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An Overview of Legal Aspects of Risk Sharing

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Abstract

This paper discusses the legal and institutional aspects relating to risk-sharing mechanisms at EU level. For this purpose, an attempt will first be made to define a “risk-sharing mechanism” and the relevant legal framework, most notably the no bail-out clause included in Article 125 TFEU. Following this, the paper will discuss the core legal and institutional considerations relating to the European Stability Mechanism, prospects for euro-bonds and some variations of fiscal stabilisation mechanisms that have been presented in the discussion. In addition, the brief considers the June 2015 Five Presidents’ Report on Completing Europe’s Economic and Monetary Union and the plans it presents for further risk-sharing among the Member States and some of the earlier proposals that have been discussed in this context, even if they have not been included in the Five Presidents’ Report. The brief places these proposals in a broader framework of legitimacy, accountability and “fairness”, which in the context of the recent EMU Reports have usually been approached as separate or additional considerations. The argument made here is, however, that a more stable EMU needs to be broadly experienced as legitimate and fair. Consequently, these questions should be addressed together, as key considerations relating to the broader framework of how decisions are made in the EMU.

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1. General legal framework

The original EMU built on two main principles: market discipline and the no bail-out clause included in Article 125(1) TFEU:

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

The no bail-out clause is linked to the prohibition of monetary financing contained in Article 123(1) TFEU. These provisions remain formally unchanged. However, various measures taken during the crisis and relating to the future design of the EMU in particular as regards risk-sharing evolve specifically around the interpretation of Article 125 TFEU. As the Tommaso Padoa-Schioppa Group concluded in 2012, the “no-bailout’ clause is still alive from a legal perspective but it has clearly lost its original power.”¹

There is no single definition for a “risk-sharing mechanism”. It is linked to the question of joint responsibility, which is in some Member States regarded as a precondition for a stable EMU, while others treat it as a univocally negative element of EMU development. The current and future EMU involves several different examples of risk-sharing. During the crisis, various different solutions have been used, ranging from bilateral loans, the establishment of the European Financial Stabilisation Mechanism and the European Financial Stability Facility to the establishment of the European Stability Mechanism and funding from the IMF and ECB.² Notwithstanding Article 125 TFEU, many of these mechanisms have relied on varying degrees of risk-sharing among the Member States. The EFSM was adopted as an economic policy measure. Under this mechanism, all Member States formally share the risk through the EU budget, which is used as collateral. In the EFSF the risk is shared by the euro states. The key measure is however the ESM, which is the permanent stability mechanism, established outside the formal Treaty framework with reference to the revised Article 136 TFEU. A further means of risk-sharing during the crisis has also been through the operations of the ECB: when the ECB balance includes bonds of a euro state, the risks related to those bonds are in practice carried jointly by the whole euro area, and ultimately divided among them. While ECB actions do not constitute a “mechanism” as such. Still, they are of a high relevance for any discussion on the legal limits of risk-sharing, for example as concerns the compatibility of its SMP and OMT programs with the no bail-out clause mentioned above.

¹ “Completing the Euro. A road map towards fiscal union in Europe. Report of the “Tommaso Padoa-Schioppa Group”, point 56 at 37.

² There is a great deal of literature on the mechanisms of financial assistance adopted during the crisis. For example the following offers a good overview of the measures that have been adopted during the crisis: De Gregorio Merino, ‘Legal developments in the Economic and Monetary Union during the debt crisis: The mechanisms of financial assistance’ (2012) *Common Market Law Review*, 1613-1645.

The concepts of 'joint responsibility' or 'risk-sharing' refer to at least two main models. First, the broader EMU framework includes examples of insurance-like risk-sharing, where risk is fundamentally priced so that each party's liability corresponds to the coverage it receives.³ In principle, such a mechanism does not involve income transfers. An example of this kind of a risk-sharing mechanism is the Single Resolution Fund. This kind of mechanisms are usually experienced as legitimate. Another kind of a risk-sharing mechanism is a model that builds on systematic income transfers between participants. In this kind of models, wealth is typically transferred from those who have more to those who have least. Examples of this kind of a model would include e.g. a country's internal fiscal equalisation mechanism. This kind of models however typically presume a great sense of solidarity among participants. Many forms of risk-sharing fall outside clear categories or contain elements of both models.

European risk-sharing can apply at different levels: between citizens, between companies, between Member States, and directly at EU level (through the EU budget). So far risk-sharing through EU-budget has been rare. The main explanation given to this is the non-existence of a specific euro-zone budget that could be used as a collateral in the context of euro area specific operations (see below Section 4).

In risk-sharing an obvious problem relates to moral hazard and the possibility of free-riders to benefit from the arrangements. Insurance-like arrangements nearly always create risks of moral hazard: payments intended as insurance-based turn into systematic income transfers. The level at which risk-sharing takes place affects the way in which moral hazard can be managed or avoided. For example, the Single Resolution Fund, which builds on risk-sharing between banks and financial institutions, builds on extensive supervision and a regulation framework, which is enforced by independent authorities and courts. The arrangements are believed to minimize the risk of free riders. Risk-sharing between Member States is more difficult to build, since States are sovereign and the possibilities of the EU institutions to ultimately enforce rules on them against their will are limited. This makes these mechanisms fragile.

Future plans involve examples of both models of risk-sharing. A key consideration relating to their potential contribution to the EMU relates specifically to two considerations: first, it is realistic to presume that it is possible to agree on a set of rules that would be both in theory and practice enforceable on sovereign states and effectively prevent free-riding? A sad but necessary conclusion from the EMU experiences so far do not support this kind of a conclusion. And second, a relevant question relating in particular to mechanisms entailing systematic income transfers involves solidarity. The 'solidarity operations' conducted so far have effectively divided euro states to creditors and debtors. The multiple experiences of unfairness experienced on both sides of the negotiating table have rather clearly demonstrated the limits of solidarity currently felt among citizens.

The key authority in interpreting the no bail-out clause in Article 125 TFEU is the ruling by the European Court of Justice (CJEU) in *Pringle*⁴. According to the Court,

³ For a discussion around the two models, see e.g. the Report of the expert group appointed by the Finnish Ministry of Justice 'Improving the resilience of Europe's Economic and Monetary Union', October 2015, available at <http://vm.fi/documents/10623/1788346/Improving+the+resilience+of+Europe%C2%B4s+Economic+and+Monetary+Union/96d236f7-2b87-4e1b-a613-d90c1ff15a8c?version=1.0> .

⁴ Case C-370/12, *Thomas Pringle v. Government of Ireland, Ireland, The Attorney General*, Judgment of the Court of Justice (Full Court) of 27 November 2012, paras 123-147 concerning the interpretation of Article 123 and 135 TFEU.

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

In this ruling, the Court confirmed the legality of the establishment of the ESM and its compatibility with Article 125 TFEU. What, however, is of a particular interest for the current study is whether the ruling has relevance for a discussion on risk-sharing mechanisms other than the ESM. It is evident that the Court only addressed the question brought before it, i.e. the decision to establish the ESM outside the formal Union legal framework. The Court therefore did not take a position relating to any other categories of risk-sharing, or mechanisms involving risk-sharing at another level.

Consequently, since the compatibility of a measure with the EU Treaties can only be settled by the CJEU, what kind of other mechanisms could be envisaged under the current Treaties (or outside them) is subject to interpretation. However, there seems to be rather general agreement among legal experts that many of the mechanisms presented below would require Treaty amendments, either because they are incompatible with Article 125 TFEU or because they would require a specific legal basis in the Treaties, or both. While formal Treaty amendments are in many ways preferably to simply stretching the interpretation of the Treaty, the procedural implication of introducing one is that it needs to be approved by all Member States and ratified by their national parliaments. Moreover, some of these proposals are likely to provoke constitutional complications at national level.

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

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

A key question in this respect is whether the EU is capable of controlling Member States' economic policies. If not, are there grounds for greater risk-sharing between the Member States?

The recent proposals concerning the further development of the EMU also bring to the fore the question of greater differentiation between euro area and the general EU institutional framework. Proposals have been made for example concerning the creation of a euro area budget, treasury, and a separate of euro area composition in the EU Parliament for matters that involve the euro area only (keeping in mind the already existing possibility of only euro area states participating in Council decision-making when euro area specific issues are concerned). This question also links to the position of the euro group, which is currently an informal body with no formal decision-making powers, even if it in practice has settled

most key questions relating to the crisis. While all these solutions are fully possible to realize through specific Treaty amendments, the most fundamental question would seem to relate to whether these plans are politically realistic. In short, it is unlikely that non –euro area Member States would agree to Treaty amendments that would develop the differentiation of the euro zone further.

2) European Stability Mechanism

2.1. Relationship of ESM to the EU legal framework and its possible inclusion

The most fundamental legal question provoking passions among EU and constitutional lawyers concerning the European Stability Mechanism is its compatibility with the EU Treaties. This is the question that the CJEU specifically addressed in *Pringle*.⁵ The ruling establishes that the decision to build the ESM outside the EU Treaties is a legally possible and solid solution. It has so far persisted all legal challenges both at European and national levels. Subsequently, the main question provoking legal interest has effectively turned into a non-issue. The ESM is currently outside the EU legal framework but linked to it through the amendment of Article 136(3) TFEU, which is intended to clarify that the Member States do have competence to set it up. Under the new Article 136(3) TFEU,

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

The linkages between the ESM and the EU institutional framework are however strong, for example because the ESM Treaty confers tasks on the EU institutions, including in particular the Commission, the ECB and the EU Court of Justice (see below).

Even if the ESM Treaty itself does not provide for a formal review clause (unlike the Fiscal Compact and the SRF Agreement), the question constantly raised in debates concerning the future design of the EMU is the incorporation of the Mechanism into the legal framework of the EU Treaties. The Five Presidents report proposes its inclusion into the EU Treaties as a medium-term objective (after 2017). Many commentators also suggest that the ESM should be developed towards a true “euro area IMF”, even if it is seldom specified what this would entail in practice, and how its tasks would be affected. The Five Presidents’ Report is silent on the need to develop the tasks of the ESM, even if the ESM relevant in the context of creating a permanent back-stop for the banking union (both the single resolution mechanism and the possible future deposit guarantee scheme), something that would require an amendment of the ESM Treaty.

As far as the inclusion of the ESM into the EU legal framework is considered, a relevant question would seem to be what its inclusion would require from a legal point-of-view. Since the ruling of the CJEU in *Pringle* merely addressed the legality of the decision to set up the ESM outside the EU legal framework, it did not specifically address other possible solutions for setting it up, and whether its inclusion would

⁵ Lenaerts, (2014). EMU and the European Union's Constitutional Framework. (2014) *European Law Review* 753-769; Adam & Mena Parras, ‘The European Stability Mechanism through the legal meanderings of the Union's constitutionalism: comment on Pringle’ (2013) *European Law Review*, 848; De Witte & Beukers, ‘Case C-370/12, Thomas Pringle v. Government of Ireland, Ireland, The Attorney General, Judgment of the Court of Justice (Full Court) of 27 November 2012’ (2013) *Common Market Law Review*, 805-848.

require Treaty amendments. Legal and institutional opinion is divided on this question. However, keeping in mind that its inclusion presumes unanimous decision-making among the Member States, and that many Member States see that a clear Treaty amendment would be required, this will in practice be needed.

The inclusion of the ESM into the EU legal framework is usually tied to a discussion of the “normalization” of the EMU solutions, and making them a part of the mainstream EU institutional setting. For many EU lawyers, the main justification for inclusion seems to relate to questions of legal style and technique. However, the legal / technical inclusion as such would not have any automatic institutional consequences. Even within the EU Treaty framework, the roles of EU institutions, the functioning of its governance bodies and ESM funding could be organized in various different ways. Even in the “normal” EU institutional framework decisions can be taken unanimously, with or without the European Parliament, and even national parliaments can be linked to decision-making.⁶ The European Investment Bank serves as a good example of a body created under the Treaties that has a separate legal personality, and the Member States are its members. The Statute of the European Investment Bank is laid down in a Protocol annexed to the Treaties. At the same time, it has its own governance bodies.

The existence of the ESM outside the formal Treaty framework is not a problem from a legal or technical point-of-view. However, the solutions used in the ESM have consequences for accountability, which are addressed in the following sub-section.

2.2. Considerations relating to conditionality and “fairness”

The new Article 136(3) TFEU quoted above creates a clear linkage between financial assistance created under the ESM and the implementation of “strict conditionality”.

This paragraph has been recently discussed for at least two reasons. First, in the context of the Greek solution found last summer, the question was raised whether the ESM funding granted actually fulfilled the criteria relating to the indispensability of funding in order to “safeguard the stability of the euro area as a whole”. Second, questions have been raised concerning the broader role of conditionality in the wider crisis management framework, and the related experiences of “unfairness” on all sides. For the creditors, conditionality has been deemed a necessary safeguard in order to avoid moral hazard, especially since the EU rules relating to economic governance have not operated in a credible manner. If the granting of financial assistance presumes strict conditionality, thus effectively reducing the recipient state’s room of maneuver, these are likely to do their utmost to avoid being subject to it. This setting has been experienced as unfair in many of the debtor states. At the same time, also the creditors have experienced the solutions made during the crisis as unfair, since they have in practice needed to

⁶ See e.g. Article 218(8) of the TFEU, under which the European Council is to act unanimously for the agreement on accession of the Union to the European Convention for the Protection of Human Rights and Fundamental Freedoms. The Council's decision concluding this agreement is to enter into force after it has been approved by the Member States in accordance with their respective constitutional requirements. A decision, as referred to in Article 311 of the TFEU and adopted unanimously by the Council, laying down the provisions relating to the system of own resources of the Union cannot enter into force until it is approved by the Member States in accordance with their respective constitutional requirements.

bear financial responsibility for decisions that they have not been able to influence. The point to consider in the context of considering the future design of the EMU is that a(n economic) policy that is not experienced as legitimate is seldom effective.⁷

The formal answer usually offered to the unfairness of the EMU places the blame firmly on the ESM. According to Article 3 of the ESM Treaty,

The purpose of the ESM shall be to mobilise and provide stability support under strict conditionality, appropriate to the financial assistance instrument chosen, to the benefit of ESM Members which are experiencing, or are threatened by severe financing problems, if indispensable to safeguard the financial stability of the euro area as a whole or its Member States.

This presumes assessment by the Commission, in liaison with the ECB, of the existence of a risk; whether public debt is sustainable; and the actual and potential financing needs of the ESM Member. The process results in a Memorandum of Understanding (MOU), negotiated by the Commission together with the ECB and, whenever possible, the IMF. The conditionality setting, however, reaches into the EU legal framework as well, since also the European Financial Stabilisation Mechanism,⁸ and the two-pack mechanism of enhanced surveillance, applied to euro states that experience or are threatened with serious difficulties with respect to their financial stability or to the sustainability of their public finances or request or receive financial assistance,⁹ include elements of conditionality. This conditionality sits ill with the EU's economic policy competence (Session 2 relating to economic governance).

When assessing the legitimacy and “fairness” of an arrangement, a key element relates not only to how decisions have been prepared and adopted, but also to whether they can be *ex post* scrutinized by a court of justice. The mechanisms of judicial review have not developed at same pace with the European level development of decision-making. In practice, appeals concerning MOU-related measures required from program countries with reference to conditionality have repeatedly been declared inadmissible by the EU Courts. This has been justified with reference to the decision-making structures used to adopt the MOUs. For example, as regards the Cypriot stability program, the Court as argued that the Commission or the European Central Bank cannot be considered responsible for the MOU, and the measures adopted by them only bind the ESM. And since the latter is not a Union body, the Court cannot assess the legality of its measures.¹⁰ The Court has also assessed the meaning of euro group statements in the restructuring of the Cypriot banking sector and established that these cannot be treated as measures that are intended to create binding effects in relation to third parties, since the

⁷ I have discussed this point further in “Further development of the EMU – should legitimacy come first or last?” at <http://eulawanalysis.blogspot.be/2015/11/further-development-of-emu-should.html>, subsequently published at Constitutional Change through Euro Crisis Law. A Multi-level Legal Analysis at page <http://eurocrisislaw.eui.eu/news/comment-further-development-of-the-emu-should-legitimacy-come-first-or-last-by-paivi-leino-sandberg/> and on page Open Government in the EU. News, research and debates on transparency & participation at <http://www.eu-opengovernment.eu/>.

⁸ See e.g. considering Ireland, Council implementing decision 2011/827/EU; considering Portugal, Council implementing decision 2011/344/EU.

⁹ Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability

¹⁰ See e.g. Case T-289/13 *Ledra Advertising Ltd v Commission and the ECB*; Case T-289/13 *Ledra Advertising Ltd v the Commission and ECB*.

formal measure was taken in the ESM governing bodies.¹¹ From a legitimacy and accountability point of view it is a problem if decisions that touch upon matters of great importance that also affect private parties directly prove to be non-challengeable at the level where they are taken, because they are decisions that “nobody is responsible for”. This is especially so keeping in mind that the practical difference between the euro group and the meeting of the ESM governing bodies is minimal: decisions are effectively taken by exactly the same group of people, even if in a different role and meeting composition. While some of these decisions have been successfully challenged at national level, these challenges have their main focus on the national implementation measures, not on the actual MOU instrument (Cf session 1 on the constitutional constraints of decision-making).

Therefore, when considering the possible inclusion of the ESM, the main reason for the project does not relate to the technical-institutional aspects of inclusion but the overall legitimacy of the construction, in particular the need to ensure that decisions of a great importance are effectively challengeable before a court. A reconsideration of the decision-making structures and court jurisdiction is a question that links to the broader question of the status of the euro area in the EU constitutional structure and its institutional solutions. This is a question that has not been addressed by the recent Reports.

2.3. ESM and Collective Action Clauses

The experiences from the crisis have stressed the need to separate liquidity problems from solvency problems. One of the elements that the Commission and the ECB need to assess before a decision granting financial assistance from the ESM is taken relates to whether public debt of the state requesting assistance is sustainable. The crisis witnessed five euro area countries, in relation to which a decision needed to be made between creating a financial assistance scheme (which was problematic from many political and legal reasons) or insolvency, the management of which was seen to create even greater risks for the euro area as a whole, since there was no established procedure for managing insolvency, and the close linkages between the banks and sovereigns.

One step towards demolishing this linkage is the banking union (session 4). A second crucial element relates to the introduction and use of Collective Action Clauses. Various proposals aimed at operationalizing sovereign debt restructuring have been made both at the euro area level and based on international law.¹² The ESM Treaty establishes that from the beginning of 2013, new sovereign bonds in the euro area must include standard collective clauses (CACs) to simplify sovereign debt restructuring. Under ESM Treaty Article 12(3),

Collective action clauses shall be included, as of January 2013, in all new euro area government securities, with maturity above one year, in a way which ensures that their legal impact is identical.

The aim of these clauses is to include terms and conditions for negating a controlled debt restructuring.

¹¹ Se e.g. Case T-327/13 *Konstantinos Mallis and Elli Konstantinou Malli v Commission and the ECB*.

¹² Bianco, ‘The Bitter End of Sovereign Debt Restructurings: The Abaclat v. Argentina Arbitration and the Eurozone Crisis’ (2013) *Legal Issues of Economic Integration*, 315, Pottakis, ‘In Search of a Modern Deus ex Machina: Towards an Orderly Bankruptcy of European Legal Orders’, (2011) *European Public Law*, 181.

It is important to note that neither the Five Presidents' report nor the recent Commission Communication address the question of orderly debt restructuring in general, or the CACs in particular. However, **the question of whether a euro state can become insolvent without serious consequences for the euro area as a whole is one of the core considerations in guaranteeing a stable EMU, and should therefore be added to the agenda for discussion.**

3. Prospects for Euro-bonds

In recent years a number of proposals relating to greater risk-sharing among Member States have been made, building on joint and several debt, a debt redemption fund, and Eurobonds.¹³ Apart from their economic function, the discussion has also related to their compatibility with the current Treaties, since the linkage of these scenarios to Article 125 TFEU is obvious. The discussion led to the appointment of an Expert Group on Debt Redemption Fund and Eurobills.¹⁴

The idea of a **debt redemption fund** was originally created by the German Council of Economic Experts, and was linked to the wish to reduce public debt reaching over 60% GDP. The plan was based on a 'fund' and a 'pact', creating a scheme that is used to reduce debt through temporary mutualisation (25 years) of debt exceeding 60 %. After that risk-sharing would be limited to financial stability mechanisms, be subject to strict conditionality, and only be used as a last-resort mechanism. The **Fund** would be used to mutualise debt exceeding 60 % through issuing joint debt backed up by a joint and several guarantee. The **Pact** would include rules intended to prevent moral hazard including debt brakes, binding consolidation agreements, and earmarking tax revenues and Member State deposits. Breaking of rules would be sanctioned. It is, however, generally understood that the creation of a debt redemption fund presumes Treaty amendments, and would also provoke constitutional debates at national level.

Eurobills refer to "government fixed-income securities up to a predefined, short-term maturity, jointly issued by the Member States". They would be divided to blue bonds used up to 60% GDP, which would constitute super safe senior bonds, covered by joint and several guarantee. Red bonds exceeding 60% GDP would always be subject to national responsibility and could not be bailed out by EU mechanisms. The idea behind eurobills was to stabilise markets and create a safe and liquid asset by establishing ceilings for financing set for each participating Member State and rules and mechanisms for preventing moral hazard through a specified institutional framework.

Both the DRF and eurobills are widely considered incompatible with Article 125 TFEU.¹⁵ For legal and political reasons, these proposals have not been included in the Five Presidents' Report. Despite the

¹³ See e.g. the Commission Green Paper on introducing Stability Bonds COM(2011) 818 final; the 2012 Commission Blueprint and a number of contributions by think-tanks on the Joint issuance of government debt.

¹⁴ Final Report of the Expert Group on Debt Redemption Fund and Eurobills Chaired by Gertrude Tumpel-Gugerell, 31 March 2014. See also Allemand, 'La faisabilité juridique des projets d'euro-obligations' (2012) *Revue trimestrielle de droit européen*, 553-594.

¹⁵ See the e.g. the Expert Report quoted above, *Ibid.*

proposals to create a solid institutional framework with strong and enforceable rules, a question remains as to whether it is realistic to expect that rules would operate better in this context, when they have so spectacularly failed to do so in the current economic governance framework. Serious concerns have been raised since the EU governance mechanisms have not necessarily been seen as sufficiently effective and strong to contain the additional potential for moral hazard. The proposals relating to joint debt also have a clear linkage to the division of competence relating to economic and financial competence between the Member States and the EU.

Can you assume joint responsibility for debt without joint responsibility for the adoption of budgetary policies? Furthermore, could a system building on joint debt be “fair” as long as Member States’ debt levels diverge as greatly as they do no?

4. Fiscal stabilisation mechanisms

The plans towards the development of a fiscal union include proposals relating to the establishment of fiscal stabilisation mechanisms.¹⁶ With monetary policy in EU exclusive domain, the instruments that are generally used to limit impacts of cyclical downturn at national level (specific monetary policies and devaluation of national currency) are not available. In the absence of monetary policy tools, Member States make recourse to internal devaluation, i.e. lowering the costs of labour. The relevant question is, whether there should be an EU level mechanism for cross-country fiscal transfers in the event of cyclical downturn. The 2012 Blueprint proposed fiscal capacity to adjust asymmetric shocks, which were linked to the idea of contractual arrangements on reforms promoting growth and jobs. The discussion concerning this has however not advanced.

These questions are linked to the possible creation of a euro area treasury and budget, which are included in the Five Presidents’ Report through the ambiguous phrase “some decisions would increasingly need to be made collectively” but with no specification on what decisions, how large the budget would be, or how taxes would be collected or used. These are questions that should definitely be discussed first. However, in this context it is useful to keep in mind that the current ‘own resources’ system (Article 311 TFEU) already operates a slightly similar federal feature, consisting of the EU’s revenues building on customs duties and sugar levies. In several federal states, the central government has a taxation right. It is possible that the use of a separate euro-area budget might be a more acceptable way to joint responsibility, if it was used to collect resources for insurance-like income transfers or other fiscal equalisation mechanisms. In general, few proposals have been made concerning how the resources would be collected, and what they would be used for. The creation of a fiscal stabilization function is not an end in itself, but should serve some legitimate purpose.

The difficulty in analyzing the legal aspects of these schemes is that the discussion has remained on a very general and abstract level. According to settled case-law by the EU Courts, the choice of the legal basis for a Union measure must rest on objective factors amenable to judicial review, including in particular the aim and the content of the measure.¹⁷ Therefore, legal basis analysis is usually

¹⁶ Hinarejos, ‘Fiscal Federalism in the European Union: Evolution and future choices for EMU’ (2014) *Common Market Law Review*, 1621-1642; Pisani-Ferry, Vihriälä, and Wolff, “Options for a Euro-area fiscal capacity”, Bruegel Policy Contribution, No 2013/01 (2013); European Parliament, *Legal options for an additional EMU fiscal capacity* (2013).

¹⁷ See C-411/06 *Commission v. Parliament and Council* para 45, C-178/03 *Commission v. Parliament and Council*, paragraph 41, and C-155/07 *Parliament v. Council*, para 34.

undertaken based on a concrete proposal, its aims and substance. In the case of fiscal stabilisation mechanisms, no such proposal exists.

In 2014 Commissioner Andor voiced proposals concerning a **short-term unemployment benefit scheme**.¹⁸ This consisted of a basic European unemployment insurance, which would replace the corresponding part of national schemes. National authorities would collect unemployment fees and send them to the European fund; the European fund would pay to the national authorities an amount that corresponds to the sum of all the basic European unemployment benefits payments to be made that month in that country. The system would operate outside EU budget and be "entirely predictable and calculable on the basis of these clear rules". The details and compatibility of the scheme with the EU treaties and its possible legal basis has not been subject to comprehensive discussion.

The Five Presidents' Report proposes the introduction of a stability scheme for the euro area's public economy. In the short run (Stage 1), the five Presidents propose the creation of an **advisory European Fiscal Board** which would coordinate and complement already existing national fiscal councils. It would provide an independent analysis, at European level, of how budgets perform against the economic objectives set out in the EU fiscal governance framework. In the longer term (Stage 2), a **common macroeconomic stabilisation function** should be set up to better deal with shocks that cannot be managed at the national level alone. It would improve the cushioning of large macroeconomic shocks and make EMU more resilient. Such a stabilisation function could build on the **European Fund for Strategic Investments** as a first step, by identifying a pool of financing sources and investment projects specific to the euro area, to be tapped into.

According to the Report, the scheme must not lead to the permanent redistribution of income between euro area countries, nor should it be a method to balance income between countries. The stability scheme must not impair incentives to practice policies that aim at a healthy public economy or inhibit intervention in structural deficiencies. The scheme should not become a crisis management tool, i.e. its purpose is not to replace the ESM. It should be open and transparent with regard to all EU Member States. Compliance with the euro convergence criteria would be the prerequisite for participation in the stability scheme. The report emphasises that the stability scheme must be implemented within the framework of the EU, so that it is compatible with the EU's public economy framework and coordination procedures. According to the Five Presidents' Report, the details of the mechanism are to be worked out by an Expert group at a later stage, which makes it difficult to address its legal and institutional implications at this stage.

Many economic arguments can probably be found in favour of a rule-based equalising mechanism. However, its creation raises similar considerations relating to compliance with the new binding convergence criteria a precondition for participation as have been raised in relation to the enforcement of other EU rules in the area – would these work better than the current criteria and procedures? How does one differentiate between economic

¹⁸ Andor, "Social dimension of the Economic and Monetary Union: what lessons to draw from the European elections?", Lecture at Hertie School of Governance, Berlin, 13 June 2014; Andor, "Basic European unemployment insurance: Countering divergences within the Economic and Monetary Union", Speech at Vienna University of Economics and Business, Vienna, 29 September 2014; Beblavý, Gros and Maselli, "Reinsurance of National Unemployment Benefit Schemes" (2015) available at <<http://www.ceps.eu/system/files/wd401.pdf>> (last visited 27 June 2015); Dolls, Fuest, Neumann and Peichl, "An Unemployment Insurance Scheme for the Euro Area", ZEW Discussion Paper No 14-095 (2014).

downturn and structural problems? Is it possible to prevent one-way income transfers by rules and institutions, when they should be enforced on sovereign States?