter of EU power extension.[800]

According to Grimm, this extension is explained by the EU's over-constitutionalisation:

> Different from national constitutions, the treaties are not confined to those provisions that reflect the functions of a constitution. They are full of provisions that would be ordinary law in the Member States. This is why they are so voluminous. As long as the treaties were treated as international law, this was not a problem. As soon as they were constitutionalised, their volume became problematic: in the EU the crucial difference between the rules for political decisions and the decisions themselves is to a large extent levelled.[801]

As shown in Part II, over-constitutionalisation continued with the creation of EMU, further encroaching constitutional constraints on Member States, particularly regarding economic policies.

Part III of the thesis aimed to lay out and analyse the EU's response to the 2007/2008 financial crisis and its impact on economic governance. In doing so, a comparative institutional perspective was adopted, namely by focusing on the three main paths to deliver social goals: the political, market and judicial processes. Indeed, the autonomy of Member States has been reduced since the financial crisis. Crucially, the progressive decrease of Member State autonomy regarding economic and monetary policies has evolved into hierarchical subordination, a process that I designate the verticalisation of the Union.

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[800] Maduro also argues that a court should not a priori assume that it is superior or inferior to any other institution in giving meaning to a particular constitutional or legal instrument, which means moving past the 'traditional American debate of counter-majoritarianism (which always assumes a weaker legitimacy of courts) or the recent European continental tradition of unquestioned judicial supremacy. Courts have a legitimacy different from the legitimacy of the political process'. See Miguel Poiares Maduro, 'Courts and Pluralism: Essay on a Theory of Judicial Adjudication in the Context of Legal and Constitutional Pluralism' in Jeffrey Dunoff and Joel Trachtman (eds), *Ruling the World? Constitutionalism, International Law, and Global Governance* (Cambridge University Press 2009) 356, 371.

[801] Dieter Grimm, 'The Democratic Costs of Constitutionalisation: The European Case' (2015) 21 European Law Journal 460, 470.

Economic policy coordination has increasingly given way to public control, with significant powers of intervention granted to the EU institutions vis-à-vis Member States with financial difficulties. This changed the relationship between the EU and its Member States. In this vein, I concur with Aymerich's assertion:

> [t]he political direction of rescued states has been decided on by European institutions (…) rather than by these states' governments. From this point of view, the management of the crisis has meant a real constitutional change in the European Union and, especially, in the eurozone. The European Union and EMU that exist today have little to do with those designed in the Treaties. Indeed, it is Community institutions and not Member States that dictate economic and budgetary policies, by virtue of a functional competence not foreseen in the Treaties: the maintenance of the stability of the eurozone. In practice, the ECB and the Commission, especially the former, have seen their areas of action greatly expanded, far beyond the original design of the Treaties.[802]

In this regard, the US and Germany's experiences provide this thesis with evidence, as they have taken different approaches to this issue. From the US we learn that the existence of balanced budget rules is not enough to achieve balanced and sustainable public budgets, as non-compliance occurs and is rarely enforced by courts. In fact, one of the factors that drove US States towards compliance was that bankruptcy had already taken place in American history, hence it was an outcome that held credibility. The observation to be made from Germany's experience is that financial dependence on the centre is the root of bailout expectations, which can have the pervasive effect of enduring fiscal misgovernance from State governments.

On monetary policy, dependence is observed in two ways. First, the ECB invests significant funds in the purchase of Member States' debt instruments on secondary markets. In fact, financial affordability becomes dependent on liquidity made available by the ECB. Secondly, targeted ECB programmes (OMT or the TPI) are conditioned on

[802] Aymerich (n 671) 99.

Member States compliance regarding EU economic governance. This effectively reinforces dependence.

Dependence is visible not only in a top-down dynamic but also bottom-up. This is the case regarding the EU budget, which is largely dependent on Member States for financing and focused on the component units of the Union for expenditure.

This verticalisation process, whereby Member States are mostly derived from the exercise of national economic policy by supranational rules, effectively promotes the sharing of responsibility with the EU in bad times and fragments monetary policy design, hence hindering the credibility of the central bank and fiscal rules. As a result, the EU's response to the financial crisis hindered the principles of democracy, subsidiarity and national diversity. It also had a concomitant effect on the credibility of supranational institutions.

EROSION OF INSTITUTIONAL CREDIBILITY

As Riker argues, '[t]he division and sharing of administrative responsibilities, which is often said to be at the heart of federal arrangements, has little or nothing to do with maintaining the bargain'.[803] Indeed, federations tend to portray a gap between the formal division of competences and the real allocation of power between levels of governance. Importantly, laws are frequently in danger of being abolished by the power of the many. In other words, if a conflict erupts between law and power, it is seldom the law which prevails.[804]

The financial crisis was a watershed moment for the EU and a sharp shift took place: one of politisation without democratisation, with a simultaneous retreat from the courts.[805] The 'executive unbound' phenomenon reduced the CJEU's scope for action (as funding bodies were established under international law) and placed the European Council at the centre of 'political Europe'.

The ECB's response to the financial crisis attests to this line of argumentation. Instead of focusing on EU-wide monetary policy and its impacts in the EU economy as a

[803] William Riker, *Federalism: Origin, Operation, Significance* (Little, Brown and Company 1964) 135.
[804] Arendt (n 8) 151.
[805] See Nicole Scicluna, 'Politicization without Democratization: How the Eurozone Crisis Is Transforming EU Law and Politics' (2014) 12 International Journal of Constitutional Law 545.

whole, it focused on a few Member States instead. In my view, it is reasonable to consider that preserving the integrity of the eurozone was the focus of the response to the financial crisis, given the assumption that debt default would lead to an exit from the currency union, potentially straining several Member States. However, it is far from certain that an inability to pay would lead to this outcome (*mutatis mutandis*, no US State left the dollar and adopted another currency pursuant to their defaults). This action is also relevant because it ties the ECB to Member States and their economic performance, raising questions on the transfer of resources within the EU. The same is true regarding the economic governance framework: by enhancing the powers of the supranational level, public control effectively makes this layer of governance co-responsible for fiscal failures, therefore, increasing the likelihood of financial assistance.

The features depicted demonstrate a mismatch between power vis-à-vis the political mandate. The ECB is not directly elected and can provide a limited representation of EU citizens. Likewise, decisions taken intergovernmentally either within the sphere of the EU legal framework or at an international law level, provide larger Member States with outsized power. Moreover, by taking visible and impactful decisions to the European electorate, national governments were, to a certain extent, able to insulate themselves from accountability.

Even the ECB, as a non-majoritarian, independent institution made major political decisions with bond-buying programmes. As Scicluna rightly highlights, 'it cannot plausibly be argued that the ECB has simply selected the "best" policy option in an objective or technocratic manner. Right or wrong, it is a profoundly political decision, which only highlights and exacerbates the Bank's lack of accountability to European citizens'.[806] While the EP and national parliaments increased their involvement in the accountability of EU executive institutions, their action was, respectively, ineffective and misplaced.

Hence, in times of crisis, EU governance represents a threat to its constitutional and economic order, particularly given the prominence of the executive power and process of verticalisation.

This threat was visible regarding the constitutionality of the ECB's asset purchase programmes, notably the OMT and PSPP. The *BVerfG* argued that monetary policy

[806] ibid.

should not to be conducted at the Union level and its actions could not entail economic or fiscal effects. Judges are fully aware that monetary policy is an exclusive Union competence and that it impacts Member States' economic and fiscal policies. It did convey, however, that there is a line over which a substantial degree of spillover to the economic and fiscal realm requires a higher threshold of accountability, particularly when such effects are so significant that they may jeopardise constitutional principles, such as the no-bailout clause and the principle of the prohibition of monetary financing. In these high stake circumstances there is a need for more accountability, precisely because it is in these situations that institutions are more strained and where it is more likely that the limits of legal framework are tested. Significantly, these judicial disputes show that the CJEU is unable to provide substantive accountability within EMU.

Credibility is, however, one of the most important features for judicial institutions to display and constantly portray. As CJEU President Lenaerts states, respecting judicial decisions is crucial to maintaining individual liberty and justice, regardless of whether the losing party is a State or a national court, particularly public declarations by officials stating that courts deliver biased rulings only because they 'did not rule in their favour, when they criticize judges personally or fail to react when the press call them enemies of the people, they undermine the rule of law'.[807]

A similar point of view was conveyed by US Supreme Court Justice Sotomayor during the oral arguments of *Dobbs v Jackson Women's Health*,[808] which dealt with abortion rights, highlighting the imperative of institution credibility. In the context of answering petitioners' arguments that the Supreme Court would act differently in this case in contrast with precedents, due to a different set of Justices with differing political backgrounds, she asked:

> Will this institution survive the stench that this creates in the public perception that the Constitution and its reading are just political acts? (…) I don't see how it is possible. It's what Casey talked about when it talked about watershed

[807] Koen Lenaerts, 'Constitutional Relationship between Legal Orders and Courts within the European Union' (*EU Law Live Weekend Edition*, 2021) <https://eulawlive.com/weekend-edition/weekend-edition-no81/> accessed 3 December 2021.

[808] *Dobbs v Jackson Women's Health*, US 19-1392, Oral arguments (2021), available at <https://www.supremecourt.gov/oral_arguments/argument_transcripts/2021/19-1392_bq7d.pdf>, accessed 3 December 2021.

> decisions. Some of them, Brown versus Board of Education it mentioned, and this one have such an entrenched set of expectations in our society that this is what the Court decided, this is what we will follow, that the -- that we won't be able to survive if people believe that (…) it's all political, how will we survive? How will the Court survive?[809]

VERTICALISATION AS SYMPTOM OF LACK OF INSTITUTIONAL ALTERNATIVES

The common thread amongst these issues is that in a scenario of evolving complexity, it is more likely that institutions will produce less consensual outcomes since more people will exercise their voice (the relationship between EU and Member States economic and fiscal policies are good examples). Thus, institutional choice and comparative institutional analysis become pivotal.

Recalling Komesar,[810] goal choice and institutional choice should be analysed in tandem. This seldom occurs, given that legal scholars tend to elect single institutional analysis rather than comparing multiple institutional alternatives. For, when a goal is set, there is always more than one possible route to take institutionally, either by markets, the adjudicative or the deliberative processes.

While there are pros and cons to every choice, institutions move together depending on their circumstances. As a result, when the facts and overall context are simple and frictionless, it is easy to perform a certain transaction. Let us consider different kinds of disputes, for instance over undue use of land, selling an asset, pollution or noise with two parties that get along well. It is reasonable to assume that, given the circumstances of each hypothesis, either markets, courts or the political process would settle those situations easily, either by coming to a non-judicial agreement, making a quick court decision or enacting a straight-forward law.

However, given that a frictionless world does not exist, these examples are likely to generate a level of disagreement between the parties, which would decrease the likelihood of a simple agreement and increase costs. Importantly, these costs occur horizontally, meaning they would occur in all institutional processes. As a result, A's

[809] ibid. 16.
[810] Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics and Public Policy* (n 3); Komesar, *Law's Limits: The Rule of Law and the Supply and Demand of Rights* (n 775).

agreement to not use B's land without its consent would probably not occur; a quick and easy court decision would be impossible, given that more resources would be in play, in general, (ie requiring more witnesses, spending more time, using more administrative staff); most likely, a legislative procedure would be more contentious, given that more lobbying, discussion, potential disagreements and, therefore, less support would occur for any given legal act.

Accordingly, when reality is complex and intricate, institutions become strained. In some cases, they could be compelled to ask themselves whether they are the correct forum to address certain issues. Whether courts are the best choice to pursue societal goals can only be adequately addressed by considering the degree and form of political malfunction and the abilities and resources available to the adjudicative process. This was precisely conveyed by US Supreme Court Justice Kavanaugh in *Dobbs v Jackson Women's Health*.[811] This case is a good example of institutional dilemma and choice, since it deals with a very contentious issue in American society. While summarising some of the arguments of the petitioners, Justice Kavanaugh expressed discomfort twice over having to deal with such a high-stake and complex issue. Indeed, he said 'I think the other side would say that the core problem here is that the Court has been forced (…) to pick sides on the most contentious social debate in American life (…)'[812] and that:

> (…) there are two interests at stake (…) [a]nd in your brief, you say that the existing framework accommodates -- that's your word -- both the interests of the pregnant woman and the interests of the fetus. And -- and the problem, I think the other side would say and the reason this issue is hard, is that you can't accommodate both interests. You have to pick. That's the fundamental problem. And one interest has to prevail over the other at any given point in time, and that's why this is so challenging, I think.

Justice Kavanaugh proceeds with remarks towards institutional comparison and choices, whereby 'they would say, therefore it should be left to the people, to the states, or to Congress'. With this statement, Justice Kavanaugh considered where to draw the

[811] *Dobbs v Jackson Women's Health, US 19-1392, Oral arguments (2021)* (n 808).
[812] ibid. 77.

line on adjudicative limits, how suitable the US Supreme Court would be in handling the issue and whether the political process could be better positioned. He, then, finishes by questioning:

> When you have those two interests at stake and both are important, as you acknowledge, why not -- why should this Court be the arbiter rather than Congress, the state legislatures, state supreme courts, the people being able to resolve this? And there will be different answers in Mississippi and New York, different answers in Alabama than California, because they're two different interests at stake and the people in those states might value those interests somewhat differently. Why is that not the right answer?[813]

While this case deals with an extremely contentious and sensitive topic, it goes to show that judges (and, by extension, courts) may adopt a deferential approach to the political process, not just regarding topics where the latter is better positioned to make decision (ie the fiscal domain)[814] but also regarding complex topics, as this case indicates regarding individual rights.

The problem with EU integration is that the possibility for institutional choice exists to a very limited extent. In fact, federal Constitutions generally provide rules regarding the organisation of the federal level of government; allocation of competences; stipulation of fundamental rights protecting basic human and citizen's rights; and freedoms against the exercise of governing powers. In contrast, the European Treaties extend beyond these core functions by regulating, in considerable detail, a wide range of matters that democratic Constitutions would leave to be determined by legislation. In other words, there is more constitutional law in the EU than constitutional federal states.[815]

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[813] ibid. 107.

[814] Fabbrini, *Economic Governance in Europe: Comparative Paradoxes and Constitutional Challenges* (n 706) 108, identifies three reasons why the political branch in the EU is more apt than the judicial branch to decide on fiscal matters, namely: better expertise; greater voice as a majoritarian branch and, on the contrary, courts non-majoritarian nature do not tackle the issue of democratic deficit.

[815] Fritz Scharpf, 'De-Constitutionalisation of European Law: The Re-Empowerment of Democratic Political Choice' in Sacha Garben and Inge Govaere (eds), *The Division of Competences between the EU and the Member States* (Hart Publishing 2017) 284, 287.

As a result, the Treaties' density and scope[816] affects the horizontal and vertical balance of powers, limiting institutional choice. On the one hand, the practical result of deliberately reducing the existence of an EU public space and legislation via a rules-based system (de-politisation) is the empowerment of authoritative judicial interpretation.[817] Moreover, the supra (Part II, Point 1.2) referred teleological interpretation and its extensive result becomes the way to perform changes to primary law without Treaty amendment. On the other hand, it simultaneously constrains Member States' actions in areas where supranational legislation is absent, thus, a national response could be made through the internal political process. As highlighted by Weiler, what good is it to have your rights protected if you do not control what gets decided?[818]

Therefore, some possibilities were put forward regarding the EU constitutional scale-back, notably on two fronts: judicial constitutionalisation and Treaty change. On the former, a comparison is made between the current state of the art in the EU with the case law of the US Supreme Court prior to the 1937 constitutional revolution.[819] This is due to the constraints it imposed upon US States pursuant to its interpretation of the dormant commerce clause.[820] However, when the Supreme Court struck down core provisions of the New Deal programme, an institutional conflict erupted, which, under the threat of packing, led the Supreme Court to remove restrictions on economic policy

[816] According to Scharpf, this rule-based idea originated in Germany where, in the 1930s, it was seen as a way to simultaneously avoid laissez-faire liberalism and state interventionism. Under this system, the state would only intervene to ensure money stability and avoid competitive market anomalies such as cartels and enterprise concentration. However, these so-called ordo-liberal principles never made it to the constitutional level, having been blocked at the constitutional assembly and by the *BVerfG*. In fact, in a 1954 decision, the court held that democratically accountable governments and parliaments were not constrained by any economic theory that could limit their policy choices. See ibid. 288.

[817] Grimm, *Constitutionalism: Past, Present and Future* (n 361) 302. Take the principles of direct effect and primacy of EU law as an example. They did not catch public attention when they were decided, since they were circumscribed to singular cases and delivered by a court that went largely unnoticed. However, the author considers them revolutionary for several reasons. First, neither direct effect nor primacy were explicitly mentioned in the Treaties, rather resulting from an interpretation that could have been different. Second, without them the EU would not have become what it is today, namely a political entity in between an international organization and a federal state. Moreover, the number of powers and their density resembles the latter rather than the former. Lastly, they radically changed the position of the CJEU, enlarging its own power by the extensive interpretation of substantive law.

[818] EU Law Live, 'A Conversation with Joseph Weiler (Part 1), on the Past, Present and Future of European Integration' (n 45).

[819] Maduro, *We The Court: The European Court of Justice and The European Economic Constitution* (n 6).

[820] Eule, 'Laying the Dormant Commerce Clause to Rest' (n 778) 431; William E Leuchtenburg, *The Supreme Court Reborn: The Constitutional Revolution in the Age of Roosevelt* (Oxford University Press 1996) 40. In the US, the commerce clause grants power to the Federal Government to regulate trade and commerce. James Madison, one of the main framers of the US Constitution, expected the competing interests in Congress to neutralise each other and, thus, prevent regulation of inter-state trade: the commerce clause would act as a negative provision after all, designed to prevent injustice among the States themselves, rather than a positive provision to be used by the Federal Government.

choices of a democratically elected government. Consequently, State governments came to be bound only by federal legislation and no longer by the dormant commerce clause, while federal legislation was afforded a wider scope of action.[821] This self-correction was induced by a potential direct conflict between the judicial branch and a highly politicised political arena.

These circumstances are unlikely to take place in the EU for many reasons, but most importantly because the European political public sphere is not adversarial or confrontational but essentially consensus-driven,[822] notably because the constitutionalisation of political choices is isolated from ongoing public debates. Policies without politics was the formula found by the EU in order to maintain an idea of national sovereignty and a sense of nation-State. Notwithstanding, this formula has created a disconnect between the democratic experience (broadly national) and effective exercise of economic power (increasingly supranational).[823]

In contrast with constitutional pluralism, which has been built over the years by the CJEU (designated as the heterarchical relationship between EU and national laws, as opposed to being hierarchical), EU economic policy is becoming less plural and more monolithic. In fact, this seems to be the outcome of the nature of EU competences regarding this matter: coordination resembles a unitary conception of policies based on strict fiscal targets and economic policy recommendations.

A second proposal is related to re-politisation in tandem with de-constitutionalisation.[824] In Grimm's view, an enhanced role of the EP would be a good idea. However, given the peculiarities of its elections, a relative detachment with EU citizens, weak EU public sphere and foreseeable loss of power of the Council could

[821] Leuchtenburg (n 820) 142. On the tendencies of the Supreme Court see Ilya Somin, 'The Supreme Court of the United States: Promoting Centralization More Than State Autonomy' in Nicholas Aroney and John Kincaid (eds), *Courts in federal countries: federalists or unitarists?* (University of Toronto Press 2017) 440.

[822] For instance, unlike the European Parliament, in the Council and in the European Council, national representatives typically represent their own Member States as a whole rather than the respective political parties. This is an element which promotes consensus rather than confrontation because inter-State relations tend to be diplomatic, given the underlying idea of sovereignty and identity. Differently, the US political public space is, essentially, adversarial. All actors are associated with their own party first, regardless of their State or district, which means that they are not primarily divided by the territory they represent but rather by the shared platform of ideas embodied in each political party. This is especially the case in the House of Representatives but also in the Senate, where, although representing their respective States, elections and the exercise of duty are markedly adversarial. This is also the case in Germany, where, despite representation of States in the *Bundesrat*, party-affiliation is strong across the layers of government.

[823] See Ivan Krastev, *After Europe* (University of Pennsylvania Press 2020) 49.

[824] Scharpf (n 815) 297; Grimm, *Constitutionalism: Past, Present and Future* (n 361) 295.

worsen the legitimacy situation. Moreover, given the over-constitutionalisation of the Treaties, a lot of areas would be outside of the scope of the EP. Therefore, an overhaul of the Treaties is suggested, in which only genuine constitutional rules would fit (ie. the creation of institutions, their roles in decision-making and fundamental rights), while the rest of the acquis would be downgraded to secondary European law.[825]

In this vein, the EU budget is a way to ensure the economic pluralism of the Union and deal with the paradox of legitimacy. It is tailored to internalise the externalities of Member States' economies and, given that it is a product of the legislative process (the annual budget), it is suitable to address legitimacy issues. MFF should also be decided in the realm of the legislative process. Instead of proposing to the European Council, the European Commission should propose the MFF to the European Parliament.

Notwithstanding, a major issue with the EU budget is that Member States try to transform it into a financially neutral instrument. Hence, a two-fold issue emerges: on the one hand, it seems that a redistribution of funds conducted through the EU budget is less legitimate than a distribution made via Member States' decisions in the European Council. On the other hand, economic policy matters are not discussed among equal partners in this institution, as the paradox of domination is very present. Therefore, what could be seen as bolstering legitimacy (given that Heads of State or Government are directly elected by their respective Member States) may, in fact, reduce it.

Of course, the facts stated above are insufficient to conclude that the European Council should not pursue its original duty, but sufficient enough to state that its current role is inadequate. However, what is the alternative? And, assuming an alternative exists, is it better? The EU budget is a small policy instrument focused on redistributive matters; it is neither focused on nor capable of pursuing the stabilisation of the EU economy. Moreover, it exhibits intergovernmental features, such as juste retour, the fact that the typology of own resources is decided by Member States, or the fact that most funding derives from national budgets. As a result, the EU budget is currently complementary and not a realistic alternative. Given the foregoing, how could an EU budget receive a transnational account or EU-wide focus (ie transnational infrastructure; innovation and technology; or stabilisation of the EU economic cycles) if economic policies are in Member States' sphere of competences?

[825] Grimm, *Constitutionalism: Past, Present and Future* (n 361) 310.

VERTICALISATION AS SYMPTOM OF A LACK OF PARTICIPATION

Part III analysed the effects that the verticalisation of the EU entailed and touched upon the most severe issues it brought to the integration process. At its root, the problem with EU economic and monetary integration is one of participation. Importantly, the degree of participation is a function of the distribution of stakes and the costs of doing so. In turn, these vary depending on factors, such as complexity and numbers.[826]

These elements help us understand that the institutional choices made in the EU led to a complex distribution of interests and power. The EU political process generated an institutional landscape with misplaced elements of legitimacy and accountability, thereby nurturing disfunction. Importantly, these features increase complexity, not only in their operative context, but also in the context of other institutional processes. First, I have shown that European and national judicatures exercised a substantial amount of restraint in highly complex situations. Significantly, the level of restraint was proportional to the complexity: the higher the stakes, the higher the restraint; the lower the stakes, the lower the restraint. However, I also argued that there are shortcomings deriving from judicial intervention in economic policy matters. Ultimately, they may even be more harmful than deference.

Second, market participation was impacted. The EU political process concluded that market failure significantly intensified the financial crisis, ultimately leading to the euro crisis. As a result, the EU economic governance adopted a surveillance approach to Member States' economic policy choices and fiscal indicators, particularly regarding those under fiscal distress. However, the premises were misguided.

Although market failure played an important role in the financial crisis, the Maastricht Treaty framework on economic governance brought about conflicting interpretations on the compatibility of the no-bailout clause and fiscal requirements, thus generating the perception that bailouts would, indeed, occur eventually. Unclear information added to the complexity in which market participants operated, therefore, leading to the adoption of a leaner approach regarding Member States' public finances (so-called market dormancy). Paradoxically, in this particular case, my view is that

[826] Neil Komesar, 'The Logic of the Law and the Essence of Economics: Reflections on Forty Years in the Wilderness' [2013] Wisconsin Law Review 265, 292.

market failure had more to do with the complexity of EU integration, most notably economic governance, and less to do with any intrinsic shortcomings in the markets.

Moreover, more people are impacted by the progression of economic and monetary integration, therefore, broadly distributing the social impact. In theory, this state of affairs reduces the stakes of citizens per capita and furthers the effect of dormancy of political majorities, which, ultimately, reduces participation. Nevertheless, EU budgetary policies and democratic input remained essentially static, with the creation of few mechanisms to deliver EU public goods and give citizens voice at the supranational level. At the same time, EU economic governance made voice at the national level less consequential, in general, but emphatically on fiscally distressed Member States. Conversely, fiscal soundness results in having more autonomy to define and implement national economic policies. This fragmentation led to an uneven distribution of interest in Member States' polities.

Be that as it may, it should not be assumed that the political process should be dismissed because it evolved in a way that enabled the production of undesired consequences. Likewise, market-based solutions should not be immediately contemplated because they were neglected in the past: institutions move together, meaning that any conditions that affect one most likely affect the other(s). In the same vein, changes intended to correct malfunctions within a certain process may further aggravate or, merely, substitute it.

Part IV will be dedicated to devising ways to address the economic policy challenges currently faced by the EU and its Member States. In doing so, I will focus on the political and market processes, as two systems that complement each other in restoring democracy, autonomy and accountability towards EU budgetary integration.

PART IV

DEMOCRACY, AUTONOMY AND ACCOUNTABILITY: TOWARDS EUROPEAN BUDGETARY UNION

CHAPTER 1

DEMOCRACY IN THE BUDGET OF THE EUROPEAN UNION

1. Addressing minoritarian bias in EU economic and budgetary policies

1.1. Changing the voting threshold?

One way to correct the previously identified biases in EU economic and budgetary policies is to change the voting threshold in the ORD and MFF from unanimity to majoritarian rule.[827] Crucially, there is a difference between negotiating with the power of the vote rather than the power of the veto:[828] indeed, a lower threshold of approval reduces the skewed distribution of power each Member State possesses under unanimity rule, which could prompt the better alignment of some Member States with citizens' preferences. As Komesar stresses, 'as majoritarian influence grows, we can get a countervailance between [majoritarian and minoritarian] forces and, with it, political outcomes that are more "balanced"'.[829]

Be that as it may, formal rule changes can run afoul of informal established decision-making processes.[830] As demonstrated in Part III, there is evidence that the logic of consensus prevails in the European Council and Council, regardless of majoritarian rule.[831] A possible explanation for this phenomenon may be that '[m]ost legislators (…) are not motivated by resource allocation efficiency and the political process is subject to severe political malfunctions such as minoritarian bias and the associated costs of rent

[827] This approach is frequently suggested. See, for instance, Lehner (n 142) 39; Angélique Boissenin, 'Le Système Budgétaire de l'Union Européenne à La Lumière de Ses Modes de Financement' (2020) 636 Revue de l'Union Européenne 138, 147.
[828] Maduro (n 6).
[829] Komesar, 'The Logic of the Law and the Essence of Economics: Reflections on Forty Years in the Wilderness' (n 826) 297.
[830] Neil Komesar, 'Governance, Economics and the Dynamics of Participation' in Neil Komesar and others (eds), *Understanding Global Governance: Institutional Choice and the Dynamics of Participation* (European University Institute 2014) 29, 43.
[831] Middelaar and Puetter (n 291) 51; Puetter, *The European Council and the Council*, (n 243) 78.

seeking'.[832] Therefore, we cannot expect that changes in the voting threshold per se will necessarily lead to a (significant) change in national governments' behaviour in the supranational institutions.

Importantly, European citizens' current political participation does not seem to be enough to reduce the skewed distribution of stakes in the EU political process. Paradoxically, more access to the decision-making process, per se, may not solve but rather aggravate problems of participation, as its dynamics depend on the costs and benefits with which it is associated. If the individual benefits of most people are low, either because they are highly disseminated or because there is an insufficient degree of information, then participation decreases, hence making the political process more prone to concentrated interests.[833] Indeed, EP elections are traditionally associated with low turnouts and reduced mobilisation of the European electorate, possibly as a result of the lower level of importance this institution is entrusted with regarding budgetary issues and EU economic policy in general.[834]

In addition, the so-called technocratic, apolitical form of governance pursued by the European Commission is, in itself, a feature that hinders participation, worsening this state of affairs. Interestingly, this matter was covered by the preparatory works leading to the 1787 US Constitutional Convention, in which some scholars considered that as size increases and participation decreases, the result would be better decision-making, leaving it to the public interested government official. In a nutshell: distance from the action would produce better output. However, the framers of the US Constitution understood that the choice was not between a biased political process and an independent and unbiased public servant, but rather a choice between biases (majoritarian and minoritarian), with the Federalists willing to risk more minoritarian bias as the price for less majoritarian bias.[835]

However, even if the dynamic of intergovernmentalism would change, that is, if removal of the unanimity voting threshold regarding ORD and the MFF would resolve

[832] Komesar, 'The Logic of the Law and the Essence of Economics: Reflections on Forty Years in the Wilderness' (n 826) 304. This idea is also conveyed by Buchanan and Tullock (n 781) 217.
[833] Neil Komesar and Miguel Poiares Maduro, 'Governance Beyond the States: A Constitutional and Comparative Institutional Approach for Global Governance' in Neil Komesar and others (eds), *Understanding Global Governance: Institutional Choice and the Dynamics of Participation* (European University Institute 2014) 3, 21.
[834] Xavier Cabannes, 'Les Pouvoirs Financiers Du Parlement Européen : Illusion Ou Désillusions ?' (2019) 633 Revue de l'Union Européenne 603.
[835] See Komesar, 'Governance, Economics and the Dynamics of Participation' (n 830) 49.

the issue of minoritarian bias, the Union would still have to deal with other problems, namely the fact that the budget was small in size, which largely contributed to its reduced visibility.

1.2. Taxation of EU citizens[836]

1.2.1. Competence for EU taxation

The EU budget has always been primarily funded by resources collected pursuant to nationally determined taxes (ie share of VAT, national contributions). The exception to this is the customs duty, which is a resource arising from EU commercial and trade policy and is passed onto the price of imported products, which is paid for by consumers. This constitutes an indirect tax.

Hence, it follows that the Union already levies taxes, even if only in the realm of commercial policy,[837] which contradicts a commonly held conception that taxation is a matter of exclusive Member State competence. Therefore, the question is not whether the EU can levy taxes on its citizens, which it can and already does, albeit based on a specific supranational policy. Rather, we should inquire whether the EU has the competence to lay taxes of general nature for EU citizens.

Articles 113-115 TFEU entrust the EU with a broad competence to approximate national laws to ensure the proper function of the internal market, including the area of taxation.[838] While article 113 TFEU expressly covers indirect taxation, article 115 TFEU allows the adoption of directives for the purpose of harmonising fiscal provisions, including in the area of direct taxation, to the extent that it directly affects the establishment or function of the internal market.

Although there are scholarly contributions suggesting that these can serve as a legal basis for EU levies[839] as was the case in past European Commission proposals,[840] it is, in

[836] For the purpose of this section, EU taxes are understood as those over which the EU exerts legislative authority, thereby defining them independently of national legislatures.
[837] In this sense, see Christian Waldhoff, 'Legal Restrictions and Possibilities for Greater Revenue Autonomy of the EU' in Thiess Büttner and Michael Thöne (eds), *The Future of EU-Finances* (Mohr Siebeck 2016) 154.
[838] For an extensive review of EU tax law, see Juliane Kokott, *EU Tax Law: A Handbook* (CHBeck 2022).
[839] Johan Lindholm, 'Squaring the Constitutional Circle: An Overview of EU Fiscal Powers' in Johan Lindholm and Anders Hultqvist (eds), *The Power to Tax in Europe* (Bloomsbury Publishing 2023) 9.
[840] European Commission, 'Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services' COM (2018) 148 final < https://eur-

my view, doubtful that these Treaty provisions are proper to pave the way for the implementation of (direct or indirect) taxes directly accruing to the EU budget. The harmonisation of national tax laws could be relevant to financing the EU budget if, for instance, the Union intended to keep a share of the nationally-raised revenue of these taxes.

While this route could be useful in specific areas, notably digital companies or financial services, in which mobility of tax subjects is high, it is difficult to envisage a similar solution regarding citizens. First, broad tax harmonisation would hinder the consequentiality of national electoral processes as well as ongoing political debates, as it would constrain Member States' ability to freely define their taxation policies, an important matter to polities. Second, given that all EU budgetary revenue is defined by the ORD, it is difficult to envisage a solution that would skip the application of article 311 TFEU.

From my point of view, there is no reason why article 311 TFEU should not be considered a valid Treaty basis concerning the financing of the EU,[841] namely for levying general or specific EU taxes.[842] [843] Own resources is, indeed, a suitably indeterminate concept to encompass a range of revenue of a very distinct nature, be it national contributions or taxes.

Therefore, the problem is not with the concept itself but with the elasticity we permit in its interpretation and, as shown, this provision has been interpreted restrictively since inception. However, that does not mean that the legal basis does not exist. It merely begs the question of whether we should interpret it more broadly.

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lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2018%3A148%3AFIN> accessed 27 December 2023.

[841] For an opposing view, see François Barreau, 'The Legitimacy of the EU's Tax-Based Own Resources' in Johan Lindholm and Anders Hultqvist (eds), *The Power to Tax in Europe* (Bloomsbury Publishing 2023) 37, 50; Mariya Senyk, 'A New System of EU Tax-Based Own Resources: How Does It Affect the Fiscal Sovereignty of Member States?' in Johan Lindholm and Anders Hultqvist (eds), *The Power to Tax in Europe* (Bloomsbury Publishing 2023) 145, 153; Kokott (n 838) 727.

[842] Specifically on EU own resources and taxation, see Sylvain Plasschaert, 'Towards an Own Tax Resource for the European Union? Why? How? And When?' (2004) 44 European Taxation 470; Heinemann, Mohl and Osterloh (n 360); Iain Begg, *An EU Tax: Overdue Reform or Federalist Fantasy?* (Friedrich-Ebert-Stiftung 2011) <https://library.fes.de/pdf-files/id/ipa/07819.pdf> accessed 11 February 2023; Alexandre de la Motte, 'A European Tax: Legal and Political Issues' (2014) 134 Revue de l'OFCE 141.

[843] The admissibility of levying federal income tax under the 16th Amendment was also discussed in the US. See, generally, Harry Hubbard, 'The Sixteenth Amendment' (1920) 33 Harvard Law Review 794. However, such an amendment is considered indispensable to sustain the current conception of the US fiscal architecture. See Erik Jensen, 'Did the Sixteenth Amendment Ever Matter? Does It Matter Today?' (2014) 108 Northwestern University Law Review 799.

Taxes are generally used to further the values of each society.[844] Article 2 TEU recognises the values shared by Europeans. These values are the basic underpinning of the legitimacy of the EU and, from an institutional standpoint, have allowed it to be more than an international organisation, albeit short of a nation-State, with competences that impact the lives of its citizens from internal and external perspectives. Internally, the EU has the capacity to legislate in a vast array of areas, notably the single market. Ironically, integration on this front has proved to be a challenging force for the principles of subsidiarity and proportionality. As Member States increasingly interconnect economically, the most effective decision-making locus in the management of externalities-based problems is not the national but the EU level. Externally, the EU has the potential to further its citizens interests more effectively than any Member State acting individually, primarily as a result of its economic weight,[845] as recognised by the establishment of the common foreign and security policy.

1.2.2. Should the EU exercise taxation powers more broadly?

The problem is not so much legal as it is political,[846] as taxation is highly connected to State sovereignty. It is important to recall that, similar to the US, the EU was created by sovereign States.[847] Hence, we must ask, why would sovereign States constitute a (federal) union? Is it not the meaning of sovereignty to be independent, in the sense of self-sufficiency? The most important underlying reason to constitute a union is a fundamental awareness of powerlessness by component States individually.

Accordingly, as with other federal unions of States, the European unification project must be understood from the moment of its inception 'on the basis of the fundamental wish for political autonomy on the part of its founding states and their incapacity to […]

[844] Ricardo García Antón, 'Does the EU Have a Legitimate Power to Enact Direct Taxes?' in Johan Lindholm and Anders Hultqvist (eds), *The Power to Tax in Europe* (Bloomsbury Publishing 2023) 19, 35.
[845] Louise Watt, 'Europe Seen with Fresh Eyes in Beijing' *Internationale Politik Quarterly* (27 March 2023) <https://ip-quarterly.com/en/europe-seen-fresh-eyes-beijing> accessed 27 December 2023; Chen Zhimin, 'Europe as a Global Player: A View from China' (2012) 20 Perspectives 7.
[846] Lindholm (n 839) 3.
[847] Resembling the EU Treaties, the US Constitution was a compact between the people of the different States, not as one nation. Rather, it was a unanimous assent of the signatory States. Evidence of this can be found in article 7, which establishes that the ratification of only nine States would suffice for it to enter into force, although it would not have a binding effect on the other four. This means that the will of the majority of the States and their respective peoples would not supersede the will of minorities. If, at that time, the people of the United States were to be considered as one nation, then the opposite would have been expected, that is, the will of the majority of US citizens would bind the minority, just as it occurs in any individual sovereign State. As a result, each US State ratified the Constitution as a sovereign body.

secure this autonomy as fully independent states'.[848] Thus, EU integration has entailed a fundamental transformation, in that each State can no longer be understood as fully sovereign. For this reason, European integration entails a process of transformation from nation-State to Member State, and not a zero-sum, multi-level struggle over sovereignty.[849] The outcome of this consciousness is the sense that accomplishing a certain set of goals – for instance, security, stability or citizens' welfare – is only conceivable together.

In the EU, the path to achieving these objectives was made possible by guaranteeing peace through economic prosperity and the integration of States. This clearly derives, for instance, from article 2 of the EEC Treaty, which focused on improving living standards and closer relations between *its Member States*, or the existence of the Assembly, which was composed of representatives of the *peoples of the States* (article 137 EEC Treaty). The Union assumed a regulatory nature, acting as an independent agent of national democracies in order to enact efficiency-enhancing regulations, furthering not only economic integration but also the bloc's commitment to open markets.[850] [851] Simultaneously, the CJEU furthered this objective with its case law regarding free movement of persons, services and goods.[852]

In the EU these freedoms are as disruptive as they are vital to its survival. They are disruptive because national boundaries are usually associated with national citizenship. By severing the nationality link, the Treaty fundamentally alters the notion of national citizenship, making free interstate movement an essential component to the advent of a wider, common, post-national geographical space. They are vital because they are part of

[848] Signe Rehling Larsen, *The Constitutional Theory of the Federation and the European Union* (Oxford University Press 2021) 56, 62.
[849] idem. 82; Christopher Bickerton, *European Integration: From Nation-States to Member States* (Oxford University Press 2012) 21; Fabian Amtenbrink and Helena Raulus, 'Contribution to: Fiscal Policy in the European Union Context - The Semi-Detached Sovereignty of Member States in the European Union' in Sjaak Jansen (ed), *Fiscal Sovereignty of the Member States in an Internal Market: Past and Future* (Wolters Kluwer 2011) 1, 2.
[850] Schelkle (n 495) 830.
[851] In a way, this resembled the situation in the United States before the New Deal and the so-called fiscal revolution, in which the US Government played a reduced role both in redistribution and macroeconomic stabilisation, which took place between the presidencies of Herbert Hoover and Lyndon Johnson. See Gerstle (n 528). Importantly, the commerce clause enshrined in the US Constitution allowed the judiciary to create a single market by regulating interstate commerce. On the scope of the commerce clause, see Amar, (n 497); Epstein (n 497); Nelson and Pushaw (n 497). In the jurisprudence see *United States v Lopez [1995] 514 US 549* (n 497).
[852] See Barnard (n 39); Maduro, *We The Court: The European Court of Justice and The European Economic Constitution* (n 6).

a broader trend of individualisation and grant an increasingly broad array of individual rights at the transnational level.[853]

Crucially, this derives not from national territorial identity but from supranational discourse[854] and the decision-making process. Thus, a set of horizontal rights, principles and purposes embodied by the EU (ie human rights, liberal democracy, rule of law or environmental concerns) are cornerstone to develop a sense of belonging that is no longer confined to, but in respect of national boundaries,[855] making European citizenship an elaborate form of post-national membership.[856] As a result, supranational activity on free movement and internal market completion have fostered a sense of union between citizens, a dynamic societal process, which has been recognised by Member States in the Treaty changes that have taken place overtime.

The attainment of the single market was more sensitive to arguments of an economic nature. Monetary union, however, pursued a different path, as national currencies were a significant expression of national authority and identity. In this case – mindful of the economic benefits and the background of inflation, unemployment and balance of payments deficits – political considerations were an important justification in the adoption of the euro. In this regard, Marjolin and Delors' reports highlighted that the euro was an important endeavour to European unity, notably if Member States wanted to continue to play a role in world affairs and ensure their own protection, given that only

[853] Ettore Recchi, *Mobile Europe: The Theory and Practice of Free Movement in the EU* (Palgrave Macmillan 2015) 3. See also Ulrich Everling, 'The European Union as a Federal Association of States and Citizens' in Armin von Bogdandy and Jürgen Bast (eds), *Principles of European Constitutional Law* (2nd edn, CHBeck 2009) 701.

[854] Yasemin Soysal, *Limits of Citizenship: Migrants and Postnational Membership in Europe* (The University of Chicago Press 1994) 164; Martin Nettesheim, 'Art 10 [Demokratische Grundsätze]' in Eberhard Grabitz, Meinhard Hilf and Martin Nettesheim (eds), *Das Recht der Europäischen Union* (CHBeck 2016) para 1-56, 54. Nettesheim considers that a structured political discourse is increasingly visible. Importantly, formerly divisive features such as language, media and institutions are increasingly being overcome.

[855] Rainer Bauböck, 'Towards a Political Theory of Migrant Transnationalism' (2003) 37 International Migration Review 700; Maurizio Ferrera, *The Boundaries of Welfare: European Integration and the New Spatial Politics of Social Protection* (Oxford University Press 2005) 205. Importantly, most citizens see themselves as European citizens, even if second to their respective State nationality. See European Commission, 'Standard Eurobarometer 91: European Citizenship' (2019) <https://europa.eu/eurobarometer/surveys/detail/2253> accessed 1 March 2023.

[856] See Anastasia Iliopoulou Penot, 'The Transnational Character of Union Citizenship' in Michael Dougan, Niamh Nic Shuibhne and Eleanor Spaventa (eds), *Empowerment and Disempowerment of the European Citizen* (Hart Publishing 2012). On the different approaches (political, legal, theoretical and social) to European citizenship, see Mihai Alexandrescu, 'European Union Citizenship and Its Avatars' in Mihai Alexandrescu (ed), *Citizens of the European Union: Status, Identity & Beyond* (Presa Universitară Clujeană 2023) 13.

unity could restore the influence they had lost.[857] In other words, once peace and the seeds of economic integration were laid down, the Union started looking not only inwards but outwards, in an evolving sense of Member States' self-preservation through the Union by resorting to integration with increased political significance.[858]

In fact, with the monetary union came a simultaneous evolutionary acknowledgement regarding the connection between the EU and its citizens, which was reflected in the Treaty of Maastricht. Crucially, Member States recognised and established EU citizenship, currently under article 20 TFEU, while the TEU states that the Union's aim is to promote peace, its values and the well-being of *its peoples*, offering *its citizens* an array of guarantees (article 3 (1) (2) TEU) with the EP directly representing the *Union's citizens* (article 10 (2) TEU).

In the literature, some authors strike a note of caution. In their view, Union citizenship as a form of transnational connection is a legal creation with limited adherence to reality. From this perspective, the bond that is necessary in order to form a European *demos* is lacking.[859] This is also expressed by the *BVerfG,* which stated, in its Maastricht judgement, that the Union must be regarded as a compound of States that does not possess a legitimising community of its own. Rather, the people of Europe primarily legitimise themselves by their respective national parliaments and, complementary, by the European Parliament.

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[857] European Commission, 'Report of the Study Group "Economic and Monetary Union 1980"' (1975) <https://aei.pitt.edu/1009/1/monetary_study_group_1980.pdf> accessed 8 March 2023, 1; Delors (n 212) 25.

[858] Monetary union improved the federal spirit of the political projects from the early 1950s and 1960s. Arguably, Brexit and the war in Ukraine have sparked the same impetus, as the establishment of the European Political Community, in 2022, has shown.

[859] Susanna Cafaro, 'The European Politeia: Democracy and Citizenship without a State' in Davor Jančić (ed), *The Changing Role of Citizens in EU Democratic Governance* (Bloomsbury Publishing 2023) 31, 33; Weiler, Haltern and Mayer (n 301); Barreau (n 841) 54; Marcel Kaufmann, 'The Legitimation of the European Union - Democracy versus Integration' in Hermann Pünder and Christian Waldhoff (eds), *Debates in German Public Law* (Hart Publishing 2014) 263, 280. Recently, Joseph Weiler reiterated the relevance of the no-demos thesis, particularly in the context of the euro crisis, whereby a fractious discourse between Northern and Southern Europe erupted. See Joseph Weiler, 'United in Fear - The Loss of Heimat and the Crises in Europe' in Lina Papdopoulou, Ingolf Pernice and Joseph Weiler (eds), *Legitimacy Issues of the European Union in the Face of Crisis* (Nomos 2017) 359, 366. While I certainly see reason in the assertion, in hindsight it seems that the management of the euro crisis may have been a pivotal moment for European integration. Indeed, the euro crisis brought the flaws of the EU edifice into broad daylight. But it was more than that: it brought the effects of Member State interdependence to the forefront of the European public, something that was not very visible in the 'good times' of the first years of the euro. The progressive internalisation of this situation in the European public has permitted the adoption of a different approach to the pandemic crisis (with the enactment of NGEU) and even the energy crisis pursuant to the war in Ukraine (with very few exceptions in the political discourse, there was overwhelming support for a solidarity-based response).

Hence, Union citizenship is seen as a subsidiary institution that cannot reach the significance of national citizenship. Its only purpose is to express the existing degree of joint policy organised at the Union level in terms of individual rights. Accordingly, the EU must be legitimated by a dual structure in which Member States, not its citizens, must be considered central reference points.[860] Importantly, then, the current conception is that taxation powers are linked to national budgets because they reflect national sovereignty and identity, which Member States want to preserve. Therefore, the underlying teleology of the Treaties is necessarily restrictive in its interpretation of the concept of own resources enshrined in article 311 TFEU.

I cannot follow this line of argumentation. At the outset, what should be understood by *demos*? Indeed, in ancient Greece, this elusive concept could range from 'the rabble, the lower classes, the public for whom ceremonies were organized, through to the *pleiones'*.[861] Some influential Greeks did not view democracy as a system that defined those who governed but, rather, those who were on the receiving end of the State's welfare. As a result, *demos* was defined as the masses. In view of the conceptual vagueness, is it politically unacceptable for a group of people, living in peace and freedom, in the same geographical space, having grown increasingly interrelated since 1957, to form a *demos*?[862]

Moreover, EU constituent power is not held by Member States alone, as it is shared with EU citizens. As Habermas argued, EU citizens hold a double capacity in the exercise of constituent power, both as citizens of their Member States and of the Union. Therefore, the division of sovereignty would not treat Member States and the EU as different subjects, but as two capacities of the same subject (ie the citizens in their legitimating role of different democratic levels). Importantly, the division of sovereignty does not apply at the source of the powers of an already constituted entity, but at the source of the entity to be constituted. As a result, Kompetenz-Kompetenz should be excluded, given that citizens are a democratic sovereign.[863]

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[860] See, for instance, Waldhoff, 'Legal Restrictions and Possibilities for Greater Revenue Autonomy of the EU' (n 837) 157; Dieter Grimm, 'Braucht Europa Eine Verfassung?' (1995) 12 JuristenZeitung 581; Lehner (n 142) 23.

[861] Tom Eijsbouts, 'People and the Peoples in EU Law To Debung the No-Demos Myth' in Lina Papadopoulou, Ingolf Pernice and Joseph Weiler (eds), *Legitimacy Issues of the European Union in the Face of Crisis* (Nomos 2017) 113, 121.

[862] ibid. 122.

[863] Jürgen Habermas, *Zur Verfassung Europas* (Suhrkamp 2011) 66. In a similar vein, see Christian Calliess, 'Art. 1 (Ex-Art. 1 EUV) [Gründung Der Europäischen Union; Grundlagen]' in Christian Calliess and

In my view, this evolution is a clear expression of the double telos of federations, which is generally based on the principles of independence and interdependence.[864] On the one hand, Member States come together in a 'federation to preserve themselves politically. Their statehood and autonomy are therefore not dissolved'. Indeed, federations are established in response to threats.[865] On the other hand, autonomy works both ways, as an expression of the dual source of authority: the federation holds distinct political authority from Member States, therefore, is not subordinated to its constituent units. As a result, by coming together in a federation, 'Member States give birth to a new political association that is autonomous from them. A federal union of states is different from the sum of its parts'. Hence, the federation is characterised by a 'double autonomy: the autonomy of the Member States and the autonomy of the Union as a whole […] the wish to live together without being one; and the wish to remain autonomous, without being fully separate from one another'.[866]

In this sense, a hierarchical relationship between the Union and Member States does not correctly explain the connection established in a federal union of States. Rather, the EU is characterised by a plurality of constitutional orders and foundational authorities that are in a heterarchical and interactive relationship with one another, as argued by constitutional pluralism.[867]

Matthias Ruffert (eds), *Das Verfassungsrecht der Europäischen Union mit Europäischer Grundrechtecharta: Kommentar* (CHBeck 2011) para 1-82, 19. However, this conception counters other views on Kompetenz-Kompetenz, whereby this power is equated with sovereignty. This hierarchical view where the Kompetenz-Kompetenz (therefore, sovereignty) lies with Member States, taken especially by the *BVerfG*, justifies the adamant protection of the ultra vires review. Supporting this view see Barreau (n 841) 37; Dieter Grimm, *The Constitution of European Democracy* (Oxford University Press 2017) 39; Paul Kirchhof, 'The European Union of States' in Armin von Bogdandy and Jürgen Bast (eds), *Principles of European Constitutional Law* (2nd edn, CHBeck 2009) 735.

[864] Arthur Benz, 'Squaring the Circle? Balancing Autonomy and Intergovernmental Relations in Federal Democracy' in Tracy B Fenwick and Andrew C Banfield (eds), *Beyond Autonomy: Practical and Theoretical Challenges to 21st Century Federalism* (Brill | Nijhoff 2021) 11.

[865] Woźniakowski, *Fiscal Unions: Economic Integration in Europe and the United States* (n 369). In the EU, reactions to the euro crisis, Brexit, the pandemic, the energy crisis and the war in Ukraine were, in my view, all manifestations pursuant to the acknowledgement of an existential threat to the Union: the fear of losing *heimat*, as mentioned by Weiler. See Weiler, 'United in Fear - The Loss of Heimat and the Crises in Europe' (n 859) 375. In fact, the war in Ukraine is serving as an engine of integration, as argued by Håkansson. See Calle Håkansson, 'The Ukraine war and the emergence of the European commission as a geopolitical actor' (2024) 46 Journal of European Integration 25.

[866] Larsen (n 848) 78, 105.

[867] On constitutional pluralism see Schütze, 'Demoicracy in Europe: Some Preliminary Thoughts' (n 302); Matej Avbelj and Jan Komarék (eds), *Constitutional Pluralism in the European Union and Beyond* (Hart Publishing 2012); Miguel Poiares Maduro, 'Contrapunctual Law: Europe's Constitutional Pluralism in Action' in Neil Walker (ed), *Sovereignty in Transition* (Hart Publishing 2003) 501.

Hence, the EU, as a Union with federal features,[868] cannot be considered as subject to its Member States, as it has a direct responsibility vis-à-vis its citizens. From this perspective, the adoption of the euro is as much an expression of this commonality as it is a need to adjust the legal framework to better reflect this. It also expresses the contradictory nature of federations in their attempts to be conservative and forward-looking. It aims to be conservative, given that it specifically aims to preserve the diversity and identity of its constituent States, which is, simultaneously, the reason for its very existence.[869] It aims to be forward-looking because it aspires to a future that Member States can only envision: being united.[870] In turn, this unity presupposes a reconciliation of divergences between States and peoples, which creates an enduring tension that must be channelled through democratic and integrated procedures in a way that restrains the States' powers in the federal setting.[871]

In other words, the Union originally envisioned by the Treaty was one of Member States, in which citizens were indirectly connected but also partitioned along their respective States of origin. In contrast, the TEU reflects a significant evolution, whereby Member States recognise the existence of a direct connection between the Union and its citizens: increasingly, citizens bond with the Union despite Member States and not only because of them.[872] As in US constitutional history, the main difference between the Articles of Confederation and the 1787 Constitution is that the latter is primarily focused on individuals and not on States.[873]

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[868] Murray Forsyth, *Union of States: The Theory and Practice of Confederations* (Leicester University Press 1981) 183.

[869] Diversity also encompasses the different reasons for EU membership by each Member State, deeply connected to their own historical development as a State. See Larsen (n 848) 121. See also Jaakkola, who argues that conferring the 'power to collect taxes on the EU would not hinder Member States' prospects of using taxes for their democratically established ends. Member States, as the primary sites of the European taxpayer's social and economic ties, would retain their power to tax alongside the EU and they would still be allowed to use taxes for various fiscal and redistributive purposes'. See Jussi Jaakkola, 'From the Governance of National Tax Systems to Governing Through European Taxation: A Justification for the EU's Power to Levy Taxes' in Johan Lindholm and Anders Hultqvist (eds), *The Power to Tax in Europe* (Bloomsbury Publishing 2023) 59, 75.

[870] Martin Diamond, 'The Ends of Federalism' (1973) 3 Publius: The Journal of Federalism 129, 130. See also Everling (n 853) 733, which argues that the federal principle 'reflects the assemblage of local and regional corporations and states, as well as their citizens [in]to a political entity capable of acting'.

[871] Likewise, the aim of the US Constitution was not to 'destroy the existence of the States but only to restrain it'. In fact, it only gave expression to 'a recognized power that had to be treated gently and not violated'. See Alexis de Tocqueville, *Democracy in America* (Eduardo Nolla ed, vol I, Liberty Fund 2012) 199.

[872] In this vein, see Habermas (n 863) 48.

[873] *Hylton v United States* [1796] 3 U.S. 171, in particular the opinion of Justice James Iredell, which was one of the most fervent supporters of States' rights during the Philadelphia Convention. See also Bruce Ackerman, 'Taxation and the Constitution' (1999) 99 Columbia Law Review 1.

This increased bond does not, however, peril diversity in Europe. Neither should there be fear that homogenisation endangers the integration process.[874] In fact, the reality is quite the opposite. By acknowledging the autonomy of Member States as a defining feature of federations (and that of the EU), it is necessary to conclude that respect for the diversity of its citizens is an intrinsic characteristic of the system.[875] In fact, it must be seen as a necessary condition for its broad societal acceptance. Connection with States of origin finds parallel with US constitutional history, whereby both the constitutional expression of 'people', as well as the empirical data, supports the view that no reference was being made to a new 'American nation', as the hodiern interpretation may suggest.[876]

As important as respecting diversity is, we should be mindful that the coexistence of unity and diversity in the federation is based on the condition of a certain degree of homogeneity between its Member States. For this reason, Member State autonomy is constrained by the EU's constitutional identity, as established in article 2 TEU. An example of this supranational constraint is the liberal democracy and rule of law contest with Poland and Hungary. In the US, for instance, the contest over slavery lasted for decades and was ultimately settled with a Civil War.[877] In other words, while diversity is a feature of federations, the degree of difference may not be so wide as to make them

[874] Joseph Weiler argues that, no matter how close the Union, it will always remain a union of different peoples and political communities. In his view, this is because a 'one nation' Europe is seen as endangering the diversity that European peoples want to preserve. See Joseph Weiler, 'Federalism without Constitutionalism: Europe's Sonderweg' in Kalypso Nicolaïdes and Robert Howse (eds), *The Federal Vision: Legitimacy and Levels of Governance in the United States and the European Union* (Oxford University Press 2001) 54, 67.

[875] This idea is conveyed by Waldhoff in Christian Waldhoff, 'Federalism – Cooperative Federalism versus Competitive Federalism' in Hermann Pünder and Christian Waldhoff (eds), *Debates in German Public Law* (Bloomsbury Publishing 2014) 117, 127-128.

[876] On the contrary, the original draft of the preamble to the 1787 Constitution expressly mentions the people of the States of New Hampshire, Massachusetts, Rhode-Island and Providence Plantations, Connecticut, New-York, New-Jersey, Pennsylvania, Delaware, Maryland, Virginia, North-Carolina, South-Carolina, and Georgia. Empirically, most citizens of the United States in 1790 did not identify the US as one nation. Rather, they would identify not as American but as a citizen of their State of origin. See Samuel Morison, *The Oxford History of the United States, 1783–1917,* vol I (Oxford University Press 1927). John Calhoun also argued that there was no political community in the US and, therefore, the people of the United States could not be considered as constituting one people or nation. Accordingly, the citizens ultimately owed their allegiance to the States and not the Union, as currently argued by the *BVerfG* regarding the EU. See John Calhoun, 'A Disquisition on Government and a Discourse on the Constitution and Government of the United States' in Richard K Crallé (ed), *The Works of John C.Calhoun: Volume 1* (Steam Power-Press 1851) 162. It appears that this understanding, even after the enactment of a Constitution, significantly eases the fears that such a foundational document, if it were to be enacted in the EU, would turn it into a *Bundesstaat*, as opposed to a *Staatenverbund*. Conveying this concern, see Grimm, *The Constitution of European Democracy* (n 863) 234.

[877] This was not exclusive of the United States. The question of sovereignty was also posed, for instance, regarding the Holy Roman Empire of the Germanic Nation, for the German Confederation of the nineteenth century, the Swiss Federation and, with particular intensity, for the German Empire of 1871. See Grimm, *The Constitution of European Democracy* (n 863) 39.

differ significantly on a fundamental level: the federation should be composed of States of the same nature[878] if it is to preserve a minimum level of unity, such as shared materials interests (ie the defence of welfare) and uniform civilization.[879]

In this vein, preference heterogeneity and cultural diversity are significantly more acute within Member States than between Member States. In fact, there may be more similarities between regions of Member States (ie northern Italy and southern Germany) than between national regions (ie northern and southern Italy). Moreover, the differences between the citizens of EU Member States are not greater than those that exist between the citizens of US States. Therefore, it is legitimate to ask, if democracies in (each of the) EU Member States and the US can handle substantial diversity, why the EU (as a whole) could not cope with a similar level of heterogeneity?[880]

Therefore, (national) identity is not necessarily synonymous with homogeneity. On the contrary, identity is a self-perception resulting from the awareness of belonging to certain groups. To a large degree, it is based on contingent factors and, for many, founded on heterogeneous contexts. Different layers of identity are, therefore, possible, without any of them needing to claim precedence.[881]

Be that as it may, a broader exercise of the power of taxation at a supranational level is at least as contentious an issue, as was the introduction of a common currency. The legal solution currently in place is mainly an expression of a deeper, substantive issue relating to the kind of integration in play. Consequently, the difficulty in promoting supranational taxation can be explained by an argumentation mismatch. While the attainment of the single market was more sensitive to arguments of an economic nature, the same cannot be said of a common budget and the correlated issue of taxation, which Member States traditionally consider should remain a matter of exclusive competence.[882]

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[878] Charles de Montesquieu, *The Spirit of the Laws* (Anne Cohler, Basia Miller and Harold Stone eds, Cambridge University Press 1989) 131.
[879] Tocqueville (n 871) 270.
[880] Alesina, Tabellini and Trebbi (n 577) 171. This study does not cover eastern Member States and relates to the 1980-2009 period, therefore, not covering the multiple crises that followed. Despite the so-called north-south divide that erupted during the euro crisis, the EU was nonetheless able to withstand it and, ultimately, adopt a different approach to COVID-19 and the war in Ukraine.
[881] Stefan Kadelbach, 'Union Citizenship' in Armin von Bogdandy and Jürgen Bast (eds), *Principles of European Constitutional Law* (2nd edn, CHBeck 2009) 433, 474.
[882] Francesco Farri, 'Between Form and Substance: At the Root of the Limits of the EU Taxing Powers' in Johan Lindholm and Anders Hultqvist (eds), *The Power to Tax in Europe* (Bloomsbury Publishing 2023) 83.

In fact, Member States' experience with the creation of monetary union shows that, when sovereignty and identity-related issues are at play, economic soundness is a necessary but ultimately insufficient condition to bring about substantial change. Therefore, it is not enough to rely on concepts such as fiscal federalism, efficiency and economies of scale in order to achieve integration in EU budgetary and fiscal realms.

As already noted, the Union's nature has deeply evolved through the development of a direct connection with its citizens.[883] Moreover, a relation of trust with its institutions seems to have developed and endured.[884] This is essential for European citizens to develop trust between themselves,[885] allowing them to link a shared array of values[886] to the pursuance and realisation of common objectives.

Additionally, since 2008, Member States have dealt with an array of crises for which an EU response was ultimately necessary.[887] This shows that, in its current state,

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[883] Arguably, the most relevant indicator is the feeling of citizenship. In this regard, the Spring 2019 Eurobarometer informs us that 73% of citizens feel European, up from 62% in 2010, especially among the segment that is definitely sure. On the contrary, 26% do not feel like European citizens, down from 37% in 2010. Importantly, only 8% are sure not to feel European. See European Commission, 'Standard Eurobarometer 91: European Citizenship' (n 855) 39. These figures contrast with the early 1980s, when 46% of people never thought of themselves as European citizens. See European Commission, 'Euro-Barometre: Public Opinion in the European Community' (1983) <https://europa.eu/eurobarometer/surveys/detail/1441> accessed 9 March 2023, 76. Arguably, the war in Ukraine only came to reinforce such European feeling among citizens, as empirical data seems to suggest. See Nils D Steiner and others, 'Rallying around the EU Flag: Russia's Invasion of Ukraine and Attitudes toward European Integration' (2023) 61 Journal of Common Market Studies 283.

[884] The EP has consistently been the most trusted EU institution, followed by the European Commission. See European Commission, 'Standard Eurobarometer 97 Summer 2022: Public Opinion in the European Union' (2022) <https://europa.eu/eurobarometer/surveys/detail/2693> accessed 9 March 2023, 106. Attributing particular relevance to trust, see Barreau (n 841) 57. Petar Markovic, 'Looking for the Silver Lining: The COVID-19 Pandemic as a Window of Opportunity for Citizen Participation in the EU' in Davor Jancic (ed), *The Changing Role of Citizens in EU Democratic Governance* (Hart Publishing 2023) 293.

[885] Although there are few studies on the subject, there is some empirical basis to affirm that confidence in government is a precondition for the development of individual trust. As concluded by Domański and Pokropek, political trust transcends partisan, cultural or historical attachments. Therefore, 'people will trust one another for as long as they perceive that their political institutions guarantee a reliable environment where people find trustworthiness and sincerity'. See Henryk Domański and Artur Pokropek, 'The Relation between Interpersonal and Institutional Trust in European Countries: Which Came First?' (2021) 213 Polish Sociological Review 87.

[886] While considering that a lack of common *demos* does not allow the EU to levy taxes on its citizens, which the author designates as the lack of power (not competence) to tax, Barreau argues such a power may be recognised by way of a common european *ethos*. See Barreau (n 841) 57.

[887] These crisis are, namely, the financial crisis, sovereign debt crisis, migration crisis, COVID-19, climate change, war in Ukraine. Notably, as a response to the most recent crises, NGEU has seen a shift in the classic North-South divide, particularly regarding the German interpretation of the programme. Specifically, Germany broadly considers NGEU as a way to strengthen EU identity/polity, as a matter of solidarity and to reinforce the position of the EU as a global player. In essence, it increasingly sees fiscal solidarity as necessary to safeguard the political cohesion of the Union as well as to provide an opportunity to Southern economies to catch up with the North. On the contrary, the so-called Northern coalition deems large-scale fiscal solidarity as justified only if it is exceptional and temporary and if it serves to strengthen

the EU already adds significant value to the Union and Member States' polities. Crucially, it also signals potential to increase its role which is, in itself, a factor to consider in the legitimacy to lay and collect taxes.[888]

The EU budget is at odds with these developments, as it still depicts a Union of fully sovereign, autarkic States with connections purely based on, and limited to, economic interests broadly based on national concerns, progressively transforming the EU budget into an anachronic instrument.[889] In my view, citizens' perceptions regarding the EU budget are mostly a result of the current setup of expenditure. As the overall amount is small, visibility is reduced. Hence, people perceive their respective national public spaces as the most effective spaces in which to perform political debates and as most relevant regarding budgetary choices. From this perspective, it is possible to better understand why, during the financial and euro crisis, a transnational debate did not occur, despite the fact that national political families had roughly the same debates and arguments as their counterparts in other Member States.[890]

Moreover, any level of fragmentation further erodes awareness and effectiveness. This occurs to a large extent in the EU and, as a result, the budget only impacts the fringes of the EU population. This is the reason that most aptly explains the general perception that the EU budget delivers poor value-for-money[891] and the ensuing fear that the introduction of a tax-based revenue stream could become contentious. However, the EU's fear of sparking negative public reactions is, to an extent, an assumption that the policies financed by the EU budget are flawed and that the public is correct in their assessment. Surely, better communication with citizens regarding the added value of current expenditure would be harmless[892] and there are some overall positive outcomes of EU expenditure, such as cohesion policy.

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the internal market. Hence, diverging visions on what the EU is and why it should be embraced coexist along the Northern–Southern cleavage in Europe. See Miró (n 424) 4.

[888] Jaakkola (n 869) 76. This is also attested by the mismatch between what the EU budget delivers and what EU citizens expect from it.

[889] European Commission, 'Future Financing of the EU, Final Report and Recommendations of the High Level Group on Own Resources' (n 155) 15; Crowe, 'The European Budgetary Galaxy' (n 148).

[890] The doubt is expressed by Mattias Kumm, 'Causes of the Financial Crisis and Causes of Citizen Resentment in Europe. What Law Has to Do With It' in Lina Papadopoulou, Ingolf Pernice and Joseph Weiler (eds), *Legitimacy Issues of the European Union in the Face of Crisis* (Nomos 2017) 129, 144. The result was that the Union was indelibly associated with austerity measures to which no alternative seemed to exist. In this unidimensional political Europe, those opposing such policies were qualified as Eurosceptics.

[891] Cipriani (n 365) 75.

[892] ibid.

Most importantly, however, on a conceptual basis, the EU budget should not be a mere redistributive instrument between Member States, as it currently is. Instead, it should work as a tool to internalise commonality in the EU and give it a more concrete expression to which people can relate to. Crucially, more than a budget, it should be an instrument to bolster voice in EU citizenry, whereby people can have meaningful debates, exercise their choices through consequential vote and pay for those choices. Crucially, as already argued in this thesis, the nature of expenditure is inextricably linked to the nature of revenues. Therefore, if expenditure is mostly invisible and misaligned with citizens priorities, they will not be willing to finance it. Additionally, if there is no financial willingness, it will be difficult to alter the nature of expenditure. Let us focus on the funding first.

1.2.3. A budget funded by taxes based on policies?

Some of the own resources, in the early stages of integration consisted of customs duties – levies collected within the framework of the CAP – as well as a residual own resources calculated in regards to the VAT accruing from consumer transactions conducted in the framework of the internal market.

Therefore, the initial sources of financing were linked to policy objectives and the activities of the Community[893] and some scholars and commentators have argued that drawing revenue from resources generated through the implementation of common policies will foster stronger Union citizenship.[894] For instance, Maduro argues that 'the sources of EU revenues should be determined by what makes the Union more legitimate to its citizens by making visible the reasons for the Union's existence and linking its revenues to the benefits and costs that different social groups obtain from European integration', for instance, 'economic activity enabled by the internal market; economic activity that, while taking place in a Member State, has important externalities in other Member States; or economic activity that Member States can no longer individually

[893] Crowe, 'The European Budgetary Galaxy' (n 148) 431.
[894] Richard Crowe, 'An EU Budget of States and Citizens' (2020) 26 European Law Journal 1. See also Tomasz P Woźniakowski and Miguel Poiares Maduro, 'Why Fiscal Justice Should Be Reinstalled through European Taxes That the Citizens Will Support : A Proposal' (*STG Policy Briefs*, 2020/07) <https://cadmus.eui.eu/handle/1814/69379> accessed 12 December 2023, in which, through empirical evidence that EU citizens would be supportive of EU taxes if connected with EU policies.

regulate and tax on their own.'[895] This reasoning is shared by Jaakkola, to whom the cross-border element of economic activities is key in allocating tax bases in the realm of the EU's taxing authority.[896] In this vein, Kumm argues that the argument, according to which a sufficiently strong identity is necessary for the EU to raise own resources, is rather weak. In his view, identity is important for the allocation of competencies and definition of policies. However, once competences are allocated and policies defined at a European level, 'then it is unlikely that funding these policies in line with criteria that are meaningfully connected to the economic benefits bestowed would be regarded as unacceptable'. In particular, by raising taxes or levies on persons and transactions profiting from the internal market, one connects regulatory responsibility with financial accountability.[897]

A good example of this is the repayment of NGEU, in which this reasoning is at the forefront of the proposal for new own resources.[898] Specifically, the European Commission proposes that 25% of the revenues generated by the EU Emissions Trading System, 75% of the revenues generated by the EU Carbon Border Adjustment Mechanism and 15% of the proceeds of the taxes to be imposed on large multinational enterprises, should become an own resource for the EU budget, rather than accrue to national budgets. The estimate is that these three new own resources would amount to a total revenue of €12 to €13.5 billion annually,[899] which would be significant but ultimately insufficient to cover the EU's annual repayments under NGEU in its entirety. In order to account for this uncertainty, the 2020 ORD stipulates that national contributions can possibly cover

[895] Maduro, 'A New Governance for the European Union and the Euro: Democracy and Justice' (n 408) 12-13.
[896] Jaakkola (n 869) 77. See also Ivailo Kalfin, 'The Importance of Own Resources in The EU Budget' in Brigid Laffan and Alfredo De Feo (eds), *EU Financing for Next Decade: Beyond the MFF 2021-2027 and the Next Generation EU* (European University Institute 2020) 61, 69.
[897] Kumm, 'Causes of the Financial Crisis and Causes of Citizen Resentment in Europe. What Law Has to Do With It' (n 890) 143.
[898] European Commission, 'Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions - The Next Generation of Own Resources for the EU Budget, COM (2021) 566 final' <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021DC0566&from=EN> accessed 28 March 2023; Christian Neumeier, 'Political Own Resources: Towards a Legal Framework' (2023) 60 Common Market Law Review 319.
[899] Slightly higher estimates (up to €17 billion per year) are presented by the European Parliament. Margit Schratzenstaller and others, 'New EU Own Resources: Possibilities and Limitations of Steering Effects and Sectoral Policy Co-Benefits' (2022) <https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2022)731895> accessed 29 March 2023, 162.

NGEU debt. Other own resources are also explored, notably a financial transaction tax, fuel tax and aviation tax, which could generate additional revenue.[900]

I share the opinion that, by linking policies to tax authority, there is a more straightforward connection between that which the EU delivers and that which it collects, thereby fostering legitimacy. It is also true that the most effective way to internalise the consequences of free movement is to levy EU taxes, notably mobile tax bases, as a transnational economic order evades national tax policies. In this vein, the EU would be solving a collective action problem.

However, policy-related taxes are employed to steer or further certain political objectives (ie countering climate change), which should be used as exceptions. Not only can they be misleading to citizens, given that they tend to become part of the system[901] even if the primary justification for their adoption ceases,[902] but they can also increase central planning (with a concomitant loss of Member State autonomy and possible misallocation of capital). Hence, if this methodology is employed with a revenue objective, then the tendency might be for the European Commission to bundle taxes with new policies or, more worryingly, to propose policies not for the sake of EU citizenry but the sake of the EU budget.

Another problem is related to the identification of tax subjects. If, for some policies, such a procedure might be relatively straightforward (ie tax subjects benefiting from cross-border activities or developing activities detrimental to the environment), the situation may differ significantly regarding other policies, for instance the common foreign and security policy. Indeed, article 2 TFEU confers competence to the Union to define and implement this policy in accordance with the TEU. However, how do we measure the economic gains and diplomatic clout that global influence might bring about? And who are we going to tax? The same may be applied to defence or health policy.

Moreover, if the objective is to address the issue of Member State dependence and achieving EU budgetary autonomy, as it should, it follows that the sufficiency criterion

[900] ibid. 135. However, the foreseen yearly revenue from these three additional sources varies significantly. The financial transaction tax (if adopted by 10 Member States under enhanced cooperation) ranges from €7.7 to €14.4 billion; for fuel tax, an additional of €0.03 and €0.20 per litre of fuel, which ranges from €11.5 and €76 billion; and an aviation tax, which ranges from €6 billion to €9.9 billion. See also Michael Thöne, 'Transferring Taxes to the Union: The Case of European Road Transport Fuel Taxes' in Thiess Büttner and Michael Thöne (eds), *The Future of EU-Finances* (Mohr Siebeck 2016) 113, suggesting the EU could levy environmental taxes based on article 192 TFEU.
[901] Brennan and Buchanan (n 441) 222.
[902] Fuest (n 375) 99.

must be an essential component in any discussion surrounding new own resources. From this perspective, policy-related taxes are unsatisfactory, as they are not created and designed to fund a budget, as is the primary function of taxes. Despite the effort to introduce alternative sources of funding other than that based on GNI, it is difficult to predict the sufficiency of revenue generated from own resources that is essentially based on environmental concerns, especially if environmental objectives are gradually achieved by Member States as well as third countries. This is not to say that this method is unacceptable in the short-term, especially considering the incipient nature of the Union's budgetary resources, but that its limitations are apparent from the outset.

Nevertheless, one may assume that more funding will be necessary. In fact, there is growing support to not only turn NGEU into a permanent instrument, but to adopt similar instruments in other areas of concern, such as the costs of climate change mitigation and adaptation, EU defence or rising energy prices.[903]

All in all, I would say that a functional connection between funding and expenditures, while pragmatic and feasible in the short-term, will ultimately be insufficient. Accordingly, we should strive for solid tax bases instead of thinking of taxes and levies as a side effect of EU policies. As in the United States, the first direct tax on income was established during the Civil War. Although it was temporary and extinguished shortly after the war, it was necessary due to federal income shortage, as revenue from custom duties and indirect taxes was mostly allocated to paying States' debts associated with the Revolutionary War.[904] Interestingly, an event, similar to that which took place in the US in the late eighteenth century, may have transpired in the EU, in which States refused to comply with growing pecuniary calls from the US Government. Significantly, the preference for new own resources over increased national contributions for NGEU repayment may be interpreted as both a recognition of its transnational nature and a refusal to increase Member State transfers. In the US, the insufficiency of commercial imposts led Alexander Hamilton to argue that such a resource alone would

[903] After NGEU, there were already mentions to possibly reforming and improving the EU fund for defense (https://www.politico.eu/article/europe-defense-efforts-budget-underwhelming-war-ukraine-russia) and to establish an EU fund to tackle the energy crisis (https://www.spdfraktion.de/system/files/documents/position-leitlinien-zukunftsgerichtete-europaeische-industriestrategie.pdf). For an overview of EU developments in the field of collective defense see Elie Perot, 'The European Union's nascent role in the field of collective defense: between deliberate and emergent strategy' (2024) 46 Journal of European Integration 1.

[904] Woźniakowski, 'The Fiscal Origins of American Power: Federal Tax Policy and US Territorial Expansion in the Nineteenth Century' (n 368).

not suffice even for present needs, let alone future needs, as 'every [power] ought to be proportionate to its [object]'.[905]

1.2.4. Linking funding to citizens to promote participation

A participation-centred approach to EU taxation calls for an assessment of how well the object of taxation was chosen vis-a-vis the goal of addressing the identified minoritarian bias in EU economic and budgetary policies. In other words, the focus on each tax at a supranational level should be on the incentives granted for citizen participation in their polity to counter the interests of the few. In an intergovernmental system of governance, such as the one currently in force in the EU, that means that each government fosters the interests of their own population (each of them minoritarian vis-à-vis the EU population as a whole).

From this perspective, indirect taxes (ie VAT, EU Emissions Trading System, plastic and fuel) or direct taxes with a narrow scope of application (ie multinational enterprises, financial transaction tax, high incomes and wealth) lack sufficient powers of mobilisation of EU citizenry due to their relative lack of visibility.[906]

In my view, it follows that broader direct taxation of the Union's citizens is necessary to entail mobilisation and could be a less imperfect alternative, which delivers a better balance, namely on economic policy, both from a governance and societal point of view. It would also cause the nature of EU integration to change fundamentally. Through direct taxation, European citizens would not only connect *with* the Union but also *between* themselves in a process that I would designate the horizontalisation of the Union. If we look at the experience of the US in order to shed some light on the potential democratic impact, it would significantly increase participation in the political process.[907]

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[905] Hamilton, 'No 30: Concerning Taxation' (n 355) 147.

[906] With a different view, supporting that indirect taxes, such as VAT, could deliver this outcome see Cipriani (n 365) 72. In this author's view, EU VAT would operate in tandem with national VAT system, without the need to create a parallel system.

[907] This is what occurred after the 16th amendment came into force, in 1913, which vested the Federal Government with the power to lay and collect direct taxes on income without apportionment between States. In fact, there were a total of 15 million ballots cast in the 1912 US presidential election. This compares with 18.5 million in 1916 and 26.6 million in 1920, almost doubling the figures in eight years. Since the US Government raised direct taxes pursuant to the 1929 Great Depression, participation grew significantly from 36.7 million in 1928, to 39.6 million in 1932 and 45.5 million in 1936. In this regard, it is worth noting that, until 1968, participation in the electoral act is roughly equivalent to the increase of the voting age population, which goes to show the motivation to vote. See https://www.statista.com/statistics/1139763/number-votes-cast-us-presidential-elections/. With a similar

If this understanding is correct, EU citizens' voice[908] would be reframed. On the one hand, the introduction of direct EU taxes to European citizens would prompt the increase of political participation, thereby creating the conditions to break the vicious circle of nationalistic *juste retour*, linking funding to citizens as a way to promote participation sequences concerning policy options. On the other hand, Member States should regain their economic policy autonomy, thereby re-establishing the value of citizens' vote in national elections (see below, Part IV, Chapter 2).[909]

Instead of the vertical link described in this thesis, whereby an attempt is made to enhance supranational legitimacy by procedural means, fiscal restrictions and surveillance are adopted to avoid the transfer of resources *between* States. While arguably allowing monetary financing to occur, the EU would be in a situation in which it could deliver equal treatment for equals.[910] Ultimately, resource legitimacy should be the main factor in choosing resources. Thus, citizens, rather than States, ought to be the main source of revenue.

1.3. EU expenditure

1.3.1. Linking expenditure to citizens to preserve the federal union of States

There are, essentially, two models of expenditure in the Union: one performed by the Union budget and one performed outside it. The stabilisation function is by and large conducted by the latter, mostly by way of the ESM and within the context of a financial emergency, which has been explained as having been a response to threat and, therefore, a form of federal constitutional defence.

Although crucial to the survival of the federation, the process of verticalisation introduced a strong unitary element,[911] which creates a paradox in the EU. In fact, many of the arguments against further fiscal integration rely, in essence, on the need to preserve national constitutional identities and the idea that the differences among the peoples of

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view, although reasoning in the context of the German *Länder* see Waldhoff, 'Federalism – Cooperative Federalism versus Competitive Federalism' (n 875) 127.

[908] See Albert Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations and States* (Harvard University Press 1970); Weiler, 'The Transformation of Europe' (n 35).

[909] For an overview of euro crisis emergency management, which sometimes introduced severe constraints of national democratic processes, see Kaidatzis, 'Socioeconomic Rights Enforcement and Resource Allocation in Times of Austerity: The Case of Greece 2015 – 2018' (n 707); Larsen (n 848).

[910] Equals are individuals in the same objective economic circumstances, usually employed in the calculation of tax burdens.

[911] Larsen (n 848) 149.

Europe are so wide and insurmountable that a pool of fiscally derived resources would put that at risk. How, then, can Europeans accept a unitary element of governance, present in complex periods (ie ESM) as well as on an on-going basis (ie the economic governance framework in force)? And it is in more difficult situations that all institutions perform worse. If this assumption is correct, then a vertical system of governance, especially in emergency situations (ie asymmetric shocks), risks hindering diversity and national identities, potentially pushing the Union to recurrent situations of inter-State tension and social conflict.

For this reason, as the example of Germany shows (see below, Part III, Chapter 2, Point 7.2),[912] it is undesirable to place States in a position of equal fiscal ability through a system of intergovernmental transfers, as highlighted by Buchanan[913] and Niskanen.[914] However, that is not the case with people, to whom the principle of equality, established in article 2 of TEU, should demand differentiation in treatment by taking into account the degree of citizens' economic and social disparity, regardless of their state of residence.

Consequently, through its budget, the EU could treat equals equally, not to ensure an equivalent standard of public services across Member States, but rather to offset the divergencies in the income and wealth levels within them. An understanding, such as the one I propose, would, I believe, positively address the 'poisonous tree' of European integration, which is the concept of the creation of a transfer union *between* States.

Union equity transfers to individuals would represent neither the subsidisation of some Member States nor charitable contributions to less financially well-off people. Rather, they would be necessary adjustments to keep the Union together and, as such, ethically owed to lower-income citizens. Therefore, potential inequities in the treatment of equals would be due to Member States' autonomous political decisions, unrelated to

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[912] See also Mattias Kumm, 'What Kind of a Constitutional Crisis Is Europe in and What Should Be Done about It?' (2013) WZB Discussion Paper No SP IV 2013-801 <https://bibliothek.wzb.eu/pdf/2013/iv13-801.pdf> accessed 5 April 2023, 16.

[913] James Buchanan, 'Federalism and Fiscal Equity' (1950) 40 The American Economic Review 583. Cautioning against this approach, Musgrave considers that although needs are experienced by individuals, they are experienced by individuals as citizens of particular jurisdictions. Hence, funds should be transferred from high capacity and low need jurisdictions to others of high need and low capacity. See Buchanan and Musgrave (n 440) 166.

[914] Niskanen argues that transferring money to States would suffer from the so-called 'fly-paper effect', ie money sticks where it lands. Therefore, a clear division of powers between supranational and national governments is of paramount importance, in order to reduce intergovernmental competition of a vertical nature. See Buchanan and Musgrave (n 440) 195. In the same vein, see Ehtisham Ahmad and Jon Craig, 'Intergovernmental Transfers' in Teresa Ter-Minassian (ed), *Fiscal Federalism in Theory and Practice* (International Monetary Fund 1997) 73, 82.

citizens' State of residence. In other words: equal treatment for equals is a value superior to that of equalisation among organic State units.[915]

The question then becomes: why should federal financing supersede supranationally mandated standards to be implemented at Member State level? Federal financing focused on citizens would be better than the alternative because adjustments between people living in different Member States should be an EU-wide concern, as evidenced by the EU's principles of equality and solidarity. In fact, this dynamic is also visible within each Member State, which denotes that solidarity between citizens is a widespread value, not confined to a few States. Of course, this does not necessarily imply uniform benefits, on the one hand, or exclusive supranational administration, on the other.[916]

Such an approach would entail several major advantages, by increasing foreseeability, transparency, effectiveness, the accuracy of citizens' expectations and the altering of inaccurate perceptions. First, it would detach potential future programmes that resemble NGEU from the occurrence of emergency events, making them more likely to be foreseen and, as a result, enhancing the Union's economic stability. Second, it would favour transparency, given that budgetary functions would not be mixed (ie in order to further certain EU policies, there would be no need to devise unrelated requirements, such as falling unemployment rates or GDP losses, as in NGEU, in order to provide some States with more funding).[917] Third, it would increase the effectiveness of the EU budget regarding its stabilisation function,[918] while redirecting national budgetary resources to different areas.[919] Fourth, the mismatch between citizens' expectations and what is

[915] Buchanan, 'Federalism and Fiscal Equity' (n 913) 591.

[916] In fact, relative metrics could be used regarding benefits, such as purchase-power-parity. Regarding administration of programmes, cash payments could be dealt with supranationally, while other direct services could be administered locally. See Helen Laad and Fred Doolittle, 'Which Level of Government Should Assist the Poor?' (1982) 35 National Tax Journal 323, 328.

[917] As Fuest argues, NGEU can be seen as a kind of insurance and redistribution mechanism, along usual national lines. In his view, 'one third of it is insurance going to the countries most affected while the other two thirds is money going to countries that have had problems before or are poorer', therefore, hindering its European nature. See Fuest (n 375) 91.

[918] For instance, corporate and income taxes are less pro-cyclical than VAT. By moving more quickly than the economy as a whole, they relief households and firms in downturns. Furthermore, these forms of taxation are more readily adjustable to the economic cycle, ie they do not need to be paid by companies that are making losses. See Lindner and Tordoir (n 145) 191, 204. In addition, the co-financing rates of current EU regional policy hinder a stable funding flow in recessions, as national and regional governments may come under fiscal strain, leading to cancellations of the projects at large.

[919] EU regional policy is frequently seen as being misaligned with national priorities. Therefore, national funds might be allocated to projects just because supranational funding is available. For instance, the committed funds for regional investment projects that materialised fell from 98.2% in 2000-2006 to 62.09% in the euro crisis period of 2007- 2013. This reduction suggests that a significant number of projects might

delivered by the EU is increasing, which means that indirect taxes will probably be insufficient to substitute current national contributions to the EU budget, *a fortiori* they will be unable to fund programmes such as NGEU or genuine EU policies. Fifth, it offers the ability to correct citizens' perceptions regarding inter-State financial relationships, namely dominance on the part of the most economically robust Member States and, conversely, subordination and guilt on less economically robust ones.[920] Finally, dependent on the definition of a clear set of competences between the supranational and national level governments, it would not over-harmonise economic policies with an encompassing top-down approach, thereby respecting diversity in the Union.

In order to bring this conceptual framework into place, however, one needs to take the EU budget's expenditure structure into account. As I have endeavoured to show, there is a fundamental link between the nature of revenue and expenditure. If that is so, then the proposed change to the former should only be adopted if a change to the latter is adopted. Indeed, it would be incongruent and, ultimately, indefensible, to argue for direct taxes on EU citizens while maintaining the current spending structure.

1.3.2. A generality principle for EU expenditure?

Basing expenditure on citizens is important in order to break the layer between Member States and the Union. However, there are other EU expenditures that do not necessarily embody this direct link. Rather, EU-added value spending means that all citizens may benefit, albeit in an indirect and diffuse manner.

In attempting to propose institutional changes to address minoritarian biases in EU economic and budgetary policies, it is necessary to keep in mind that the issue might not be tackled correctly. In other words, in my attempt to deal with the verticalisation problem, whereby national institutions and national interests are the primary focus, namely in the European Council and the Council, one needs to caution against the transfer of biases phenomenon from these institutions to other European institutions. For instance, some authors argue that the European Parliament should have a prominent, leading role

not be a priority for Member States. See ibid. 201. From the point of view of respecting each State's spending priorities, unconditional grants to sub-national governments are a better alternative because they will be guided by local preferences and needs. See Ahmad and Craig (n 914) 78.

[920] This specific point is very well explained by Kumm, 'Causes of the Financial Crisis and Causes of Citizen Resentment in Europe. What Law Has to Do With It' (n 890) 142.

in the budgetary process, including in the revenue realm, because they see this as embodying EU-wide legitimacy, hence bringing about an integrated view on the issues.[921]

Although conceivable, one should not take that conclusion as a straightforward way to resolve the issue. In fact, MEPs have local constituencies and may be interested in Union spending for their constituents, especially if such expenditure has a high degree of visibility, hence neglecting spending on European public goods.[922] Accordingly, we could merely be transferring biases from some institutions to others. In this case, such a transfer could very well be between the minoritarian biases identified in intergovernmental institutions (ie. the European Council and the Council) in the form of juste retour, for the so-called pork-barrel-spending associated with local constituencies in the EP. By primarily shifting our attention for this latter institution because of intergovernmentalism's shortcomings, we could not only fail to successfully address the underlying problem but also hinder democratic expectations. In fact, it could possibly exacerbate the issue regarding a 'transfer union' and entrench the EP's nationalistic approaches over the supranational budget.

In order to counter the fear of the exploitation of the few over the many, there were proposals to largely maintain the current institutional system of competitive federalism, by keeping a decentralised power to tax concomitant with reverse revenue sharing (essentially, GNI-based funding). Drawing from the experience of the US, the main rationale is that 'once a central government assumes significant control over the tax base of a community of subgovernments, it will invariably take on functions that are either best left to the subunits of government, or not worth performing at any level of government'.[923] From this perspective, the case against an EU Government's power to tax is that this power has, historically, been frequently abused. Unless properly constrained, either formally or by competition, political power tends to overreach. Therefore, by confining taxation competences to the national level, special interest spending could be effectively prevented from spreading all over the Union.

[921] Lehner (n 142) 38; Motte (n 842) 147.
[922] Friedrich Heinemann, 'Strategies for a European EU Budget' in Thiess Büttner and Michael Thöne (eds), *The Future of EU-Finances* (Mohr Siebeck 2016) 95, 108.
[923] James M Buchanan and Dwight R Lee, 'On a Fiscal Constitution for the European Union' (1994) 5 Journal des Economistes et des Etudes Humaines 219, 228. The authors provide an exemplificatory list of projects proposed for federal funding in the past, the nature of which has been replicated over the years. In their view, the projects are only viable due to the political benefits accruing for local representatives.

Moreover, transferring the power to tax to the supranational level enables the forming and enforcing of a tax cartel, whereby additional revenue taken from different layers of government will do more than offset any reduction in collected revenue. On the other hand, a Federal Government capable of collecting significant revenue would see an increase in the demand of centralised spending from sub-national authorities, possibly directed towards areas of governance of the exclusive responsibility of the latter.[924]

However, as I have explained, reverse revenue sharing, as a way to keep autonomous national taxation power, has important limits in EU budgetary history, as the interpretation of national transfer and EU budgetary expenditure shows. Indeed, projects with benefits that primarily accrue to the citizens of a certain sub-national or national jurisdiction should be approved and financed by their respective budgets. On the contrary, if the supranational level provides financing for local-added value projects, it would relieve national budgets from that expense but, most importantly, it would incur an opportunity cost from failing to provide community-wide benefits with these funds.

Hence, a generality principle should be attached to Union spending in order to ensure that majorities are required to approve expenditure able to generate value for every group of citizens, indistinctively.[925] Such a principle could substantially reduce minoritarian bias, either spending related to the allocation of funds or the stabilisation of the Union's economy. Moreover, it would improve institutional independence while deciding on expenditure and, importantly, better safeguarding the democratic process of a federation of States by establishing a connection between the nature of spending and revenue.

If conceived in this way, the Union would be able to reconcile national and supranational interests, thereby expanding the scope of EU policies and favouring cross-national ideological majorities. Hence, citizens' support of the Union's decisions would not be limited to the right to vote, directly or indirectly, for EU representatives or leaders.[926] These are necessary, but ultimately insufficient conditions. Rather, there is a need to develop what Weiler has designated a political messianism – that is the 'promise

[924] ibid.
[925] Buchanan and Musgrave (n 440) 26.
[926] Miguel Poiares Maduro, 'A Roadmap to Exit the Crisis: Democracy and Justice in Europe' in Lina Papadopoulou, Ingolf Pernice and Joseph Weiler (eds), *Legitimacy Issues of the European Union in the Face of Crisis* (Nomos 2018) 341, 355-356.

of an attractive Promised Land'.[927] In my view, in the context of the EU, a generality principle can better address output legitimacy as well as political messianism, just as the taxation of EU citizens can improve input legitimacy by leading to more quantitative (numbers) and qualitative (meaningful) participation in electoral and non-electoral moments in the EU public sphere.

Such a principle might not only counter minoritarian but also majoritarian bias. By its very nature, expenditure of this type would, necessarily, foster transnational divisiveness between citizens, as opposed to discord along national lines. Therefore, citizens' voice would not be confined to the national boundaries and economic might of their respective Member States. Rather, citizens would be in the minority or majority of ideology in the EU public sphere, which is more volatile than the economic indicators that currently define Member States' power.

Also, in this vein, EU expenditure would embrace two essential principles of fiscal federalism when placed in multinational contexts: non-centralisation and constituents' autonomy.[928] Regarding the former, by restricting spending to a generality requirement, centralisation at the federal level would be more difficult to instigate, as States are diverse and have distinctive local preferences. However, non-centralisation does not adequately capture the way in which the public policy development process shapes the polity as a whole. In fact, the exercise of governing in multinational and multilevel systems, necessarily, entails an identity assumption by the Federal Government and, therefore, places hurdles in the way of dealing with minorities. A generality principle could ease this effect.

Nevertheless, non-centralisation is not enough to deal with majoritarian bias – the autonomy of constituent parts is essential as well. Although I will better demonstrate this matter below (Part IV, Chapter 2), it suffices to say here that European economic governance increasingly constrains Member State autonomy concerning the exercise of economic policies. In multinational and multilevel contexts, autonomy is necessary in order to address different national societal needs. Accordingly, it is important for the

[927] Weiler, 'United in Fear - The Loss of Heimat and the Crises in Europe' (n 859) 365.
[928] Peter Graefe, 'Is Non-Centralization an Adequate Principle for Fiscal Federalism in a Multinational Context? Reflections from the Canadian Case' in François Boucher and Alain Noël (eds), *Fiscal Federalism in Multinational States: Autonomy, Equality, and Diversity* (McGill-Queen's University Press 2021) 112.

different component units to be able to freely exercise their internal constitutional competences, unconstrained by the centre of the federation.[929]

This circular dialogue between generality and stabilisation policies based on EU citizens, on the one hand, and non-centralisation and autonomy, on the other hand, should be the basis of the relationship between the Union, its Member States and their people. From the outset, EU integration has been shaped by these latter concepts. In other words, the budget should be maintained at a reduced level and Member States should be able to define, implement and execute their own economic policies largely autonomously. This approach was reversed during the financial and euro crisis, when the opposite emerged. In fact, EU economic governance became an exercise with a significant degree of administrative centralisation and dependence on supranational authorisations, depending on the level of financial distress experienced by different States.

Finally, EU expenditure would be supported by taxes decided at supranational level and paid for by EU citizens, thereby establishing a more adequate framework for debate from a fiscal and democratic standpoint. A Union of proxy politics is, indeed, the way to grasp the promised land, given the difficulty in aiming for great results from a small (nation-State) perspective in an interconnected world. Importantly, however, such proxy politics can only be initiated, from my point of view, if there is an adequate fiscal and budgetary framework to provide an adequate basis for dialogue.

2. Member States legislators as key for a two-force approach

The idea that the whole is greater than the sum of parts favours the view that the Union cannot be strictly subject to its Member States. However, there is the risk that an EU-wide approach will average out singularities, in the sense that the specificities of some Member States are not adequately captured in a decision-making framework with generality features. As a result, these also need a proper voice in the political process so that their sovereignty is suitably respected. Sovereignty, not economic power, was the basis of Madison's reasoning when conceptualising the inter-State relationship in the political process.[930] Therefore, the US Constitution does not carry each States' differences

[929] ibid.

[930] Madison was of the view that it was correct to apportion a proportional share in the government to every district. Nevertheless, among independent and sovereign States bound together, the parties, however unequal in size, ought to have an equal share in the common councils, in what he saw as a good balance

into the composition of the Senate: State equality, not economic power, is the basis for better State relationships in a pluralistic, legislative decision-making process.

In my view, if the Union is going to successfully develop a different economic governance framework, then a generality principle on expenditure, coupled with broader EU taxation powers, needs to recognise the key role of Member States in the definition of spending and revenue. This perspective differs from those that view the EP as the better interpreter of European interests, the Council as the place in which national interests are located and the European Commission as a technocratic body.[931]

Instead, the views of the peoples' representatives and the Member States' representatives would feed into such a scheme, whereby majoritarian and minoritarian interests would constantly confront each other within a framework of generality, thereby enriching the decision-making process with both visions and, ultimately, benefitting Union resource allocation. Importantly, this would be a better way to accommodate direct (EP through citizens) and indirect (resulting from Member States' national democratic processes) legitimacies. However, the creation of a European public space is largely dependent on the establishment of a larger Union budget. In other words: a public space would work around and through the budget, not despite it, as NGEU and discussions on the increase of the common defence fund have shown.

Another matter to discuss in this realm is how and who should represent Member States in the upper legislative chamber. The Council has been criticised for its lack of consistency between various formations as some have acquired more weight than others. In addition, as integration grew, the Council increasingly lost autonomy vis-à-vis the European Council, with some authors arguing that this latter institution should convert into an EU Senate.[932]

As such, should the Union continue on the path of governmentalisation in its representation of national citizens in the EU? And should national parliaments' relevance, albeit having been recognised a special role in Protocol No 1 TFEU, be limited to

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between proportional and equal representation. See James Madison, 'No 62: Concerning the Constitution of the Senate, with Regard to the Qualifications of the Members; the Manner of Appointing Them; the Equality of Representation; the Number of the Senators, and the Duration of Their Appointments' in George Carey and James McClellan (eds), *The Federalist* (Liberty Fund 2001) 319, 320.

[931] Grimm, *The Constitution of European Democracy* (n 863) 114. However, the author is critical that the EP needs to be built on transnational discussion platforms, which are still lacking.

[932] Fabbrini, 'The Relation Between the European Council and the Council: Institutional Arguments in Favour of an EU Senate' (n 248).

receiving information, exercise a somewhat problematic and inconsequential early warning mechanism as foreseen in Protocol No 2 TFEU[933] or be placed under asymmetrical and contentious interparliamentary cooperation?[934]

National governments conduct their governance based on national political agendas and managing national budgets. Therefore, in a framework where national contributions are a source of EU funding, national governments will demand to represent their respective citizens. However, in the context I am proposing in this thesis (that citizens contribute to the EU budget directly), the link created by national contributions is severed.

As a result, the relationship with EU citizens, secured by the EP, in my view, would need to be complemented with representatives of the citizens of each Member State. This could be better conducted by the national parliaments' nomination of several representatives to the European Council, among their respective members. Institutionally, this would mean merging it with the Council. Considering the German context of executive federalism – one in which the *Länder* mostly execute federally-enacted legislation – Waldhoff correctly argues that the German 'model of participation of the Länder regarding federal legislation leads to a shift in the separation of powers. Via the federal body, the Bundesrat […] the Länder, particularly, the executive branches of the Länder, participate in the policy-making on a federal level. This leads to a loss of influence and political range for the Länder governments/parliaments'.[935]

Therefore, while it is true that governments hold a special kind of legitimacy, as people usually vote to choose national executive branches, several advantages from representatives appointed by national parliaments should be stressed. First, it would align with the nature of the (legislative) functions exercised, thereby ceasing the mixed role played by national governments (an executive role domestically and a legislative and quasi-executive role in the EU-realm). Second, there would be a more meaningful and equal involvement of national parliaments, whereby all would choose the same number of representatives. By doing so, all would have 'equality of arms' in providing voice to their constituents. Third, it would simplify the EU's institutional landscape, therefore,

[933] Fabbrini and Granat (n 310) 119; Ian Cooper, 'A "Virtual Third Chamber" for the European Union? National Parliaments after the Treaty of Lisbon' (2012) 35 West European Politics 441.
[934] See above on the EP and national parliaments, Part III, Chapter 1, Point 2. See also Diane Fromage, 'The European Parliament in the Post-Crisis Era: An Institution Empowered on Paper Only?' (2018) 40 Journal of European Integration 281, 288.
[935] ibid.

making it more perceptible and cognizable to the European public: Europeans would be more easily acquainted with the fact that nationally nominated lawmakers hold legislative competences at the EU level. These advantages bring about another, perhaps more important, advantage related to the potential to significantly improve the accountability of EU political institutions. In contrast with intergovernmentalism, which largely reflects national political priorities in a European institutional setting, the referred EU representatives would portray a clearer, more coherent and less diffuse mandate in EU-wide affairs. Importantly, EU-wide affairs, backed by EU taxes, are a better method to address the lack of public space to debate shared issues.

The consequentiality of severing the link between national funding and executive representation (which naturally develops around national issues) should not be overlooked or dismissed. Crucially, European preferences would find a more fertile ground in which to be presented and, ultimately, decided upon by majoritarian vote with less peril of nationalistic issues because the topics under debate and the funding to make them come to fruition would not be national but European.

From this perspective, one should caution the practice of strictly dividing budgetary competences between the Council and EP. Some authors have suggested, for instance, that the Council should retain the ultimate authority on the spending cap and leave decisions regarding the spending structure to the European Parliament.[936] This proposal could, eventually, be compatible with the current EU budgetary structure and underlying teleology, albeit not without the risk of aggravating the minoritarian bias in the European Council (ie by further reducing the EU budget). *A fortiori*, in the context of the reform I propose in this thesis, a solution that removes Member States' voice from expenditure would be difficult to accept from a democratic standpoint, as Member States should continue to be the backbone of European integration and anchor local identities.

Federalism only makes sense if it respects economic and fiscal autonomy of its constituent parts, allowing for differences and legislative experimentation.[937] This way,

[936] Clemens Fuest, Friedrich Heinemann and Martin Ungerer, 'Reforming the Financing of the European Union: A Proposal' (2015) 50 Intereconomics 288.

[937] Waldhoff, 'Federalism – Cooperative Federalism versus Competitive Federalism' (n 875) 122-126. Regarding Germany, Waldhoff considers that fiscal equalisation is a historical remnant of a time in which the country was being developed and political unity was threatened. Accordingly, it is a regime that has lost nearly all meaning today. See also, for the example of Canada, Jennifer Wallner, '(Dis)Empowerment and Self-Rule: Fiscal Federalism and Minority Nations in Canada' in François Boucher and Alain Noël (eds), *Fiscal Federalism in Multinational States: Autonomy, Equality, and Diversity* (McGill-Queen's University Press 2021) 87. Wallner shows that a country of significant cultural, linguistic and identity

the Union would embrace the diversity of Member States' economic structures and disparate citizens' preferences, therefore, grasping the legitimising effect of the federal structure. Furthermore, by allowing Member States more autonomy in economic and fiscal policies, national institutions would be more valued, namely national parliaments.

diversity, such as Canada, can succeed in the relationship between federal and provincial governmental given that there is a high degree of representation and participation in shaping such relation and the significant provincial independence in the definition of the tax base. For instance, discrepancies of treatment of the Northern Territories in comparison with other Provinces is explained by the degree of dependence from the Federal Government, which is much more acute in the former than in the latter.

CHAPTER 2

AUTONOMY AND ACCOUNTABILITY OF MEMBER STATES

3. Bankruptcy framework for Member States

3.1. Importance of sovereign debt restructuring

As explained in Part III, Chapter 2, the few existing elements of a market-based approach regarding Member States' fiscal compliance turned into a surveillance paradigm after the financial crisis. In essence, this means that economic intermediation is less based on market (greater) dispersion and more concentrated in the political process.

Another insight is that this shift provides incentives that change the relationship dynamic between supranational and national authorities. The dependency from the former has grown steadily since the surveillance framework was set up as a response to the financial crisis. This dependence is evident in several ways: its direct provision of financial assistance to Member States, indirect support for maintaining affordable interest rates in the bond market and the EU regional policy's growing reliance on public investment in various countries. These developments have been accompanied by legal changes that impose stricter restrictions and monitoring on public finances. However, there has been only modest progress in reducing debt, as some Member States have exceeded the maximum allowed debt-to-GDP threshold by more than double.

Simultaneously, the judiciary has played a limited role in enforcing public finance restrictions.[938] In fact, the opposite often holds true, as courts rarely have the required expertise or necessary tools to comprehensively evaluate all the implications that decisions regarding debt and deficits involve: the market and the political processes are better equipped to handle this task, given their access to experts who support the decision-making process.

Furthermore, budgetary decisions hold an inherent political nature. They often reflect the views of a majority at a particular point in time. Therefore, it is exceedingly challenging for the judiciary to incorporate this diversity in legal proceedings, at least not

[938] In this vein, see David Skeel, 'Institutional Choice in an Economic Crisis' (2013) 2 Wisconsin Law Review 629, 638. More generally see Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics and Public Policy* (n 3) 53, arguing that the capacity of courts is limited and that participation costs in the judicial process are high.

without significantly increasing the costs of the procedure, either by requiring more witnesses, hiring experts to provide advice or extending the time needed to reach a decision. In a word: increasing the costs of the procedure would convert the courtroom into a super-auditing, as stated by the New York Court of Appeals. These factors may explain why courts tend to defer to political institutions,[939] as they may struggle to produce high-quality results, especially in complex situations, such as evaluating public budgets and economic contexts.

When addressing the financial crisis in the context of multi-level governance, some alternatives have been employed: state default and supranational bailout. However, within the EMU, no State has defaulted on its debt obligations prior to receiving a bailout.

Nevertheless, these are not the only alternatives to consider. There is room to explore another option, which would blend market and judicial elements while reducing their dependence on the political process in the long-term: allowing Member States to orderly default on their debts.[940] This option is connected with that which I suggested previously and should be adopted in tandem. It would yield three essential outcomes. Firstly, since a significant portion of the current EU economic governance framework would become obsolete, States would regain autonomy in defining their own economic and fiscal policies, thereby restoring democratic legitimacy. Secondly, fiscal responsibility would be integrated into the market process, increasing participation from actors beyond Member States' governments and reducing the inter-State politicisation of internal issues. Thirdly, because of the aforementioned outcomes, States' fiscal choices and consequences would become an internal matter and largely cease to be a topic of an EU-wide discussion.[941] Importantly, the establishment of a proper legal framework for fiscal responsibility would help rebuild inter-State trust.

[939] Aymerich (n 671) 99; Pinelli (n 688) 111.
[940] For a brief mention of the need for an EU framework for debt restructuring in the context of the proposal for the 2023 SGP revision, see Jakob De Haan and Fabian Amtenbrink, 'The Reform of the European Fiscal Rules: In Search of Mechanisms Ensuring Sustainable Debt Levels' (2023) 20 The Economists' Voice 63.
[941] As Zgaga argues, granting fiscal sovereignty to the EU will only be possible if the fiscal sovereignty of Member States is not undermined. See Tiziano Zgaga, 'The Fiscal Sovereignty of the European Union after the COVID-19 Pandemic and the War in Ukraine' (2023) 45 Journal of European Integration 703, 707.

Bankruptcy procedures typically pertain to companies, although they have been applied for local and municipal governments.[942] [943] Currently, there are no bankruptcy procedures in place for sovereign entities, whether unitary or federal states (including at sub-national level). Sovereign debtors are both uniquely vulnerable to, and, uniquely, shielded against, creditors legal remedies. Unlike corporate bankruptcy procedures, there are no laws that protect an overindebted sovereign borrower from creditors' legal actions in the event of non-compliance with payment obligations. Simultaneously, there is no orderly, court-supervised procedure in place to reorganise a sovereign entity's financial affairs. As a result, when it comes to debt instruments, especially those governed by foreign law, there are two alternatives:[944] either pay the debt according to its contractual terms or face enforcement action.

Nonetheless, creditors' strength is also their weakness. Sovereigns can be held accountable when engaging in commercial activities outside of their border, either by adhering to the restrictive theory of sovereign immunity or by including a waiver of sovereign immunity in bond contracts. This waiver secures the sovereign's consent to foreign jurisdiction and judgement enforcement proceedings. However, sovereigns often have limited assets abroad,[945] with a significant portion held by central banks, which are typically considered separate legal entities and, usually, inaccessible when satisfying creditor's claims.[946] From an international law perspective, general bankruptcy principles

[942] For instance, in the US, the first federal municipal bankruptcy statute was passed in 1933, whereby municipalities were permitted to negotiate settlements of their debts with creditors. Once a settlement was approved by a certain amount of the creditors (75%), it could be imposed on the minority. As for the courts, they did not have jurisdiction or control over the governing powers of municipalities. However, they were required to determine the fairness and equitability of the plan. Currently, it is regulated under Chapter 9 of the US bankruptcy law. No such legal framework exists at the EU-level.

[943] For instance, in Portugal, the law on the finances of local municipalities and inter-municipalities (Law No 73/2013) establishes a mechanism for municipal financial prevention and recovery. Every time the legally establish debt level is overcome, financial recovery procedures may be mandatory or voluntary, depending of the level of financial imbalance. As a general rule, the State cannot assume responsibility for the obligations of municipalities, nor can it assume the commitments arising from them. Although the procedure does not allow for debt restructuring, it does hinder access to budgetary funds which would otherwise be spent by municipalities. In any case, there is certainty that financing will occur from the national government and, as such, protects them from the deterrent effect of market forces.

[944] Regarding domestic law governed bonds, it is possible to impose a particular solution, for instance by legislative fiat. This was the case in Greece which, in the midst of its debt restructuring in 2012, passed a law imposing collective action clauses in all local law bonds with retroactive effects. See Jeromin Zettelmeyer, Christoph Trebesch and G Mitu Gulati, 'Managing Holdouts: The Case of the 2012 Greek Exchange' in Rosa Maria Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford University Press 2014) 25.

[945] Rosa Maria Lastra, 'How to Fill the International Law Lacunae in Sovereign Insolvency in European Union Law?', *ESCB Legal Conference 2016* (European Central Bank 2017) 56, 57.

[946] Lee Buchheit and Elena Daly, 'Minimizing Holdout Creditors: Carrots' in Rosa Maria Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford University Press 2014) 3; See also Robert Kolb,

and outcomes, such as the 'no creditor worse off principle', cannot be applied because States are not subject to liquidation.[947] Additionally, sovereigns are entitled to protection from governance constraints that could be imposed during a bankruptcy procedure, as there can be no insolvency court or other bodies determining policy choices. However, it is worth noting that this notion has evolved, especially during the eurozone crisis.[948]

Despite these advantages, this solution is often met with scepticism. In fact, critics typically highlight several challenges. These will be addressed in the following section.

3.2. Challenges

3.2.1. Holdout problem

While most sovereign entities adhere to their debt obligations, there are instances in which they find themselves unable to service its bonds. In such cases, they typically engage with their creditors to negotiate an agreement. Ideally, the financial terms of the settlements will be favourable to the debtor, often in the form of debt relief. Conversely, this increases the likelihood of compliance, improving the creditor's prospects for repayment when the obligations are due.

However, what if one or several creditors disagree with the terms agreed upon by the majority of creditors and refuse to give their consent for a bond exchange? This issue is generally referred to as the holdout problem. These creditors create two issues. First, in the absence of provisions (of a contractual or legislative nature) stating otherwise, a deadlock situation can emerge, whereby any modification to the bond can only be successful if consent is granted by every bondholder. Veto power is, therefore, granted to all of them, thereby creating the conditions for minoritarian bias, that is, a minority (or only one member, for that matter) may prevent a situation that is generally favourable and agreed to by the (large) majority.

Secondly, it may foster a 'rush to the exit', which means that some creditors may resort to enforcement action sooner, rather than later, in an effort to recover the full value of their bonds instead of being faced with a settlement subsequently negotiated by the

'Sovereign Debt: Theory, Defaults, and Sanctions' in Robert Kolb (ed), *Sovereign Debt: From Safety to Default* (Wiley 2011) 3.

[947] Steven Schwarcz, 'A Minimalist Approach to State "Bankruptcy"' (2011) 59 UCLA Law Review 324, 335.

[948] For an overview, see Markakis (n 279).

majority of creditors. By doing so, other bondholders may find themselves with fewer options.[949]

In essence, there are two main avenues to devise State restructuring: the contractual way or the institutional way.

3.2.1.1. Contractual-based State restructuring: collective actions clauses

A CAC is a contractual provision in a multi-creditor debt instrument that allows the majority of bondholders to agree to the modification of the contract, including payment terms, provided that a certain threshold is met.[950] The most significant consequence of this provision is that the decision becomes binding on the dissenting minority.[951] In this regard, CACs serve a dual purpose: firstly, they facilitate sovereign debt restructuring and, secondly, they require investors to share the costs of borrowers' financial distress, thus reducing the burden on taxpayers.

Collective actions clauses have been promoted since 1995 by academics and public officials.[952] However, due to resistance from creditors and borrowers, it was not until 2003 that they became widely adopted.[953] The shift occurred with the US Treasury's initiative to include CACs in bonds issued under New York Law and when EU Member States incorporated these clauses into international debt issuances.[954]

There has been increasing pressure to strengthen the contractual framework to more effectively address the collective action problem, particularly in light of the experiences

[949] David Billington, 'European Collective Action Clauses' in Rosa Maria Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford University Press 2014) 399, 400.
[950] A 75% majority of votes is the typical requirement of CACs. However, according to Bradley and Gulati, voting threshold to change the terms may vary from 18.75% to 85% of the outstanding bondholders. See Michael Bradley and Mitu Gulati, 'Collective Action Clauses for the Eurozone' (2014) 18 Review of Finance 2045.
[951] Buchheit and Daly (n 946) 21.
[952] This happened in the context of the G-10 meeting, whereby a working group was formed to propose policies for an orderly management of severe sovereign liquidity crisis, in order to prevent rescue packages becoming a source of moral hazard. A report was delivered in 2012. See Group of 10, 'Report of the G-10 Working Group on Contractual Clauses' (2012) <https://www.bis.org/publ/gten08.htm> accessed 30 May 2022.
[953] Sönke Häseler, 'Collective Action Clauses in Sovereign Bonds' in Robert Kolb (ed), *Sovereign Debt: From Safety to Default* (Wiley 2011) 235.
[954] Economic and Financial Committee, 'Implementation of the EU Commitment on Collective Action Clauses in Documentation of International Debt Issuance, ECFIN/CEFCPE (2004) REP/50483 Final' <https://europa.eu/efc/sites/default/files/docs/pages/cacs_en.pdf> accessed 31 May 2022.

of the Argentine (2005) and Greek (2012) debt restructurings.[955] Pursuant to article 12 (3) ESM Treaty, in January 2013, the eurozone initiated the inclusion of standardised 'double-limb' aggregation CACs in all of the euro area's new government bonds with maturities exceeding one year, irrespective of whether the bonds were governed by domestic or foreign law. These CACs require a minimum level of support across all series of securities being restructured as well as within each series. In the case of the eurozone, the former requires a 75% threshold, while the latter only requires 66.67%.[956]

Subsequently, in 2014, the International Capital Market Association proposed enhancing CACs,[957] by advocating for the use of single-limb clauses. These types of clauses enable the restructuring of bonds through a single vote, encompassing all instruments or a subset of instruments, thereby preventing a creditor or group of creditors from holding bonds in one particular series.[958] These single-limb clauses were endorsed by the IMF in the same year[959] and have gained widespread adoption worldwide.[960]

This development was followed by the eurozone in December 2018, whereby the Eurogroup announced its support for finance ministers to amend the ESM Treaty. This amendment would require the gradual introduction of single-limb CACs in all euro area issuances as of 2022, which was later confirmed by euro area Heads of State and the Government of the euro area.[961]

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[955] Kay Chung and Michael Papaioannou, 'Do Enhanced Collective Action Clauses Affect Sovereign Borrowing Costs?' (2020) IMF Working Paper WP/20/162 <https://www.imf.org/en/Publications/WP/Issues/2020/08/07/Do-Enhanced-Collective-Action-Clauses-Affect-Sovereign-Borrowing-Costs-48960> accessed 27 May 2022, 9. See also Christian Hofmann, 'A Legal Analysis of the Eurozone Crisis' in Christoph Paulus (ed), *A Debt Restructuring Mechanism for Sovereigns: Do we need a legal procedure?* (Verlag CHBeck 2014) 43, 63.

[956] See Euro Area Model CAC 2012, Common Terms of Reference (2012) <https://europa.eu/efc/sites/default/files/docs/pages/cac_-_text_model_cac.pdf> accessed 30 May 2022. See also European Council, 'Conclusions' (n 461) 31.

[957] International Capital Markets Association, 'Standard Aggregrated Collective Action Clauses ("CACS") for the Terms and Conditions of Sovereign Notes' (2014) <https://www.icmagroup.org/assets/documents/Resources/ICMA Model Standard CACs August 2014.pdf> accessed 30 May 2022.

[958] Chung and Papaioannou (n 955) 10.

[959] International Monetary Fund, 'Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring' (October 2014) <https://www.imf.org/external/np/pp/eng/2014/090214.pdf> accessed 3 June 2022.

[960] European Central Bank, 'The IMF's Role in Sovereign Debt Restructurings' (September 2021) Occasional Paper Series 262 <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op262~f0e9e1e77e.en.pdf> accessed 3 June 2022.

[961] Euro Summit, 'Euro Summit Meeting (14 December 2018) - Statement, EURO 503/18' <https://www.consilium.europa.eu/media/37563/20181214-euro-summit-statement.pdf> accessed 31 May 2022. See also EFC Sub-Committee on EU Sovereign Debt Markets, '2022 Collective Action Clause: Explanatory Note' (2022) <https://europa.eu/efc/system/files/2021-04/EA Model CAC - Draft Explanatory Note.pdf> accessed 31 May 2022.

3.2.1.2. Procedure-based State restructuring

Another way to conduct State restructuring involves establishing a well-defined legal procedure.[962] Notably, Adam Smith recognised the necessity for such a method. In his words, '[w]hen it becomes necessary for a State to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open and avowed bankruptcy is always the measure which is both least dishonourable to the debtor, and least harmful for the creditor'.[963]

While a procedure-based approach has not yet been fully implemented, several proposals have emerged with many drawing inspiration from US bankruptcy laws, specifically chapter nine (pertaining to municipalities) and Chapter 11 (concerning corporations). These proposals often aim to achieve a few key objectives: the admittance of a temporary halt on creditor claims, the resolution of holdout issues by bolstering creditor coordination and the establishment of a mechanism that permits new funding during and after the restructuring process.

The earliest attempt to create a formal mechanism goes back to 1979, when a group of developing countries proposed the formation of an international debt commission, which was responsible for addressing various emerging crises. Despite never coming to fruition due to opposition from creditor countries and lack of authority to enforce binding decisions, some of its objectives remain relevant. These include: debt reorganisation, party coordination, the appointment of a neutral arbiter or mediator and the facilitation of raising new financing.[964]

Following the debt crises of the 1980s, an interest grew in extending bankruptcy protection to sovereign States. In this context, in 1981, Christopher Oechsli proposed a procedure analogous to Chapter 11 of the US bankruptcy code. Oechsli argued that many of the procedures outlined in Chapter 11 could be applied to the renegotiation of debt in

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[962] This procedure has been designated as 'statutory' or a 'restructuring mechanism', which entails a supranational administrative body (ie the IMF) to manage the process. However, I prefer to refer to it as procedure-based, in order to capture the idea of a structured, open and transparent process, regardless of the managerial body and its legal nature.

[963] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (The Electronic Classics Series 2005) 770.

[964] Kenneth Rogoff and Jeromin Zettelmeyer, 'Bankruptcy Procedures for Sovereigns: A History of Ldeas, 1976-2001' (2002) IMF Staff Papers 49 (3) <https://www.imf.org/en/Publications/WP/Issues/2016/12/30/Bankruptcy-Procedures-for-Sovereigns-A-History-of-Ideas-1976-2001-15993> accessed 1 June 2022, 472.

less developed countries. These procedures included: the establishment of a creditor committee, an independent examiner, a monitoring party that does not take control of the debtor's business and a formal initiation procedure. Oechsli emphasised that the IMF could be entrusted with monitoring, but stressed the importance of including debtors in its formulation of a restructuring plan. Regarding the initiation procedure, it should be triggered by creditors or debtors, although creditors and the IMF may not necessarily accept the debtor petition.[965]

Debevoise complements Oechsli's proposal by suggesting that article VIII (2) (b) of the IMF's Articles of Agreement grants the authority to order a stay on the collection of debt.[966] This interpretation would, in fact, allow the IMF to issue a payment standstill decision with a far-reaching scope.

In 1995, Jeffrey Sachs made an influential contribution that would shape many subsequent proposals thereafter, advocating for the IMF's transition from primarily being an international lender of last resort to becoming more of a bankruptcy court. Sachs contended that, due to the nature of the IMF lending "taxpayer dollars", it should be exceedingly cautious about providing funds in risky circumstances. However, he pointed out that extreme crises involve risks. Consequently, IMF loans tended to be insufficient and often arrived late. By the time these loans were disbursed, the government might have already lost control of the situation.[967]

This led to the well-known Sovereign Debt Restructuring Mechanism proposal by Anne Krueger, who was acting as the first deputy managing director of the IMF, at the time.[968] The author presented this tool as a 'catalyst' to encourage debtors and creditors to negotiate unsustainable debt restructuring in a timely and efficient manner, as long as

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[965] Christopher Oechsli, 'Procedural Guidelines for Renegotiating LDC Debt: An Analogy to Chapter 11 of the U.S. Bankruptcy Reform Act' (1981) 21 Virgina Journal of International Law 305.
[966] Whitney Debevoise, 'Exchange Controls and External Indebtedness: A Modest Proposal for a Deferral Mechanism Employing the Bretton Woods Concepts' (1984) 7 Houston Journal of International Law 157.
[967] Jeffrey Sachs, 'Do We Need an International Lender of Last Resort', *Frank D. Graham Lecture at Princeton University* (1995) <https://www.jeffsachs.org/newspaper-articles/rnscc4pw7ep45shcf835rm8652tfpt> accessed 1 June 2022, 14.
[968] Anne Krueger, 'A New Approach to Sovereign Debt Restructuring - Address by Anne Krueger, First Deputy Managing Director, IMF' (26 November 2001) <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sp112601> accessed 2 June 2022; Anne Krueger, 'A New Approach To Sovereign Debt Restructuring' (2002) <https://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf> accessed 3 June 2022. For a detailed analysis of Sovereign Debt Restructuring Mechanism, see Rodrigo Olivares-Caminal, 'Statutory Sovereign Debt Resolution Mechanisms' in Rosa Maria Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford University Press 2014) 333.

these negotiations were conducted in good faith and led to policies capable of preventing similar problems from arising in the future. In return, the debtor country would be granted legal protection from creditors opposing restructuring. In Krueger's view, '[t]he mere knowledge that such a framework was in place should encourage debtors and creditors to reach agreement of their own accord. Our model is one of a domestic bankruptcy court, but for a number of reasons it could not operate exactly like that. It is better to think of it as an international workout mechanism'.[969]

According to Rogoff and Zettelmeyer, this proposal is to be welcomed on two fronts: incentives on motivation and good behaviour.[970] On motivation, the IMF's unilateral standstill procedure is a suitable mechanism to deal with liquidity crises, debt crises and emphasise bailout implications on moral hazard. Regarding behaviour incentives, it explicitly refers good faith in debtors as a critical issue, in symmetry with the US Bankruptcy Code, Chapter 11 (Section 1123), which links it to the principle of necessity, meaning that the debtor shall not seek debt reduction beyond that which is necessary to establish medium-term debt sustainability.

Lastly, in 2016, Guzman and Stiglitz proposed a Soft Law Mechanism for Sovereign Debt Restructuring.[971] Based on nine UN principles on Sovereign Debt Restructuring processes, approved by its General Assembly in September 2015,[972] the mechanism recognised that the sovereign State must have the right to decide its policies, consistent with its objectives, including the right to decide whether to restructure its debt (sovereignty principle). However, a duty to negotiate in good faith would fall on both the debtor and creditor when the sovereign's debt position becomes unsustainable (good faith principle), with a view of restoring sustainability (sustainability principle). This includes

[969] Krueger, 'A New Approach to Sovereign Debt Restructuring - Address by Anne Krueger, First Deputy Managing Director, IMF' (n 968).
[970] Rogoff and Zettelmeyer (n 964) 490.
[971] Martin Guzman and Joseph Stiglitz, 'A Soft Law Mechanism for Sovereign Debt Restructuring: Based on UN Principles' (2016 Friedrich Ebert Stiftung) <https://library.fes.de/pdf-files/iez/12873.pdf> accessed 2 June 2022. Similar features have been proposed by Kathrin Berensmann, 'An Insolvency Procedure for Sovereign States: A Viable Instrument for Preventing and Resolving Debt Crises?' in Robert Kolb (ed), *Sovereign Debt: From Safety to Default* (Wiley 2011) 379. For an analysis, see Giuseppe Bianco, *Restructuring Sovereign Debt: Private Creditors and International Law* (University of Oslo: Faculty of Law 2018).
[972] United Nations, 'Resolution Adopted by the General Assembly on 10 September 2015' (2015) <https://documents-dds-ny.un.org/doc/UNDOC/GEN/N15/277/81/PDF/N1527781.pdf?OpenElement> accessed 2 June 2022. This was preceded by United Nations, 'Resolution Adopted by the General Assembly on 9 September 2014' (2014) <https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-03/N1453005.pdf> accessed 2 June 2022.

disclosing potential conflicts of interest that could undermine the outcome of a restructuring process, ie holding credit default swaps (transparency principle). Creditors should be treated in an impartial, independent (impartiality principle) and non-discriminatory manner (equitable treatment principle), while debtors should be protected by the principle of international law according to which no country can renounce its immunity (sovereign immunity principle). Importantly, all levels of the restructuring procedure, including its institutions and operations, should respect the requirement of inclusiveness and the rule of law (legitimacy principle). Lastly, sovereign debt restructuring agreements approved by a qualified majority of creditors cannot be affected by a minority of creditors, who must respect the decisions adopted by the majority. In order to do that, the UN encourages States to include CACs in their sovereign debt issuances (majority restructuring principle).

Plans for a European Union mechanism have also been proposed. The creation of a European Sovereign Debt Mechanism, similar to Anne Kruger's proposal, has been suggested.[973] Other proposals, based on the ESM, have been developed by the Committee on International Economics and Policy Reform[974] and by the German Council of Economic Experts.[975] The former proposes to amend the ESM Treaty in order to (i) condition ESM lending to certain debt thresholds, and (ii) prevent holdouts in ESM-sanctioned debt restructurings by enforcing their claims through European courts. At the same time, 'both the restructuring country and "innocent bystanders" would need to have access to ESM lending to deal with the fallout of a restructuring'.[976] The latter is based on maturity extensions to address liquidity crises and, if necessary, significant debt restructuring, if the problem includes solvency issues. Moreover, the terms of a sovereign debt restructuring should be imposed by the ESM.

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[973] Bettina Nunner-Krautgasser, 'The Importance of Being Prepared: A Call for a European Sovereign Debt Restructuring Mechanism' in Christoph Paulus (ed), *A Debt Restructuring Mechanism for Sovereigns: Do we need a legal procedure?* (CHBeck 2014) 241; Daniella Strik, 'Investment Protection of Sovereign Debt and Its Implications on the Future of Investment Law in the EU' (2012) 29 Journal of International Arbitration 183.

[974] Lee Buchheit and others, 'Revisiting Sovereign Bankruptcy: Committee on International Economic Policy and Reform' (October 2013) <https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5904&context=faculty_scholarship> accessed 3 June 2022.

[975] Jochen Andritzky and others, 'A Mechanism to Regulate Sovereign Debt Restructuring in the Euro Area' (2016) Working Paper 04/2016 <https://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/download/publikationen/arbeitspapier_04_2016.pdf> accessed 3 June 2022.

[976] Buchheit and others (n 974) 35.

3.2.2. Sovereignty problem

3.2.2.1. Restriction of Member State autonomy in economic policy-making

One of the reasons why the IMF procedure was rejected was the EU's fear of many countries losing national autonomy [977] and this fear is understandable, given the diversity within an institution composed of 190 members.[978]

This question is important because, unlike municipalities, States (both in the EU and US) are considered sovereign entities, thus, any restriction on their autonomy should be anchored in the Treaties or their respective Constitutions. The issue has been given particular attention in the US Supreme Court's case law. For instance, in 1936 *Ashton* case,[979] Justice Cardozo argued that:

> There is room at least for argument that within the meaning of the Constitution the bankruptcy concept does not embrace the states themselves. In the public law of the United States a state is a sovereign or at least a quasi sovereign. Not so a local governmental unit, though the state may have invested it with governmental power. Such a governmental unit may be brought into court against its will without violating the Eleventh Amendment. It may be subjected to mandamus or to equitable remedies. Neither public corporations nor political subdivisions are clothed with that immunity from suit which belongs to the state alone by virtue of its sovereignty.

The application of the municipal bankruptcy act at the State level could, therefore, be unconstitutional if one embraces Justice Cardozo's view. However, from a financial perspective, a high burden of debt effectively limits autonomy,[980] as the fiscal position will be used to assess credit risk. The higher the risk, the higher the cost of borrowing, hence, resulting in a decrease of autonomy in the definition of national economic and fiscal policies.

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[977] Christoph Ohler, 'Der Staatsbankrott' (2005) 60 JuristenZeitung 590, 598.
[978] See https://www.imf.org/external/np/sec/memdir/memdate.htm.
[979] *Ashton v Cameron County Water Improvement District No 1* [1936] 298 US 513, 542.
[980] In this vein see, in the literature, Krautgasser (n 973) 243.

A similar view was adopted by the US Supreme Court in *Bekins*[981] when assessing the 1937 revised municipal bankruptcy law enacted by Congress. Given its voluntary nature and the passive role of the bankruptcy court, which was limited to approve or disapprove a plan, the US Supreme Court held that the Federal Bankruptcy law should be understood as providing cities and States with the power to impair contracts in the case of a dire financial situation. This prerogative was, at the time, reserved to the Federal Government. In this way, '[t]he bankruptcy power is competent to give relief to debtors in such a plight'. By removing such reserved power, '[t]he State acts in aid, and not in derogation, of its sovereign powers' given that '[i]t invites the intervention of the bankruptcy power to save its agency which the State itself is powerless to rescue'. In conclusion, the US Supreme Court argues that it sees 'no ground for the conclusion that the Federal Constitution, in the interest of state sovereignty, has reduced both sovereigns to helplessness in such a case',[982] especially considering that the statute was drawn to respect the sovereignty of the State, for instance, by retaining control of its fiscal affairs.

However, the situation might not be as simple as presented by the US Supreme Court regarding States' fiscal sovereignty. In McConnel's view, courts must determine States' eligibility for the process, which involves a judicial assessment of the applicant's solvency. This analytical exercise indirectly compels courts to evaluate whether a State has exhausted its ability to raise revenue and reduce spending. While courts do not have authority to draw up bankruptcy plans, they can refuse to accept it or condition its acceptance according to the satisfaction of certain requirements. Both actions can have a substantial impact on Member States sovereignty, as taxation is at the core of sovereign powers. In this sense, McConnel concludes that bankruptcy would, in effect, transfer the control of fiscal affairs to the court.[983] This would be the case regardless of the body chosen to administer the process, as discussed below (Part IV, Chapter 2, Point 3.2.3.3) regarding the issue of independence.

In the context of the EU, the situation is different. Member States agreed to build an ever-closer Union since 1957. In the initial decades, integration mostly deepened on the regulatory and technical side. As this process continued, Member States became

[981] *United States v Bekins* [1938] 304 US 27.
[982] ibid. 54.
[983] Michael McConnell, 'Extending Bankruptcy Law to States' in Peter Conti-Brown and David Skeel (eds), *When States Go Broke: The Origins, Context, and Solutions for the American States in Fiscal Crisis* (Cambridge University Press 2012) 229, 233.

increasingly interdependent and in need of accommodating national measures' spillover effects. This gradual interdependence resulted in a reduction of Member States autonomy.

More recently, the establishment of EMU has driven the need to coordinate politically sensitive topics, such as national economic policies. As argued above (Part III, interim conclusions), the European economic governance framework in place constitutes a fundamental shift in the relationship between the Union and Member States, as they renounced an important part of their sovereignty for the freedom to design their national economic policies.

Hence, a bankruptcy procedure would be less intrusive in comparison with other regions of the world[984] if viewed alongside the proposals in this thesis regarding the political process.

3.2.2.2. Restriction of Member State autonomy in filing the procedure

Connected to the previous issue is the question of whether States should have the autonomy to initiate a bankruptcy procedure or if this autonomy should be restricted (for instance, mandatory filing in case certain thresholds are met).

In the US, this issue has been dealt with from the perspective of the constitutionality of wavering States' rights. From this point of view, we must ascertain the purpose of federalism: is it to protect the States' or people's rights? In *New York v United States*,[985] the US Supreme Court addressed the issue of federal mandates desired by several States. Significantly, it stated that separation of powers and State sovereignty are not ends in and of themselves. Rather, the objective of federalism is to secure the individual liberties that flow from the diffusion of sovereign power. Therefore, the 'Constitution does not protect the sovereignty of States for the benefit of the States or state governments as abstract political entities, or even for the benefit of the public officials governing the States'.[986] Importantly, the intention is to prevent the existence of excessive power in any branch. As a result, when 'Congress exceeds its authority relative to the States […] the departure from the constitutional plan cannot be ratified by the "consent" of state officials'.

[984] David Skeel, 'Rules-Based Restructuring and the Eurozone Crisis' in Franklin Allen, Elena Carletti and Giancarlo Corsetti (eds), *Life in the Eurozone With or Without Sovereign Default?* (FIC Press 2011) 97, 101. See also Jeannette Abel, *The Resolution of Sovereign Debt Crises: Instruments, Inefficiencies and Options for the Way Forward* (Nomos/Routledge 2017) 403.
[985] *New York v United States* [1992] 505 US 144.
[986] ibid. 181. In the same vein, see *Bond v United States* [2014] 572 US 844.

Accordingly, the 'division of power among the three branches is violated where one branch invades the territory of another, whether or not the encroached-upon branch approves the encroachment'.[987]

If the US Supreme Court applied this interpretation to the initiation of sovereign debt restructuring procedure, even on a voluntary basis, it would possibly find it unconstitutional. However, two arguments contradict this interpretation.[988] First, States are permitted to waive their immunity under the eleventh amendment to stand in court regarding cases brought about by individuals. As such, the same should be allowed regarding bankruptcy courts. Second, building upon the *Bekins* doctrine, it is difficult to justify that while enterprises and municipalities are legally able to restructure their portfolio of debts and gain financial autonomy (despite not being considered sovereign entities by the US Supreme Court), States are barred from it.[989] Paradoxically, with the objective of protecting formal State sovereignty, preventing an orderly reorganisation hinders future autonomy prospects.

Like the argument made in the preceding sub-section, EU Member States had agreed to delegate a significant portion of their economic policy decision-making autonomy to the EU level, either in the event of receiving financial assistance from the ESM and ensuing implementation of an MoU or by strictly complying with the extensive obligations stemming from the supranational economic governance framework. Given this legal context, granting Member States the autonomy to decide whether and when to file for bankruptcy would, in fact, increase their status as sovereign entities.

The more practical issue is that, as Gelpern argues, 'governments, much like people and firms, are incorrigible procrastinators when it comes to acknowledging and dealing with debt problems'.[990] From this perspective, there are economic, political and financial reasons that may determine a filing delay. The economic reason is related to potential

[987] *New York v United States* (n 985) 182.
[988] McConnell, 'Extending Bankruptcy Law to States' (n 983) 235.
[989] Nevertheless, the restriction preventing States from impairing contractual obligations (contract clause) is not absolute. See Robert Hale, 'The Supreme Court and the Contract Clause: III' (1944) 57 Harvard Law Review 852; More recently, Stephen Befort, 'Unilateral Alteration of Public Sector Collective Bargaining Agreements and the Contract Clause' (2011) 59 Buffalo Law Review 1; Tommy Tobin, 'Far from a "Dead Letter": The Contract Clause and North Carolina Association of Educators V. State' (2018) 96 North Carolina Law Review 1681.
[990] Anna Gelpern, 'A Skeptic's Case for Sovereign Bankruptcy' in Christoph Paulus (ed), *A Debt Restructuring Mechanism for Sovereigns: Do we need a legal procedure?* (CHBeck 2014) 261, 265.

currency depreciations, bank runs, harsh economic downturns and social unrest, which are generally worse than private bankruptcies.

The political reason relates to incentives. Few politicians would want to be associated with such dire socio-economic consequences, particularly given the shorter-time span of political life and the way in which they are chosen compared to leaders of private entities. However, default may still be attractive when other measures have failed[991] and when people have already had the time to psychologically adjust to the prospect of national failure and its ensuing consequences.[992]

The financial reason relates to alternatives. If bailout options are available, the probability that procrastination continues past the point of debt viability will be higher. Therefore, the existence of mechanisms of financial assistance make matters worse rather than better, as States typically incur more debt and worsen their financial positions.

3.2.2.3. Sovereign specificities

Another objection related to sovereignty is the matter of singularities associated with States when compared with enterprises, for instance, the impossibility of liquidation and the different natures of participants and their objectives. First, from an international law perspective, while debtor-companies with good structural economic indicators may be reorganised, those in deteriorated condition will often be liquidated. Courts, the debtor-company and its creditors allocate significant resources to determining whether the company is worth more reorganised or liquidated. In contrast, it is impossible to liquidate States.[993] Maximising value for creditors is not appropriate given that a sovereign must be left with the financial means to perform certain functions of government. Therefore, reorganisation should be the only admissible goal of any sovereign debt restructuring.

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[991] Anna Gelpern, 'Financial Crisis Containment' (2009) 41 Connecticut Law Review 1051, 1102. As the author notes, by analysing case studies '[i]n every case, officials knew the depth and breadth of the crisis before they had the political and legal capacity for adequate response. Governments began with incremental measures premised on no or very limited insolvency, and continued on this path until they secured the political space and legal authority to deploy robust containment policies. Collective action problems on a vast scale stood in the way of crisis response. Non-crisis resolution and debt management tools proved inadequate to contain the crisis and had to be supplemented with some combination of new laws, dedicated institutions, and regulatory adjustment-a process that took months, sometimes years'.

[992] Gelpern, 'A Skeptic's Case for Sovereign Bankruptcy' (n 990). See also Levitin (n 602).

[993] Steven Schwarcz, 'Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach' (2000) 85 Cornell Law Review 956, 958; François Gianviti and others, 'A European Mechanism for Sovereign Debt Crisis Resolution: A Proposal' (Bruegl Blueprint 10, 2010) <https://www.bruegel.org/2010/11/a-european-mechanism-for-sovereign-debt-crisis-resolution-a-proposal/> accessed 14 June 2022, 23.

Second, participants in the process differ significantly, as citizens are dissimilar to shareholders. Problems in sovereign debt management affect a large number of people, typically disrupting economic activity and adopting restrictive fiscal policies. As capital is more mobile than people, shareholders are more able to exit and diversify investments, unlike citizens.[994]

Lastly, the objective of a country is to promote the well-being of citizens and it is not a mere investment instrument.

Despite the differences, there are several similarities that advise in favour of a restructuring procedure, such as the large volume of credit that States and some enterprises must handle, or the difficulty in coping with financial obligations in a situation of fiscal distress. Some States and enterprises are also considered too big to fail.[995]

3.2.3. Legal problems

3.2.3.1. Moral hazard concerns of the debtor

In the debate on a sovereign bankruptcy framework, moral hazard is usually one of the main concerns.[996] In the EU, for instance, the concept of moral hazard has been at the forefront since the Treaty of Maastricht. This concern finds expression in article 125 (1) TFEU, which prohibits both the EU and Member States from assuming the financial commitments of another Member State. Article 123 (1) TFEU also prohibited the ECB from engaging in monetary financing.

The prospect of debt relief, at some point, may, indeed, exacerbate the problem of debt discontinuity,[997] which essentially highlights the perils of the disconnect between the moment of issuance, moment of payment and correspondent accountability.

Moral hazard risk can be identified in several instances. First, it would grant a powerful tool for States beforehand, with which they could pressure bondholders to

[994] Abel (n 984) 405.
[995] ibid. 407.
[996] Ugo Panizza, 'Do We Need a Mechanism for Solving Sovereign Debt Crises? A Rule-Based Discussion' in Christoph Paulus (ed), *A Debt Restructuring Mechanism for Sovereigns: Do we need a legal procedure?* (CHBeck 2014) 223, 227.
[997] Stewart Sterk, 'The Continuity of Legislatures: Of Contracts and the Contracts Clause' (1988) 88 Columbia Law Review 647.

accept the proposed new payment terms in order to avoid a legal proceeding, or to seek bailout from a supranational government.

Second, when a country is facing financial distress, self-fulfilling runs on a country's debt may occur, creating multiple equilibria. As Panizza states, 'in a good equilibrium, a solvent borrower has continuous access to finance and remains solvent. In the bad equilibrium, the sudden withdrawal of financial resources caused by panicked lenders can push an otherwise solvent borrower towards insolvency'.[998] In the latter situation, during bankruptcy proceedings, countries usually resort to the IMF as an effective international lender of last resort to provide bridge financing. In the EU, the IMF provided certain Member States with funding during the sovereign debt crisis, alongside the EFSF and the ESM.[999]

While resorting to these lenders may contribute to managing financial instability, it may also be a source of moral hazard and overborrowing. In fact, as already explained, if creditors know or believe they can count on a supranational institution to provide funding when sovereign defaults occur, they will be less careful when lending. As Dooley argues, 'private creditors watch what the [International Monetary] Fund does very carefully, not for wisdom about the credit worthiness of countries, but for clues about the terms on which official creditors will lend to debtor governments' and, therefore, 'the "threat of crisis" is the only effective incentive for repayment by sovereign debtors'.[1000]

Lastly, at the end of the procedure, moral hazard manifests in the form of debt pressure relief. Given that this is a way to discharge debt, incentives to comply with EU and national public finance obligations could diminish. In a way, bankruptcy could have the same effect as supranational bailouts.

Although these are legitimate concerns, this perspective undervalues the fact that reality is not static but dynamic. Relying on a bankruptcy procedure would prompt

[998] Panizza (n 996).
[999] For a thorough analysis of the institutional participation in the EU sovereign debt crisis see Nicolas Véron, 'The IMF's Role in the Euro-Area Crisis: Financial Sector Aspects' (2016) Bruegel Policy Contribution 13/2016 <https://www.bruegel.org/2016/08/the-imfs-role-in-the-euro-area-crisis-financial-sector-aspects/> accessed 7 June 2022.
[1000] Michael Dooley, 'Can Output Losses Following International Financial Crises Be Avoided?' (2000) National Bureau of Economic Research Working Paper 7531 <https://www.nber.org/system/files/working_papers/w7531/w7531.pdf> accessed 8 June 2022.

investor adjustment, in the future, by imposing a range of sanctions,[1001] which would have a deterrent effect.

Moreover, it is premised on the assumption that decision-makers will be tempted by the bankruptcy option rather than viewing it as a last resort measure. Apart from the fact that States' governments can threaten to default on their debt, even in the absence of a framework, Skeel convincingly argues that 'one of the most attractive features of state bankruptcy is the extent to which its benefits would arise even if no state ever filed for bankruptcy',[1002] not least because of the presence of a neutral party ensuring the existence of due process.[1003]

3.2.3.2. Sufficiency and suitability of collective action clauses

Procedure-based sovereign debt restructuring is also frequently considered unnecessary and unsuitable. It is unnecessary because the contractual approach has evolved and proved sufficient in dealing with the issue. In the context of the EU, some literature considers that it could be a proxy for a bankruptcy procedure,[1004] not least because most debt contracts already entail single or double-limb clauses.[1005] Unsuitable,

[1001] For instance, economic sanctions, such as increasing the cost of loans; hindering market access both to the public and private sectors; and declining national output. See Kolb (n 946) 7 and Odette Lienau, 'The Longer-Term Consequences of Sovereign Debt Restructuring' in Rosa Maria Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford University Press 2014) 85. But also political sanctions, as shown by Carmen Reinhart and Kenneth Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* (Princeton University Press 2010) and Daniel Waldenström, 'How Important Are the Political Costs of Domestic Defaults?' in Robert Kolb (ed), *Sovereign Debt: From Safety to Default* (Wiley 2011) 287. In the EU, the share of domestic debt (debt held by residents in a given Member State) is not negligible, granting voters relevant accountability power. In this sense see Daniel Gros, 'Restructuring in a Monetary Union: Economic Aspects' in Rosa Maria Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford University Press 2014) 195.

[1002] David Skeel, 'State Bankruptcy from the Ground Up' in Peter Conti-Brown and David Skeel (eds), *When States Go Broke: The Origins, Context, and Solutions for the American States in Fiscal Crisis* (Cambridge University Press 2012) 191, 195. With an opposing view, Edmund McMahon, 'State Bankruptcy Is a Bad Idea' *Wall Street Journal* (New York, 24 January 2011) <https://www.wsj.com/articles/SB10001424052748704881304576094091992370356> accessed 7 March 2022.

[1003] Abel (n 984) 413; Patrick Bolton, 'Toward a Statutory Approach to Sovereign Debt Restructuring: Lessons from Corporate Bankruptcy Practice around the World' (2003) 50 IMF Staff Papers 41, 62.

[1004] In this sense see Yves Mersch, 'Reflections on the Feasibility of a Sovereign Debt Restructuring Mechanism in the Euro Area', *ESCB Legal Conference 2016* (European Central Bank 2017) 6. See also Ludger Schuknecht, 'The German Perspective: The Structure of the European Stability Mechanism' in Christoph Paulus (ed), *A Debt Restructuring Mechanism for Sovereigns: Do we need a legal procedure?* (CHBeck 2014) 185.

[1005] Chung and Papaioannou (n 955) 10, signal that, as of March 2020, an estimated $1.3 trillion of foreign law-governed bonds was outstanding. Approximately 51% of the outstanding debt stock includes single-limb CACs, while 45% has double-limb CACs. Only 4% did not include any CACs.

since CACs strike a good balance between creditors and debtors, by avoiding a 'regulatory overkill'.[1006]

Others indicate that CACs are insufficient legal figures to adequately deal with the issue, given the many existing gaps.[1007] There are three main issues with CACs, namely: insufficient comprehensiveness of debt restructuring, an insufficient reduction of debt and the problem of new financing.[1008] The first limitation is linked to the complexity of the debt profile. According to Bolton and Skeel, restructuring with CACs has mostly been done by smaller countries, which display a less complex profile (ie only a few different bonds). Therefore, bond diversity (ie maturities and payout terms) reduces the effectiveness of restructuring. In addition, the size of creditor losses is also significantly correlated with the holdout rate (ie Ukraine in 1999 and Greece in 2012), suggesting that CACs alone do not assure full participation.[1009]

Be that as it may, single-limb clauses are an improvement. In fact, empirical evidence shows that this type of CAC helps reduce holdout rates, especially if they imply high losses for creditors. In contrast, CACs with bond-by-bond voting or two-limb clauses are insufficient to achieve high participation rates.[1010]

In this context, the Greek restructuring stands out, not only because it was the largest debt restructuring in the history of sovereign defaults, but also because it is the only eurozone Member State to have done it so far. This restructuring took place in the form of private sector involvement. Single-limb CACs were introduced retroactively to all domestic bonds issued under Greek law,[1011] contributing to the success of the

[1006] Udaibir Das, Michael Papaioannou and Christoph Trebesch, 'Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts' (2012) IMF Working Paper 12/203 <https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf> accessed 8 June 2022. See also Nouriel Roubini and Brad Setser, 'The Reform of the Sovereign Debt Restructuring Process: Problems, Proposed Solutions, and the Argentine Episode' (2004) 1 Journal of Restructuring Finance 173.

[1007] Lastra, 'How to Fill the International Law Lacunae in Sovereign Insolvency in European Union Law?' (945) 56. The author indicates issues regarding applicable law, litigation, collateral, human rights and protection of democracy. See also Christoph Paulus, 'How Could the General Principles of National Insolvency Law Contribute to the Development of a State Insolvency Regime?', *ESCB Legal Conference 2016* (European Central Bank 2017) 64, and Otto Heinz, 'Issues and Possible Reforms in the Context of a Euro Area/EU Sovereign Insolvency Framework', *ESCB Legal Conference 2016* (European Central Bank 2017) 93, 102.

[1008] Patrick Bolton and David Skeel, 'Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?' (2004) 53 Emory Law Journal 763, 772.

[1009] Chuck Fang, Julian Schumacher and Christoph Trebesch, 'Restructuring Sovereign Bonds: Holdouts, Haircuts and the Effectiveness of CACs' (2021) 69 IMF Economic Review 155.

[1010] ibid.

[1011] Hofmann (n 955) 66; Lee Buchheit, 'Use of the Local Law Advantage in the Restructuring of European Sovereign Bonds' in Franklin Allen, Elena Carletti and Mitu Gulati (eds), *Institutions and the Crisis* (European University Institute 2018) 95.

operation. Greece achieved a total participation of €199.2 billion, or 96.9% of eligible principal. In the end, debt declined by about €107 billion as the result of the exchange, or 52% percent of the eligible debt, which meant significant losses were accepted by creditors.

A closely related limitation is insufficient debt reduction. Private creditors, in particular, will weigh the benefits and costs of reduced debt repayment, therefore, a debt restructuring that is too creditor-friendly may result in a lower-than-expected improvement in its debt profile. In addition, CACs do not address sovereign's non-bond debt (ie bank loans).

The participation of public creditors is constrained for additional reasons. Article 125 (1) TFEU, in the CJEU's interpretation, permits the provision of assistance under conditionality. The question is whether assistance can be interpreted in terms of granting access to credit or writing down principal. Ioannidis argues that the latter option could be acceptable if a focus shift to the protection of the interests of the public creditor is adopted. If there is a danger that, without restructuring, the public creditor would be exposed to greater losses due to a debtor's inability to pay, then the purpose of the involvement would be to protect the creditor's investment, not to offer the debtor an alternative means of funding. Only the latter situation, according to the author, was intended to be covered (thus, prohibited) by the drafters of Article 125 TFEU.

This reasoning is also consistent with State aid law framework. When dealing with debtor enterprises, it has been long-standing case law of the Court to assess the requirement of economic advantage, prescribed in article 107 (1) TFEU, that the State should behave as a private creditor[1012] driven by the maximisation of profits or limitation of losses.

Be that as it may, it is difficult to determine whether the motivation for restructuring is based on these considerations or aimed at offering further assistance, as Ioannidis also notes.[1013] It would also render sovereign restructuring more contentious (therefore, lengthier) and increase uncertainty. Accordingly, the reading that views the direct assumption of Member States' liabilities and waiving of loans offered to pay for old

[1012] Case C-342/96, *Kingdom of Spain v Commission of the European Communities* [1999] ECR I-2459; Samuel Cornella, 'The "Market Economy Investor Principle" to Evaluate State Aid: Latest Developments and New Perspectives' (2015) 22 Maastricht Journal of European and Comparative Law 553.
[1013] Ioannidis, 'Debt Restructuring in the Light of Pringle and Gauweiler - Flexibility and Conditionality' (n 604) 81.

liabilities as interchangeable measures, for the purposes of article 125 TFEU, is more plausible.[1014] Similarly, the ESM Treaty (recital 12) only refers to private sector involvement and only in exceptional circumstances.

The ECB is also a relevant creditor in potential debt restructurings, given its ability to purchase significant amounts of sovereign bonds in secondary markets. In *Gauweiler*, the Court did not directly address the issue. Notwithstanding, it did state that the lack of privileged creditor status exposed the ECB to the risk of a debt cut decided by other creditors. It argued that this was an inherent risk of the operation.[1015] These statements are difficult to reconcile with the Court's other references to avoiding moral hazard and fostering fiscal discipline as objectives of article 123 TFEU. As such, although not yet settled in case law, it is likely that a restructuring involving the ECB would breach the Treaties and prevent its participation.[1016]

These limitations in EU law are crucial, especially because the ESM is intended to be an institution whereby loans (or other types of assistance) are provided to ensure liquidity (Member States' abilities to roll-over their debt obligation). In practice, there is a gradual debt ownership swap from the private to public sector. Problematically, if assistance programmes provide significant funding, the ESM will progressively become a more important creditor, which could make meeting the CACs modification thresholds more challenging. Importantly, as seen above (Part III, Chapter 1, Point 4.2.1), the problem with ESM influence is that not only are funds controlled by Heads of State or the Government, thereby potentiating tensions between sovereigns,[1017] but also that power is skewed towards a few Member States.

[1014] Christian Hofmann, 'Greek Debt Relief' (2017) 37 Oxford Journal of Legal Studies 1, 24.
[1015] Gauweiler (n 636), para 126. However, in his opinion, AG Cruz Villalón states that the ECB would not actively contribute to bringing about a restructuring but would, instead, seek to recover in full the claim securitised on the bond. *Case C-62/14, Peter Gauweiler and Others v Deutscher Bundestag,* EU:C:2015:400, Opinion of AG Cruz Villalón, paras 235-236.
[1016] Funds held by central banks are usually entitled to immunity from satisfaction of creditors' claims in case their country defaults, which was the case of Banco Central de la República Argentina, as described by Thomas Baxter and David Gross, 'Special Immunities: Central Bank Immunity' in Rosa Maria Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford University Press 2014) 117. However, such cases are different from central banks directly participating in principal payment reduction of purchased bonds.
[1017] In this vein, see Paulus, 'How Could the General Principles of National Insolvency Law Contribute to the Development of a State Insolvency Regime?' (n 1007) 76.

Lastly, I will address the problem of new financing. An essential feature in preserving companies' value in US's Chapter 11 and in the EU's Directive 2019/1023[1018] is the possibility of obtaining DIP financing. This type of funding may be even more important for sovereign debtors because of their vulnerability to capital flight. Arguably, the ESM could serve a similar function but, like the IMF, it does not tie its lending to the negotiation of a restructuring agreement between Member States and their creditors. Consequently, investors have an incentive to wait until a bailout becomes unavoidable and new financing is provided by public sector institutions.[1019]

3.2.3.3. Lack of independence in overseeing the process

Lack of independence in overseeing the bankruptcy procedure has been one of the most contentious issues in the literature. In the sovereign realm, independence while conducting the process is crucial, given that it provides credibility and legitimacy. These are important features to achieve State acceptance, not only regarding the procedure itself but also compliance with its final outcome.

For instance, in the absence of a criterion to define and measure debt sustainability, there is a risk of political interference, regardless of the body responsible. The same occurs regarding the conduction of the various stages of the legal procedure, for example, in designing (or mediating the agreement of) a reform programme, calculating interim financing or determining a standstill of debt payments.

In this context, international bodies, such as the IMF, could be seen as an option, given their experience and expertise, having addressed the sovereign debt crisis. However, according to Bolton and Skeel, the IMF has attracted criticism on two fronts: a conflict of interest and lack of transparency associated with political capture. First, the IMF usually performs the function of a bridge-creditor of the sovereign debtor. However, its responsibility as decision-maker would be to mediate impartially among the various creditors of the sovereign debtor, which might place it in a conflict of interest. Second, their sustainability calculations are frequently driven by political convenience rather than

[1018] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring.
[1019] Bolton and Skeel (n 1008) 775.

scientific rigour.[1020] Although the criticism might not be totally accurate,[1021] it does highlight the lack of consensus around this international body, raising doubts regarding its suitability.

In the context of the EU, this proposal is unrealistic, not least because it has already established the ESM as a funding body.[1022] Moreover, EU institutions have already developed expertise in dealing with debt crises and the IMF attracted some criticism for having been part of the solution.[1023]

Nevertheless, the same partiality issues that were identified regarding the IMF can be found in the ESM. At the outset, the stability mechanism is funded by Member State transfers, which makes impartiality difficult to obtain given the inherent political sensitivity it entails, especially in moments of market turmoil. Moreover, as seen above (Part III, Chapter 1, Point 4.2.1), its governance rules on decision-making disproportionately skew power towards the wealthiest countries. As Maduro argues, '[e]ven when consensus is reached, the process of reaching it under the shadow of veto is very different from the process of doing so under the shadow of vote'.[1024] A feasible option under the ESM would be to amend its legal framework in order to foresee an automatic funding instrument when a bankruptcy process is triggered.

Some authors have considered political institutions a viable compromise solution, given that geopolitical considerations will always play a certain role. As such, a simpler, more coordinated process might be a fair price to pay, even if it comes with additional political influence.[1025]

Other solutions outside of the political process include alternative dispute resolution, such as arbitration (either ad-hoc or a standing tribunal) as suggested by

[1020] ibid. 810. The authors argue that 'IMF decision-making has in some instances been driven more by political pressures by the United States or other G-7 members than by the economics of the crisis in question. As decisionmaker in a restructuring, its motives and impartiality may continually be questioned, making it ultimately an ineffective administrator of the restructuring process'. These shortcomings would also apply to a new independent committee established within the IMF.
[1021] Gelpern, 'A Skeptic's Case for Sovereign Bankruptcy' (n 990) 275. Moreover, Panizza (n 996) 223, argues that the dispute settlement mechanism of the World Trade Organisation is often requested to rule on issues with larger financial and political implications than adjudicating of sovereign default, for which there is no precise solution. Yet, these are considered to be impartial and abided for.
[1022] Schuknecht (n 1004) 186.
[1023] Russell Kincaid, 'The IMF's Role in the Euro Area's Crisis: What Are the Lessons from the IMF's Participation in the Troika?' in Moisés Schwartz and Shinji Takagi (eds), *Background Papers on The IMF and the Crises in Greece, Ireland, and Portugal* (International Monetary Fund 2017) 137, 179.
[1024] Maduro, *We The Court: The European Court of Justice and The European Economic Constitution* (n 6) 123.
[1025] Panizza (n 996) 233.

Kaiser.[1026] Under this proposal, debtors and creditors should be allowed to appoint the arbitration panel, which would hold the authority to manage the whole legal proceeding, including deciding who should assess the capacity to pay. A key advantage of the standing tribunal over ad-hoc is that it provides a neutral forum between the creditors and the sovereign debtor, enabling the lowering of emotion in the dispute resolution.[1027] Moreover, it is a forum able to provide cohesion and structure to sovereign default, as well as a perception that complex issues are dealt by experienced arbitrators.

Finally, I will say a few words on the courts as overseers of the legal process, namely those specialising in corporate bankruptcy or insolvency.[1028] The main idea is that debtors should be allowed to file for bankruptcy in the courts of any foreign jurisdiction with a connection to the private debt issued at least eighteen months prior to bankruptcy, in order to avoid last minute issuance with forum shopping purposes. Choosing national (home) courts should not be allowed in order to avoid national bias.

There are at least two objections: planned forum shopping and courts' inability to deal with cases of this scale. First, it will enable sovereign debtors to shop for the laxest forum, which could risk increasing debtors' moral hazard if debt discharge is made too easy. As Skeel notes, this criticism has frequently been directed at the US corporate bankruptcy framework, given that most filings have taken place in Delaware and New York courts, whose judges rush cases and are generous to debtors. However, there is evidence that creditors often choose Delaware as a bankruptcy location as well, which is an indication that a confluence of interests exists between parties. Moreover, judges have an incentive to perform better in order to attract challenging cases and, in the end, if the procedure is debtor-prone, creditors can always vote against the bankruptcy plan.[1029]

[1026] Jürgen Kaiser, 'Resolving Sovereign Debt Crises Towards a Fair and Transparent International Insolvency Framework' (Friedrich Ebert Stiftung, September 2010) <https://library.fes.de/pdf-files/iez/10263.pdf> accessed 15 June 2022, 17 and 29. See also the proposal of creating a 'Resolvency Court' under the CJEU, suggested by Christoph Paulus, 'Should Politics Be Replaced by a Legal Proceeding?' in Christoph Paulus (ed), *A Debt Restructuring Mechanism for Sovereigns: Do we need a legal procedure?* (CHBeck 2014) 191.

[1027] Christoph Paulus and Steven Kargman, 'Reforming the Process of Sovereign Debt Restructuring: A Proposal for a Sovereign Debt Tribunal', *Workshop on Debt, Finance and Emerging Issues in Financial Integration* (8 and 9 April 2008) <https://www.iiiglobal.org/sites/default/files/119_Workshop_Debt_Kargman Paulus-Paper.pdf>, accessed 15 June 2022.

[1028] Bolton and Skeel (n 1008) 812.

[1029] David Skeel, 'What's So Bad About Delaware?' (2001) 54 Vanderbilt Law Review 309; Bolton and Skeel (n 1008).

The EU Insolvency Regulation[1030] took a different approach. In article 3 (1) (a), it establishes the centre of a debtor's main interest as a factor to attribute court jurisdiction to open insolvency proceedings. The centre of main interest is defined as the place where the debtor conducts the administration of its interests on a regular basis and a place that is ascertainable by third parties.[1031] This solution may obviate some problems previously signalled in the US, notably, judges' incentives to attract large cases or judges' closeness with local bankruptcy lawyers, which may turn them debtor-friendly. However, it may also create other issues, such as uneven expertise and effectiveness in each Member States' courts, a diverse level of implementation and different qualitative results.

This takes me to the second objection, which is related to courts' inability to deal with bankruptcy cases, particularly complex ones. Allowing forum shopping in the US has led Delaware to excel in corporate and bankruptcy laws and legal proceedings, alongside New York and Texas.[1032] Although not perfect,[1033] the fact that it is widely used allows for specialisation, benefitting the speed of procedure as well as the quality and judges' expertise.[1034]

Notwithstanding, sovereign restructuring is very different from corporate restructuring, not least because countries, particularly developed ones, can resort to different instruments (such as taxation), hold a wider debt market than most enterprises and have a different epilogue (they cannot be dissolved).

These features call for a different legal approach, aiming to strike a balance between debtor and creditor rights, unlike those normally achieved under the principle of the weaker party in a legal relationship. In this vein, if the debtor is privileged to choose the forum, the creditor sees the jurisdiction attributed to the countries with law that governs bond issuances. If history is of any guide to predict the future then, almost invariably,

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[1030] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings [2015] OJ L141/19. According to Recital 9, it applies to natural or legal persons.
[1031] See Peter Stone, *Stone on Private International Law in the European Union* (Edward Elgar 2018) 759; Ian Fletcher, 'Scope and Jurisdiction' in Gabriel Moss, Ian Fletcher and Stuart Isaacs (eds), *Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings* (Oxford University Press 2016) 47.
[1032] Jeffrey P Fuller, 'ANALYSIS: Three Bankruptcy Courts Remain Top Megacase Magnets' (*Bloomberg Law*, 17 December 2021) <https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-three-bankruptcy-courts-remain-top-megacase-magnets> accessed 22 June 2022.
[1033] Lynn LoPucki and Sara Kalin, 'The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom"' (2001) 54 Vanderbilt Law Review 231.
[1034] As noted by Skeel, the bankruptcies of large companies such as Maxwell, Polly Peck, WorldCom and Global Crossing involved larger amounts of outstanding debt than most sovereign debt restructuring cases. More recently, the bankruptcy of Lehman Brothers was considered more complex than a potential restructuring of New York State. Skeel, 'State Bankruptcy from the Ground Up' (n 1002) 196.

American, English, German and French courts will deal with bankruptcy cases, as most issuances are made under their laws.[1035] Consequently, a link between the choice of courts and place of issuance ensures that the case will be overseen by a jurisdiction that is unlikely to be debtor-prone and, as such, strike a better balance between the different parties.

3.2.3.4. Compatibility with the European Union Treaties

A debt restructuring mechanism is essentially a process with the purpose of restoring financial viability to its subject, through a reduction in the overall principal, reduction of interest, establishment of new deadlines for payments, among other types of measures. In any case, the debtor will emerge with improved and more advantageous financial circumstances.

The features of this framework are challenging under EU law essentially due to the existence of the prohibition of monetary financing in article 123 TFEU and the no-bailout clause in article 125 TFEU. The common aim of these provisions is to ensure that correct incentives are in place for Member States to pursue sound budgetary policies.[1036] In stating that the ECB should refrain from purchasing debt in primary markets and that neither the EU nor Member States are liable for or able to assume each other's commitments, the question arises as to whether a scenario of financial relief, with their institutional involvement, would be possible.

As I have argued above (Part III, Chapter 1, Point 4.1), the purchase of bonds in the secondary market produces a similar effect as the purchase of bonds in the primary market. This means that, with a reasonable degree of certainty, the ECB would provide the necessary market liquidity. From this perspective, relief from the original conditions of the purchase on the (secondary) market might be interpreted as monetary financing of Member State(s), since it would alleviate budgetary pressures.

Likewise, the teleology of article 125 is to promote sound budgetary policies. In this regard, Maduro argues that this objective would be endangered only if the EU or a Member State became legally responsible for the debt of another Member State, in which

[1035] Philip Wood, 'Choice of Governing Law for Bonds' (2020) 15 Capital Markets Law Journal 3, 6. US and English law are the dominant choices. When combined with German and French law, they cover more than 80% of the world's jurisdictions.
[1036] See Kämmerer (n 225) 155.

case the practice would be in violation of the Treaty. This would not be the case if financial assistance was provided voluntarily to a Member State that was no longer capable of fulfilling its commitments. In this scenario, neither the EU nor the Member States are *ex ante* assuming any liability or committing to the obligations of that Member State. In fact, the struggling Member State would develop a bilateral relationship with the creditor, who would independently decide on the debt relief.[1037]

Moreover, the CJEU decided that the ESM was compatible with article 125 TFEU, given that financial assistance was necessary to ensure financial stability of the eurozone as a whole and because of the attached conditionality.

Importantly, there are two sides to, or moments, in the legal relationship between a creditor and a debtor. Granting financial assistance marks the initial moment in which the relationship begins and legal obligations are defined for both parties. This was the side the Court focused on in *Pringle* to ensure that, from the outset, the objective of maintaining sound budgetary policies in Member States through market pressure was preserved.

However, there is another side to the creditor-debtor relationship, which involves the fulfilment of the debtor's obligations, most notably the repayment of funds. The CJEU did not analyse the relationship from this perspective. Nevertheless, there is a risk of non-performing loans: situations in which debtors may not be able to meet their repayment obligations. The question arises whether, at the outset, debtors are aware or can reasonably assume that their debts will be forgiven at some point. However, this matter relates to maintaining pressure on Member States' budgetary policy, not to debt forgiveness. From this perspective, debt forgiveness by EU institutions or Member States may or may not be contrary to the Treaties, depending on whether the debtor is aware of the creditors' intentions before entering into debt. If there is no prior knowledge, then debt forgiveness should be permitted under EU law. In fact, in the *Gauweiler* case, the Court argued that the ECB's potential exposure to losses would not, in itself, reduce market discipline.

[1037] See Miguel Poiares Maduro, 'EU Law and Sovereign Debt Relief' in Koen Lenaerts and others (eds), *An Ever-Changing Union? Perspectives on the Future of EU Law in Honour of Allan Rosas* (Hart Publishing 2020) 75, 77-78. In contrast, see Ohler, 'Article 125 (Ex Article 103 TEC) [Prohibition to Assume Liabilities]' (n 427) 188, arguing that for the 'assumption' requirement to be met, it is irrelevant whether the support is given unilaterally, on a voluntary basis by one Member State or due to an agreement between Member States. However, article 125 covers not only loans but also the purchasing of bonds on the primary market by other Member States if they are conducted under market conditions.

The lack of awareness of original creditors' intentions may not be as straightforward as it seems. Crucially, the ECB's asset purchase programs were designed to operate as unpredictably as possible. Nevertheless, the intervention of the ECB was not a matter of *if* but *when*, given that preventing the break-up of the eurozone became one of the ECB's *de facto* objectives. Concomitantly, if one of the main objectives of granting financial assistance is preserving financial stability within the euro area, then a similar logic may underlie it.

In this context, Maduro argues that the form and extent of debt relief are not irrelevant. In fact, the more substantial the debt relief, the harder it becomes to demonstrate that conditionality-based financial aid represents a functional equivalent. Debt relief, the author argues, particularly a haircut, reduces the incentive to consolidate budget policies and can heighten moral hazard. Hence, in order to preserve market discipline, differentiated credit risk needs to be maintained. In addition, conditionality must be in place in order to offset the fact that market funding will be unnecessary when the assistance is in place.[1038]

However, the relevance of the form and extent of debt relief must be assessed not by focusing on these two features, but by considering the type of procedure established for debt restructuring. In essence, moral hazard is a cognitive process by which subjects anticipate that present actions will be replicated in the future. The form and extent of debt relief provide limited information about creditors' future decisions. What truly informs us of the likelihood of decision-replication is how such decisions are carried out. This point could be applied to that which I have discussed: the current process of verticalisation within the EU has increasingly shed light on what future decisions might resemble, such as the dominance demonstrated by the ECB in Member States' debt markets, as well as the overly prescriptive approach of the EU economic governance framework, which reduces national ownership of economic policy and encourages supranational assistance.

Conversely, a process based on a debt restructuring framework would offer enhanced legal certainty for both creditors and debtors, creating a legal relationship with market actors that discourages future fiscal recklessness. Crucially, national fiscal policies would come under closer scrutiny by the market. Their willingness to provide more or less funding would, thus, be proportional to the degree of success or failure each

[1038] Maduro, 'EU Law and Sovereign Debt Relief' (n 1037) 81.

Member State demonstrates in conducting their economic policies. Similarly, the readiness to undertake restructuring would reduce the likelihood of future funding being granted which, in turn, would reduce moral hazard. Ultimately, the anticipation of a debt restructuring process would enhance fiscal responsibility and diminish the threat of restructuring.

In light of this, debt relief would be acceptable within the framework of the case law and compatible with current Treaty provisions, especially articles 123 and 125 TFEU.

3.2.4. Financial problems

3.2.4.1. Market access and reputation

One of the most important factors influencing debt payment is a country's reputation. As States aim to ensure access to future market financing, they prioritise debt repayments, which, in turn, instils confidence in lenders, encouraging them to continue extending funding. In the 1840s, this consequence was recognised as the primary cost of default in US States,[1039] even though it may not always be a primary concern.[1040]

Fear of reputational sanctions also plays a significant role as it can affect relationships that rely on trust, to some extent. For instance, pursuant to a debt default, other governmental suppliers may begin to request advance payments before shipping goods or providing services. Similarly, a resident population may reduce its level of trust in its government.[1041] These spillover events increase the overall cost of default.

This reasoning can be traced back to game theory, notably, repeated games. As explained by Benoit and Krishna, '[i]n a repeated setting, players can condition their behavior at any stage of the game on the observed past behavior of other players. As a

[1039] William English, 'Understanding the Costs of Sovereign Default: American State Debts in the 1840's' (1996) 86 The American Economic Review 259, 268. Disturbance of market access also occurred in Finland in the 1990s, during the years of depression. Finnish bond yields rose quickly and widened significantly compared to German equivalents. As Rehn explains, this mechanism, or its mere threat, could enforce a long-run budget constraint on an economy and prevent it from over-borrowing. See Rehn (n 538) 84.

[1040] Smaller countries meet their debt-related obligations not to keep their reputation but because it is seldom possible for them to display one, as argued by Jeremy Bullow and Kenneth Rogoff, 'Sovereign Debt: Is to Forgive to Forget?' (1989) 79 The American Economic Review 43. However, the authors mostly focus on Third-World debt management problems. In contrast, EU Member States are considered relatively rich countries and have reputations to maintain.

[1041] Kolb (n 946) 8. The author exemplifies with defaults of the Spanish Empire in the 16th century (inability to pay to the army); Peru in 1826 (fearing Europe, as a main financier and export destination, would seize exports as compensation); or Russia in 1993 (court litigation and seizures).

result, a player may behave in a way that is not in his or her short run interests because any attempt to realize short run gains may lead to future losses if other players retaliate'.[1042] Therefore, as much as it would benefit sovereigns not to comply with payment obligations in the short-term, the need to repeatedly engage with financial markets provides the necessary incentive to behave differently.[1043]

In this context, it is argued that reputation costs can be successfully addressed by instituting a procedure for sovereign restructuring. The idea is that institutionalisation would reduce costs by making it more socially acceptable and transparent: a country that undergoes such a procedure would be positioned to gain trustworthiness, while a country that depends on financial assistance will be judged as a risk factor, potentially hindering new investments.[1044] Moreover, the assumption that all creditors would cease lending if there was a default against one of them is empirically incorrect, as is the assumption that such an exclusion would be permanent.[1045]

3.2.4.2. Bond market disruption and contagion

Another objection is that a bankruptcy procedure would disrupt bond markets and increase States' borrowing costs, even those with better fiscal indicators by way of contagion.[1046]

In the EU, this argument was used by the ECB during the sovereign debt crisis.[1047] In the US, similar arguments emerged in 1934 (during the debate that preceded the enactment of Chapter 9 of the Bankruptcy Act by the US Congress) and 2011 (during the debate exploring the possibility of a States' bankruptcy bill, which was not adopted). Regarding the debate on Chapter 9, opponents of the bill contended that opening the doors of the bankruptcy court to municipal corporations represented a radical departure from long-established practices that would adversely affect municipal bond markets. They

[1042] Jean-Pierre Benoit and Vijay Krishna, 'Finitely Repeated Games' (1985) 53 Econometrica 905.
[1043] In this vein, see Jonathan Eaton, Mark Gersovitz and Joseph Stiglitz, 'The Pure Theory of Country Risk' (1986) National Bureau of Economic Research Working Paper No 1894 <https://www.nber.org/system/files/working_papers/w1894/w1894.pdf> accessed 31 May 2022.
[1044] Abel (n 984) 413. In this vein, see Erik Jones, 'The Politics of NGEU', *REBUILD Launch Conference* (24 February 2022) <https://rebuildcentre.eu/event/rebuild-launch-conference/> accessed 12 April 2024, which stated that ESM reliance was beginning to become 'toxic'.
[1045] Kolb (n 946) 6.
[1046] David Skeel, 'States of Bankruptcy' (2012) 79 The University of Chicago Law Review 677; Abel (n 984) 408.
[1047] Peter Spiegel, 'Trichet Warns on Bail-out System Dangers' *Financial Times* (29 October 2010) <https://www.ft.com/content/cba1de4a-e37c-11df-8ad3-00144feabdc0> accessed 13 June 2022.

were particularly concerned about solvent cities being impacted by the spillover effects from insolvent ones. Furthermore, opponents argued that only a small percentage of municipalities would likely use such an instrument and that, therefore, the costs would outweigh the benefits.[1048]

Regarding the States' potential bankruptcy bill, the main issue raised in discussion was that congressman Mike Quigley feared that the bankruptcy of a few States would cause a contagion effect on the others, regardless of merit. It was stated that the bankruptcy of States would cripple the bond markets and that '[p]ermitting States to break their promises to bondholders would decrease investor confidence and damage States' ability to invest in much-needed infrastructure'.[1049] The problem, once again, was the fact that fiscal issues were confined to few States:

> The municipal bond market is now responding to legitimate concerns about the long-term structural imbalances in these six to eight States. But I believe we would be correct to distinguish these bad apples from the other 40-some States that have been relatively well managed and only have temporary deficits. That is why a one size-fits-all approach like bankruptcy for States could do more harm than good.[1050]

This argument relies on misguided assumptions: first, that the market does not differentiate between financially sound Member States and those at risk of default and, second, that the negative effects will be significant and durable.[1051]

From a theoretical viewpoint, effects on costs could go either way. Sovereign debt contracts are difficult to enforce, therefore, willingness to pay is connected to default

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[1048] Jonathan Henes and Stephen Hessler, 'Deja Vu, All Over Again' *New York Law Journal* (27 June 2011) <https://www.kirkland.com/-/media/publications/article/2011/06/deja-vu-all-over-again/newyorklawjournal_june-2011.pdf> accessed 7 March 2022.

[1049] Hearing of the Courts, Commercial and Administrative Subcommittee of the House Judiciary Committee 'Role of Public Employee Pensions in Contributing to State Insolvency and the Possibility of a State Bankruptcy Chaper' (14 February 2011) <https://www.govinfo.gov/content/pkg/CHRG-112hhrg64585/html/CHRG-112hhrg64585.htm> accessed 7 March 2022.

[1050] Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs of the Committee on Oversight and Government Reform, 'State and Municipal Debt: The Coming Crisis?' (9 February 2011) <https://www.govinfo.gov/content/pkg/CHRG-112hhrg68362/pdf/CHRG-112hhrg68362.pdf> accessed 7 March 2022.

[1051] Skeel, 'States of Bankruptcy' (n 1046) 718.

costs. Thus, improving a system to reduce such costs would not only provide less compliance incentives but also increase investment risks and increasing borrowing costs as a result. On the other hand, too much accumulated debt and a delayed default may lead to a loss of value and overborrowing, thereby, worsening sovereign risk profile and bond yields. Addressing these concerns could lead to lower costs.[1052]

However, from an empirical viewpoint the hypothesis lacks a solid foundation. Concerning the market's ability to differentiate evidence from the US municipal bond market demonstrates that markets function to a significant degree with proper differentiation.[1053] Contagion and inadequate differentiation is frequently exemplified, as in Orange County when it filed for municipal bankruptcy in 1994 after defaulting on debt,[1054] which triggered a market-wide decrease in the value of bonds, even without direct exposure. Nevertheless, it is important to note that the bankruptcy option has been available since the 1930s, making it more likely that the reaction was due to the default itself, rather than the mere existence of the bankruptcy option. Additionally, this effect only lasted for one day,[1055] making it more difficult to suggest a causal relationship and justifying the avoidance of a particular public policy.

A proper restructuring procedure would also contribute to an increase in risk assessments and consequent country differentiation in the EU, enhancing markets' ability to distinguish between higher and lower borrower quality and adjust premiums, accordingly. As Paulus argues, 'in the beginning there is likely to be a mess when and if the new set of rules were introduced here and now. However, it would be wrong to assume that this messy situation would last forever'.[1056] On the contrary, a transparent and predictable process mitigates chaotic market reactions and fosters market discipline on Member States, since all participants know which rules to follow. In this way, it can significantly contribute to the stability of the EU as a whole and promote price stability,

[1052] Panizza (n 996) 229.
[1053] See Municipal Bonds <https://www.municipalbonds.com/screener/#sort_by=yield&sort_direction=asc&page=3> accessed 7 March 2022.
[1054] John Halstead, Shantaram Hedge and Linda Klein, 'Orange County Bankruptcy: Financial Contagion in the Municipal Bond and Bank Equity Markets' (2004) 39 The Financial Review 293, 313.
[1055] Skeel, 'States of Bankruptcy' (n 1046) 720.
[1056] Christoph Paulus, 'A Resolvency Proceeding for Defaulting Sovereigns' in Patrick S Kenadjian, Klaus-Albert Bauer and Andreas Cahn (eds), *Collective Action Clauses and the Restructuring of Sovereign Debt* (De Gruyter 2013) 181, 189.

as long as the ECB refrains from intervening in the secondary bond market, effectively monetising national public debts and deficits.

There is a significant amount of evidence to show that other implemented solutions resembling limited restructuring, such as CACs, do not bring about additional borrowing costs when compared to non-CAC bonds,[1057] suggesting that restructuring options do not cause contagion.

Regarding significance and the durability of costs, sovereign defaults generally have no substantial negative impact on subsequent growth, as they often mark the final stage of a crisis and the beginning of economic recovery.[1058] In fact, there is growing evidence that costs associated with sovereign debt restructuring are neither stringent[1059] nor long-lasting.[1060]

3.3. Bankruptcy procedure as bolstering Member States' democratic processes and mutual trust

The previous section discussed the costs associated with sovereign debt default and restructuring, highlighting the challenges they pose while emphasizing that they are not insurmountable.[1061] However, in a world of imperfect alternatives, these costs should only be considered excessive if less burdensome options are available.[1062] As seen above (Part III, Chapter 2, Point 5), bailouts are one option in the market realm, but they bring about very significant costs from a financial, economic, social and political perspective in the short-to-long-term. At the same time, there is a significant risk that it will leave the underlying issue of fiscal responsibility and debt overhang unresolved.

[1057] Abel (n 984) 411; Fang, Schumacher and Trebesch (n 1009) 120.
[1058] Eduardo Yeyati and Ugo Panizza, 'The Elusive Costs of Sovereign Defaults' (2011) 94 Journal of Development Economic 95.
[1059] Kevin Kordana, 'Tax Increases in Municipal Bankruptcies' (1997) 83 Virginia Law Review 1035, 1074; Richard Schragger, 'Democracy and Debt' (2012) 121 The Yale Law Journal 860, 874.
[1060] Ugo Panizza, Federico Sturzenegger and Jeromin Zettelmeyer, 'The Economics and Law of Sovereign Debt and Default' (2009) 47 Journal of Economic Literature 651, 664.
[1061] A good overview on sovereign default costs is given by Bianca De Paoli, Glenn Hoggarth and Victoria Saporta, 'Output Costs of Sovereign Default' in Robert Kolb (ed), *Sovereign Debt: From Safety to Default* (Wiley 2011) 23. See also Adam Feibelman, 'American States and Sovereign Debt Restructuring' in Peter Conti-Brown and David Skeel (eds), *When States Go Broke: The Origins, Context, and Solutions for the American States in Fiscal Crisis* (Cambridge University Press 2012) 146, 172.
[1062] Clayton Gillette, 'What States Can Learn From Municipal Insolvency' in Peter Conti-Brown and David Skeel (eds), When States Go Broke: The Origins, Context, and Solutions for the American States in Fiscal Crisis (Cambridge University Press 2012) 108.

In the context of the EU, there are other reasons that might favour the implementation of a bankruptcy procedure and shed light on how the Union can achieve a better balance from a democratic and accountability perspective. There is a well-established body of literature arguing for a democratic deficit in the EU that flows primarily from deficient (or in the absence of) national internalisation of interdependency costs.[1063] Indeed, functionalistic and instrumental approaches have the critical shortcomings of presenting solutions for EU integration as inevitable to the maintenance of a flawed political project, most notably, the euro. As shown above (Part II, Point 1), the functionalistic approach, as developed by EU institutions, is considered one of the reasons why Member States later decided to adopt a markedly intergovernmental method within the European Council regarding economic policy, rather than furthering supranational economic policies.

With Lindseth, I would argue that EU integration should not be purely technocratic. Instead, it should be viewed as a democratic process in which the supranational solution is seen as a suitable substitute, in a democratic sense, for reducing national politics.[1064] In a way, it seems that the 'legacy costs' of an originally flawed EMU have been borne almost entirely by so-called debtor countries, which is inconsistent with the shared democratic responsibility each Member State embodies in such an endeavour.[1065]

Even if the EU's democratic identity has slowly been emerging, allowing for the existence of emergency governance in the absence of a sovereign State,[1066] this relationship needs to work both ways and be effectively owned by each Member State. Merely signing an international treaty that obliges States to pass a national law or agreeing to constitutional amendments that introduce balanced budget rules is insufficient, as this process will always be seen as externally-driven and, to some extent, imposed during times of financial hardship. This context is hardly conducive to facilitating a national

[1063] Maduro, 'A New Governance for the European Union and the Euro: Democracy and Justice' (n 408); Fritz Scharpf, 'Democratic Legitimacy under Conditions of Regulatory Competition: Why Europe Differs from the United States' in Kalypso Nicolaidis and Robert Howse (eds), *The Federal Vision: Legitimacy and Levels of Governance in the United States and the European Union* (Oxford University Press 2001); Simon Hix and Bjørn Høyland, *The Political System of the European Union* (3rd edn, Bloomsbury Publishing 2011).

[1064] Peter Lindseth, 'Thoughts on the Maduro Report: Saving the Euro Through European Democratization?' (*EUtopialaw*, 2012) <https://eutopialaw.wordpress.com/2012/11/13/1608/> accessed 6 April 2022.

[1065] Peter Lindseth, 'Power and Legitimacy in the Eurozone: Can Integration and Democracy Be Reconciled?' in Maurice Adams, Federico Fabbrini and Pierre Larouche (eds), *The Constitutionalization of European Budgetary Constraints* (Bloomsbury Publishing 2014).

[1066] Larsen (n 848) 149.

debate on whether a 'golden rule' should be introduced. From this perspective, it may be untenable to continue pursuing supranational economic coordination since its output imposes and ensures compliance with budgetary restrictions, as is the case with the EU economic governance framework and financial assistance programmes. This paradigm places a heavier burden on so-called 'debtor countries', as they are more likely to face financial constraints and need to introduce restrictions.

Another hurdle to overcome in EU economic integration is the fear of becoming a 'transfer union', meaning the establishment of a system of a permanent and continuous flow of financial means, from more developed to less developed Member States. From the 'creditor countries'' perspective, not only does this generate moral hazard, but it essentially builds up a system in which little accountability and responsibility exist and, in the long-term, creates financially dependent States.

Hence, beyond providing financial grants to Member States in need, there are concerns about consolidating a transfer-dependency system. This is yet another reason to consider a market-based process within a new EU federal consensus. If triggered, sovereign debt restructuring would be conducted through a legally binding process, providing legal certainty. While some Member States and EU institutions would have to bear some losses, these would be internalised in creditor and debtor countries' political processes. The major difference lies in the certainty that transfer dependency was severed, the no-bailout clause reassured, individual responsibility was bolstered and market confidence restored. This confidence applies not only in the sense that Member States, whose debt is being restructured, would be in better financial conditions, but also because each market participant would have the incentive to scrutinise national economic policy sustainability and make actual risk differentiation.[1067]

[1067] In the same vein see Jeromin Zettelmeyer, 'Ist Der Euro Noch Zu Retten? - Vorschläge Für Eine Neue Europäische Wirtschaftspolitik' (*politik für europa*, 2017) <https://library.fes.de/pdf-files/id/ipa/12819.pdf> accessed 3 May 2022, 11.

PART IV CONCLUSION

HORIZONTALISATION OF THE EUROPEAN UNION

Part IV acknowledges that, in EU economic governance and policy, there is a deficient model of financing, expenditure and representation of EU citizens. This stems from the fact that the European Council's outcomes in these areas are increasingly at odds with the deliverables expected by EU citizens. I argue that this disconnect is at the heart of the so-called democratic deficit. In order to address the problem, a two-limb approach is adopted: one deriving from the political process and another from the market process.

Regarding the political process, firstly, it is essential to enhance the democratic credentials regarding the financing of the Union. To this end, I propose to adopt a direct tax on income of EU citizens, directly accruing to the EU budget. Significantly, underpinning this proposal is the idea of a Union of citizens, bound together by the EU budget.

I have not only endeavoured to show that the EU already holds a wide enough competence to lay and collect taxes to finance its budget, including direct taxes on EU citizens. The problem is, indeed, more related to the political environment influencing the interpretation of article 311 TFEU than to constitutional hurdles. In this vein, a restrictive approach is consistent with the intergovernmental method of EU economic policy.

However, EU citizens hold a double capacity in their exercise of constituent power, as citizens of their Member States and the Union. Therefore, the division of sovereignty would not take place between Member States and the EU as different subjects, but between two capacities of the same subject: the citizens in their legitimating role of different democratic levels.

The nationalistic mindset regarding revenue was also present in the early stages of US federalism. In fact, federalism in the nineteenth century in the US fostered the pursuit of State-oriented economic objectives, whereby States held a broad authority over taxation. Prior to the Civil War, US revenue was mostly limited to customs duty. After it and until 1913, when a constitutional amendment was allowed to levy federal income tax, federal revenue was divided almost equally between customs duties and excises on alcohol and tobacco. One of the conclusions from the EU and US' experiences is that national contributions are efficient and sufficient in nascent integration stages. Hence, as EU integration progresses and deepens, so, too, should our thinking on funding.

Second, citizens will only accept democratising revenue if the nature of expenditure changes. The EU budget traditionally focuses on redistributive policies, mostly agriculture and cohesion. Although these policies may deliver some EU-wide benefits, they are increasingly misaligned with current societal needs. In fact, the CAP and cohesion resemble political priorities developed within the framework of the EEC Treaty. While retaining some relevance, they do not fully match the dynamic societal progress of ensuing decades. As a result, supranational discourse and the decision-making process have fostered a union between citizens – a dynamic societal process recognised by Member States in the Treaty changes, which were approved over time. In this context, essentially static expenditure appears increasingly anachronistic, given that it does not allow the Union to tackle common challenges such as the euro-crisis, COVID-19 and, recently, the war in Ukraine.

Moreover, the CAP and cohesion policy have generated economic inefficiencies. In fact, geographic pre-allocation of funding hinders the adoption of other policies that would benefit Member States in the absence of spending. One the one hand, the agricultural sector is decreasing in economic and social importance in the EU. Although connected with important objectives, such as healthy nutrition, economic development in post-war Europe has been able to accommodate many of the sector's anxieties. On the other hand, the cohesion policy has led to pork-barrel spending. As a result, financial support was needlessly granted to regions within richer Member States.[1068]

Importantly, NGEU has enabled a nascent change in the nature of EU expenditure, slowly transitioning towards policies[1069] that fund investments capable of delivering a greater degree of transnational benefits, such as mitigating the socio-economic effects brought about by the pandemic, preparing the EU for future sanitary catastrophes and achieving EU climate targets. Notwithstanding, the proximity between Member State responsibility and national outcomes resembles the redistributive mindset, enhances national lines and blurs the transnational dimension of the programme.

[1068] Fabbrini (n 364) 22; Benedetto (n 144).

[1069] The link between funding and policy areas allowed the Council's Legal Service to conclude that no financial assistance existed and, therefore, the requirements of article 122 (1) TFEU, as opposed to article 122 (2), were met. See Council of the European Union, 'Opinion of the Legal Service on the Proposals on Next Generation EU (2020) 9062/20' (n 374) para 120-122. De Witte argues that there is 'increase eagerness of European institutions to use EU funding (…) to advance European-wide objectives rather than (or in addition to) redistribution among the member states. See Witte, 'Integration Through Funding: The Union's Finances as Policy Instrument' (n 600) 235.

Therefore, a generality principle is proposed for Union spending to ensure that majorities are required to approve expenditure that is able to generate value for all groups of citizens, indistinctively. Adopting such a principle would achieve three main objectives: substantially reducing minoritarian bias, improving institutional independence while deciding on expenditure and establishing a connection between the nature of spending and nature of revenue.

If conceived in this way, the Union would be able to reconcile national and supranational interests, thereby expanding the scope of EU policies and favouring cross-national ideological majorities. Consequently, expenditure of this type would foster transnational divisiveness between citizens, as opposed to discord along national lines. In a word: citizens would be connected to the EU through Member States and despite them. This is the first part of the process that I designate as horizontalisation of the Union.

Third, although this thesis emphasises the role and importance of EU citizens in the political process, it also recognises the importance of Member States in the definition of spending and revenue. In this way, majoritarian and minoritarian interests would constantly confront each other within a framework of generality, thereby enriching the decision-making process with both visions and, ultimately, benefitting Union resource allocation.

Accordingly, in a context where the link created by national contributions is severed, the EU's relationship with its citizens (secured by the EP) needs to be complemented with representatives of the citizens of each Member State. This could be better conducted by merging the European Council and the Council into one legislative upper-chamber, which would be made up of representatives nominated by each national parliaments, among their respective members.

Regarding the market process, this thesis acknowledges that the double telos of federations (principles of independence and interdependence) is recognised by the EU and addressed by intergovernmentalism and public control of Member States' finances. However, this approach fails to take comparative institutional analysis into consideration, as the implemented solution derives solely from the political process, particularly the sum of Member States' political processes. It does not take into account institutional alternatives. I suggest that another approach should be taken.

In order to address the verticalisation of the EU, Member State accountability must be matched by autonomy. As explained regarding the US and others, ownership is an important compliance feature. *A fortiori*, fiscal rules and responsibility for fiscal distress are crucial in a monetary union. If members perceive that such distress is more a result of supranationally defined and enforced framework and less of national decisions, the incentive will be to request supranational assistance. Merely signing an international treaty, which obliges States to pass a national law or set of constitutional amendments to introduce balanced budget rules is not enough, as this process will always be seen as externally-driven and, to some extent, imposed during times of financial hardship. This context is hardly conducive to facilitating a national debate on whether a 'golden rule' should be introduced.

From this perspective, it may be untenable to continue pursuing supranational economic coordination with an output that imposes and ensures compliance with budgetary restrictions, as is the case with the EU economic governance framework and financial assistance programmes.[1070] Accordingly, fiscal rules should be de-constitutionalised and the secondary law that underpins them, mostly revoked.[1071] In fact, administrative surveillance and impositions of courses of action and financial sanctions, which are due to entail a deterrent effect, should be replaced by the system devised regarding debt restructuring, given that financial responsibility must be coupled with the freedom to make fiscal policy decisions. Economic coordination should be changed too. Instead of coordinating different national economies, Member States should duly discuss EU economic policy priorities within the EU budget negotiations with the EP.

A market-based solution, such as the restructuring of Member States' public debt, would also address concerns on the consolidation of a transfer-dependency system by providing legal certainty. Crucially, creditors and debtors (of a public or private nature) would have to accept losses within a fair and transparent process, thereby severing transfer dependency, reassuring the no-bailout clause, bolstering individual responsibility and restoring market confidence. This confidence is necessary not only because Member

[1070] As Martinico argues, 'flexibility and asymmetry are two of the most important features of Canadian federalism, elements partly explicable by taking into account the cultural and economic diversity present in the territory'. Accordingly, the different component units of a federal system benefit from operating in a flexible legal and institutional framework, in which different integration dynamics exist. See Giuseppe Martinico, 'A Multi-Speed EU? An Institutional and Legal Assessment' (2015) Instituto Affari Internazionali 15 <https://www.iai.it/en/pubblicazioni/multi-speed-eu-institutional-and-legal-assessment> accessed 15 March 2024, 4.
[1071] Grimm, *Constitutionalism: Past, Present, and Future* (n 361) 310.

States with restructured debt would be in better condition financially, but also because each market participant would have the incentive to scrutinise national economic policy sustainability and make actual risk differentiation.

Albeit requiring unanimous vote, these changes could be more easily implemented by simplified procedures, as they relate to Part III TFEU. In this sense, revising the Treaties to reduce their size and complexity in economic governance and policies would create the necessary space for public debate, as de-constitutionalisation opens more room for discussion and taking different options. Accordingly, a Treaty reduction would, in my view, not only be a positive step forward in EU integration but also a necessary one. In fact, the opposition many authors express regarding the laying and collecting of EU direct taxes is also understood from this perspective: if citizens directly and visibly contribute to the EU budget, then they should have the capability to influence the way the funds are spent. In the current state of affairs, this is a difficult endeavour, as the Treaty mandates many expenditure segments, such as agriculture and cohesion policies.

This would, indeed, restore the correlation between the political decisions of the voters and fiscal policy,[1072] representing a shift in the dynamics of EU integration towards Member States and the EU, in a model that is, simultaneously, centrifugal and centripetal, respectively. It is centrifugal because Member States are recognised for their individual importance and singularity. As a result, they would become less dependent on centrally-defined economic and fiscal indicators, as well as better able to express their cultural and sociological preferences. National parliaments would become more involved where they should, which is at Member State level, strengthening their connection with the will of the voters. Crucially, the will of national voters is not compensated by Member State representation by the respective Heads of State or Government in the European Council, if anything because, as a collective body, it does not equate to upholding the decision-making power of each individual Member State and does not create a Member State-specific profile.[1073] It is also centripetal because EU legislators would be in better position to express the collective views of EU citizens as a whole, not just the sum of parts.

Both processes would increase the numbers of political participation (as citizens would increase their voice in their respective Member States), as well as in market participation (as scrutiny of economic and fiscal policies would disperse through the

[1072] Waldhoff, 'Federalism – Cooperative Federalism versus Competitive Federalism' (n 875) 127.
[1073] ibid. 128.

market). Although this rise in numbers would possibly increase the complexity of the process, it would, in my view, deliver a better result in terms of Member State financial autonomy, sustainability and addressing democratic concerns. Crucially, this process would be in line with the principle of subsidiarity, which calls for action to be placed at the most effective level of governance.

It is important to note that the suggested approaches work in tandem. In fact, the EU already tried to establish something that resembled compliance through market forces, albeit subject to criticism, without the intervention of the political process as described here. It is currently trying to push some level of political integration with NGEU, however, by placing Member States in economic and fiscal arrears.

PART V

CONCLUSIVE REFLECTIONS

This thesis has endeavoured to respond to the question of how the legal and institutional framework of the European Union should develop in order to create a budgetary union. To answer this, I elect a comparative method. First, I consistently compare the different stages of the EU integration process with those of the US. Second, I compare the institutional processes used to deliver public policy outcomes (the political, judicial and market processes in the EU). This comparative methodology is essential to this thesis. Because institutions move together, in difficult situations, they become strained and deliver lower quality results. However, the solution to dismiss one of the processes cannot be based on these lower quality results alone, because it may still be the better option when compared with others. As a result, employing a comparative institutional approach allows a comprehensive analysis and presents a more complete and, arguably, better set of proposals.

The thesis considers the Maastricht Treaty and the 2007/2008 financial crisis as pivotal moments in the EU. The former formalised the bifurcation of the Union, the moment when monetary and economic policies were decoupled from the same level of implementation. The latter provided the factual conditions with the necessary level of complexity, to test the quality of the institutional framework and its ability to respond. As a result, this dissertation was divided into three different parts, starting with the competences of the European Union and the existing legal framework before the financial crisis and, in Part III, focusing on the EU's response to the financial crisis and its main shortcomings.

This sequential approach allowed me to frame this thesis around two fundamental axes of relationship between the Union and its Member States: verticalisation (*de iure condito*) and horizontalisation (*de iure condendo*). Part II served the purpose of demonstrating, in a holistic manner, how the former gradually evolved in the EU. The CJEU has developed into a strong institution by interpreting the Treaties in a way that diluted the agreed upon system of distribution of competences in favour of supranational institutions. Importantly, the demarcation method was expected to contain EU integration and protect Member State autonomy. By not doing so, it hindered the principles of democracy, subsidiarity and national diversity.

The verticalisation process was furthered by the Treaty of Maastricht, by creating a single currency governed by a monetary policy common to all Member States. Interestingly, I have endeavoured to demonstrate that the division between EMU and non-EMU members is mostly artificial. Indeed, from relevant Treaty provisions and the ESCB and ECB Statute it is possible to draw up a principle I designate the 'consistent standard', which requires central banks of all EU Member States to pursue a monetary policy consistent with the decisions of the ECB. As a result, the effects of the common currency are broadly similar in non-EMU Member States, which means that the differentiated integration in economic governance for EMU Member States, analysed in Part III, is generally unjustified on this basis alone.

Economic and fiscal policies, however, remained a competence of each Member State, therefore, misaligning monetary, economic and fiscal policies at the same level of governance. Nevertheless, to address the potential imbalances that could come around, the Treaty established restrictions on public debt and deficit of Member States.

This mismatch is well documented. In fact, a single monetary policy should be coupled with a correspondent budgetary instrument of macroeconomic stabilisation because the diversity of Member States' economic structures entails different reactions to ECB decisions, as a single monetary policy entails different economic effects. This was the reason that the Treaties chose to establish hard law provisions on national public finance indicators on public debt and deficit, as well as the ECB's prohibition of assistance to Member States. It was also the way in which Member States kept economic policies within the national realm.

Unlike the described evolution, the EU budget is an economic and fiscal tool that has remained mostly static overtime. The most relevant change in the three identified periods relates to the financing side of the budget. In fact, in the interim period (1970-1988), there was an attempt to transition from national contributions to EU own resources. Understandably, as the nature of funding changed, the Assembly sought to exert more influence on the expenditure, which remained under the influence of Member States in the Council. Consequently, this equated to the most unstable period of EU finances due to institutional conflict. Nevertheless, the main conclusion drawn from this experience is that the nature of funding should match the nature of expenditure, as proposed in Part IV.

Such a framework was designed to deliver successful results in what Komesar designated frictionless contexts, which are periods of relative stability that turn

governance into a simpler exercise. The decision to create EMU with the referred mismatch, on the contrary, miscalculated the magnitude and level of complexity of its effects.

What this thesis shows are the consequences this characteristic entailed relating to institutional processes and that they move together, particularly within difficult contexts in which they all perform worse: the 2007/2008 financial crisis sparked an acute crisis among Member States and a cross-cutting change in the political, judicial and market realms.

Part III of the thesis presents and analyses the developments that occurred since the 2007/2008 financial crisis, as well as its consequences from a comparative institutional perspective. The financial crisis is understood in this thesis as the EU's first existential threat as a federation of States, therefore, a pivotal moment that spurred a number of unlikely developments, if such an event had not taken place.

This part explored the legal and institutional developments from a comparative, institutional perspective. The importance of this approach is that it allows a holistic view of EU integration. Rather than focusing only on one of the processes – either the political, market or the judiciary – this methodology enables the understanding that all processes have strengths and weaknesses, hence providing a better-informed framework to pave the way forward.

Thus, Part III looked at how executive and legislative institutions responded to the crisis, namely in economic, monetary and budgetary policies.

Within the political process, Member States were forced to transfer more power, even if informally, to the European Council. This exercise also impacted the Council's activity by effectively shifting from a legislative institution following the community method to a policy coordination body mirroring the European Council's views.

This was, indeed, a paradox and an implicit assumption that economic policies needed some form of common deliberation in addition to coordination. However, the form of deliberation found in this institution was one in which the economic situation of each Member State would determine its influence. Despite the European Council's and Council's consensus-seeking nature, such deliberations were not made among *de facto* equals, hindering the principle of equality between States. This is particularly visible in the solutions found to tackle the financial crisis, most notably the ESM, in which its legal

framework was particularly acute in attributing more power to the few Member States with the most economic weight. Executive dominance reinforced the Commission as an enforcer of strict and complex public finance supranational framework, also showing its legislative initiative to be overly conditioned by the European Council.

More intergovernmentalism has also spurred a redefinition in the legislative realm. In addition to the evolving role of the Council, the other EU legislative institution (the EP) has seen its influence dither, particularly regarding EU economic governance or in the establishment of different financial funds. In these areas, it had little-to-no intervention, leaving the institution that, arguably, best embodies the views of European citizens largely on the sidelines. As a result, there have been calls, in literature, for more intervention from national parliaments. However, these may further aggravate the problem of power of the few. In fact, Parliaments of economically stronger States may have more influence than parliaments of economically weaker ones. In this sense, entrusting national parliaments with more competences relating to EU affairs would, potentially, deepen the issues of democratic legitimacy and effectiveness of action. Moreover, as national executives represent national interests, so too do their respective parliaments, therefore, the incentives for accountability exist regarding these interests, not the European interest as a whole.

Another major unforeseen consequence of the rising complexity of problems facing EMU was the role played by the ECB, particularly its Member State, bond buying programmes. These actions hindered the principle of the prohibition of monetary financing (intended to foster market pressure on Member States' public finances). In fact, one of the main drivers for increased liquidity on the debt primary market was the increasing certainty that the ECB would purchase those bonds on the secondary market. As a result, the Treaty's objective that bond market liquidity would be the result of prudent and sound national fiscal policies has been increasingly undermined by the demand artificially created by the ECB. As a result, a powerful institution with a reduced level of scrutiny has largely replaced the EU's economic governance constitutional configuration.

The central bank also hampered its own independence. In fact, singleness of monetary policy should be understood to mean the existence of a homogeneous policy for the Union as a whole. This is suggested by the experience of US States. Like EU Member States, they exhibit divergent bond yields and inflation rates. Nevertheless, this

diversity motivated an intervention of the FED in US States' bond markets. In contrast, by significantly increasing its portfolio with Member States debt, the ECB was increasingly tied to their economic and fiscal choices and policy results.

It seems clear from the ECB's decision-making process that there was a small minority of central bank governors (or even the sole voice of the *Bundesbank*) against a programme that could greatly breach, arguably, the two most important principles of economic and monetary integration with the aim of obtaining little financial gain from the majority of Member States, as severe interest rates were concentrated on a minority. Therefore, it is legitimate to consider that a low-impact majority has prevailed over a high-impact minority in the sense that the intensity of opinion of a few governors was, to some extent, disregarded.

Nevertheless, in the absence of a different type of EU budget, the adoption of unconventional monetary policy measures was arguably unavoidable. In fact, verticalisation is also eminently present in the EU budget. In particular, it is overly reliant on Member States regarding the nature of funding and their respective ceilings. In fact, the majority of the financing still comes from national contributions and, crucially, Article 311 TFEU stipulates that only Member States are competent to unanimously decide on the types of own resources and revenue ceilings in the own resources' decision. In contrast with economic governance and monetary policy, the budget is dependent on its constituent units. Interestingly, the current structure of the EU considerably resembles that which existed in the US before the civil war, which was also receptive to the pursuit of State-oriented economic objectives, when they enjoyed broad authority over taxation, police power and domain.

On expenditure, the EU budget is focused on Member States rather than EU-added value. In fact, the CAP and cohesion policy are either increasingly misaligned with current societal needs or have generated economic inefficiencies. Yet, they are still responsible for more than half of the spending. Although, NGEU enabled a nascent change in the nature of EU expenditure, slowly transitioning towards policies that fund investments capable of delivering a greater degree of transnational benefits, the proximity between Member State responsibility and national outcomes resembles the redistributive mindset, enhances national lines and blurs the transnational dimension of the programme. By contrast, the US fiscal response to COVID-19 ascended to $4.1 trillion in expenditure, the majority allocated to natural persons and businesses directly. Notably, it provided

cash payments to natural persons and increased unemployment benefits and forgivable loans to small businesses, among other measures, as well as funding for States, making it a more integrated and coherent approach.

In short, the EU political process has changed significantly with the creation of EMU and the financial crisis. We can conclude that it brought about a complex array of institutions and rules that set the conditions for a top-down relation of dependence to occur between the Union and its Member States, changing the nature of EU executive and legislative institutions. This process has developed in a way that does not favour the EU's shared values of democratic legitimacy and State equality. As I have shown, a skewed distribution of interest (minoritarian and majoritarian) was salient in the EU, with many institutions taking actions that were not considered possible when they were created.

The cross-cutting analysis within the political process has revealed, therefore, many flaws brought about by the strong surveillance approach that was undertaken following the financial crisis. However, single institutional analysis is often a shortcoming in choosing institutions to deliver public policy goals, as there are many ways to achieve them.

This is why I analyse the market process, one of the hallmarks on the Maastricht Treaty, under which market actors should enforce the budgetary discipline of Member States. However, I have argued that, paradoxically, the fact that there is a supranational obligation to achieve certain outcomes makes the Union co-responsible for Member States' failure. Nevertheless, failure to comply is only a problem if there is reason to expect that ensuing difficulties will be resolved by a bailout. As a result, the EDP is, in itself, an expression of doubt regarding the effectiveness of those rules. Such a procedure also reflects doubts in the market to deliver sound public finances. Evidence of this state of affairs is found in the comparison with the political process, where it was found that Union institutions, not Member States, dictated economic and budgetary policies, in order to preserve the stability of the eurozone as a whole. Therefore, in a way, the market process was never effectively used in the Union.

In this chapter, I compared how other federations have dealt with the problem of moral hazard stemming from bailouts, notably the US and Germany. These countries have taken different approaches to bailouts' pressure compared with other sub-national units. From US history, I have shown that having balanced budget rules, even if adopted by States on their own motion, is not enough to guarantee effective compliance, particularly

because courts seldom enforce those State constitutional provisions. In fact, the factor that drives US States towards compliance is their history of bankruptcies throughout the centuries. If allowed to work, this is the powerful message that the market process delivers and the contribution it has to offer for long-term (financial) stability. Germany, on the other hand, is a very interesting example because it provides an approach that is counterfactual to that of the US. Indeed, unlike the US States, the *Länder* are not considered sovereign entities and, in the German constitutional system, they are, to different degrees, financially dependent on the federal level, given the distributive nature of the taxation system. As shown, this feature can have the pervasive effect of enduring misgovernance from State governments regarding financial matters. At the time of writing, the picture of EU Member States is not clear enough to come to a conclusion on such misgovernance, as the ECB only started changing monetary policy in September 2022 but still holds a large portfolio of assets, which is slowly reducing, and targeted programmes in place (ie TPI).

Finally, I have analysed the interaction of the developments in the political process and requirements of fiscal discipline with the judicial branch, particularly the CJEU and some national judiciaries. Unsurprisingly, the CJEU has been called to syndicate ECB programmes – a situation which the founding fathers of the Treaties did not anticipate. Unlike its approach regarding the single market, the establishment of the ESM and actions taken by the ECB were dealt with much caution by the Court. In particular, the deferential approach to the ECB's response sparked vehement criticism from the *BVerfG*. In fact, the Court's awareness of financial emergency and the fear of EMU's potential collapse prompted the legitimation of executive action regardless of the institutional forum (including the recourse to EU institutions outside of the EU legal order).

Hence, a bifurcation is also visible in the capacity of syndication by the Court, whereby, in difficult situations, institutions deliver poorer results. As we have seen, this also occurred in EU political institutions and serves, once again, as evidence that institutions move together, which turns single institutional analysis into an exercise of limited usefulness when choosing public policy goals and institutions to implement them.

Judicial control also occurred in the courts of Member States. In this realm, I wrote not from a debtor/creditor perspective, but from the perspective of judicial supply and demand of rights. This approach was useful to assess the national courts' capacity to deliver results in contexts with different levels of complexity. The conclusion is that

national courts were also deferential to varying situations. In my view, this provides more evidence that the judicial process should not lead EU integration, as it did in earlier decades or as part of the literature calls for. The limits of integration through courts were clearly reached with the financial crisis and ensuing adopted solutions.

Accordingly, Part IV focused on the how to address the findings of Part III. In this vein, I consider that the EU must achieve a Budgetary Union in order to embolden three essential features: to tackle the democratic deficit that has plagued the EU for decades and is also affecting Member States and guarantee the autonomy and accountability of both the EU and Member States in economic, fiscal and budgetary matters.

Therefore, Part IV is the epilogue of the comparative institutional analysis employed in the thesis. This methodology has allowed me to compare between and within processes (ie the various Union institutions). First, it allowed me to conclude that there are serious issues in all processes, therefore, the alternatives are imperfect. Second, that EU integration must not proceed with single institutional analysis. If I had taken this approach, either the political or market processes would have been out of the analysis and the solutions that both have to offer would have been neglected. In my view, the EU would be in balance with more than market forces because it is difficult for Member States' economies to develop without significant investment from the Union. At the same time, the EU would be imbalanced in regard to the role of political institutions and the EU budget. This is the lesson we should draw from the German taxation system and dysfunction in which the EU political process has found itself in, pursuant to the financial crisis.

As a result, to improve the relationship between the EU and Member States and enhance the effectiveness of their respective public policies, this thesis elected the political and market process as main drivers for change. However, the thesis also acknowledges the role that courts can have in complementing the market-based solution. In this part, I focus on developing concrete proposals stemming from the concept of horizontalisation. This concept conveys the opposite idea of top-down hierarchy and dependence. It applies equally to both processes but materialises differently.

Regarding the political process, European citizens can connect between themselves and, through a horizontal connection, directly with the Union. In the market process, this means increased participation of different institutional actors and the detachment of the political process.

European citizens know what they want from the EU. In fact, citizens' preferences vary more regarding national than supranational policies and priorities. However, *juste retour* creates a nationalistic dynamic, favouring Member States and stepping away from EU added value. For instance, despite several surveys showing majoritarian support for more EU involvement in health-related issues, Member States drastically cut EU budgetary programmes with resources that were not directly allocated to them. This practice increasingly generated a disconnect between citizens demands from the EU and the results their national governments are willing to provide in the European Council.

However, a voting change in ORD and the MFF, for instance, to qualified majority, would probably reduce neither the skewed distribution of power each Member State possesses under unanimity rule nor allow for a better alignment with citizens' preferences. Crucially, formal rule change can run afoul of the logic of consensus prevailing in the European Council and the Council regardless of whether majoritarian rule is already in place.

Importantly, the view purported in this thesis is that the referred disconnect occurs because there is a silent majority (EU citizenry) with limited incentives to participate in the EU political process. This is why it is crucial to discuss revenues, the nature of which is capable of mobilising a higher number of citizens, such as EU taxes.

In literature, there is growing support for taxes associated with certain policies and several examples are currently in place (ie the EU Emissions Trading System and EU Carbon Border Adjustment Mechanism) or under discussion (ie a financial transaction tax, fuel tax and aviation tax).

While linking policies to tax authority establishes a more visible connection to EU output, policy-related taxes are employed to develop certain political objectives, portraying several aspects that should be considered. First, they can be misleading as they tend to become permanent regardless of whether the primary justification for the adoption ceases. Second, they can amount to central planning, with the concomitant loss of Member State autonomy. Third, policies may be proposed not for the purpose of addressing a certain social objective, but for revenue purposes. Fourth, tax subjects are not always easily identifiable, such as in common foreign and security policy, defence or health, in which economic gains and diplomatic clout might give the EU global influence. Fifth, policy-related taxes are also unsatisfactory in meeting the sufficiency criterion

because financing a budget is not in their nature (ie taxes based on environmental policy). However, sufficiency is a crucial component to cease dependence on Member States.

The most important question, therefore, is whether direct taxation should be linked to national budgets only or, additionally, to the Union budget. The position adopted in this thesis is that there is no reason why article 311 TFEU should not be considered a valid Treaty basis concerning the financing of the EU, namely for levying general and specific EU taxes.

Crucially, the problem is not legal but political, as taxation is highly connected to State sovereignty. However, I have also shown that a federation is not subordinated to its constituent units. On the contrary, its aim is to balance the autonomy of every layer of governance. The autonomy of Member States is not lost in establishing the EU. Nevertheless, the EU also holds autonomy regarding its Member States. Consequently, the EU, as a Union with federal features, cannot be considered subject to its Member States, as it has a direct responsibility vis-à-vis its citizens. From this, it follows that Union direct taxation of its citizens could be a less imperfect alternative and deliver a better balance, namely on economic policy, from a governance and societal point of view. European citizens would also become connected with not only the Union but between themselves.

Consequently, a central financial authority could treat equals equally, not to ensure an equivalent standard of public services, but to offset divergencies in the income and wealth levels of different Member States. Union equity transfers to individuals would represent neither the subsidisation of some Member States nor charitable contributions to financially less well-off people. Rather, they would be necessary adjustments to keep the Union together and, as such, ethically due to lower-income citizens. Such an approach would favour foreseeability, transparency and match citizens expectations.

Accordingly, this thesis proposes the introduction of a generality principle to be attached to Union spending. On the one hand, it should ensure that majorities are required to approve expenditure to generate value for all groups of citizens indistinctively.[1074] Such a principle could substantially reduce minoritarian bias, either spending-related (the allocation of funds) or related to the stabilisation of the Union's economy. Such a principle might not only counter minoritarian but also majoritarian bias, given that

[1074] Buchanan and Musgrave (n 440) 26.

expenditure of this type would foster transnational divisiveness between citizens, as opposed to discord along national lines.

Such a reform on the nature of revenue and expenditure of the EU budget needs to recognise the substantive role of Member States in a new EU legislative chamber. In this chamber, representatives of Member States in the European Council (in its new legislative capacity) would come from national parliaments. In this vein, the views of the people's representatives and Member States' representatives would constantly confront each other within a framework of generality.

The other segment blends the market and judicial elements while reducing dependence on the political process in the long-term: allowing Member States to orderly default on their debts. This option would yield three essential outcomes. Firstly, Member States would regain autonomy in defining their own economic and fiscal policies, thereby restoring States' democratic legitimacy. Secondly, it would increase participation from actors beyond Member State governments, thereby reducing the current minoritarian bias identified in EU economic governance. Thirdly, it would deliver an important reduction of inter-State politicisation of national issues. Consequently, fiscal choices and consequences of States would become an internal matter and largely cease to be a topic of EU-wide discussion. Importantly, the establishment of a proper legal framework for fiscal responsibility would foster inter-State trust.

Importantly, this thesis has endeavoured to tackle some of the issues usually associated with bankruptcy. At the outset, a bankruptcy procedure would yield better results regarding the decrease of autonomy in Member States' economic policies. First, CACs have a significant problem of potential non-participation of private parties and public authorities or institutions. Regarding the former, a restructuring that is too creditor-friendly may result in a lower-than-expected reduction of debt. Regarding the latter, constraints are essentially connected with Treaty requirements, namely Articles 123 and 125 TFEU. However, given increasing public intervention and the consequent concentration of debt holders in public authorities or bodies, it is possible that CACs thresholds are difficult to meet. Such a process would be exposed to the skewed distribution of interest identified regarding the EU political institutions. Finally, a procedure-based solution is more encompassing than CACs, as these do not address sovereign's non-bond debt.

Regarding the necessary financing for the transition, the ESM could serve that function. However, like the IMF, it does not tie its lending to a negotiation of a restructuring agreement between Member States and their creditors. Consequently, investors have an incentive to wait until a bailout becomes unavoidable and new financing is provided by public sector institutions.

Another important insight is the fear of losing national autonomy, which is important because, unlike municipalities, States are considered sovereign entities. However, the restrictive European economic governance framework in place implied a significant renouncement of States' sovereignty to freely design their national economic policies. Accordingly, a bankruptcy procedure would be less intrusive in comparison.

Regarding the bodies that oversee the process, institutions such as the IMF or the ESM should not be considered as a realistic option, given the conflict of interest and lack of transparency associated with political capture. A better option would be to include alternative dispute resolution, such as arbitration or rely on courts, particularly those that specialise in corporate bankruptcy or insolvency. This would more effectively deliver equality of arms between the parties. A key advantage of arbitration is that it provides cohesion and structure to sovereign default, as well as a perception that complex issues are dealt by experienced arbitrators. Regarding corporate bankruptcy or insolvency courts, it could achieve a procedural and substantive outcome. First, debtors should be allowed to file for bankruptcy in the courts of any foreign jurisdiction with a connection to private debt issued at least eighteen months prior to bankruptcy, in order to avoid last minute issuance with forum shopping purposes. This levels the disadvantaged position of the debtor vis-à-vis its creditors. Second, the admissibility of this forum shopping is mitigated by the fact that debtors usually choose courts capable of issuing quality decisions, as evidenced by courts in Delaware, New York and Texas. Although imperfect, frequent usage allows for specialisation, benefitting the speed of procedure as well as quality and judges' expertise.

Finally, allowing debt restructuring to occur is usually associated with fears of hindering market access and reputation as well as disrupting the bond market and contagion of other States. I argue that a procedure for sovereign restructuring would reduce costs by making it more acceptable and transparent. In fact, undergoing such a procedure could be a factor of trustworthiness. In contrast, financial assistance could be understood as a risk factor. If exclusion from the market happens in one State, it is

inaccurate to state that the same will occur in other States, as is the assumption that such an exclusion would be permanent.

There is also empirical evidence from the US municipal bond market, which demonstrates the market's significant ability to differentiate to a degree with proper differentiation. Contagion and inadequate differentiation are, therefore, unlikely outcomes. Increased risk assessment and country differentiation is, furthermore, promoted by a proper restructuring procedure, enhancing markets' ability to distinguish between higher and lower borrower quality and adjust premiums accordingly. Importantly, a transparent and predictable process mitigates chaotic market reactions and fosters market discipline on Member States.

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