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The Structural Reforms in EU Member States: Exploring Sanction-Based Mechanisms

Armin Steinbach[†]

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Abstract

An insufficient level of structural reforms remains a perennial phenomenon in the EU. Despite the gradual expansion of macroeconomic governance, legal instruments fostering the implementation of structural reforms have been underexploited. This article examines the leeway provided by EU Treaties and legislation to use existing and new instruments to incentivize structural reforms more forcefully. First, in light of the recent change in the EU Commission's enforcement practice, we highlight how the sanctions-based regime under the Stability and Growth Pact (SGP) can be extended to incorporate structural reforms. There is significant room for manoeuvre to account for the implementation of structural reforms both in the preventive and the corrective arm of the SGP. Second, contractual agreements on structural reforms offer an alternative to the sanction based system. Unlike existing instruments, contractual agreements allow for more egalitarian and reward-based incentives and thus deviate from the classic 'surveillance model' of economic governance in the EU. We can conceptualize such agreements in two ways: First, as agreements concluded between the EU and individual Member States, underpinned by financial support as an incentive. Second, as mutual agreements concluded between Member States, which agree on the implementation of structural reforms as a kind of barter trading ensuring reciprocity. We highlight the legal boundaries on scope and design of such agreements and how they relate to the institutional governance setting in the EU.

Keywords: Economic governance; structural reforms; Stability and Growth Pact; contractual agreements

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[†] Senior Research Fellow at the Max-Planck Institute for Research on Collective Goods in Bonn (Germany). Email: Steinbach@coll.mpg.de

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I. INTRODUCTION

The regime governing the EU Member States' fiscal and macroeconomic policies has undergone significant changes over the last few years. As a reaction to the sovereign debt crises, the legal framework has been modified on various occasions and the scope of economic policy surveillance has been expanded significantly. At the same time, an insufficient level of structural reforms persists[1] and has been lamented widely.[2] Some of these reforms are critical for the

[1] S Deroose and J Griesse, 'Implementing economic reforms - are EU Member States responding to European Semester recommendations?' (October 2014) ECOFIN Economic Brief, 17 <http://ec.europa.eu/economy_finance/publications/economic_briefs/2014/pdf/eb37_en.pdf> accessed 7 January 2016.

[2] European Commission, '2015 European Semester: Country-specific recommendations' (Communication) COM (2015) 250 final; OECD, *Economic Policy Reforms 2012: Going for Growth* (OECD Publishing 2012), Chapter 1; D

growth and sustainability of the euro zone as a whole, as they imply positive externalities across countries.[3]

In the past, economic governance in the EU has addressed the lack of structural reforms mainly through five mechanisms. First, before the inception of the euro area, Member States coordinated their economic policies through the (implicit) pressure exerted through compliance with the convergence criteria. Second, during the first decade of the euro, structural reforms were incorporated into the Broad Economic Policy Guidelines, but progress was limited mainly due to the lack of binding coordination mechanisms. Third, more recently significant reforms were implemented in countries under conditionality-based financial assistance programmes aiming at both fiscal and macroeconomic stability.[4] However, reforms have been implemented only under severe pressure, while ownership for the reforms stayed weak. In addition, conditionality-based programmes only applied to a few countries in the first place – they do not offer an instrument to allow for a broader implementation of structural reforms going beyond countries under the programmes.

Anderson and others, 'Fiscal Consolidation in the Euro Area: How Much Pain Can Structural Reforms Ease?' (October 2013) IMF Working Paper <http://www.imf.org/
external/pubs/ft
/wp/2013/wp13211.pdf> accessed 7 January 2016; European Central Bank, 'Progress with structural reforms across the euro area and their possible impacts' (2015) ECB Economic Bulletin, 2 <https://www.ecb.europa.eu/pub/pdf/other/art01_eb201502.en.pdf> accessed 7 January 2016.

[3] Simulations show that the simultaneous implementation of structural reforms throughout the euro zone would have a bigger effect on output than they would if implemented by countries in isolation, highlighting the benefits of coordinated policy action; see European Commission, *Quarterly Report on the Euro Area 13(4)* (2014) <http://ec.europa.eu/economy_finance/publications /qr_euro_area/2014/pdf/qrea4_en.pdf> accessed 7 January 2016.

[4] F Fabbrini, 'The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective' (2014) 32 Berkeley Journal International Law 64, 73-74.

Fourth, since the introduction of the EU 2020 strategy and the European Semester, the focus of the initially purely fiscal governance has been broadened towards other fields of economic and social policy. However, these instruments (still largely) remain in the sphere of 'soft coordination', which lacks concrete policy tools or a binding effect.[5]

Fifth, reforms of the binding and sanction-based EU legal framework have allowed for stronger surveillance within the EU, with extended mechanisms on fiscal and macroeconomic governance. In this vein, the Commission announced it would interpret the Stability and Growth Pact (SGP) and the Macroeconomic Imbalance Procedure (MIP) as offering leeway for the account of structural reforms under these procedures to the extent possible.[6] This avenue indeed offers opportunities to perform the existing sanction-based surveillance system with a stronger focus on the implementation of structural reforms.

A sixth (and as yet unexploited) enforcement mechanism relies on the idea of so-called Convergence and Competitiveness Instrument (CCI) proposed by the Commission encompassing contractual arrangements to be agreed between Member State and the Commission underpinned

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[5] KA Armstrong, 'The Lisbon Agenda and Europe 2020: From the Governance of Coordination to the Coordination of Governance' in P Copeland and D Papadimitriou (eds), *The EU's Lisbon Strategy* (Palgrave Macmillan 2012) 208-228; on the poor compliance record regarding the implementation of country-specific recommendations, see Deroose and Griesse (n 1) 1; however, the Commission can indirectly incentivize the implementation of the country-specific recommendations based on Articles 121(2) and 148(4) TFEU in line with Article 23 of Regulation (EU) No 1303/2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, *OJ L 347, 20.12.2013, p. 320–469*. Based on this provision, the Commission can request the Member State to prioritize projects identified in the country-specific recommendations in order to obtain financial support from the European Structural and Investment Funds.

[6] European Commission, 'Communication, Making the Best Use of the Flexibility Within the Existing Rules of the SGP' COM (2015) 12 final, 9.

by financial support.[7] A similar idea is 'mutually agreed contractual arrangements' ('*Vertragspartnerschaften*'), floated by German Chancellor Merkel in 2012.[8] The underlying idea is to obtain 'hard' reform commitments from Member States *without* delegating more power to new or old European institutions. Alternatively, one may extend this idea towards bilateral agreements on national reform commitments between Euro members without involving the EU, as envisaged by a joint report from France and Germany on economic reforms focusing on competitiveness and investment issues.[9] This joint report by the respective minsters of economic affairs remained purely political in nature without taking legal effect, but both its level of detail and reciprocal nature could give an indication of the possible design of bilateral CCIs on national reform commitments.[10] Under bilateral agreements between Member States, reciprocity in the deal would ensure the positive cross-border spillovers from the domestic reforms and increase the Member States' otherwise lacking willingness to reform.

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[7] See the two Communications: European Commission, Towards a deep an genuine EMU: the introduction of a Convergence and Competitiveness Instrument' (Communication) COM (2013) 165 final; and European Commission, 'Towards a deep and genuine EMU: Ex ante coordination of plans for major economic policy reforms' (Communication) COM (2013) 166 final. The contractual arrangements were mentioned already in the Commission's blueprint for a deep and genuine economic and monetary union: launching a European debate, European Commission, 'A blueprint for a deep and genuine economic and monetary union Launching a European Debate' (Communication) COM (2012) 777 final/2.

[8] N Busse and M Schäfers, 'Fahrplan für die nächsten Monate' *FAZ* (12 December 2012) <http://www.faz.net/aktuell/politik/europaeische-union/eu-gipfel-fahrplan-fuer-die-naechsten-monate-11992749.html> accessed 7 February 2016.

[9] J Duffy, 'French-German Report to Focus on Reform and Investment' (*Euro Insight*, 27 November 2014) <https://euroinsight.mni-news.com/posts/french-german-report-to-focus-on-reform-and-investment> accessed 7 February 2016.

[10] The report was prepared by two academics and outlined a broad reform agenda covering regulatory initiatives, investment strategies and reform priorities, see H Enderlein and J Pisani-Ferry, 'Reforms, Investments and Growth, An agenda for France, Germany and Europe' <https://www.hertie-school.org/fileadmin/images/Downloads/core_faculty/Henrik_Enderlein/Enderlein_Pisani_Report_EN.pdf> accessed 20 March 2016.

Against this background, this analysis explores the existing (but not yet exploited) scope for manoeuvre provided under the current legal framework in promoting structural reforms (fifth and sixth issue mentioned above). On this basis, this contribution seeks to offer legal as well as policy insight. From a legal perspective, the implementation issues surrounding sanction-based and reward-based mechanisms have not featured prominently in the discourse. There are various strands of legal literature on economic governance. In recent years, they focussed on the competence and legality issues surrounding the anti-crisis instruments employed by EU institutions[11], the complex evolution of both soft and hard formats of governance[12] and the overall gradual expansion of coordination methods.[13] This article seeks to add insight into the legal feasibility of practically relevant coordination

[11] More recently, the discussion particularly focused on the competence and legality review of the OMT program (Case C-62/14, ECLI:EU:C:2015:400, *Gauweiler*) and the European Stability Mechanism (ESM) (Case C-370/12, ECLI:EU:C:2012:756, *Pringle*). On the compatibility of OMT programmes with EU law, see A Steinbach, 'The compatibility of the ECB's sovereign bond purchases with EU law and German constitutional law' (2013) 39 Yale Journal of International Law Online 15; Borgers, 'Outright Monetary Transactions and the stability mandate of the ECB: Gauweiler' (2016) 53 CMLR 1-58; on the ESM see S Adam and FJ Mena Parras, 'The European Stability Mechanism through the Legal Meanderings of the Union's Constitutionalism: Comment on Pringle' (2013) 38 EL REV. 848, 860.

[12] On the complementarity of hard law and soft law, see M Dawson, 'Three Waves of New Governance in the European Union' (2011) 36 EL Rev. 208; KA Armstrong, 'The Character of EU Law and Governance: From 'Community Method' to New Modes of Governance' (2011) 63 Current Legal Problems 179-214.

[13] A Steinbach, *Economic Policy Coordination in the Euro Area* (Routledge 2014) 72-171; KA Armstrong, 'The New Governance of EU Fiscal Discipline' (2013) 38 EL Rev. 601; A Hinarejos, *The Euro Area Crisis in Constitutional Perspective* (OUP 2015) 15; MW Bauer and S Becker, 'The Unexpected Winner of the Crisis: The European Commission's Strengthened Role in Economic Governance' (2014) 36 Journal of European Integration 213-222; G Majone, *Rethinking the Union of Europe Post-Crisis* (CUP 2014) 199, 308; D Chalmers, 'The European Redistributive State and a European Law of Struggle' (2012) 18 European Law Journal 676-682; A Scott, 'Does Economic Union Require a Fiscal Union?' in LW Shuibhne and NN Gormley (eds), *From Single Market to Economic Union* (OUP 2012) 40-50.

mechanisms (and thus also to offer policy relevance) by exploring the existing surveillance regime and the scope of manoeuver remaining under the current sanction-based rules incorporated in the Stability and Growth Pact. Also, only scant attention has been given to the (policy-relevant) attempts to shift coordination efforts into a more egalitarian direction by allowing contractual relationships within the multilevel EU governance system to pave the way for a reward-based approach towards economic policy coordination – this gap begs an inquiry on the different formats of contractual agreements.

Thus, this article seeks to offer insight into the coordination instruments both *de lege lata* (Stability and Growth Pact) and *de lege ferenda* (contractual agreements). By tying the legal analysis to the policy issue of an insufficient level of structural reforms, we explore incentive-based mechanisms that promote the implementation of structural reforms in EU Member States. Incentive-based mechanisms refer to both the established sanction-based logic of the existing surveillance mechanisms as well as to reward-based instruments offering benefits to Member States for implementing structural reforms. While the sanction-based logic is enshrined in SGP and MIP, contractual agreements rather follow a reward-based approach.

The article is structured as follows: Section II identifies the flexibility within the existing fiscal surveillance system, with a particular view towards promoting structural reforms. In particular, relevant norms of the SGP and MIP are interpreted and contrasted with the Commission's more recent enforcement practice. Section III examines reward-based coordination discussing nature and scope of contractual agreements between the EU and Member States or between Member States providing a 'quid pro quo' of structural reforms and financial support. Section IV concludes.

II. Sanction-based Promotion of Structural Reforms Under the SGP

The SGP remains the key instrument of fiscal policy coordination, featuring binding rules and sanction mechanisms.[14] In the past, application of the SGP focused on fiscal policy and compliance with numerical budget rules. This narrow focus has been subject to criticism pointing, inter alia, at other elements promoting growth and positive long-term budgetary effects, such as structural reforms. The Commission has identified structural reforms as key elements of the EU's economic policy strategy for growth.[15] In line with the overall trend towards broadening the surveillance focus from a purely fiscal to a more macroeconomic perspective, incentive-based tools can be extended towards promoting structural reforms.

Under the preventive arm of the SGP, the so-called structural reform clause provides the legal basis for introducing the implementation of structural reforms under the fiscal surveillance regime. According to Article 5 of Regulation No. 1466/97, the Commission and Council shall 'take into account the implementation of major structural reforms' when defining the adjustment path to the medium-term budgetary objective. Major structural reforms may, under specific circumstances, justify a temporary deviation from the MTO of the concerned Member State or from the adjustment path towards it. Thus, under the preventive arm, there is an explicit reference allowing the linking of the fiscal regime under the SGP to a broader macroeconomic dimension of structural reforms.[16]

1.Connecting Coordination Mechanisms

In this vein, the explicit reference to structural reforms in Article 5 (which had been incorporated into the Regulation already in 2005) may serve as the basis to connect various economic policy coordination tools to each other. Structural reforms are typically dealt with in the

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[14] For an interpretation of the SGP as a tool to avoid free-riding, see Steinbach, *Economic Policy* (n 13) 28; P De Grauwe, *Economics of Monetary Union* (10th edn, OUP 2014) 218-224.

[15] European Commission, 'Annual Growth Survey 2015' (Communication) COM (2014) 902.

[16] Regarding the evolutionary process towards linking the purely fiscal focus of EU surveillance to a more comprehensive macroeconomic regime, see Steinbach, *Economic Policy* (n 13) 103-130.

country-specific recommendations of the European Semester. These recommendations are issued in May of each year and provide country-specific policy advice to Member States in areas deemed as priorities for the next 12-18 months.[17]

The implementation of structural reforms identified in the country-specific reforms within the European Semester into the SGP through Article 5 of Regulation No. 1466/97 sets up a comprehensive coordination mechanism that expands the fiscal policy focus of the SGP. It creates a link between the implementation of Europe 2020's aims and the fiscal policy requirements of the SGP, interweaving economic and social policy recommendations with fiscal policy commitments. The recommendations typically address a variety of subjects, including public finances, tax policy issues, and labour market questions. Through the European Semester, the EU is no longer restricted to issuing economic and fiscal policy aims. It now also advises national governments on specific measures to reach these aims. We thus see a clear effort to consolidate, synchronize and expand existing forms of coordination.[18] The avowed aim is to stop fiscal and economic policy isolation and align policies with each other.

Importantly, through the structural reform clause, the recommendations under the European Semester are upgraded in terms of their binding nature. Usually, country-specific recommendations are non-binding; the only way the Commission typically can force states to adhere to its recommendations is through peer pressure, i.e., 'naming and shaming'.[19] However, once the country-specific recommendations are channelled through the structural reform clause, they factually gain binding nature as they are tied to the enforcement of fiscal rules.

2. Structural Reforms Under the SGP

A. Preventive Arm

In its Communication, the Commission has set out a number of principles to be followed for the structural reforms clause to be

[17] For a detailed analysis of the European Semester, see Armstrong, 'The New Governance' (n 13) 601.

[18] Steinbach, *Economic Policy* (n 13) 173-176.

[19] Steinbach, *Economic Policy* (n 13) 126.

activated.[20] First, reforms must be major in terms of their effect on growth and the sustainability of public finances. Requiring a significant impact enables the Commission to request sizeable and effective reforms and an appropriate choice of policy mix. Second, reforms must have a long-term positive budgetary effect where this effect can correspond to direct budgetary savings from reforms (e.g., pension reform) or through increased revenues (e.g., as a result of an increased labour force). Third, and most controversial, is that the wording of Article 5 of Regulation No. 1466/97 requires the 'implementation' of structural reforms. As pointed out by the Council Legal Service, the Commission's approach is rather ambiguous on this point.[21] While the Commission requires 'full implementation' of the reform, it acknowledges that adopted reforms may take time and thus views the implementation of reforms as fulfilled when 'the Member State presents a medium-term structural reform plan'. By contrast, the Council refers to the Code of Conduct, according to which the 'implementation' pursuant to Article 5 requires that 'only adopted reforms should be considered'.[22]

(1) Interpreting and Applying the Term 'Implementation' of Structural Reforms

The question at stake is what status of implementation is required, that is, whether these reforms have to be formally adopted under domestic laws, giving them binding force,[23] or whether a detailed structural reform plan is sufficient.[24] From a legal perspective, given that interpretation of the term 'implementation' is at stake, recourse should be taken to conventional modes of legal interpretation. Reference to the literal meaning[25] produces ambiguous results as shown in the

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[20] European Commission, 'Making the Best Use of the Flexibility Within the Existing Rules of the SGP' (Communication) COM (2015) 12 final, 11.

[21] Council of the European Union, 'Opinion of the Legal Service', Ref 7739/15 (7 April 2015), para. 21.

[22] ibid para. 23.

[23] ibid para. 23.

[24] European Commission, 'Making the Best Use of the Flexibility Within the Existing Rules of the SGP' (Communication) COM (2015) 12 final, 11.

[25] On this mode of interpretation see only Case 30/59, ECLI:EU:C:1961:2, *Steenkolenmijnen in Limburg v ECSC High Authority*, 49; Case 207/81, ECLI:EU:C:1982:281, *Felicitas v Finanzamt* ; see also the Court's literal and

controversial perceptions between Commission and Council.[26] Implementation clearly is a stepwise approach that ranges from initial internal decision-making among policy-makers up to the actual entering into force of a specific measure. A restrictive reading would imply the completion of the entire implementation process, which, however, would render the clause impractical given the lengthy implementation process.

Looking from a contextual perspective[27], however, guidance on interpretation may be sought from practice under the financial support programmes of the EU. The pattern of conditionality and disbursement of payment offers an understanding that the favourable treatment (under EU financial assistance, the disbursement of loans) is typically granted on the basis of formalized commitments and their forward-looking implementation. Under the support programmes for Greece, for instance, before each disbursement, a joint mission of Commission, ECB and IMF staff frequently monitors compliance with the conditions of the conditionality programme. More specifically, disbursements of respective tranches are linked to the implementation of milestones agreed between Greece and the troika institutions. Disbursements are tied to forward-looking commitments, including steps to implement these reforms fully through secondary legislation, other administrative acts and complementary reforms.[28] It becomes clear that the practice of

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systematic approach to interpreting Article 125 TFEU, see V Borger, 'The ESM and the European Court's Predicament in Pringle' (2013) 14 German Law Journal 113, 117.

[26] European Commission, 'Making the Best Use of the Flexibility Within the Existing Rules of the SGP' (Communication) COM (2015) 12 final, 10; Council of the European Union, 'Opinion of the Legal Service', Ref 7739/15 (7 April 2015), para. 23; European Union, 'Specifications on the implementation of the Stability and Growth Pact (Code of Conduct)' (3 September 2012) 5.

[27] The Court takes account of the meaning of a provision in light of scheme and context, Case 149/77, ECLI:EU:C:1978:130, *Defrenne v SABENA*, Case 87/75, ECLI:EU:C:1976:18, *Bresciani v Amministrazione Italiana delle Finanze*. The Court also applies interpretation methods cumulatively, see more recently Case C-399/11, ECLI:EU:C:2013:107, *Melloni v Ministerio Fiscal*.

[28] Report on Greece's compliance with the milestones for the disbursement to the Hellenic Republic of the third tranche of EUR 1.0bn of the EFSF instalment related to the fourth review under the second programme, 11 August 2014.

requiring implementation of reforms as prerequisite for a disbursement is an institutionalized alternation of 'quid pro quo' on a forward-looking basis. Through the splitting of the financial support into disbursements, the milestones towards implementation can be coupled to respective disbursements.

Applying this functionality to the exchange of structural reforms in return for favourable treatment under Article 5 of Regulation No. 1466/97, one can infer that, in general, a forward-looking commitment should suffice. This implies that implementation in terms of a credible, comprehensive and detailed plan should be sufficient. However, given that the split into disbursements provides an effective tool to review and control the actual implementation (that is, transformation of structural reforms into legislative acts), the question is whether a similar implementation control can be operationalized with regard to Article 5 of Regulation No-1466/97. Indeed, the metric of Article 5 provides such implementation control in case of a Member State's failure to implement the agreed reform. In such a case, the temporary deviation from the Medium-Term Budgetary Objective (MTO) will no longer be considered as warranted.[29] On the basis of Article 6(2) and Article 10(2) of Regulation No. 1466/97, the Commission can issue a warning to the Member State and ultimately propose to the Council a recommendation to request that Member States take appropriate policy measures. In case of continued failure to implement the structural reform, euro area Member States may ultimately be requested to lodge an interest-bearing deposit.[30] The existing sanction-based instruments allow an interpretation of the term 'implementation' under Article 5 based on an alternation of ex-ante assessment and ex-post control.

This finding is also in line with an interpretation focusing on the purpose and spirit of the provision.[31] Its aim is to provide temporary fiscal relief

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[29] European Commission, 'Council Recommendation on the 2015 National Reform Programme of Belgium and delivering a Council opinion on the 2015 Stability Programme of Belgium' COM (2015) 252 final, 12.

[30] Article 4 of Regulation (EU) No 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, OJ L 306, 23.11.2011, p. 1–7. .

[31] On this mode of interpretation see already Case 65/76, ECLI:EU:C:1977:7, *Derycke* 34; Case 79/81, ECLI:EU:C:1983:70, *Baccini v ONEM* 1076.

in return for the implementation of measures that actually have a long-term positive budgetary effect. This aim can be sufficiently safeguarded through the control mechanism described above, which allows a return to the initial MTO and imposes sanctions in case of implementation failure. In sum, the deviation from the MTO is warranted based on credible reform commitments, the implementation of which is sufficiently incentivized by the threat of modification of the favourable MTO path.

(2) Streamlining Coordination Mechanisms

In terms of consistency between the various economic policy coordination instruments, the choice of structural reforms under Article 5 should be streamlined with the policy recommendations of other EU economic policy instruments. First, the Commission can take recourse to the structural reforms identified in the country-specific recommendations under the European Semester, which offer a detailed set of goals and instruments across economic and social policy areas. Second, the Commission should streamline the application of Article 5 by way of reference to the country-specific recommendations issued under its MIP based on Regulation No 1176/2011. The scope of the MIP goes beyond fiscal parameters that extend to all possible factors related to macroeconomic performance.[32] More specifically, according to Article 8 of Regulation No 1176/2011, the Council adopts a country-specific corrective action plan listing the specific actions required to resolve the imbalances.

Given the significant degree of parallel proceedings under SGP and MIP, the structural reforms clause under the corrective arm provides the legal basis to ensure consistency between the two policy tools. In fact, by June 2015, seven Member States were involved in parallel proceedings under the EDP and the MIP, demonstrating the practical

[32] Steinbach, *Economic Policy* (n 13) 103-122; M Buti and N Carnot, 'The EMU Debt Crisis: Early Lessons and Reforms' (2012) 50 JCMS 899-911; D Gros, 'Macroeconomic Imbalances in the Euro Area: Symptom or cause of the crisis?' (2012) CEPS Policy brief, 266 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2060118> accessed 7 February 2016.

relevance of applying both economic policy regimes consistently.[33] Also, 16 out of 27 Member States were subject to the MIP and thus had received country-specific recommendations under this procedure. The structural reform agenda spelled out in detail under the MIP[34] should thus be the natural reference point for the structural reform clause under the SGP.

B. Corrective Arm

While there is an explicit reference to structural reforms under the preventive arm in Article 5 of Regulation No. 1466/97, the relevant norms of the corrective arm are silent on the treatment of structural reforms. The only legal term potentially allowing the incorporation of structural reforms into the assessment under the corrective arm is laid down in Article 2 of Regulation No. 1467/97, which states that the Commission '[…] shall take into account all relevant factors […] in so far as they significantly affect the assessment of compliance with the deficit and debt criteria by the Member State concerned'. The reference to 'relevant factors' has been interpreted by the Commission as including the implementation of structural reforms set out in the European Semester.[35]

Given the vagueness of this provision, the question is whether this interpretation remains within the boundaries of the legal text. A number of aspects can be put forward in the affirmative: First, the Commission enjoys wide leeway of discretion in the application of EU rules. On

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[33] Croatia, France, Ireland, Portugal, Slovenia, Spain and the United Kingdom.

[34] For example, Belgium has to 'improve the functioning of the labour market by reducing financial disincentives to work, increasing labour market access for specific target groups and addressing skills shortages and mismatches' (European Commission, 'Council Recommendation on the 2015 National Reform Programme of Belgium and delivering a Council opinion on the 2015 Stability Programme of Belgium' COM (2015) 252 final, 6). And France has to 'remove the restrictions on access to and the exercise of regulated professions, beyond the legal professions, in particular as regards the health professions as from 2015', European Commission, 'Council Recommendation on the 2015 National Reform Programme of France and delivering a Council opinion on the 2015 Stability Programme of France' COM (2015) 260 final, 7.

[35] European Commission, 'Making the Best Use of the Flexibility Within the Existing Rules of the SGP' (Communication) COM (2015) 12 final, 13.

various occasions, the Court has confirmed that the Commission enjoys wide discretion in the assessment of economic circumstances.[36] Second, there is no indication that interpreting structural reforms as 'relevant factors' would be incompatible with the overall purpose of the excessive deficit procedure. The main purpose of the excessive deficit procedure is to ensure the prompt correction of excessive deficits, i.e., making sure that Member States return to a sustainable fiscal position. Structural reforms would have to further this goal. The Commission[37] and other EU institutions[38] have repeatedly underscored the relevance of structural reforms as an essential element for long-term positive budgetary development. Structural reforms are a requisite for growth as the basis for fiscal sustainability. The positive correlation between structural reforms and positive budgetary effects is also acknowledged in Article 5 of Regulation No. 1466/97, which explicitly refers to structural reforms that have such a positive budgetary effect. Third, and in the same vein, for the sake of consistency between the preventive and corrective arm of the SGP, the same reasoning and logic should be applied given that both arms share the overriding fiscal policy goals.

Consequently, structural reforms could likely be integrated into the excessive deficit procedure under the same conditions as discussed above for the preventive arm, that is, they must be major, have a long-term positive budgetary effect and be implemented within the meaning discussed above. The peculiar design allows the Commission to account for structural reforms on two stages of the excessive deficit procedure. First, when assessing whether an excessive deficit procedure needs to be launched, the Commission may examine all 'relevant factors' concerning the economic, budgetary and debt

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[36] See only, Case T-201/04, ECLI:EU:T:2007:289, *Microsoft v Commission*, para. 87; Case T-168/01, ECLI:EU:T:2006:265, *GlaxoSmithKline v. Commission*, para. 57.

[37] European Commission, 'Making the Best Use of the Flexibility Within the Existing Rules of the SGP' (Communication) COM (2015) 12 final, 5.

[38] J-C Juncker, 'Completing Europe's Economic and Monetary Union' (2015) Five Presidents' Report <https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf> accessed 7 February 2016, 7.

positions.[39] The Commission may consider structural reforms as mitigating or aggravating factors that have an effect on its decision to open the procedure or not. Second, structural reforms as a relevant factor are also considered for determining the deadline for the correction of the excessive deficit. Thus, the implementation of major structural reforms constitutes a relevant factor that allows for a multiannual path for the correction of excessive deficit.[40]

As under the preventive arm, the review and control of the implementation of reforms are ensured through procedural remedies. Failure to implement the reform will induce the Commission to consider the Member State's conduct insufficient, leading to the opening of the excessive deficit procedure or to the shortening of the deadline for the correction of the excessive deficit. For Euro area Member States, this means that the Commission may recommend to the Council the imposition of a fine.[41]In sum, there is significant leeway to account for the implementation of structural reforms both in the preventive and corrective arm of the SGP. A comprehensive and detailed structural reform plan containing well-specified measures, verifiable information and credible timelines may lead to a modification of the medium-term budgetary objective. The requirements attached to the degree of implementation should not be too high, given that there is sufficient potential for sanctions and withdrawal of the favourable treatment. Similarly, under the EDP, structural reforms may be a relevant factor when decisions are made about opening procedures and setting the deadline for the correction of the excessive deficit. Incorporation of country-specific recommendations under the European Semester, as well as the corrective action plan under the MIP, ensures consistency of the economic policy tools.

3. Investments and the Structural Reform Clause

The discussion on implementing structural reforms in Member States is often tied to Member States' policy space to promote investments.

[39] European Commission, 'Making the Best Use of the Flexibility Within the Existing Rules of the SGP' (Communication) COM (2015) 12 final, 13.

[40] ibid 13.

[41] Article 6 of Regulation (EU) No 1173/2011.

Politically, the connection is valid given that structural reforms often imply fiscal retraction in the short term, triggering a discussion on using investments as a measure to counter such short-term effects and lay the ground for long-term growth. The EU Commission has addressed such concerns by explicitly linking structural reforms with investments.[42]

The Commission considers that some investments may be deemed to be equivalent to major structural reforms within the meaning of the structural reforms and may, under certain conditions, justify a temporary deviation from the Medium-Term Budgetary Objective of the concerned Member State or from the adjustment path towards it. More specifically, a Member State will benefit under five conditions: i) if its GDP growth is negative or if the GDP remains well below its potential; ii) if the deviation from the MTO does not lead to a deficit above the reference value of 3%; iii) if the deviation is linked to national expenditure on a project co-funded by the EU under one of its various funds; iv) if the co-financed expenditure does not substitute for nationally financed investments, so that total public investments are not reduced; and v) if the Member State compensates for any temporary deviations. The (economic) purpose of this extension of the structural reform clause is to allow Member States to benefit from this clause when their own growth is negative and better reflect the country-specific economic situation.[43] In this vein, the Commission's decision is economically founded on those studies that find an over-proportionate decline of public investments during phases of budgetary consolidations.[44]

However, the Commission's assimilation of 'public investments' and 'structural reforms' is questionable. Apart from the obvious literal difference between the two terms, the Commission's own use of the concepts 'investments' and 'structural reforms' suggests that these terms cannot be used interchangeably as legal terms. In its 2015

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[42] European Commission, 'Communication, Making the Best Use of the Flexibility Within the Existing Rules of the SGP' COM (2015) 12 final, 8.

[43] European Commission, 'Communication, Making the Best Use of the Flexibility Within the Existing Rules of the SGP' COM (2015) 12 final, 8-9.

[44] A Turrini, 'Public investment and the EU fiscal framework, European Commission' (2004) Economic Papers No 202, 4.

Annual Report, for instance, the Commission refers to its well-established economic policy strategy resting on three pillars comprising investments, structural reforms and fiscal responsibility.[45] According to that economic policy strategy, investments and structural reforms constitute individual pillars of the EU economic policy and rest on different concepts, though sharing the common goal of promoting sustainable growth. More specifically, structural reforms relate to reallocating resources efficiently, for example by reducing barriers to the reallocation of capital and labour across firms, thus helping to ensure that the most productive firms can achieve their growth potential and the less efficient ones are restructured or leave the industry.[46] By contrast, through investments in macroeconomic terms, the public sector increases and improves the stock of capital employed in the production of the goods and services they provide.[47] 'Public investments' and 'structural reforms' refer to distinct concepts both in relation to the use of these terms in the EU legal framework as well as with regard to the general meaning of these terms.

Undisputedly, even though public investments and structural reforms are conceptually different, there may be cases of coincidence. For example, reforms in the education sector may well go hand in hand with additional investment spending in this area. In such a case, it may be artificial to disentangle structural reforms and public investments, given that both are tied to each other and contribute to improving the adjustment capacity of an economy. However, the Commission broadly assimilates investments and structural reforms and limits eligible investments to projects co-funded by the EU funds which have positive budgetary effect within Article 5 of Regulation No. 1466/97.[48] This approach raises concerns on three grounds: First, and considering the distinct concept of investment and structural reforms, there is no ground

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[45] European Commission, 'Annual Growth Survey 2015' (Communication) COM (2014) 902, 5.

[46] E Canton and others, 'The Role of Structural Reform for Adjustment and Growth' (June 2014) ECFIN Economic Brief 34, 1-2.

[47] A Turrini, 'Public investment and the EU fiscal framework, European Commission' (2004) Economic Papers No 202, 6.

[48] European Commission, 'Annual Growth Survey 2015' (Communication) COM (2014) 902, 8.

for a general assumption that all co-financing expenditures by Member States amount to structural reforms.[49] Rather, a case-by-case analysis that examines to which investments the implementation of structural reforms is intrinsically tied should be made before investments qualify as structural reforms within the meaning of Article 5(1) of Regulation No. 1466/97. It may be comprehensible from the Commission's perspective to avoid a burdensome and disputable assessment of specific investments as to their quality as structural reform, but a general assimilation of investments and structural reforms would not account for the conceptual differences between these terms.

Second, and related to the analysis above, there is an issue of discrimination. In fact, the Commission discriminates against domestic public investments. The Commission gives privilege to any expenditure that is co-funded by the EU for the assessment of 'structural reforms' pursuant to Article 5 of Regulation No. 1466/97. This is an open discrimination against national public investments that might equally be linked to structural reforms. Such discrimination ignores the fact that economic policy-making remains within the competence of the Member States. In principle, Member States retain competence for economic policy (Article 4(1), 5(2) TEU). Instead, the EU's competence lies in coordination of the policies, that is in arranging coordination of policies that remain national in nature.[50] Member States can adopt measures in this field, as long as the competences of the Union are not infringed.[51] The conduct of economic policy inherently enshrines the right to identify and implement investment and structural reform priorities according to a Member State's preference, and in observance of the country-specific state of the economy. The freedom to exercise economic policy as a genuine domain of Member States may be restricted if the EU choices

[49] Council of the European Union, 'Opinion of the Legal Service', Ref 7739/15 (7 April 2015), para. 19.

[50] Hinarejos (n 13) 73; D Chalmers and others, *European Union Law* (2nd ed., CUP 2010) 210; B de Witte and T Beukers, 'The Court of Justice approves the creation of the European Stability Mechanism outside the EU legal order: Pringle' (2013) 50 CML Rev. 805, 832.

[51] R Palmstorfer, 'To Bail Out or Not to Bail Out? The Current Framework of Financial Assistance for Euro Area Member States Measured against the Requirements of EU Primary Law' (2012) 37 EL Rev. 771, 773.

of economic policies override national choices. Under the MIP, such measures can be a part of the action plan.[52] By contrast, the granting of privileges – under the fiscal surveillance of the EU – to economic policy projects identified by the EU through the activities of its funds (while domestic investment projects enjoy a less favourable treatment), generates conflicts with Member States freedom in conducting economic policies.

Third, from the perspective of effectively implementing the legal fiscal framework and given the overall intention of the fiscal surveillance in ensuring sustainable fiscal conduct, there is no indication why investments co-funded by the EU should rather qualify as a structural reform than domestic investment projects. There is neither a general legal rule nor an economic rationale according to which projects promoted by EU funds would be considered fundamentally different from domestic projects, except for the fact that the latter typically imply larger cross-border spillover effects. For example, projects co-funded under the Connecting Europe Facility (CEF) do not primarily promote projects amounting to structural reforms more than domestic projects would do. The CEF finances projects that fill the missing links in Europe's energy, transport and digital infrastructure.[53] Even though this infrastructure may promote the completion of the internal market, there is no indication that a national infrastructure project would not serve similar goals or contribute otherwise to structural reforms in terms of reallocating resources more efficiently.

In sum, an extensive interpretation of the term 'public investment' as a structural reform within the meaning of Article 5 of Regulation No. 1367/97 seems to overstretch the literal and contextual meaning of this provision. However, the Commission’s general tendency to promote investments within the boundaries of the fiscal rules may be compatible with the relevant provision under two conditions. First, a case-by-case examination of the investments at stake must give consideration to

[52] Article 8 of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances.

[53] Regulation (EU) No 1316/2013 establishing the Connecting Europe Facility, amending Regulation (EU) No 913/2010 and repealing Regulations (EC) no. 680/2007 and (EC) no. 67/2010, OJ L 348, 20.12.2013, p. 129–171.

whether a project is linked to the implementation of structural reforms rather than generally equating public investments and structural reforms. Second, the general privilege of projects co-funded by EU funds over national investment projects appears to be untenable in light of the wording and purpose of the rules. Domestic investments should generally be treated like EU projects when considering their quality as structural reforms for the application of Article 5 of Regulation No.. 1466/97. Practical inconveniences seem inevitable: While there are no legal or economic grounds for discrimination, one must concede that considering all public investments as potentially qualifying as structural reforms would imply an additional burden of examination on the Commission's side.

III. Contractual Agreements Promoting Structural Reforms

The current surveillance system under the SGP operates in a hierarchical manner, that is, the EU Commission leads the procedure and has the right to decide authoritatively on the structural reforms that are to be implemented. Also, the SGP incentivizes through sanctions rather than rewards, as monetary or procedural penalties can be imposed in case of non-compliance of a Member State.[54] That would be fundamentally different if structural reforms were incentivized and incorporated by contractual agreements. Such agreements would modify the existing logic, as structural reforms would be negotiated between the parties and incentives would be set through rewarding the implementation of structural reforms. One can conceptualize such agreements in two ways: First, through agreements concluded between the EU and individual Member States, underpinned by financial support as an incentive. Second, as mutual agreements concluded between

[54] The sanction-based application of the SGP thus remains within in the 'surveillance model' of EU coordination, in which the EU is the 'discipline enforcer', applying numerical fiscal rules and the existing budgetary and economic surveillance system, see Hinarejos (n 13) 181; T Börzel, 'European Governance: Negotiation and Competition in the Shadow of Hierarchy' (2010) 48 JCMS 191; A De Streel, 'EU Fiscal Governance and the Effectiveness of its Reform' in M Adams and others (eds), *The Constitutionalization of European Budgetary Constraints* (Hart Publishing 2014) 85, 87.

Member States, which agree on the implementation of structural reforms in the respective country as a kind of barter trading.

The EU Commission had proposed the Convergence and Competitiveness Instrument (CCI) encompassing contractual arrangements to be agreed between a Member State and the Commission underpinned by financial support.[55] In principle, participation is voluntary and Member States would need to present an action plan similar to that required under the Excessive Imbalance Procedure of the MIP.[56] The arrangements would be based on the country-specific recommendations adopted under the MIP.[57] The accompanying financial support would only be granted for reforms that create positive spillovers across Member States and thus promote the functioning of EMU. Financial support should be designed to support the financing of difficult reforms. In case of non-compliance with the contract, the financial support can be withheld.[58]

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[55] See the two Communications: European Commission, 'Towards a deep an genuine EMU: the introduction of a Convergence and Competitiveness Instrument' (Communication) COM (2013) 165 final; and European Commission, 'Towards a deep and genuine EMU: Ex ante coordination of plans for major economic policy reforms' (Communication) COM (2013) 166 final. The contractual arrangements were mentioned already in European Commission, 'A blueprint for a deep and genuine economic and monetary union Launching a European Debate' (Communication) COM (2012) 777 final/2.

[56] European Commission, 'A blueprint for a deep and genuine economic and monetary union Launching a European Debate' (Communication) COM (2012) 777 final/2, 21; see also KA Armstrong, 'Differentiated Economic Governance and the Reshaping of Dominium-Law' in M Adams and others (eds), *The Constitutionalization of European Budgetary Constraints* (Hart Publishing 2014) 65, 77.

[57] European Commission, 'A blueprint for a deep and genuine economic and monetary union Launching a European Debate' (Communication) COM (2012) 777 final/2, 21.

[58] European Commission, 'A blueprint for a deep and genuine economic and monetary union Launching a European Debate' (Communication) COM (2012) 777 final/2, 22; for an economic consideration, see HP Grüner, 'The Political Economy of Structural Reform and Fiscal Consolidation Revisited' (2013) Economic Papers 487 <http://ec.europa.eu/economy_finance/publications/economic_paper/2013/pdf/ecp487_en.pdf> accessed 7 February 2016, 37.

In view of the existing coordination instruments, the main function of contractual agreements is to add a reward-based enforcement mechanism of country-specific recommendations on a voluntary basis and sidelining the sanctions-based systems as foreseen by the SGP and MIP. Its scope of application is naturally greater, as the choice of structural reforms is wider and the point in time of their implementation is unrestricted, whilst the SGP allows for sanctions if certain fiscal parameters are fulfilled. Thus, in practice the added-value of contractual agreements could be seen as an instrument fostering structural reforms during 'good times' when proceedings under SGP and MIP have not been triggered yet. This would also help to maintain structural reform efforts when political-economy mechanisms would rather lower the efforts to undertake structural reforms. This is further supported by the greater ownership that voluntary commitments would have compared to the policy recommendations under the European Semester, which are typically seen by national policy-makers as undesirable interventions of the EU into the national policy space.

1. Contractual Agreements Between the EU and Member States

Assessing the legal feasibility of contractual agreements raises questions regarding the legal nature of contractual agreements and the possible legal basis to allow for such agreements sidelined by a funding facility.

A. Legal Nature of Contractual Agreements

The EU treaties are silent on contractual agreements between the EU and its Member States. In the absence of an explicit legal basis under primary or secondary law, which would provide for a certain competence of the EU vis-à-vis the Member States, general considerations apply in principle as to the EU’s ability to enter contractual relationships. One may consider such agreements as constituting international law treaties or, based on specific secondary law, as Memoranda of Understanding.

In general, the EU can enter into international agreements according to Article 47 TEU and Article 335 TFEU. In addition, Article 216 TFEU explicitly recognizes the EU’s possibility to conclude agreements with

third countries and international organizations. The ability to enter into agreements with EU Member States is implicitly acknowledged by Article 50 (2) TEU, according to which the EU concludes an agreement with a Member State leaving the EU.[59] Also, any agreement between the EU and a Member State must remain within the substantial competences granted to the EU under the treaties.[60] The principle of conferral in Article 5 TEU would be violated if the EU were to conclude an agreement outside of the scope of the legal basis of the EU treaties.

Considering the scope of EU contractual external action determined by the EU treaty, it is hard to see how a contractual agreement between the EU and its Member States could be set up as an international treaty, since the competences of EU and Member States to act on a specific field are mutually exclusive. Whoever holds exclusive competence is solely competent to conclude agreements and, in the field of shared competence, Member States lose their competence to the extent that the Union has exercised its competence (Article 2 (2) TFEU). In case of contractual agreements foreseeing structural reforms in Member States, the EU may be competent based on Article 136 TFEU or Article 173 TFEU. Agreements promoting the implementation of structural reforms generally appear connected to Article 136 TFEU as a regular norm providing for economic policy coordination. In the past, Article 136 TFEU has been the core legal basis for extending budgetary surveillance and economic coordination,[61] giving rise to concerns about an inadmissible stretching of the boundaries of this norm.[62] According to the Commission, the contractual agreements could be part of the Macroeconomic Imbalance Procedure and based

[59] For a different view, see European Parliament*, Legal options for an additional EMU fiscal capacity* (2013) 20, which argues that this would undermine the legislative procedure foreseen by the EU Treaties.

[60] See also the 24th Declaration concerning the legal personality of the European Union.

[61] Hinarejos (n 13) 33.

[62] K Tuori and K Tuori, *The Eurozone Crisis: A Constitutional Analysis* (CUP 2014) 168-171.

on Article 136 TFEU.[63] However, given that this norm is potentially in conflict with the genuine Member States' competence to conduct economic policy, coordination competences granted to the EU in this area should be interpreted restrictively.[64] In relation to the coordination competences under Article 136 TFEU, this means that they must remain within the scope of the relevant provisions (Article 121 and 126 TFEU).[65] Article 121 (3) and (4) TFEU established a peculiar system of macroeconomic monitoring by setting up the authoritative surveillance competence of the EU institutions. More specifically, Article 8 (1) of the Macroeconomic Imbalance Procedure foresees that the EU Commission and the Member States develop national reform programmes that – unlike the contractual agreements – can be made binding as corrective action plans by the Council.[66] Considering the MIP's focus on removing macroeconomic imbalances through structural reforms, there is a significant conceptual similarity with the measures envisaged to form part of contractual agreements, for which the EU Commission and the respective Member State consensually negotiate the reforms to be incorporated into the agreement. Since contractual agreements are less authoritative due to their consensual nature, they should be deemed compatible with the more intrusive competence granted to the Commission under Article 121 TFEU.[67] Member States enter contractual agreements on a voluntary basis securing their policy space and the choice of structural reforms, their general competence in

[63] European Commission, 'A blueprint for a deep and genuine economic and monetary union Launching a European Debate' (Communication) COM (2012) 777 final/2.

[64] J Jäger and E Springle, *Asymmetric Crisis in Europe and Possible Futures* (Taylor & Francis Ltd 2015); U Häde in C Calliess and M Ruffert (eds), *EUV/AUEV-Kommentar* (4th edn, C.H. Beck 2011) Art. 136 TFEU, para. 4.

[65] J-V Louis, 'The Economic and Monetary Union' (2004) 41 CML Rev. 575; U Häde, 'Art. 136 AEUV - eine neue Generalklausel für die Wirtschafts- und Währungsunion?' [2011] JZ 333; B Kempen in R Streinz (ed), *EUV/AEUV-Kommentar* (2nd edn, C.H. Beck 2012) Art. 126 AEUV, para. 2.

[66] Article 8(2) of Regulation 1176/2011.

[67] However, one may ask whether there is a need for an additional legal obligation under a contractual agreement, as Member States under the MIP are bound by the specific measures adopted under this procedure, European Parliament (n 59) 21. The added value of the contractual agreements may then only be the incentivizing of funding (reward-based incentives).

dealing with economic policy issues is acknowledged, and their position is not worsened in case of non-compliance with the contractual agreement (apart from losing the support under the financial incentive scheme).[68] Most importantly, structural reforms agreed upon under contractual agreements are intended to ensure conformity with the broad guidelines referred to in Article 121 (4) TFEU,[69] and they reduce the risk of the proper functioning of the Economic and Monetary Union being jeopardized, which indicates a parallel between the structural reforms under the MIP and the contractual agreements.[70] If the EU can conclude agreements in line with the principle of conferral and to the extent that it enjoys internal competence, Member States cannot longer conclude agreements in this area.[71]

Alternatively, the contractual relationship may be established as a Memorandum of Understanding (MoU). While the EU treaties are silent on this instrument, it has been used frequently during the crisis, rendering financial assistance to states conditional on a number of structural reforms.[72] More formally, MoUs have even become an integral part of Article 13(3) ESM Treaty as the instrument detailing the conditionality attached to the financial assistance facility.[73] There is

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[68] ibid 22.

[69] For a background on the guidelines and their effect, see D Hodson, *Governing the Euro Area Good Times and Bad* (OUP 2011) chapter 5.

[70] See also European Parliament (n 59) 22.

[71] This is different in the case of 'mixed agreements' that are concluded by both the EU and the Member States with third countries. See A Steinbach, 'Kompetenzkonflikte bei der Änderung gemischter Abkommen durch die EG und ihre Mitgliedstaaten' (2007) 18 EuZW 109-112.

[72] Armstrong, 'The New Governance' (n 13) 602. See also Hinarejos (n 13) 131; C Kilpatrick, 'Are the Bailouts Immune to EU Social Challenge Because They Are Not EU Law?' (2014) 10 EuConst 393, 411.

[73] Similarly, the European Financial Stabilisation Mechanism (EFSM) was established on the basis of an Council Regulation (EU) No. 407/2010 establishing a European Financial Stabilisation Mechanism, OJ L 118, 12.5.2010, p. 1–4.. Loans and credit lines offered under this regulation are adopted by 'implementing decisions' of the Council under conditions to be determined by the Commission and contained in MoUs. See Council Implementing Decision 2011/77/EU on granting Union financial assistance to Ireland (as amended) OJ L 30, 4.2.2011, p. 34–39 ; Council Implementing Decision 2011/344/EU on granting

some conceptual similarity between the MoUs under the ESM and the contractual agreement discussed here – both tie financial support to conditionality and largely concern the implementation of structural reforms. Incentives towards compliance with contractual agreements can then be set by financial assistance that is granted only if there is compliance, and withheld in case of non-compliance. Similar to the approach chosen under the ESM Treaty, one could adopt secondary legislation allowing for the conclusion of contractual agreements. However, the MoUs under the ESM Treaty were concluded under an international agreement outside of the EU legal framework. By contrast, if MoUs foreseeing contractual agreements were set up under EU secondary law within EU competence and being adopted by the EU Commission, they would become an integral part of the EU legal order. As such, compatibility with other EU legislation and in particular with the fiscal and macroeconomic regime under the SGP and the MIP would have to be ensured – this would be facilitated by the fact that the EU Commission would be the leading institutions both in governing the ordinary fiscal regime and the conceptual agreements.

B. Funding Contractual Agreements

Without the possibility to conclude contractual agreements through international treaties, contractual agreements ought to be established on the basis of secondary legislation.[74] One may consider three potential legal grounds in the EU treaties, which allow for the establishment of funding support sidelining contractual agreements.

First, Articles 136 and 121 TFEU may serve as legal basis for a funding scheme sidelining contractual agreements. In *Pringle*, however, the Court found in relation to the ESM that 'neither Article 122(2) TFEU nor any other provision of the EU and FEU Treaties confers a specific power on the Union to establish a permanent stability mechanism such

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Union financial assistance to Portugal (as amended OJ L 159, 17.6.2011, p. 88–92. See Armstrong, 'The New Governance' (n 13) 606.

[74] See also PP Craig, 'Economic Governance and the Euro Crisis: Constitutional Architecture and Constitutional Implications' in M Adams and others (eds) *The Constitutionalization of EU Budgetary Constraints* (Hart Publishing 2014) 29.

as the ESM',[75] which raises the question whether the fund attached to contractual agreements would be construed as a stability mechanism like the ESM. However, this is unlikely given the peculiar function of the ESM, as 'the ESM is not concerned with the coordination of the economic policies of the Member States, but rather constitutes a financing mechanism'.[76] Comparison with the ESM thus depends on whether contractual agreements are considered as an economic policy coordination tool or as a permanent stability mechanism. Connecting country-specific policy recommendations to incentivizing payments contains elements of both economic policy conduct and financial support. But while under the ESM financial support seeks 'to safeguard the financial stability of the euro area',[77] under contractual agreements financial support aims at the implementation of structural reforms in order to promote the economic adjustment capacity of a Member State. In sum, in light of the different design and intention of the ESM and contractual agreements discussed here and given that Article 136 TFEU has been the basis for more intrusive policy tools such as the national reform programmes under the Macroeconomic Imbalance Procedure, which does not require the consent of the country concerned, voluntary contractual agreements and financial support should remain within the ambit of economic policy coordination under Article 136 TFEU.

Second, an alternative legal basis that is particularly relevant for the establishment for the fund attached to the contractual agreements lies in Article 175 (3) TFEU. Under this norm, specific measures serving the goals of Article 174 TFEU (promotion of overall harmonious development and strengthening of its economic, social and territorial cohesion) can be adopted, including the use of the EU funds specified in Article 175 (1) TFEU. Article 175 (3) provides the basis to adopt further measures, and the phrase 'specific actions […] outside the Funds' indicates that this provision could be used to establish new

[75] Case C-370/12, ECLI:EU:C:2012:756, *Pringle v Government of Ireland* para. 105.
[76] ibid., para. 110.
[77] Ibid.,, para. 142.

financial support instruments.[78] Accordingly, the European Union Solidarity Fund (EUSF) was set up in response to major natural disasters and expressed European solidarity to disaster-stricken regions within Europe.[79] Also, the European Globalization Adjustment Fund, which provides support to people who have lost their jobs as a result of major structural changes in world trade patterns due to globalization, had been based on this provision.[80] The degree of flexibility under this norm is further highlighted by the establishment of the European Grouping of Territorial Cooperation (EGTC), the objective of which is to facilitate and promote cross-border, transnational and interregional cooperation between its members. The EGTC enjoys the legal capacity accorded to legal entities by national law and may be used to implement programmes co-financed by the Community or any other cross-border cooperation project with or without Community funding.[81] Hence, in light of the instruments previously used under Article 175 (3), there are opportunities to design and endow the fund supporting contractual agreements on this basis, provided contractual agreements aim at strengthening the EU's economic, social and territorial cohesion.

Third, and depending on the specific design of the contractual agreements, Article 352 TFEU could provide the legal basis for a fund outside of the regular EU budget and of an agency entrusted with the implementation.[82] According to the flexibility clause, the EU can take

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[78] A Puttler in R Streinz (ed), *EUV/AEUV-Kommentar* (2nd edn, C.H. Beck 2012) Art. 175 AEUV, para. 7; B Eggers in E Grabitz and others (eds), *Das Recht der Europäischen Union: EUV/AEUV* (C.H. Beck, March 2011) Art. 175 AEUV, para. 5.

[79] Council Regulation (EC) No. 2012/2002 establishing the European Union Solidarity Fund OJ L 313, 14.11.2002, p. 3–8**.**

[80] Regulation (EC) No. 1927/2006 establishing the European Globalisation Adjustment Fund, OJ L 406, 30.12.2006, p. 1–6

[81] Regulation (EC) 1082/2006 on a European grouping of territorial cooperation (EGTC), OJ L 210, 31.7.2006, p. 19–24.

[82] R Repasi, 'Legal options for an additional EMU fiscal capacity' (2013) <http://www.europarl.europa.eu/RegData/etudes/note/join/2013/474397/IPOL-AFCO_NT%282013%29474397_EN.pdf> accessed 7 February 2016, 12; on the limitations to use Article 352 TFEU as legal basis, see Hinarejos (n 13) 107; A Arnull, 'Left to its Own Devices? Opinion 2/94 and the Protection of Fundamental

appropriate measures if action by the Union should prove necessary, within the framework of the policies defined in the treaties, to attain one of the objectives set out in the treaties. In *Pringle*, the Court left unanswered the question whether a stability mechanism such as the ESM could be based on Article 352 TFEU.[83] In principle, establishing a fund that promotes structural reforms under Article 352 TFEU appears to be feasible if the fund is necessary to attain the objectives mentioned in Article 3 TEU, notably to attain a 'sustainable development of Europe based on balanced economic growth' and to safeguard the 'economic and monetary union whose currency is the Euro'. However, actions under the flexibility clause must observe limitations imposed by the EU treaties, that is, they must not alter the institutional setting established by primary law. For example, Article 153 (4) TFEU must be observed – this rule allows the EU to support the Member States' social and labour policies, excluding any harmonization of the laws and regulations of the Member States. Given that any contractual agreement is intended to be in line with the country-specific policy recommendations given under the European Semester and the MIP, the policy instruments integrated into contractual agreements are likely to be compatible with other treaty provisions. However, given the unanimity requirement under Article 352 TFEU, and as the Court has made clear in the *Single European Patent*[84] case (namely that it is possible to make use of legal bases requiring unanimity through enhanced cooperation), resorting to enhanced cooperation might be the more realistic option, provided the above legal bases should not suffice given the specific design of contractual agreements.[85]

Rights in the European Union' in A Dashwood and C Hillion (eds), *The General Law of EC External Relations* (London, Sweet & Maxwell 2000) 61-78, chapter 5.

[83] Case C-370/12 *Pringle v Government of Ireland* (n 75), para. 67; see also Adam and Mena Parras (n 11) 852, 859.

[84] Joined Cases C-274/11 and C-295/11, ECLI:EU:C:2013:240, *Spain and Italy v Council*.

[85] There are, however, obvious legal and political restrictions associated with actions within enhanced cooperation, which cannot be discussed here. See M Schwartz, 'A Memorandum of Misunderstanding - The Doomed Road of the European Stability Mechanism and a Possible Way Out: Enhanced Cooperation' (2014) 51 CML Rev. 389-423.

2. Inter se Agreements Between Member States

A. General Design

As an alternative to the contractual relationship between the EU and its Member States, one may also consider bi- or plurilateral agreements between Member States without the involvement of the EU. The interdependence of Member States participating in a single currency means that each state has a vital stake in all the others following sound economic policies. The crisis has shown that a lack of necessary reforms in one Member State can have negative effects in others. Conversely, the adoption of structural reforms in one country has a positive spillover effect on others – hence, there is a mutual interest in implementing structural reforms.[86] Contractual agreements between Member States respond to this rationale. They are bilateral agreements between Member States in which the latter, voluntarily and at their own motion, commit to a certain reform or set of binding reforms. Reciprocity in the deal would ensure the positive cross-border spillovers from the domestic deal and increase the Member States' otherwise lacking willingness to reform.

The practical relevance of such agreements is illustrated by the ambitions expressed in the joint report from France and Germany on economic reforms focusing on competitiveness and investment issues.[87] Even though such bilateral reform agendas have not been considered binding, they reflect both design and nature of the CCIs on a bilateral basis and it remains possible that bilateral agreements on structural reforms may politically more likely to be concluded given the reciprocal character of reforms.

In the past, treaties between Member States related to EU matters were seen as possible threat to the EU legal order, especially when they applied to some (not all) Member States ('partial agreements') and were formed without involving the EU institutions.[88] However, Member

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[86] Grüner (n 58) 30.

[87] Duffy (n 9) and Enderlein and Pisan-Ferry (n 10). To date, this initiative has been a rather political project without leading to a contractual or otherwise legally relevant coordination.

[88] S Peers, 'Towards a New Form of EU Law?: The Use of EU Institutions outside the EU Legal Framework' (2013) 9 EuConst 37, 40.

States resorting to international agreements outside the EU legal order is, in itself, nothing new.[89] Past *inter se* agreements include arrangements such as the Schengen framework[90] or the Prüm Convention, in the area of justice and home affairs. In these cases, deeper integration was pursued by some, but not all, Member States by using an instrument of international law.[91] More recently, *inter se* agreements between Member States reflected a general trend of intergovernmentalism being prevalent as strategy throughout the Euro crisis.[92] A significant part of crisis-related measures – particularly related to budgetary surveillance system, financial stability measures and bailout mechanisms for countries in fiscal distress – has been addressed through measures outside the EU legal framework.[93] This is done through international agreements, as experienced with the treaties establishing the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM), both of which are supplementary to EU law measures governing the EMU.[94] This approach is in line with an intergovernmental type of governance focussing on the leeway enjoyed by national governments to rely on the flexibility to act outside EU law.[95] While crisis management outside the EU mechanisms proved effective to offer high flexibility in designing tailor-made policy tools, the limits of intergovernmentalism from the perspective of legitimacy and consistency have been voiced

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89 F Fabbrini, *Economic Governance in Europe: Comparative Paradoxes, Constitutional Challenges* (OUP 2016) 106.

90 The Schengen acquis - Convention implementing the Schengen Agreement between the Governments of the States of the Benelux Economic Union, the Federal Republic of Germany and the French Republic on the gradual abolition of checks at their common borders [2000] OJ L 239/19.

91 Hinarejos (n 13) 90.

92 Fabbrini, 'The Euro-Crisis and the Courts' (n 4) 110; Hinarejos (n 13) 111; KA Armstrong, *Governing Social Inclusion. Europeanization through Policy Coordination* (OUP 2010) 67.

93 Fabbrini, 'The Euro-Crisis and the Courts' (n 4) 110.

94 Peers (n 89) 39.

95 Fabbrini, 'The Euro-Crisis and the Courts' (n 4) 110; see also M Messina, 'Strengthening Economic Governance of the European Union through Enhanced Cooperation: A Still Possible, but Already Missed, Opportunity' (2014) 39 EL Rev. 404; Schwartz (n 85) 389.

repeatedly.[96] It remains to be seen what role intergovernmentalism will play in post-crisis times over the coming years.

B. Legal Scope

EU law imposes restrictions on agreements between Member States.[97] In principle, international treaties involving Member States may be in conflict with the Union's competences. Member States concluding an international treaty in areas for which the adoption of EU secondary law is possible encroach upon the allocation of competences under the EU Treaties. Particularly, as far as the respective competence refers to the ordinary legislative procedure, the co-decision rights of the European Parliament would be infringed.[98] The allocation of competences in relation to exclusive and shared competences determines the scope of restrictions on Member States to conclude international agreements. It is well established that, in areas of exclusive EU competence (Articles 2(1), 3(1) TFEU), Member States no longer have the right to enter into obligations with third countries.[99] While the Court has explicitly made this restriction in relation to third countries only, it must also apply for the relation between Member States.[100] By contrast, in the area of shared competence (Articles 2 (2), 4(2) TFEU), Member States are

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[96] E Chiti and PG Teixeira, 'The constitutional implications of the European responses to the financial and public debt crisis' (2013) 50 CML Rev. 683; readers are invited to study various disciplinary perspectives in J Habermas, *The Crisis of the European Union* (Polity 2012), D Cohn-Bendit and G Verhofstadt, *For Europe* (Carl Hanser Verlag 2012) and S Goulard and M Monti, *De la Démocratie en Europe* (Flammarion 2013).

[97] See S Hindelang, 'Circumventing Primacy of EU Law and the CJEU's Judicial Monopoly by Resorting to Dispute Resolution Mechanisms Provided for in Inter se Treaties? The Case of Intra-EU Investment Arbitration' (2012) 39 Legal Issues of Economic Integration 179-206.

[98] European Parliament (n 59) 20.

[99] Case 22/70, ECLI:EU:C:1971:32, *Commision v Council (AETR)* 273; Case 804/79, ECLI:EU:C:1981:93, *Commission v United Kingdom (Sea Fisheries)* para. 20.

[100] R Repasi, 'Völkervertragliche Freiräume für EU-Mitgliedstaaten' [2013] Europarecht 45, 52; D Thym, *Ungleichzeitigkeit und europäisches Verfassungsrecht* (Nomos 2004) 298-299.

excluded only once the EU exercises its competence.[101] That is, if the EU exercises its internal competence, *inter se* treaties between Member States are no longer admissible.[102]

Similar considerations apply in areas where the EU performs coordinating functions, as the Court spelled out in its *Pringle* judgment on the compatibility of the ESM Treaty with EU law. The Court noted that in areas where the European Treaties do not confer a 'specific competence' on the EU, Member States are generally free to act.[103] In the areas concerned here – economic, labour, social policy (Article 2 (3), 5 TFEU) – the Treaty does not confer specific competences, as the EU is allowed to act only by coordination. More specifically, Member States enjoy full competence in the domain of economic and fiscal policy and are thus free to enter into *inter se* treaties. Regarding the prospective content of mutual agreements, general restrictions exist in relation to the EU's exclusive competence to conduct currency and monetary policy (Article 3 (1) c) TFEU). However, if *inter se* agreements coordinating economic policy have an effect on the stability of the euro or the inflation, this would not justify the EU's exclusive competence, as 'such an influence would constitute only the indirect consequence of the economic policy measures adopted'.[104]

However, even though Member States continue to enjoy the freedom to conclude *inter se* treaties, they remain bound by the principle of sincere cooperation under Article 4(3) TEU, according to which the Union and the Member States shall assist each other in carrying out the tasks that arise from the treaties. Above all, this principle requires Member States to show restraint in cases of shared competences, so as not to predetermine potential future EU activities.[105] This also applies to international agreements among Member States.[106] In particular, this

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[101] The scope of the limitations has also been clarified in Protocol no. 25 on the exercise of shared competence.

[102] See also Adam and Mena Parras (n 11) 862.

[103] Case C-370/12 *Pringle v Government of Ireland* (n 75), para. 105.

[104] See Case C-370/12 *Pringle v Government of Ireland* (n 75), para. 97.

[105] Repasi, 'Völkervertragliche Freiräume' (n 100) 45, 52;

[106] Palmstorfer (n 51) 774; Palmstorfer (n 51) 774; M Ruffert in C Calliess and M Ruffert (eds), *EUV/AEUV* (4th edn, C.H. Beck 2011) Art. 1 AEUV, para. 13.

principle may also restrict Member States' freedom regarding the content of mutual agreements that aim to implement structural reforms, given that the EU has gained competence in specific fields of economic policy, particularly where fiscal policy conduct is concerned. The EU budgetary and macroeconomic surveillance system has been established on the grounds of Article 121 and 136 TFEU. As discussed above, structural reforms covering economic, social and labour policy have been incorporated into the European Semester, the SGP and the MIP and are developed and decided on by the Commission and the Council. The principle of sincere cooperation requires that mutual agreements between Member States would be in conformity with the country-specific recommendations and adjustment programmes adopted under the EU coordination mechanisms. In conclusion, EU Member States are generally free to conclude *inter se* treaties if these concern competences that genuinely remain in the domain of the Member States. However, content and design of the agreements must take into account the existing legal framework on EU coordination, thus safeguarding the functions of EU institutions.[107]

Member States may also design mutual agreements by way of involving the EU, potentially as a broker and monitoring body for the agreement. The EU Commission would then facilitate and monitor bilateral agreements, and the CJEU may be called upon for judicial review. Guidance on the feasibility of such integration of EU institutions into *inter se* treaties can be sought from the Court's *Pringle* judgment. In that case, the CJEU approved the involvement of EU institutions under the intergovernmental ESM Treaty to be in line with the principle of sincere cooperation (Article 4(3) TEU).[108] The Court found no infringement of Article 13 TEU by assigning specific tasks to some EU institutions in areas which do not fall under the exclusive competence of the Union, 'provided that those tasks do not alter the essential character of the powers conferred on those institutions by the EU and

[107] For a similar debate on the compatibility of the intergovernmental fiscal compact with the EU fiscal policy surveillance, see Repasi, 'Völkervertragliche Freiräume' (n 100) 70.

[108] Case C-370/12 *Pringle v Government of Ireland* (n 75), para.152.

TFEU Treaties.'[109] While this finding has been criticized as hampering the institutional design of the EU,[110] allocating tasks to EU institutions in framing *inter se* agreements remains in line with established CJEU jurisprudence.

IV. CONCLUSIONS

We currently observe a political-economy climate that gives little indication for deepening integration towards a 'fiscal federalism model' – Member States will continue to retain competence to conduct economic policy.[111] It is thus likely that under-provision of structural reforms will remain a perennial phenomenon in the EU. The crisis revealed the adverse implications of sluggish structural reforms which led to comprehensive reform obligations for countries under financial assistance programmes.

Beyond that, there is scope to employ existing and new legal instruments for the purpose of advancing structural reforms across the euro zone. By exploiting the existing surveillance tools and by introducing new arrangements under the current rules, surveillance and policy options are diversified, which enables more targeted responses to country-specific needs.[112] There is significant leeway to account for

[109] Case C-370/12 *Pringle v Government of Ireland* (n 75) para. 158; for a comprehensive analysis of the case-law preceding the *Pringle* judgment, in particular the Court's rulings in *Bangladesh* and *Lomé*, see Peers (n 89); see also Hinarejos (n 13) 126.

[110] PP Craig, 'Pringle and Use of EU Institutions Outside the EU Legal Framework: Foundations, Procedure and Substance' (2013) 9 EuConst 263.

[111] Armstrong, 'The Character of EU Law' (n 12) 179; Armstrong, *Governing Social Inclusion* (n 93).

[112] It is acknowledged that economic governance in the EU is already very multipolar and complex, and generates distrust in the efficacy of both domestic and European politics. Introducing new instruments might add to this complexity in an undesirable way. On the growth of coordination instruments see, inter alia, Steinbach, *Economic Policy* (n 13); MG Tutty, 'EU Economic Policy Surveillance of Member States' (2013) IIEA Economic Governance Paper, <http://www.iiea.com/ftp/Publications/EU%20Economic%20Policy%20Surveillance%20of%20Member%20States-IIEA%20Economic%20Governance%20Paper%206%20_Michael%20G%20Tutty.pdf> accessed 7 February 2016.

the implementation of structural reforms both in the preventive and the corrective arm of the SGP. Incorporating structural reform agendas developed under the European Semester and/or the MIP into the proceedings of the SGP would continue the overall trend of applying EU economic surveillance more broadly in a macroeconomic sense rather than being limited to fiscal parameters only. Thus, the current regime offers some flexibility in incorporating structural reforms, even though remaining within the traditional sanction-based logic of implementing policy reforms. Given the mixed compliance record, alternatives to sanctions should be considered.

In this view, contractual agreements between the EU and Member States or among Member States would add a new legal instrument to the arsenal fostering structural reforms in the euro zone. Unlike existing instruments, contractual agreements allow for more egalitarian and reward-based incentives and thus deviate from the classical 'surveillance model' of economic governance in the EU.[113] Rewards would be set either through financial incentives or by reciprocity in the deal if other Member States also commit to structural reforms that generate positive spillover effects.

What are the implications for the further trajectory of economic policy coordination efforts within the EU? Making use of the described flexibility options is likely to be the short-term avenue pursued by the EU institutions. In this vein, the Five Presidents' Report has stressed the use of existing instruments in implementing structural reforms.[114] This may imply a stronger role of the European Semester as the forum to assess comprehensively, on a country-specific basis, the need for structural reforms, which could then be implemented under the MIP and SGP or through arrangements as discussed in this analysis.

By contrast, the outlook for the implementation of contractual agreements seems far less clear. We should remember that it was the Commission that tabled the proposals of the Convergence and Competitiveness Instrument, which were then referred to by Germany

[113] Hinarejos (n 13) 181; Börzel (n 54) 191; De Streel (n 54) 87.
[114] Juncker (n 38) 8.

as potential 'Vertragspartnerschaften'. This explains the different reactions to the proposals. The European Parliament was rather sceptical towards the proposal, probably for fears about its role in contractual agreements[115], while the Council reacted more positively.[116] The involvement of the European Parliament in contractual agreements does not seem to be a likely scenario considering the experience with MoU-based conditionality programmes during the crisis. The role of EU institutions would even be marginal if Member States were to conclude inter se agreements among each other making it most likely that EU institutions will put forward the incompatibility of such agreements with the EU legal order. By contrast, the role of the national parliaments involved could be strengthened through inter se agreements creating stronger ownership and legitimacy of these agreements. As the MoU experience during the crisis has shown, legality review is a preeminent issue. If contractual agreements were based on EU law (i.e. if agreed as MoUs based on secondary legislation), they could be challenged on grounds of EU law, while if the agreements were not EU law only national courts could assess legality on the basis of national law.[117]

Despite the blurry outlook on implementation given heterogeneity of interests, one should consider contractual agreements as an additional policy instrument from a normative perspective. It abandons the current purely sanction-based approach of policy coordination and provides new strategic offers to Member States by incorporating rewards either on financial (EU contractual agreements) or reciprocal (inter se agreements) basis. Also, consistency of policy tools is not likely to suffer given the frequency and visibility of recommendations issued under the EU semester.

What about political feasibility of contractual agreements? The latest Five Presidents' Report does not explicitly refer to contractual agreements as a policy tool highlighting that this approach has recently

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[115] European Parliament resolution on future legislative proposals on EMU: response to the Commission communications 2013/2609(RSP), 24-25.

[116] European Council Conclusions EUCO 217/13, 19/20 December 2013, para. 32.

[117] Kilpatrick (n 72) 396, 407 discussing also the past experience with the reviewability of decisions adopted under the structural funds.

lost support, which according to commentators is due to some Member States' resistance against this proposal. The vanishing support among Member States may also reflect the concern mainly of the net transfer beneficiaries of current EU financial support schemes that conditionality-based transfers would become the rule increasing the EU's scope of intervention with national policies. However, both Member States and EU should not set aside the option of contractual agreement without further ado. Member States would benefit from incentivizing mechanisms that are – from a political-economy perspective – more effective, as financial support is more persuasive to constituents than just being spared from sanctions. And the EU would enlarge its policy space by diversifying the tools available to improve compliance with EU economic rules.